

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.  
Form 424B5  
May 08, 2012

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[TABLE OF CONTENTS](#)

[ANNEX B](#)

[TABLE OF CONTENTS 4](#)

[TABLE OF CONTENTS](#)

[Table of Contents](#)

**This preliminary prospectus supplement relates to an effective registration statement under the Securities Act of 1933, but is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.**

Filed pursuant to Rule 424(b)(5)  
Registration No. 333-173099

**SUBJECT TO COMPLETION, DATED May 8, 2012**

PRELIMINARY PROSPECTUS SUPPLEMENT  
(to Prospectus dated April 15, 2011)

## Shares

### Common Stock

We are offering \_\_\_\_\_ shares of our common stock pursuant to this prospectus supplement and the accompanying prospectus. Our common stock is traded on the NASDAQ Global Select Market under the symbol "KTOS." On May 4, 2012, the last reported sale price of our common stock on the NASDAQ Global Select Market was \$5.11 per share.

Certain of our stockholders, including affiliates of Bandel Carano, a member of our board of directors, may participate in this offering. In the event such stockholders participate in this offering, we expect to enter into a standstill agreement with such parties restricting the sale or other transfer or pledge of our common stock held by them.

**Investing in our common stock involves a high degree of risk. Please read "Risk Factors" beginning on page S-16 of this prospectus supplement, on page 3 of the accompanying prospectus and in the documents incorporated by reference into this prospectus supplement.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

|   | <b>Per Share</b> | <b>Total</b> |
|---|------------------|--------------|
| Public Offering Price   | \$               | \$           |
| Underwriting Discounts and Commissions                                | \$               | \$           |
| Proceeds to Kratos Defense & Security Solutions, Inc. before expenses | \$               | \$           |

Delivery of the shares of common stock is expected to be made on or about May , 2012. We have granted the underwriter an option for a period of 30 days to purchase up to an additional shares of our common stock solely to cover over-allotments, if any. If the underwriter exercises the option in full, the total public offering price will be \$ , the total underwriting discounts and commissions payable by us will be \$ , and our total proceeds, before expenses, will be \$ .

The underwriter expects to deliver the common stock in book-entry form only, through the facilities of The Depository Trust Company, against payment in immediately available funds on or about May , 2012.

## **B. Riley & Co., LLC**

Prospectus Supplement dated May , 2012

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Table of Contents

**TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| <b><u>PROSPECTUS SUPPLEMENT</u></b>  |             |
| <u>PROSPECTUS SUPPLEMENT SUMMARY</u>   | S-1         |
| <u>RISK FACTORS</u>  | S-16        |
| <u>CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>                          | S-39        |
| <u>USE OF PROCEEDS</u>   | S-40        |
| <u>UNAUDITED PRO FORMA COMBINED AND CONDENSED COMBINED FINANCIAL DATA</u>            | S-40        |
| <u>MATERIAL UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS FOR NON-U.S. HOLDERS</u> | S-52        |
| <u>UNDERWRITING</u>  | S-55        |
| <u>LEGAL MATTERS</u>   | S-58        |
| <u>EXPERTS</u>   | S-58        |
| <u>WHERE YOU CAN FIND ADDITIONAL INFORMATION</u>                                     | S-59        |
| <u>INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE</u>                               | S-59        |
| <b><u>PROSPECTUS</u></b>   |             |
| <u>ABOUT THIS PROSPECTUS</u>   | 1           |
| <u>KRATOS DEFENSE &amp; SECURITY SOLUTIONS, INC.</u>                                 | 2           |
| <u>RISK FACTORS</u>  | 3           |
| <u>CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS</u>                     | 3           |
| <u>THE SECURITIES WE MAY OFFER</u>   | 4           |
| <u>RATIO OF EARNINGS TO FIXED CHARGES</u>  | 7           |
| <u>USE OF PROCEEDS</u>   | 7           |
| <u>DESCRIPTION OF CAPITAL STOCK</u>  | 7           |
| <u>DESCRIPTION OF DEBT SECURITIES</u>  | 11          |
| <u>DESCRIPTION OF WARRANTS</u>   | 17          |
| <u>DESCRIPTION OF UNITS</u>  | 19          |
| <u>LEGAL OWNERSHIP OF SECURITIES</u>   | 20          |
| <u>PLAN OF DISTRIBUTION</u>  | 24          |
| <u>LEGAL MATTERS</u>   | 25          |
| <u>EXPERTS</u>   | 25          |
| <u>MATERIAL CHANGES</u>  | 26          |
| <u>WHERE YOU CAN FIND ADDITIONAL INFORMATION</u>                                     | 27          |

Table of Contents

**ABOUT THIS PROSPECTUS SUPPLEMENT**

This prospectus supplement and the accompanying prospectus are part of a registration statement that we filed with the Securities and Exchange Commission ("SEC") utilizing a "shelf" registration process. This document is in two parts. The first part is this prospectus supplement, including the documents incorporated by reference, which describes the specific terms of this offering. The second part, the accompanying prospectus, including the documents incorporated by reference, provides more general information. Generally, when we refer to this prospectus, we are referring to both parts of this document combined. We urge you to carefully read this prospectus supplement and the accompanying prospectus, and the documents incorporated by reference herein and therein, before buying any of the securities being offered under this prospectus supplement. This prospectus supplement may add or update information contained in the accompanying prospectus and the documents incorporated by reference therein. To the extent that any statement we make in this prospectus supplement is inconsistent with statements made in the accompanying prospectus or any documents incorporated by reference therein that were filed before the date of this prospectus supplement, the statements made in this prospectus supplement will be deemed to modify or supersede those made in the accompanying prospectus and such documents incorporated by reference therein.

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus, or incorporated by reference herein or therein. We have not authorized anyone to provide you with different information. No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus supplement and the accompanying prospectus. You should not rely on any unauthorized information or representation. This prospectus supplement is an offer to sell only the securities offered hereby, and only under circumstances and in jurisdictions where it is lawful to do so. You should assume that the information in this prospectus supplement and the accompanying prospectus is accurate only as of the date on the front of the applicable document and that any information we have incorporated by reference is accurate only as of the date of the document incorporated by reference, regardless of the date of delivery of this prospectus supplement or the accompanying prospectus, or any sale of a security.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus to "the Company," "we," "us," "our" and "Kratos" refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its consolidated subsidiaries.

Table of Contents

**PROSPECTUS SUPPLEMENT SUMMARY**

*This summary is not complete and does not contain all of the information that you should consider before investing in the securities offered by this prospectus. You should read this summary together with the entire prospectus supplement and the accompanying prospectus, including our financial statements, the notes to those financial statements and the other documents that are incorporated by reference in this prospectus supplement and the accompanying prospectus, before making an investment decision. See "Risk Factors" beginning on page S-16 of this prospectus supplement for a discussion of the risks involved in investing in our securities.*

**Kratos Defense & Security Solutions, Inc.**

**Our Business**

Kratos is a specialized national security technology business providing mission-critical products, services and solutions for U.S. national security priorities. Our core capabilities are sophisticated engineering, manufacturing, system integration and test and evaluation offerings for national security platforms and programs. Our principal products and services are related to Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance ("C5ISR"). We offer our customers products, solutions, services and expertise to support their mission-critical needs by leveraging our skills across our core offering areas in C5ISR.

We manufacture and design specialized electronic defense components subsystems and systems for electronic attack, electronic warfare and missile system platforms; integrated technology solutions for satellite communications; products and solutions for unmanned systems; products and services related to cybersecurity and cyberwarfare; products and solutions for ballistic missile defense; weapons systems trainers; advanced network engineering and information technology ("IT") services; weapons systems lifecycle support and sustainment; military weapon range operations and technical services; and public safety, critical infrastructure security and surveillance systems. We believe our stable client base, strong client relationships, broad array of contract vehicles, large employee base possessing national security clearances, extensive list of past performance qualifications, and significant management and operational capabilities position us for continued growth.

Prior to 2008, we were also an independent provider of outsourced engineering and network deployment services, security systems engineering and integration services and other technical services for the wireless communications industry, the U.S. Government and enterprise customers. In 2006 and 2007, we undertook a transformation strategy whereby we divested our commercial wireless-related businesses and chose to pursue business with the U.S. Government, primarily the U.S. Department of Defense ("DoD"), through strategic acquisitions. On September 12, 2007, we changed our name from Wireless Facilities, Inc. to Kratos Defense & Security Solutions, Inc. Our new name reflects our revised focus as a defense contractor and security systems integrator for the U.S. Government, state and local agencies and commercial customers. In connection with our name change, we changed our NASDAQ Global Select Market trading symbol to "KTOS".

**Competitive Strengths**

We believe we have robust capabilities, customer relationships and past performance qualifications in our respective business areas, including a work force that is experienced with the various programs we service and the customers we serve. We believe the following key strengths distinguish us competitively:

*Significant and highly specialized experience.* Through existing customer engagements and the government-focused acquisitions we have completed over the past several years, we have amassed significant and highly specialized experience in areas directly related to C5ISR, including cybersecurity, cyberwarfare, information assurance and situational awareness; military range operations and technical services; missile, rocket, and weapons systems test and evaluation;

Table of Contents

mission launch services; modeling and simulation, unmanned aerial vehicle products and technology, advanced network engineering and IT services; and public safety, security and surveillance systems integration. We also produce products and provide solutions and services related to certain C5ISR platforms, unmanned system platforms, weapons systems, national security related assets and warfighter systems, including electronic attack and electronic warfare systems. This collective experience, or past performance qualifications, is a requirement for the majority of our contract vehicles and customer engagements. Further enhancing our specialized expertise, many of our approximately 4,100 employees have national security clearances, including top secret and higher. We believe these characteristics represent a significant competitive strength and position us to win renewal or follow-on business.

*Specialized national security focus aligned with mission-critical national security priorities.* Continued concerns related to the threats posed by certain foreign nations and terrorists have caused the U.S. Government to identify national security as an area of functional and spending priority. Budget pressures, particularly related to DoD spending, have placed a premium on developing and fielding relatively low-cost, high-technology solutions to assist in national security missions. Our primary capabilities and areas of focus, listed below, are strongly aligned with the objectives of the U.S. Government:

Intelligence, surveillance and reconnaissance

Command, control and combat systems

Unmanned systems

Ballistic missile defense

Cybersecurity and information assurance

Satellite communications and radio frequency detection

*Diverse base of key contracts with low concentration.* Many of our contracts are single award, where Kratos is the only awardee by the customer. Additionally, as a result of our business development focus on securing key contracts, we are also a preferred contractor on numerous multi-year, government-wide acquisition contracts ("GWACs") and multiple award contracts. Our preferred contractor status provides us with the opportunity to bid on billions of dollars of business each year against a discrete number of other pre-qualified companies. We have a highly diverse base of contracts with no contracts representing more than 3% of 2011 revenue. We believe our diverse base of key contracts and low reliance on any one contract provides us with a stable, balanced revenue stream.

*In-depth understanding of client missions.* We have a reputation for providing mission-critical products, services and solutions to our clients. Our long-term relationships with the U.S. Army, U.S. Navy and U.S. Air Force and other national security related customers enable us to develop an in-depth understanding of their missions and technical needs. In addition, the majority of our employees are located at our customer sites, at secure manufacturing facilities or at critical infrastructure locations, all of which provides valuable strategic insight into our clients' ongoing missions and future program requirements. This understanding of our clients' missions, in conjunction with the strategic location of our employees, enables us to offer technical solutions tailored to our clients' specific requirements and evolving mission objectives. In addition, once we are on-site with a customer, we have historically been successful in winning re-compete business.

*Significant cash flow visibility driven by stable backlog.* As of March 25, 2012, our pro forma total backlog was approximately \$1.3 billion, of which approximately \$600 million was funded backlog. The majority of our pro forma sales are from orders issued under long-term contracts, typically three to five years in duration. Our contract backlog provides visibility into stable future revenue and cash flow over a diverse set of contracts.



Table of Contents

*Highly skilled employees and an experienced management team.* We deliver our services through a skilled workforce of approximately 4,100 employees. Our senior managers have significant experience with U.S. Government agencies, the U.S. military and U.S. Government contractors. Members of our management team have experience growing businesses both organically and through acquisitions. We believe that the cumulative experience and differentiated expertise of our personnel in our core focus areas, coupled with our sizable employee base, many of whom hold national security clearances, allows us to qualify for and bid on larger projects in a prime contracting role.

**Proposed Acquisition of Composite Engineering, Inc.**

*Overview of the Acquisition*

On May 8, 2012, we entered into a stock purchase agreement to acquire all of the outstanding shares of common stock of Composite Engineering, Inc., a California corporation ("CEI"). See "Terms of Acquisition and Related Financing Transaction Stock Purchase Agreement." Since the completion of the acquisition of CEI is subject to various conditions, it is not certain that we will acquire CEI within the expected timeframe or at all. Failure to complete the acquisition of CEI could adversely affect our stock price and our future business or financial results and would affect the use of proceeds from this offering. See "Risk Factors Risks Related to the Proposed Acquisition of CEI" and "Use of Proceeds".

*Overview of CEI's Business*

CEI specializes in the design, manufacture, test and operation of aerial target drone systems and composite structures. CEI has a proven track record of identifying and capitalizing upon market opportunities, consistently displacing previously entrenched and highly capable competition. Building on a solid base of manufacturing expertise, a core competence in composite manufacturing and a proven ability to solve complex customer problems, CEI methodically identified, influenced, pursued and prevailed, growing from a component supplier into a systems integrator with a leading position in the subscale aerial target market in the U.S.

CEI accomplished this evolution through capable technical leadership and a focused product development strategy, resulting in a suite of aerial target drone systems, two of which are sole-source to the U.S. Air Force and the U.S. Navy. CEI also participates heavily in the design and manufacture of the world's most advanced supersonic sea skimming target system, the Multi-Stage Supersonic Target (MSST). In addition, CEI's aerostructures comprise 70% of the MQM-107E, the U.S. Army's primary target system.

Aerial targets, like CEI's BQM-167A and BQM-167X, are used as enemy missile and aircraft threat surrogates to test the effectiveness of air defense systems and to train operators in employing air-to-air and surface-to-air missile systems. These target systems provide meaningful cost savings, as they are recoverable and reusable, can be easily configured with a variety of payloads, and therefore provide utility to both weapons development programs and in troop readiness for training and qualifications. CEI's market-leading target drones are capable of flying at altitudes as low as 6.6 feet to over 54,800 feet, and of flying advanced maneuvers and constant altitude turns.

CEI's technical evolution also resulted in sustained growth in its financial performance, based on a successful and systematic attack on both the domestic and international targets marketplace. We believe that a significant portion of the projected growth for CEI is derived from contracts already in hand, supplemented by the execution of a sound strategy that includes (i) further penetration into the international marketplace for existing products, coupled with (ii) fielding of products that are moving from development into production phase.

CEI is vertically integrated, with a core group of engineers and support personnel representing every discipline required for the effective design, build, test, manufacture and support of high



Table of Contents

performance unmanned aircraft. CEI's diverse, highly skilled, and dedicated workforce, enables CEI to sustain existing business and CEI possesses the ability to continue its upward growth trajectory. CEI has built a solid record of success by winning highly competitive domestic and international contracts. CEI entered and now thrives in the arena of classified programs, reinforcing its reputation for specialization and excellence in product development and operations.

***Strategic Rationale***

We believe that the proposed acquisition will provide long-term strategic and financial benefits to our stockholders, including long-term growth in revenues, earnings, cash flows and returns on equity, and will offer other important benefits including:

*Strong fit with our current business, existing core competencies, and strategic plan.* CEI's business today is the manufacture and production of composite unmanned aerial systems including aerial targets, drones, missiles and other aircraft. One of our core competencies is the manufacture and production of various electronics and avionics inside of the aircraft that CEI produces, enabling the aircraft to fly, maneuver, be tracked, controlled, and execute the desired mission. Additionally, we currently produce electronics that are included in flight control ground stations that communicate with and fly CEI aircraft. Furthermore, we have historically been one of the premier aerial target and weapons range operators in the U.S., where our personnel operate and maintain the subscale aerial target flights for the U.S. armed services.

CEI is currently the sole-source provider of subscale aerial targets for the U.S. Air Force and the U.S. Navy. As noted above, we currently provide significant electronics and avionics content for CEI targets and ground control stations. Over the past several years, a number of aerial target contract awards have been awarded to CEI, with a near 100 percent bid/win success rate. A primary reason for CEI's success rate is that CEI's aircraft are made of composites via a state of the art manufacturing process. The proprietary composite manufacturing technology and materials that CEI utilizes in the production of its aircraft provide the CEI targets unequalled flight and profile performance, speed, time on station capabilities and radio frequency signature. These characteristics have enabled CEI to establish sole-source positions on significant U.S. Air Force and U.S. Navy programs.

*Acquisition of a scarce asset.* A significant portion of CEI's revenue is generated from contracts under which CEI is the sole-source provider. CEI represents one of the very few companies in the world that can manufacture composite aircraft having flight characteristics representative of fourth generation jet fighter aircrafts that can also internally and externally carry mission specific payloads, including electronic warfare, electronic attack and classified payloads.

*Strong growth opportunities.* Aerial threats to U.S. armed forces, including both aircraft and missile systems, are expanding at a rapid rate in both quantity and quality. The ability of the U.S. to combat, neutralize, and defeat these threats relies on state of the art weaponry and on pilots and warfighters who routinely receive unsurpassed training. As aerial threats evolve, the ability of the U.S. to emulate or replicate these threats in a live fire-training environment is invaluable to the readiness of the armed forces. CEI is the world leader in rapid low cost design, development, and production of leading edge aerial targets.

*Additional expansion of business and product offering and profit margins.* Since 2009, we have continued to diversify our solutions offering to a more balanced mix of niche and specialty product offerings due to the inherently less competitive environment as compared to a more heavily weighted traditional pure services offering and higher profit margins typically realized with a specialized product mix. Our acquisition of CEI would allow us to add the production and manufacture of aerial targets to our existing product offerings of electronics, avionics and flight control systems for CEI's aerial targets. We believe CEI's position as a sole-source

Table of Contents

provider to a number of its aerial target offerings would contribute to the expansion of our EBITDA margins.

*Opportunities to achieve significant synergies.* Upon completion of the acquisition, management expects that certain existing CEI overhead and management costs will be eliminated, resulting in certain cost efficiencies. In addition, management believes that operational efficiencies resulting from the identification and execution of production and manufacturing efficiencies will benefit the combined organization.

***Terms of Acquisition and Related Financing Transaction***

*Stock Purchase Agreement*

On May 8, 2012, we entered into a stock purchase agreement (the "CEI Purchase Agreement") with CEI, the shareholders of CEI (each, a "CEI Shareholder" and collectively, the "CEI Shareholders"), and Amy Fournier, in her capacity as shareholder representative thereunder (the "Shareholder Representative"). The boards of directors of Kratos and CEI have approved the CEI Purchase Agreement and the transactions contemplated thereby. Pursuant to the terms of the CEI Purchase Agreement, we will acquire all of the issued and outstanding shares of common stock of CEI ("CEI Common Stock"), for an aggregate purchase price of \$155.0 million, of which \$135.0 million will be paid in cash, subject to adjustments for transaction expenses incurred by CEI, indebtedness of CEI, post-closing working capital adjustments, and CEI's tax liabilities for the 2012 taxable year, and \$20.0 million will be paid in shares of our common stock. The number of shares of our common stock issuable to the CEI Shareholders will be based on the issue price of our common stock in this offering (such shares, the "Consideration Shares") and, following the closing of the acquisition and completion of this offering, the CEI Shareholders will have certain piggy-back registration rights with respect to the Consideration Shares. Unless otherwise registered under the Securities Act of 1933, as amended (the "Securities Act"), the Consideration Shares may be sold by the CEI Shareholders in accordance with Rule 144 promulgated under the Securities Act.

Upon completion of the acquisition, we will withhold an aggregate of \$12.7 million from the cash portion of the purchase price, to be delivered to an escrow agent, of which (i) \$10.7 million will be held as collateral and security for the rights of certain indemnified parties, including in connection with post-closing working capital adjustments, and (ii) \$2.0 million will be held to pay the costs and expenses of the Shareholder Representative and the CEI Shareholders after the completion of the acquisition. Upon completion of the acquisition, and subject to the satisfaction or waiver of the conditions set forth in the CEI Purchase Agreement, CEI will become our wholly owned subsidiary.

Pursuant to the terms of the CEI Purchase Agreement, Kratos and the CEI Shareholders expect to make an election under Section 338(h)(10) of the Internal Revenue Code, which will allow the Company to deduct for income tax purposes the goodwill attributable to CEI over a 15-year amortization period.

The completion of the acquisition is subject to customary closing conditions, including (i) the expiration of all applicable waiting periods under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), (ii) subject to certain materiality exceptions, the accuracy of the representations and warranties made by each of Kratos and CEI and the compliance by each of Kratos and CEI with their respective obligations under the CEI Purchase Agreement, (iii) the absence of a material adverse effect on CEI, (iv) the receipt of certain required consents, (v) the receipt of certain legal opinions, (vi) the receipt of certificates of certain officers of Kratos and CEI, and (vii) other closing conditions set forth in the CEI Purchase Agreement.

Kratos and CEI have made customary representations, warranties, and covenants in the CEI Purchase Agreement, including, among other things, covenants regarding (i) the operation of CEI's business prior to the closing, (ii) Kratos' obligations with respect to certain offers of employment, the issuance of restricted stock units to certain key managers of CEI to induce them to accept employment

Table of Contents

with Kratos and the provision of indemnification insurance for CEI's directors and officers, and (iii) the parties' obligations to cooperate in seeking regulatory approvals, including under the HSR Act.

The CEI Purchase Agreement contains certain termination rights for each of Kratos and CEI and the Shareholder Representative (acting together). The CEI Purchase Agreement also provides for indemnification of the CEI Shareholders and Kratos, under certain circumstances, provided, however, that the CEI Shareholders shall not be liable for certain losses until the aggregate amount of such losses exceeds \$1.5 million and shall not be liable for aggregate losses in excess of the purchase price.

The foregoing description of the CEI Purchase Agreement does not purport to be complete and is qualified in its entirety by reference to the CEI Purchase Agreement, a copy of which is attached hereto as Annex A.

*Financing Transaction*

We estimate our cash requirements in connection with the acquisition of CEI to be approximately \$141.5 million. On May 4, 2012, we entered into a second amendment (the "Second Amendment") to our existing Credit and Security Agreement ("Credit Agreement"), dated as of May 19, 2010, as amended and restated as of July 27, 2011, with KeyBank National Association ("KeyBank") and certain other lenders. Among other things, the Second Amendment (i) increased the amount of the Credit Agreement from \$90.0 million to \$110.0 million, (ii) added to and modified the definitions of certain terms contained in the Credit Agreement, (iii) added Cathay Bank as a lender under the Credit Agreement and (iv) updated certain schedules to the Credit Agreement.

On May 8, 2012, we entered into a third amendment (the "Third Amendment" and together with the Second Amendment, the "Credit Amendments") to the Credit Agreement. Under the terms of the Third Amendment, the definitions of certain terms of the Credit Agreement were modified and the acquisition of CEI was approved.

We expect to use the net proceeds from this offering together with the borrowings under our credit facility to fund the purchase of the CEI Common Stock in connection with the acquisition of CEI and to pay related fees and expenses. If the acquisition of CEI is not completed, we will use the net proceeds from this offering for general corporate purposes. See "Use of Proceeds". The acquisition of CEI and the above referenced financing transaction are referred to elsewhere herein as the "Transactions".

**Certain Relationships**

Certain of our stockholders, including affiliates of Bandal Carano, a director of the Company, may participate in this offering. Such stockholders have expressed an interest in acquiring approximately 50% of the shares of common stock being offered pursuant to this prospectus supplement, excluding any shares that may be sold upon exercise of the over-allotment option. In the event such stockholders participate in this offering, we expect to enter into a standstill agreement with such parties restricting the sale or other transfer or pledge of our common stock held by them.

**Our Corporate Information**

We were initially incorporated in the state of New York in 1994, commenced operations in 1995 and were reincorporated in Delaware in 1998. On September 12, 2007, we changed our name from Wireless Facilities, Inc. to Kratos Defense & Security Solutions, Inc. Our executive offices are located at 4820 Eastgate Mall, Suite 200, San Diego, California 92121, and our telephone number is (858) 812-7300. We maintain an Internet website at [www.kratosdefense.com](http://www.kratosdefense.com). Information contained in or accessible through our website does not constitute part of this prospectus supplement or the accompanying prospectus.

Table of Contents

**The Offering**

|  |  |
|--|--|
| Issuer                                       | Kratos Defense & Security Solutions, Inc.  |
| Common stock offered by us                   | shares of common stock (or shares of common stock if the underwriter exercises its option to purchase additional shares in full).  |
| Common stock outstanding after this offering | shares of common stock (or shares of common stock if the underwriter exercises its option to purchase additional shares in full).  |
| Over-allotment option                        | shares of common stock   |
| Use of proceeds                              | We expect the net proceeds from this offering will be approximately \$ million (or \$ million if the underwriter exercises its option to purchase additional shares in full) after deducting underwriting discounts and commissions, as described in "Underwriting," and estimated offering expenses payable by us. We intend to use the net proceeds from this offering to fund the cash consideration payable to the CEI stockholders in connection with our proposed acquisition thereof. In the event that the acquisition of CEI is not consummated, we intend to use the net proceeds from this offering for general corporate purposes, including the acquisition of or investment in other businesses, services and technologies that are complementary to our own and other general corporate expenses. Pending such uses, we intend to invest the net proceeds in short-term, investment grade securities. See "Use of Proceeds" on page S-40 of this prospectus supplement. |
| NASDAQ Global Select Market symbol           | "KTOS"   |
| Risk factors                                 | This investment involves a high degree of risk. See "Risk Factors" beginning on page S-16 of this prospectus supplement, on page 3 of the accompanying prospectus and in the documents incorporated by reference into this prospectus supplement for a discussion of factors you should carefully consider before deciding to invest in our common stock.  |

The number of shares of our common stock to be outstanding immediately after the closing of this offering is based on 32,511,287 shares of common stock outstanding as of April 30, 2012 and excludes, as of that date:

3,913,894 shares of common stock issuable as Consideration Shares pursuant to the CEI Purchase Agreement, assuming an issuance price of \$5.11, the last reported sale price of our common stock on the NASDAQ Global Select Market on May 4, 2012;

1,956,947 shares of common stock issuable upon vesting of restricted stock units to be granted as an inducement to certain key managers' acceptance of employment with the Company following the acquisition of CEI, assuming an issuance price of \$5.11, the last reported sale price of our common stock on the NASDAQ Global Select Market on May 4, 2012;

Table of Contents

1,682,746 shares of common stock issuable upon the exercise of outstanding stock options at a weighted average exercise price of \$23.76 per share;

4,373,533 shares of common stock available for future grant under our 1999 Employee Stock Purchase Plan, 2005 Equity Incentive Plan, and 2011 Equity Incentive Plan and under the Amended and Restated Herley Industries, Inc. 2010 Stock Plan and Amended and Restated Integral Systems, Inc. 2008 Stock Incentive Plan, which plans were assumed by us in each case in accordance with NASDAQ Rule 5635 (collectively, the "Plans"); and

1,765,135 shares of common stock issuable upon the vesting and settlement of restricted stock units.

Table of Contents**Summary Consolidated Historical Financial Data of Kratos**

The following table sets forth a summary of our consolidated historical financial data as of the dates and for each of the periods indicated. The consolidated historical financial data for the years ended December 27, 2009, December 26, 2010 and December 25, 2011 and as of December 26, 2010 and December 25, 2011 is derived from our audited consolidated financial statements, which are incorporated by reference into this prospectus supplement. The consolidated historical financial data as of December 27, 2009 has been derived from our audited consolidated financial statements not included or incorporated by reference herein. The consolidated historical financial data for the three months ended March 27, 2011 and for and as of the three months ended March 25, 2012 are derived from our unaudited condensed consolidated financial statements, which are incorporated by reference into this prospectus supplement. The historical results presented below are not necessarily indicative of results that can be expected for any future period and should be read in conjunction with the sections entitled "Use of Proceeds," and "Unaudited Pro Forma Combined Financial Data" included elsewhere in this prospectus supplement, as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations," appearing in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 25, 2011 and our audited and unaudited consolidated financial statements incorporated by reference herein. See "Where You Can Find Additional Information."

|  | Fiscal Year Ended    |                      |                      | Three                                | Three                                |
|--|----------------------|----------------------|----------------------|--------------------------------------|--------------------------------------|
|  | December 27,<br>2009 | December 26,<br>2010 | December 25,<br>2011 | Months<br>Ended<br>March 27,<br>2011 | Months<br>Ended<br>March 25,<br>2012 |
|  | (in millions)        |                      |                      |                                      |                                      |
| <b>Statement of Operations:</b>  |                      |                      |                      |                                      |                                      |
| Service revenues   | \$ 314.0             | \$ 284.8             | \$ 353.6             | \$ 79.8                              | \$ 105.2                             |
| Product sales  | 20.5                 | 123.7                | 369.5                | 43.0                                 | 109.8                                |
| Total revenue  | 334.5                | 408.5                | 723.1                | 122.8                                | 215.0                                |
| Cost of service revenues   | 255.7                | 221.2                | 263.1                | 60.3                                 | 81.8                                 |
| Cost of product sales  | 15.2                 | 103                  | 267.8                | 35.1                                 | 75.3                                 |
| Total costs  | 270.9                | 324.2                | 530.9                | 95.4                                 | 157.1                                |
| Gross profit   | 63.6                 | 84.3                 | 192.2                | 27.4                                 | 57.9                                 |
| Selling, general and administrative expenses   | 47.7                 | 57.3                 | 142.5                | 19.6                                 | 45.0                                 |
| Research and development expenses  | 1.8                  | 2.2                  | 9.0                  | 0.6                                  | 3.8                                  |
| Recovery of unauthorized issuance of stock options, stock option investigation and related fees, and litigation settlement | (0.2)                | (1.4)                |                      |                                      |                                      |
| Impairment of goodwill   | 41.3                 |                      |                      |                                      |                                      |
| Merger and acquisition expenses  |                      | 3.1                  | 12.5                 | 5.8                                  | 0.9                                  |
| Other income, net  | 0.1                  | 1.1                  | 0.1                  | 0.3                                  | 0.5                                  |
| Interest expense, net  | (10.4)               | (22.3)               | (51.1)               | (6.7)                                | (16.1)                               |
| Income (loss) before income taxes  | (37.3)               | 1.9                  | (22.8)               | (5.0)                                | (7.4)                                |
| Tax (benefit) provision  | 1.0                  | (12.7)               | 1.9                  | (1.2)                                | (4.2)                                |
| Income (loss) from continuing operations   | \$ (38.3)            | \$ 14.6              | \$ (24.7)            | \$ (3.8)                             | \$ (3.2)                             |
| <b>Balance Sheet Data (at period end) and Other Data:</b>  |                      |                      |                      |                                      |                                      |
| Cash and cash equivalents  | \$ 9.9               | \$ 10.8              | \$ 69.8              | \$                                   | \$ 74.8                              |
| Property and equipment, net  | 4.3                  | 28.4                 | 73.0                 |                                      | 72.7                                 |
| Total assets   | 241.6                | 535.7                | 1,216.4              |                                      | 1,237.4                              |
| Short-term debt  | 4.7                  | 0.6                  | 1.6                  |                                      | 1.6                                  |
| Long-term debt   | 51.6                 | 226.1                | 631.5                |                                      | 631.1                                |
| Long-term debt premium   |                      |                      | 22.8                 |                                      | 21.8                                 |
| Total stockholders' equity   | 124.9                | 169.9                | 312.6                |                                      | 310.7                                |
| Depreciation and amortization  | 8.3                  | 12.9                 | 48.0                 |                                      | 13.7                                 |
| Capital expenditures   | 0.4                  | 2.3                  | 7.5                  |                                      | 2.7                                  |
| <b>Other Financial Data:</b>   |                      |                      |                      |                                      |                                      |
| EBITDA   | (18.6)               | 37.1                 | 76.3                 | 6.5                                  | 22.4                                 |

|                 |      |      |      |      |      |
|-----------------|------|------|------|------|------|
| Adjusted EBITDA | 24.7 | 39.7 | 91.8 | 12.6 | 24.4 |
|-----------------|------|------|------|------|------|

S-9

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## Table of Contents

As presented in the table below, EBITDA and Adjusted EBITDA are non-GAAP financial measures. EBITDA is defined as GAAP income (loss) from continuing operations plus, net interest expense, provision (benefit) for income taxes, depreciation and amortization. Adjusted EBITDA is defined as EBITDA plus stock-based compensation expense, acquisition costs, impairment of goodwill, stock option investigation and related fees and certain recovery and settlement amounts, and less other income related to interest rate swap agreements.

EBITDA and Adjusted EBITDA as calculated by us may be calculated differently than EBITDA for other companies. We have provided EBITDA and Adjusted EBITDA because we believe it is a commonly used measure of financial performance in comparable companies and is provided to help investors evaluate companies on a consistent basis, as well as to enhance an understanding of our operating results. Our management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating our operating performance and capital resources and cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and non-GAAP financial measures as reported by us may not be comparable to similarly titled amounts reported by other companies. EBITDA and Adjusted EBITDA should not be construed as either an alternative to net income or as an indicator of our operating performance or an alternative to cash flow as a measure of liquidity.

The following table reconciles our income (loss) from continuing operations to EBITDA and EBITDA to Adjusted EBITDA for the periods presented:

|   | Fiscal Year Ended    |                      |                      | Three<br>Months<br>Ended | Three<br>Months<br>Ended |
|---|----------------------|----------------------|----------------------|--------------------------|--------------------------|
|   | December 27,<br>2009 | December 26,<br>2010 | December 25,<br>2011 | March 27,<br>2011        | March 25,<br>2012        |
|   | (in millions)        |                      |                      |                          |                          |
| Income (loss) from continuing operations  | \$ (38.3)            | \$ 14.6              | \$ (24.7)            | \$ (3.8)                 | \$ (3.2)                 |
| Interest expense, net   | 10.4                 | 22.3                 | 51.1                 | 6.7                      | 16.1                     |
| Provision (benefit) for income taxes  | 1.0                  | (12.7)               | 1.9                  | (1.2)                    | (4.2)                    |
| Depreciation and amortization   | 8.3                  | 12.9                 | 48.0                 | 4.8                      | 13.7                     |
| <b>EBITDA</b>   | <b>(18.6)</b>        | <b>37.1</b>          | <b>76.3</b>          | <b>6.5</b>               | <b>22.4</b>              |
| Stock-based compensation expense(a)   | 1.7                  | 1.9                  | 3.3                  | 0.6                      | 1.1                      |
| Acquisition costs(b)  |                      | 3.1                  | 12.5                 | 5.8                      | 0.9                      |
| Impairment of goodwill(c)   | 41.3                 |                      |                      |                          |                          |
| Stock option investigation and related fees, recovery of unauthorized issuance of stock options, litigation settlement and other(d) | 0.4                  | (1.4)                |                      |                          |                          |
| Other income related to interest rate swap agreements(e)  | (0.1)                | (1.0)                | (0.3)                | (0.3)                    |                          |
| <b>Adjusted EBITDA</b>  | <b>\$ 24.7</b>       | <b>\$ 39.7</b>       | <b>\$ 91.8</b>       | <b>\$ 12.6</b>           | <b>\$ 24.4</b>           |

- 
- (a) Stock-based compensation expense represents non-cash compensation charges related to the issuance of stock options to certain employees and directors.
- (b) Fees related to acquisition expenses.
- (c) Non-cash charge related to the impairment of goodwill.
- (d) Costs which are primarily comprised of non-recurring expenses associated with our historical stock option investigation, 2004 and 2007 securities and derivative litigation and recovery of those costs.
- (e) Non-cash mark-to-market charge for interest rate swap agreements.





Table of Contents**Summary Historical Financial Data of CEI**

The following table sets forth a summary of CEI's historical financial data as of the dates and for each of the periods indicated. The historical financial data as of January 1, 2011 and December 31, 2011 and for the years ended December 26, 2009, January 1, 2011 and December 31, 2011 is derived from CEI's audited financial statements set forth in Annex B of this prospectus supplement. The consolidated historical financial data for the three months ended March 31, 2011 and for and as of the three months ended March 31, 2012 are derived from CEI's unaudited condensed consolidated financial statements set forth in Annex B of this prospectus supplement. The historical results presented below are not necessarily indicative of results that can be expected for any future period and should be read in conjunction with CEI's audited and unaudited financial statements included herein.

|   | Fiscal Year Ended    |                    |                      | Three                                | Three                                |
|---|----------------------|--------------------|----------------------|--------------------------------------|--------------------------------------|
|   | December 26,<br>2009 | January 1,<br>2011 | December 31,<br>2011 | Months<br>Ended<br>March 31,<br>2011 | Months<br>Ended<br>March 31,<br>2012 |
| (in millions)   |                      |                    |                      |                                      |                                      |
| <b>Statement of Operations:</b>                           |                      |                    |                      |                                      |                                      |
| Net sales   | \$ 76.3              | \$ 73.6            | \$ 94.1              | \$ 21.0                              | \$ 24.9                              |
| Cost and expenses   | 57.4                 | 56.7               | 66.5                 | 14.5                                 | 17.6                                 |
| Gross profit  | 18.9                 | 16.9               | 27.6                 | 6.5                                  | 7.3                                  |
| Selling, general and administrative expenses              | 15.2                 | 12.7               | 13.4                 | 3.2                                  | 5.3                                  |
| Accrued contract revenue refunds                          |                      |                    | (1.4)                |                                      |                                      |
| Other income, net   |                      |                    | 0.1                  |                                      |                                      |
| Interest expense, net                                     | (0.4)                | (0.4)              | (0.4)                | (0.1)                                | (0.1)                                |
| Income before income taxes                                | 3.3                  | 3.8                | 12.5                 | 3.2                                  | 1.9                                  |
| Tax (benefit) provision                                   |                      |                    |                      |                                      |                                      |
| Income from continuing operations                         | \$ 3.3               | \$ 3.8             | \$ 12.5              | \$ 3.2                               | \$ 1.9                               |
| <b>Balance Sheet Data (at period end) and Other Data:</b> |                      |                    |                      |                                      |                                      |
| Cash and cash equivalents                                 | \$ 1.1               | \$ 0.1             |                      | \$ 6.9                               |                                      |
| Property and equipment, net                               | 4.7                  | 5.5                |                      | 6.0                                  |                                      |
| Total assets  | 28.8                 | 47.4               |                      | 50.0                                 |                                      |
| Total debt  | 8.2                  | 7.3                |                      | 2.6                                  |                                      |
| Total stockholders' equity                                | 9.1                  | 16.4               |                      | 18.3                                 |                                      |
| Depreciation and amortization                             | 1.3                  | 1.6                |                      | 0.3                                  |                                      |
| Capital expenditures                                      | 2.2                  | 1.7                |                      | 0.8                                  |                                      |
| <b>Other Financial Data:</b>                              |                      |                    |                      |                                      |                                      |
| EBITDA  | 5.5                  | 14.5               |                      | 3.6                                  | 2.3                                  |
| Adjusted EBITDA   | 5.5                  | 15.9               |                      | 3.6                                  | 2.3                                  |

As presented in the table below, EBITDA and Adjusted EBITDA are non-GAAP financial measures. EBITDA is defined as GAAP net income from continuing operations plus net interest expense, depreciation and amortization. Adjusted EBITDA is defined as EBITDA plus other non-recurring items.

EBITDA and Adjusted EBITDA as calculated by us may be calculated differently than EBITDA for other companies. We have provided EBITDA and Adjusted EBITDA because we believe it is a commonly used measure of financial performance in comparable companies and is provided to help investors evaluate companies on a consistent basis, as well as to enhance an understanding of our operating results. Management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating operating performance and capital resources and



Table of Contents

cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and non-GAAP financial measures as reported by us may not be comparable to similarly titled amounts reported by other companies. EBITDA and Adjusted EBITDA should not be construed as either an alternative to net income or as an indicator of our operating performance or an alternative to cash flow as a measure of liquidity.

The following table reconciles CEI's net income from continuing operations to EBITDA and EBITDA to Adjusted EBITDA for the period presented:

|                                       | January 1,<br>2011 | December 31,<br>2011 | Three Months<br>Ended<br>March 31, 2011 | Three Months<br>Ended<br>March 31, 2012 |
|---------------------------------------|--------------------|----------------------|---|---|
|                                       | (in millions)      |                      |   |   |
| Net income from continuing operations | \$ 3.8             | \$ 12.5              | \$ 3.2                                  | \$ 1.9                                  |
| Interest expense, net                 | 0.4                | 0.4                  | 0.1                                     | 0.1                                     |
| Depreciation and amortization         | 1.3                | 1.6                  | 0.3                                     | 0.3                                     |
| EBITDA                                | 5.5                | 14.5                 | 3.6                                     | 2.3                                     |
| Contract revenue refund(a)            |                    | 1.4                  |   |   |
| Adjusted EBITDA                       | \$ 5.5             | \$ 15.9              | \$ 3.6                                  | \$ 2.3                                  |

(a) Reflects costs from a prior year contract which were subsequently identified as overestimated and which will be owed as a refund to the government.

Table of Contents

**Summary Unaudited Pro Forma Combined and Condensed Combined Consolidated  
Financial and Operating Information**

The following table sets forth summary unaudited pro forma combined and condensed combined consolidated financial information of Kratos. The summary unaudited pro forma combined and condensed combined financial data is intended to show how the proposed acquisition of CEI might have affected historical financial statements of Kratos if such acquisition had been completed at an earlier time and was prepared based on the historical financial results reported by Kratos and CEI. The following should be read in connection with the audited and unaudited financial statements of CEI, set forth in Annex B of this prospectus supplement, and our audited and unaudited consolidated financial statements which are incorporated by reference into this prospectus supplement. See "Where You Can Find Additional Information" beginning on page S-58.

The summary unaudited pro forma combined and condensed combined financial statements were prepared in accordance with the regulations of the SEC. The pro forma adjustments reflecting the completion of the acquisition of CEI are based upon the acquisition method of accounting in accordance with GAAP, and upon the assumptions set forth in the notes to the unaudited pro forma combined and condensed combined financial statements. During 2011, Kratos acquired Herley Industries, Inc. ("Herley"), Integral Systems, Inc. ("Integral") and SecureInfo Corporation ("SecureInfo"). The acquisition of each of Herley, Integral and SecureInfo was completed on March 25, 2011, July 27, 2011, and November 15, 2011, respectively.

The summary unaudited pro forma condensed combined balance sheet as of March 25, 2012 combines the historical condensed consolidated balance sheets of Kratos as of March 25, 2012 and CEI as of March 31, 2012.

The summary unaudited pro forma condensed combined statements of operations for the three months ended March 25, 2012 combine the historical condensed consolidated statements of operations of Kratos and CEI for their respective three months ended March 25, 2012 and March 31, 2012. The summary unaudited pro forma combined statements of operations for the year ended December 25, 2011 combine the historical consolidated statements of operations of Kratos and CEI for their respective twelve months ended December 25, 2011 and December 31, 2011, respectively, of Herley for the three month period ended January 30, 2011, and of Integral for the six month period ended July 1, 2011 and gives effect to the Transactions as if they had occurred on December 27, 2010. The pro forma results do not include the acquisition made of the critical infrastructure business in January 2012, SecureInfo operating results from December 27, 2010 to November 15, 2011, Herley operating results from January 31, 2011 to March 25, 2011, and Integral operating results from July 2, 2011 to July 27, 2011.

The unaudited pro forma combined and condensed combined financial information also gives effect to this offering and the related draw on our revolving credit facility.

The summary unaudited pro forma combined and condensed combined consolidated financial information is provided for illustrative purposes only and does not purport to represent what Kratos' actual consolidated results of operations or the consolidated financial position would have been had the

Table of Contents

transactions occurred on the dates assumed, nor are they necessarily indicative of future consolidated results of operations or consolidated financial position.

|  | <b>Pro Forma Year Ended<br/>December 25, 2011<br/>(in millions, except share<br/>and per share data)</b> |        | <b>Pro Forma<br/>Three Months Ended<br/>March 25, 2012</b> |         |
|--|--|--------|--|---------|
| <b>Statement of Operations Data:</b>                     |  |        |  |         |
| Revenue  | \$   | 971.1  | \$   | 239.9   |
| Operating income from continuing operations              |  | 23.7   |  | 6.5     |
| Loss from continuing operations                          |  | (45.7) |  | (5.5)   |
| Basic loss from continuing operations per common share   | \$   | (0.79) | \$   | (0.10)  |
| Diluted loss from continuing operations per common share | \$   | (0.79) | \$   | (0.10)  |
| Weighted average common shares outstanding:              |  |        |  |         |
| Basic  |  | 57.7   |  | 56.0    |
| Diluted  |  | 57.7   |  | 56.0    |
| <b>Balance Sheet Data (at period end):</b>               |  |        |  |         |
| Cash and cash equivalents                                |  |        | \$   | 83.1    |
| Total assets   |  |        |  | 1,419.1 |
| Short-term debt  |  |        |  | 1.6     |
| Long-term debt   |  |        |  | 671.1   |
| Long-term debt premium                                   |  |        |  | 21.8    |
| Total liabilities  |  |        |  | 993.3   |
| Total stockholders' equity                               |  |        |  | 425.8   |
| <b>Other Data:</b>                                       |  |        |  |         |
| EBITDA   | \$   | 102.9  | \$   | 24.1    |
| Adjusted EBITDA  |  | 135.4  |  | 26.7    |

As presented in the table below, EBITDA and Adjusted EBITDA are non-GAAP financial measures. EBITDA is defined as GAAP loss from continuing operations plus net interest expense, provision for income taxes, depreciation and amortization. Adjusted EBITDA is defined as EBITDA plus stock-based compensation expense, other (income) expense related to interest rate swap agreements, a contract revenue refund, acquisition costs, impact of anticipated reduction of duplicative costs, litigation costs and settlements, employment termination and settlement costs, and other one-time costs that are non-recurring in nature.

EBITDA and Adjusted EBITDA as calculated by us may be calculated differently than EBITDA for other companies. We have provided EBITDA and Adjusted EBITDA because we believe it is a commonly used measure of financial performance in comparable companies and is provided to help investors evaluate companies on a consistent basis, as well as to enhance an understanding of our operating results. Our management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating our operating performance and capital resources and cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and non-GAAP financial measures as reported by us may not be comparable to similarly titled amounts reported by other companies. EBITDA and Adjusted EBITDA should not be construed as either an alternative to net income or as an indicator of our operating performance or an alternative to cash flow as a measure of liquidity.

Table of Contents

The following tables reconcile our pro forma loss from continuing operations to EBITDA and EBITDA to Adjusted EBITDA to reflect the acquisition of CEI, Herley, and Integral for the periods presented:

|   | <b>Pro Forma<br/>Year Ended<br/>December 25,<br/>2011</b> | <b>Pro Forma<br/>Three Months<br/>Ended<br/>March 25,<br/>2012</b> |
|---|---|--|
|   | (in millions)   |  |
| Loss from continuing operations                         | \$ (45.7)   | \$ (5.5)   |
| Interest expense, net                                   | 65.4  | 16.5   |
| Provision (benefit) for income taxes                    | 3.0   | (4.0)  |
| Depreciation and amortization                           | 80.2  | 17.1   |
| <b>EBITDA</b>   | <b>102.9</b>  | <b>24.1</b>  |
| Stock-based compensation expense(a)                     | 5.8   | 1.7  |
| Other (income) expense(b)                               | 1.1   |  |
| Acquisition costs(c)                                    | 13.6  | 0.9  |
| Impact of anticipated reduction of duplicative costs(d) | 8.8   |  |
| Other(e)  | 3.2   |  |
| <b>Adjusted EBITDA</b>                                  | <b>\$ 135.4</b>   | <b>\$ 26.7</b>   |

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- (a) Stock-based compensation expense represents non-cash compensation charges related to the issuance of stock options to certain employees and directors.
- (b) Reflects other (income) expense as a result of a non-cash mark-to-market charge for interest rate swap agreements and costs from a prior year contract which were subsequently identified as overestimated and which will be owed as a refund to the government.
- (c) Fees related to acquisition expenses.
- (d) Expenses related to public company costs, related to Herley and Integral, and personnel costs that are duplicative and expected to be eliminated.
- (e) Primarily relates to adjustments to the liability for unused office space, non-recurring operating expenses related to the launch of a new line of business and other one-time costs that are non-recurring in nature.

Table of Contents

**RISK FACTORS**

*An investment in our common stock involves a substantial risk of loss. You should carefully consider these risk factors, together with all of the other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus, as modified and superseded pursuant to Rule 412 under the Securities Act, before you decide to invest in our common stock. The occurrence of any of the following risks could harm our business. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our operations. You should also refer to the other information contained in this prospectus supplement and the accompanying prospectus or incorporated by reference herein or therein, including our financial statements and the notes to those statements and the information set forth under the heading "Cautionary Note Regarding Forward-Looking Statements."*

**Risks Related to the Proposed Acquisition of CEI**

*The proposed acquisition of CEI may not be completed within the expected timeframe, or at all, and the failure to complete such acquisition could adversely affect our stock price and our future business and financial results.*

On May 8, 2012, we entered into the CEI Purchase Agreement with CEI. The CEI Purchase Agreement is an executory contract subject to numerous closing conditions beyond our control, and there is no guarantee that these conditions will be satisfied in a timely manner or at all. If any of the conditions to the proposed acquisition are not satisfied (or waived by the other party), we may not complete the acquisition or realize the anticipated benefits thereof. Disputes regarding interpretations of the CEI Purchase Agreement could also delay or prevent the closing. In addition, the market price of our common stock may reflect various market assumptions as to whether and when the proposed acquisition will occur. Consequently, the failure to complete the acquisition within the expected timeframe, or at all, could result in a significant change in the market price of our common stock and could adversely affect our future business and financial results.

*The offering of common stock pursuant to this prospectus supplement is not conditioned on the completion of the proposed acquisition.*

The offering of common stock pursuant to this prospectus supplement is not conditioned on completion of the proposed acquisition. Although certain information contained in this prospectus supplement generally assumes the completion of the acquisition, we cannot assure you that the acquisition will be consummated on the terms described in this prospectus supplement or at all. If we do not complete the proposed acquisition, we will retain broad discretion to use the net proceeds from this offering of common stock for general corporate purposes, including the acquisition of or investment in other businesses, services and technologies that are complementary to our own and other general corporate expenses.

*We may experience difficulties in integrating CEI's business and realizing the expected benefits of the proposed acquisition.*

Our ability to achieve the benefits we anticipate from the proposed acquisition will depend in large part upon whether we are able to integrate CEI's business into our business in an efficient and effective manner. Because the businesses of CEI and Kratos differ, we may not be able to integrate CEI's business smoothly or successfully and the process may take longer than expected. The integration of certain operations, including CEI's international operations, and the differences in operational culture following the acquisition will require the dedication of significant management resources, which may distract management's attention from day-to-day business operations. If we are unable to successfully integrate the operations of CEI's business into our business, we may be unable to realize



Table of Contents

the revenue growth, synergies and other anticipated benefits we expect to achieve as a result of the proposed acquisition and our business and results of operations could be adversely affected.

***The announcement and pendency of the proposed acquisition may cause disruptions in CEI's business, which could have an adverse effect on our business, financial condition or results of operations following completion of the acquisition.***

The announcement and pendency of the proposed acquisition could cause disruptions in the business of CEI. Specifically:

current and prospective employees of CEI may experience uncertainty about their future roles with Kratos, which might adversely affect the ability of CEI to retain key personnel and attract new personnel;

current and prospective customers of CEI may experience uncertainty about the ability of CEI to meet their needs, which might cause customers to seek other suppliers for the products and services provided by CEI; and

management's attention may be focused on the acquisition, which may divert management's attention from the core business of CEI and other opportunities that could have been beneficial to CEI.

This could have an adverse effect on the business, financial condition or results of operations of CEI prior to the completion of the acquisition and on us following the completion of the acquisition. These disruptions to CEI's business could be exacerbated by a delay in the completion of the acquisition.

***The historical and unaudited pro forma financial information included elsewhere in this prospectus supplement may not be representative of our results as a combined company after the acquisition, and accordingly, you have limited financial information on which to evaluate the combined company and your investment decision.***

We and CEI have no prior history as a combined entity and our operations have not previously been managed on a combined basis. The pro forma financial information, which was prepared in accordance with Article 11 of the SEC's Regulation S-X, is presented for informational purposes only and is not necessarily indicative of the financial position or results of operations that would have actually occurred had the acquisition been completed at or as of the dates indicated, nor is it indicative of the future operating results or financial position of the combined company. The pro forma financial information does not reflect future nonrecurring charges resulting from the acquisition. The unaudited pro forma financial information does not reflect future events that may occur after the acquisition, including the potential realization of operating cost savings (synergies) or restructuring activities or other costs related to the planned integration of CEI, and does not consider potential impacts of current market conditions on revenues, expense efficiencies or asset dispositions. The pro forma financial information presented in this prospectus supplement is based in part on certain assumptions regarding the acquisition that we believe are reasonable under the circumstances. We cannot assure you that our assumptions will prove to be accurate over time.

***CEI may have liabilities that are not known, probable or estimable at this time.***

As a result of the acquisition, CEI will become our subsidiary and we will effectively assume all of its liabilities, whether or not asserted. There could be unasserted claims or assessments that we failed or were unable to discover or identify in the course of performing due diligence investigations of CEI. In addition, there may be liabilities that are neither probable nor estimable at this time which may become probable and estimable in the future. Any such liabilities, individually or in the aggregate,

Table of Contents

could have a material adverse effect on our business. We may learn additional information about CEI that adversely affects us, such as unknown, unasserted or contingent liabilities and issues relating to compliance with applicable laws.

**Risks Related to Our Business Currently and Following the Proposed Acquisition of CEI**

*Our business could be adversely affected by changes in the contracting or fiscal policies of the U.S. Government and governmental entities.*

We derive a significant portion of our revenue from contracts with the U.S. Government and government agencies and subcontracts under U.S. Government prime contracts, and the continued success and growth of our business will continue to depend on our successful procurement of government contracts, either directly or through prime contractors. With the passage of the Budget Control Act of 2011 ("Budget Control Act"), current projections of the DoD indicate that government spending is expected to decrease. Any such reductions or other government budgetary constraints and any changes in government contracting policies could directly affect our financial performance. Among the factors that could adversely affect our business are:

changes in fiscal policies or decreases in available government funding, including budgetary constraints affecting U.S. Government spending generally or specific departments or agencies in particular;

the adoption of new laws or regulations or changes to existing laws or regulations;

changes in political or social attitudes with respect to security and defense issues;

changes in U.S. Government programs or requirements, including the increased use of small business providers;

increases in the U.S. Government initiatives related to in-sourcing;

changes in or delays related to U.S. Government restrictions on the export of defense articles and services;

potential delays or changes in the government appropriations process; and

delays in the payment of our invoices by government payment offices.

These and other factors could cause governments and government agencies, or prime contractors that use us as a subcontractor, to reduce their purchases under existing contracts, to exercise their rights to terminate contracts at-will or to abstain from exercising options to renew contracts, any of which could have an adverse effect on our business, financial condition and results of operations. Many of our government customers are subject to stringent budgetary constraints. The award of additional contracts from government agencies could be adversely affected by spending reductions or budget cutbacks at these agencies.

*Significant delays or reductions in appropriations for our programs and U.S. Government funding more broadly may negatively impact our business and programs and could have a material adverse effect on our financial position, results of operations and/or cash flows.*

The funding of U.S. Government programs is subject to an annual congressional budget authorization and appropriation process. For many programs, Congress appropriates funds on a fiscal year basis even though the program performance period may extend over several fiscal years. Consequently, programs are often partially funded initially and additional funds are committed only as Congress makes further appropriations. If we incur costs in excess of funds committed on a contract, we are at risk for reimbursement of those costs until additional funds are appropriated. We cannot predict the extent to which total funding and/or funding for individual programs will be included,

Table of Contents

increased or reduced as part of the recently enacted Consolidated Appropriations Act of 2012, which decreased DoD funding by 3.3% from 2011 levels. The impact, severity and duration of the current U.S. economic situation and sweeping economic plans adopted or to be adopted by the U.S. Government could adversely affect the funding for individual programs and delay purchasing or payment decisions by our customers. In the event that government funding for any of our programs becomes unavailable, or is reduced or delayed, our contract or subcontract under such program may be terminated or adjusted by the U.S. Government, which could have a material adverse effect on our financial position, results of operations, and/or cash flows.

In August 2011, Congress and the Administration enacted the Budget Control Act in order to permit an increase in the federal government's borrowing limit while reducing projected net government spending over the next 10 years. The Budget Act contains \$900 billion in immediate cuts to discretionary spending for 2012-2021. It also established a bipartisan congressional Joint Select Committee on Deficit Reduction (the "Joint Committee") which is charged with recommending legislation that would reduce net government spending by \$1.2 to \$1.5 trillion over the next 10 years, in addition to the \$900 billion in immediate discretionary spending reductions referenced above. The Joint Committee was unable to identify the required reductions, thereby triggering a provision of the Budget Control Act called "sequestration," which requires very substantial automatic spending cuts which will start in 2013 and be split between defense and non-defense programs and continue over a nine-year period. Should Congress and the Administration fail to change or delay the pending sequestration imposed by the Budget Act, our customers could see their budgets dramatically reduced across the board with a corresponding impact upon procurement of products and services and this could have significant consequences to our business and industry. Although it appears Congressional leadership and the Administration are considering options to avoid such an outcome, it remains uncertain as to whether they will succeed in doing so.

We believe that spending on modernization and maintenance of defense, intelligence and homeland security assets will continue to be a national priority. The vast majority of our programs are funded in the DoD base budget and not the Overseas Contingency Operations budget. We also believe that our business is aligned with mission critical national security priorities, particularly in the areas of unmanned aerial vehicles, cybersecurity, ballistic missile defense, space programs and science and technology efforts, where the proposed defense budget for fiscal year 2013 has actually allocated increased funding.

***If we fail to establish and maintain important relationships with government entities and agencies and other government contractors, our ability to bid successfully for new business may be adversely affected.***

To develop new business opportunities, we primarily rely on establishing and maintaining relationships with various government entities and agencies. We may be unable to successfully maintain our relationships with government entities and agencies, and any failure to do so could materially adversely affect our ability to compete successfully for new business. In addition, we often act as a subcontractor or in "teaming" arrangements in which we and other contractors bid together on particular contracts or programs for the U.S. Government or government agencies. As a subcontractor or team member, we often lack control over fulfillment of a contract, and poor performance on the contract could tarnish our reputation, even when we perform as required. We expect to continue to depend on relationships with other contractors for a portion of our revenue in the foreseeable future. Moreover, our revenue and operating results could be materially adversely affected if any prime contractor or teammate chooses to offer a client services of the type that we provide or if any prime contractor or teammate teams with other companies to independently provide those services.

Table of Contents

***We depend on U.S. Government agencies as our primary customers, and if our reputation or relationships with these agencies were harmed, our future revenues and growth prospects would be adversely affected.***

In fiscal 2009, 2010 and 2011, we generated 86%, 87% and 74%, respectively, of our total revenues from contracts with the U.S. Government (including all branches of the U.S. military), either as a prime contractor or a subcontractor. We expect to continue to derive most of our revenues from work performed under U.S. Government contracts. Our reputation and relationship with the U.S. Government, and in particular with the agencies of the DoD and the U.S. intelligence community, are key factors in maintaining and growing these revenues. Negative press reports regarding conflicts of interest, poor contract performance, employee misconduct, information security breaches or other aspects of our business, regardless of accuracy, could harm our reputation, particularly with these agencies. If our reputation is negatively affected, or if we are suspended or debarred (or proposed for suspension or debarment) from contracting with government agencies for any reason, the amount of business with the U.S. Government would decrease and our future revenues and growth prospects would be adversely affected.

***Loss of our General Services Administration ("GSA") contracts or GWACs would impair our ability to attract new business.***

We are a prime contractor under several GSA contracts and GWAC vehicles. We believe that our ability to provide services under these contracts will continue to be important to our business because of the multiple opportunities for new engagements each contract provides. If we were to lose our position as prime contractor on one or more of these contracts, we could lose substantial revenues and our operating results could suffer. GSA contracts and other GWACs typically have a one or two-year initial term with multiple options exercisable at the government client's discretion to extend the contract for one or more years. We cannot be assured that our government clients will continue to exercise the options remaining on our current contracts, nor can we be assured that our future clients will exercise options on any contracts we may receive in the future.

***We derive a substantial amount of our revenues from the sale of our solutions either directly or indirectly to U.S. Government entities pursuant to government contracts, which differ materially from standard commercial contracts, involve competitive bidding and may be subject to cancellation or delay without penalty, any of which may produce volatility in our revenues and earnings.***

Government contracts frequently include provisions that are not standard in private commercial transactions and are subject to laws and regulations that give the U.S. Government rights and remedies not typically found in commercial contracts, including provisions permitting the U.S. Government to:

terminate our existing contracts;

reduce potential future income from our existing contracts;

modify some of the terms and conditions in our existing contracts;

suspend or permanently prohibit us from doing business with the U.S. Government or with any specific government agency;

impose fines and penalties;

subject us to criminal prosecution;

suspend work under existing multiple year contracts and related task orders if the necessary funds are not appropriated by Congress;

decline to exercise an option to extend an existing multiple year contract; and

claim rights in technologies and systems invented, developed or produced by us.

Table of Contents

In addition, government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted and typically impose provisions that permit cancellation in the event that necessary funds are unavailable to the public agency. Competitive procurements impose substantial costs and managerial time and effort in order to prepare bids and proposals for contracts that may not be awarded to us. In many cases, unsuccessful bidders for government agency contracts are provided the opportunity to formally protest certain contract awards through various agencies, administrative and judicial channels. The protest process may substantially delay a successful bidder's contract performance, result in cancellation of the contract award entirely and distract management. We may not be awarded contracts for which we bid, and substantial delays or cancellation of purchases may follow our successful bids as a result of such protests.

Certain of our government contracts also contain "organizational conflict of interest" clauses that could limit our ability to compete for certain related follow-on contracts. For example, when we work on the design of a particular solution, we may be precluded from competing for the contract to install that solution. While we actively monitor our contracts to avoid these conflicts, we cannot guarantee that we will be able to avoid all organizational conflict of interest issues.

***We may not receive the full amounts estimated under the contracts in our backlog, which could reduce our revenue in future periods below the levels anticipated and which makes backlog an uncertain indicator of future operating results.***

As of March 25, 2012, our total backlog was approximately \$1.1 billion of which \$500 million was funded. On a pro forma basis, our backlog was approximately \$1.3 billion, of which approximately \$600 million was funded. Funded backlog is estimated future revenue under government contracts and task orders for which funding has been appropriated by Congress and authorized for expenditure by the applicable agency, plus our estimate of the future revenue we expect to realize from our commercial contracts that are under firm orders. Although funded backlog represents only business which is considered to be firm, cancellations or scope adjustments may still occur. The remaining \$600 million and \$700 million of our total backlog and total pro forma backlog as of March 25, 2012, respectively, is unfunded. Unfunded backlog reflects our estimate of future revenue under awarded government contracts and task orders for which either funding has not yet been appropriated or expenditure has not yet been authorized. Unfunded backlog does not include estimates of revenue from GWAC or GSA schedules beyond awarded or funded task orders but does include estimates of revenue beyond awarded or funded task orders for other types of indefinite delivery, indefinite quantity contracts. The amount of unfunded backlog is not exact or guaranteed and is based upon, among other things, management's experience under such contracts and similar contracts, the particular clients, the type of work and budgetary expectations. Our management may not accurately assess these factors or estimate the revenue we will realize from these contracts, and our unfunded and total backlog may not reflect the actual revenue ultimately received from these contracts.

Backlog is typically subject to large variations from quarter to quarter and comparisons of backlog from period to period are not necessarily indicative of future revenues. The contracts comprising our backlog may not result in actual revenue in any particular period or at all, and the actual revenue from such contracts may differ from our backlog estimates. The timing of receipt of revenues, if any, on projects included in backlog could change because many factors affect the scheduling of projects. Cancellation of or adjustments to contracts may occur. Additionally, all U.S. Government contracts included in backlog, whether or not funded, may be terminated at the convenience of the U.S. Government. The failure to realize all amounts in our backlog could adversely affect our revenues and gross margins. As a result, our funded and total backlog as of any particular date may not be an accurate indicator of our future earnings.

Table of Contents

***We significantly increased our leverage in connection with the financing of recent acquisitions and we have substantial indebtedness, which could have a negative impact on our financing options and liquidity position and have adverse effects on our business.***

In connection with the acquisition of Herley and Integral, we incurred \$285.0 million and \$115.0 million of indebtedness, respectively. As of March 25, 2012, we had approximately \$654.5 million of total indebtedness outstanding, which includes \$21.8 million of unamortized debt premium, and \$1.2 million of capital lease obligations. As a result of this increased indebtedness, our interest payment obligations have increased significantly. The degree to which we are leveraged could have adverse effects on our business, including the following:

it may make it difficult for us to satisfy our obligations under our outstanding 10% Senior Secured Notes due 2017 (the "Notes"), other indebtedness and contractual and commercial commitments;

it may limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;

it may require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;

it may restrict us from making strategic acquisitions or exploiting business opportunities;

it may place us at a competitive disadvantage compared to our competitors that have less debt;

it may limit our ability to borrow additional funds;

it may prevent us from raising the funds necessary to repurchase our outstanding Notes tendered to us if there is a change of control, which would constitute a default under the indenture governing such notes and under our credit facility; and

it may decrease our ability to compete effectively or operate successfully under adverse economic and industry conditions.

Our ability to meet our debt service obligations will depend upon our future performance, which may be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

***Despite our current indebtedness level, we and our subsidiaries may incur substantially more debt, which could exacerbate the risks associated with our substantial leverage.***

We expect to draw approximately \$40.0 million on our existing credit facility in connection with the acquisition of CEI and we may incur substantial additional indebtedness in the future. Although the indenture and the amended credit and security agreement governing our credit facility will limit our ability and the ability of our subsidiaries to incur additional indebtedness, these restrictions are subject to a number of qualifications and exceptions and, under certain circumstances, debt incurred in compliance with these restrictions could be substantial. For example, indebtedness in excess of \$25.0 million may be incurred under our credit facility in reliance on the \$15.0 million general debt basket as well as the fixed charge debt incurrence test under which additional indebtedness may be secured subject to certain conditions. In addition, the indenture and the amended credit and security agreement governing our credit facility will not prevent us from incurring obligations that do not constitute indebtedness. To the extent that we incur additional indebtedness or such other obligations, the risks associated with our substantial leverage described above, including our possible inability to service our debt, would increase.

Table of Contents

***Our debt service obligations may adversely affect our cash flow.***

A higher level of indebtedness increases the risk that we may default on our debt obligations. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. If we are unable to generate sufficient cash flow to pay the interest on our debt, we may have to delay or curtail our operations.

Our ability to generate cash flows from operations and to make scheduled payments on our indebtedness will depend on our future financial performance. Our future financial performance will be affected by a range of economic, competitive and business factors that we cannot control. A significant reduction in operating cash flows resulting from changes in economic conditions, increased competition or other events beyond our control could increase the need for additional or alternative sources of liquidity and could have a material adverse effect on our business, financial condition, results of operations, prospects and our ability to service our debt and other obligations. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as reducing capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. These alternative strategies may not be affected on satisfactory terms, if at all, and they may not yield sufficient funds to make required payments on our indebtedness.

If, for any reason, we are unable to meet our debt service and repayment obligations, we would be in default under the terms of the agreements governing our debt, which would allow our creditors at that time to declare certain outstanding indebtedness to be due and payable, which would in turn trigger cross-acceleration or cross-default rights between the relevant agreements. In addition, our lenders could compel us to apply all of our available cash to repay our borrowings or they could prevent us from making payments on our indebtedness. If the amounts outstanding under any of our indebtedness, were to be accelerated, our assets may not be sufficient to repay in full the money owed to the lenders or to our other debt holders.

***A portion of our business is conducted through foreign subsidiaries, and the failure to generate sufficient cash flow from these subsidiaries or otherwise repatriate or receive cash from these subsidiaries could result in our inability to repay our indebtedness.***

As of March 25, 2012, approximately 4.5% of our consolidated assets were held by foreign subsidiaries. Our ability to meet our debt service obligations with cash from foreign subsidiaries will depend upon the results of operations of these subsidiaries and may be subject to legal, contractual or other restrictions and other business considerations. In addition, dividend and interest payments to us from the foreign subsidiaries may be subject to foreign withholding taxes, which would reduce the amount of funds we receive from such foreign subsidiaries. Dividends and other distributions from our foreign subsidiaries may also be subject to fluctuations in currency exchange rates and legal and other restrictions on repatriation, which could further reduce the amount of funds we receive from such foreign subsidiaries. In general, when an entity in a foreign jurisdiction repatriates cash to the U.S., the amount of such cash is treated as a dividend taxable at current U.S. tax rates. Accordingly, upon the distribution of cash to us from our foreign subsidiaries, we will be subject to U.S. income taxes. Although foreign tax credits may be available to reduce the amount of the additional tax liability, these credits may be limited and only offset the tax paid in the foreign jurisdiction, not the excess of the U.S. tax rate over the foreign tax rate. Therefore, to the extent that we must use cash generated in foreign jurisdictions to make principal or interest payments on our indebtedness, there may be a cost associated with repatriating the cash to the U.S.



Table of Contents

***The indenture and the amended credit and security agreement governing our credit facility impose significant operating and financial restrictions on us and our subsidiaries that may prevent us and our subsidiaries from pursuing certain business opportunities and restrict our ability to operate our business.***

The indenture and the amended credit and security agreement governing our credit facility contain covenants that restrict our and our subsidiaries' ability to:

incur or guarantee additional indebtedness or issue certain preferred stock;

pay dividends or make other distributions on, or redeem or purchase, any equity interests or make other restricted payments;

make certain acquisitions or investments;

create or incur liens;

transfer or sell assets;

incur restrictions on the payments of dividends or other distributions from our restricted subsidiaries;

enter into transactions with affiliates; and

consummate a merger or consolidation or sell, assign, transfer, lease or otherwise dispose of all or substantially all of our assets.

Our credit facility also requires us to comply with specified financial ratios, including a borrowing base availability and minimum fixed charge coverage ratio. Our ability to comply with these covenants will likely be affected by many factors, including events beyond our control, and we may not be able to satisfy those requirements. Our failure to comply with our debt-related obligations of our credit facility could result in an event of default under our other indebtedness and the acceleration of such indebtedness, in whole or in part, could result in an event of default under the indenture.

The restrictions contained in the indenture and in the amended credit and security agreement governing our credit facility will also limit our ability and the ability of our subsidiaries to plan for or react to market conditions and meet capital needs or otherwise restrict our respective activities or business plans and adversely affect our ability to finance our respective operations, enter into acquisitions or engage in other business activities that would be in our respective interests.

***We may need additional capital to fund the growth of our business, and financing may not be available on favorable terms or at all.***

We currently anticipate that our available capital resources, including our credit facility and operating cash flow, will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, such resources may not be sufficient to fund the long-term growth of our business. If we determine that it is necessary to raise additional funds, either through an expansion or refinancing of our credit facility or through public or private debt or equity financings, additional financing may not be available on terms favorable to us, or at all. Disruptions in the capital and credit markets may continue indefinitely or intensify, which could adversely affect our ability to access these markets. Limitations on our borrowing base contained in our credit facility may limit our access to capital, and we could fall out of compliance with financial and other covenants contained in our credit facility which, if not waived, would restrict our access to capital and could require us to pay down our existing debt under the credit facility. Our lenders may not agree to extend additional or continuing credit under our credit facility or waive restrictions on our access to capital. If we were to conduct a public or private offering of securities, any new offering would be likely to dilute our stockholders' equity ownership. If adequate funds are not available or are not available on acceptable terms, we may not be able to take advantage of available opportunities, develop new



Table of Contents

products or otherwise respond to competitive pressures and our business, operating results or financial condition could be materially adversely affected.

***We have incurred and may continue to incur goodwill impairment charges in our reporting entities, which could harm our profitability.***

As of March 25, 2012 and December 25, 2011, goodwill represented approximately 47% of our total assets. In accordance with *Financial Accounting Standards Board Accounting Standards Codification Topic 350 Intangibles Goodwill and Other*, we periodically review the carrying values of our goodwill to determine whether such carrying values exceed the fair market value. Our acquired companies are subject to annual review for goodwill impairment. If impairment testing indicates that the carrying value of a reporting unit exceeds its fair value, the goodwill of the reporting unit is deemed impaired. Accordingly, an impairment charge would be recognized for that reporting unit in the period identified.

The identification and measurement of impairment involves the estimation of the fair value of reporting units. Accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in industry or market conditions among other things. Our annual goodwill impairment assessment for 2011 resulted in an estimated fair value over net carrying value of our Kratos Government Solutions ("KGS") reporting unit of approximately 3.5%. Given the current market conditions and continued economic uncertainty in the U.S. defense industry as a result of the Budget Control Act, the fair value of our KGS reporting unit may deteriorate, resulting in an impairment of our goodwill within that unit. Due to continual changes in market and general business conditions, we cannot predict whether, and to what extent, our goodwill and long-lived intangible assets may be impaired in future periods. Any resulting impairment loss could harm our profitability and financial condition.

***Recent acquisitions and potential future acquisitions could prove difficult to integrate, disrupt our business, dilute stockholder value and strain our resources.***

We continually evaluate opportunities to acquire new businesses as part of our ongoing strategy, and we may in the future acquire additional businesses that we believe could complement or expand our business or increase our customer base. Integrating the operations of acquired businesses successfully or otherwise realizing any of the anticipated benefits of acquisitions, including anticipated cost savings and additional revenue opportunities, involves a number of potential challenges. The failure to meet these integration challenges could seriously harm our financial condition and results of operations. Realizing the benefits of acquisitions depends in part on the integration of operations and personnel. These integration activities are complex and time-consuming, and we may encounter unexpected difficulties or incur unexpected costs, including:

our inability to achieve the operating synergies anticipated in the acquisitions;

diversion of management attention from ongoing business concerns to integration matters;

difficulties in consolidating and rationalizing IT platforms and administrative infrastructures;

complexities associated with managing the geographic separation of the combined businesses and consolidating multiple physical locations where management may determine consolidation is desirable;

difficulties in integrating personnel from different corporate cultures while maintaining focus on providing consistent, high quality customer service;

Table of Contents

difficulties or delays in transitioning U.S. Government contracts pursuant to federal acquisition regulations;

challenges in demonstrating to customers of Kratos and to customers of acquired businesses that the acquisition will not result in adverse changes in customer service standards or business focus;

possible cash flow interruption or loss of revenue as a result of change of ownership transitional matters; and

inability to generate sufficient revenue to offset acquisition costs.

Acquired businesses may have liabilities or adverse operating issues that we fail to discover through due diligence prior to the acquisition. In particular, to the extent that prior owners of any acquired businesses or properties failed to comply with or otherwise violated applicable laws or regulations, or failed to fulfill their contractual obligations to the U.S. Government or other clients, we, as the successor owner, may be financially responsible for these violations and failures and may suffer reputational harm or otherwise be adversely affected. Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairment in the future that could harm our financial results. In addition, if we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted, which could affect the market price of our stock. Acquisitions and/or the related equity financings could also impact our ability to utilize our net operating loss ("NOL") carryforwards. As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. Acquisitions frequently involve benefits related to integration of operations. The failure to successfully integrate the operations or otherwise to realize any of the anticipated benefits of the acquisition could seriously harm our results of operations.

***If we are unable to manage our growth, our business and financial results could suffer.***

Sustaining our growth has placed significant demands on our management, as well as on our administrative, operational and financial resources. For us to continue to manage our growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If we are unable to manage our growth while maintaining our quality of service and profit margins, or if new systems that we implement to assist in managing our growth do not produce the expected benefits, our business, prospects, financial condition or operating results could be adversely affected.

Additionally, our future financial results depend in part on our ability to profitably manage our growth on a combined basis with the businesses we acquire. Management will need to maintain existing customers and attract new customers, recruit, retain and effectively manage employees, as well as expand operations and integrate customer support and financial control systems. If the integration-related expenses and capital expenditure requirements are greater than anticipated or if we are unable to manage our growth profitably after business acquisitions, our financial condition and results of operations may suffer.

***Our ability to utilize our net operating loss carryforwards and certain other tax attributes may be limited.***

Federal and state income tax laws impose restrictions on the utilization of NOL and tax credit carryforwards in the event that an "ownership change" occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code of 1986, as amended ("Section 382"). In general, an ownership change occurs when shareholders owning 5% or more of a "loss corporation" (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382

Table of Contents

limitation is calculated by multiplying the loss corporation's value at the time of the ownership change by the greater of the long-term tax-exempt rate determined by the Internal Revenue Service ("IRS") in the month of the ownership change or the two preceding months. In March 2010, an "ownership change" occurred and as a result, our ability to utilize NOL carryforwards will be limited to \$28.1 million a year for the five years succeeding the ownership change and \$11.6 million per year thereafter. If the entire limitation amount is not utilized in a year, any excess can be carried forward and utilized in future years. For the fiscal year ended December 25, 2011, there was no impact of such limitations on the income tax provision since the amount of taxable income did not exceed the annual limitation amount. However, we believe this equity offering could result in an "ownership change" under Section 382. While we currently do not anticipate that this equity offering will result in a reduction of the current annual limitation of our NOLs, we will not be able to complete this assessment until after the offering is completed. In addition, future equity offerings or acquisitions that have equity as a component of the purchase price could also result in an "ownership change." If and when any other "ownership change" occurs, utilization of the NOL or other tax attributes may be further limited.

***We face intense competition from many competitors that have greater resources than we do, which could result in price reductions, reduced profitability or loss of market share.***

We operate in highly competitive markets and generally encounter intense competition to win contracts from many other firms, including mid-tier federal contractors with specialized capabilities and large defense and IT services providers. Competition in our markets may increase as a result of a number of factors, such as the entrance of new or larger competitors, including those formed through alliances or consolidation. These competitors may have greater financial, technical, marketing and public relations resources, larger client bases and greater brand or name recognition than we do. These competitors could, among other things:

divert sales from us by winning very large-scale government contracts, a risk that is enhanced by the recent trend in government procurement practices to bundle services into larger contracts;

force us to charge lower prices; or

adversely affect our relationships with current clients, including our ability to continue to win competitively awarded engagements in which we are the incumbent.

If we lose business to our competitors or are forced to lower our prices, our revenue and our operating profits could decline. In addition, we may face competition from our subcontractors who, from time-to-time, seek to obtain prime contractor status on contracts for which they currently serve as a subcontractor to us. If one or more of our current subcontractors are awarded prime contractor status on such contracts in the future, it could divert sales from us or could force us to charge lower prices, which could cause our margins to suffer.

***Our financial results may vary significantly from quarter to quarter.***

We expect our revenue and operating results to vary from quarter to quarter. Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of our expenses are fixed in the short-term. We may incur significant operating expenses during the start-up and early stages of large contracts and may not be able to recognize corresponding revenue in that same quarter. We may also incur additional expenses when contracts are terminated or expire and are not renewed.

In addition, payments due to us from U.S. Government agencies may be delayed due to billing cycles or as a result of failures of government budgets to gain congressional and administration approval in a timely manner. The U.S. Government's fiscal year ends September 30. If a federal budget

Table of Contents

for the next federal fiscal year has not been approved by that date in each year, our clients may have to suspend engagements that we are working on until a budget has been approved. Any such suspensions may reduce our revenue in the fourth quarter of the federal fiscal year or the first quarter of the subsequent year. The U.S. Government's fiscal year end can also trigger increased purchase requests from clients for equipment and materials. Any increased purchase requests we receive as a result of the U.S. Government's fiscal year end would serve to increase our third or fourth quarter revenue, but will generally decrease profit margins for that quarter, as these activities generally are not as profitable as our typical offerings.

Additional factors that may cause our financial results to fluctuate from quarter to quarter include those addressed elsewhere in these Risk Factors and the following, among others:

the terms of customer contracts that affect the timing of revenue recognition;

variability in demand for our services and solutions;

commencement, completion or termination of contracts during any particular quarter;

timing of award or performance incentive fee notices;

timing of significant bid and proposal costs;

variable purchasing patterns under GSA Schedule 70 contracts, GWACs, blanket purchase agreements and other indefinite delivery/indefinite quantity contracts;

restrictions on and delays related to the export of defense articles and services;

costs related to government inquiries;

strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs and joint ventures;

strategic investments or changes in business strategy;

changes in the extent to which we use subcontractors;

seasonal fluctuations in our staff utilization rates;

changes in our effective tax rate including changes in our judgment as to the necessity of the valuation allowance recorded against our deferred tax assets; and

the length of sales cycles.

Significant fluctuations in our operating results for a particular quarter could cause us to fall out of compliance with the financial covenants related to our debt, which if not waived, could restrict our access to capital and cause us to take extreme measures to pay down our debt under

the credit facility. In addition, fluctuations in our financial results could cause our stock price to decline.

***Our margins and operating results may suffer if we experience unfavorable changes in the proportion of cost-plus-fee or fixed-price contracts in our total contract mix.***

Although fixed-price contracts entail a greater risk of a reduced profit or financial loss on a contract compared to other types of contracts we enter into, fixed-price contracts typically provide higher profit opportunities because we may be able to benefit from cost savings. In contrast, cost-plus-fee contracts are subject to statutory limits on profit margins, and generally are the least profitable of our contract types. Our U.S. Government customers typically determine what type of contract we enter into. Cost-plus-fee and fixed-price contracts in our federal business accounted for approximately 19% and 67%, respectively, of our federal business revenues for the year ended

Table of Contents

December 25, 2011. To the extent that we enter into more cost-plus-fee or less fixed-price contracts in proportion to our total contract mix in the future, our margins and operating results may suffer.

***Our cash flow and profitability could be reduced if expenditures are incurred prior to the final receipt of a contract.***

We provide various professional services, specialized products, and sometimes procure equipment and materials on behalf of our U.S. Government customers under various contractual arrangements. From time to time, in order to ensure that we satisfy our customers' delivery requirements and schedules, we may elect to initiate procurement in advance of receiving final authorization from the government customer or a prime contractor. If our government or prime contractor customers' requirements should change or if the government or the prime contractor should direct the anticipated procurement to a contractor other than us or if the equipment or materials become obsolete or require modification before we are under contract for the procurement, our investment in the equipment or materials might be at risk if we cannot efficiently resell them. This could reduce anticipated earnings or result in a loss, negatively affecting our cash flow and profitability.

***Failure to properly manage projects may result in additional costs or claims.***

Our engagements often involve large scale, highly complex projects. The quality of our performance on such projects depends in large part upon our ability to manage the relationship with our customers and to effectively manage the project and deploy appropriate resources, including third-party contractors and our own personnel, in a timely manner. Any defects or errors or failure to meet clients' expectations could result in claims for substantial damages against us. Our contracts generally limit our liability for damages that arise from negligent acts, error, mistakes or omissions in rendering services to our clients. However, we cannot be sure that these contractual provisions will protect us from liability for damages in the event we are sued. In addition, in certain instances, we guarantee customers that we will complete a project by a scheduled date. If the project experiences a performance problem, we may not be able to recover the additional costs we will incur, which could exceed revenues realized from a project. Finally, if we underestimate the resources or time we need to complete a project with capped or fixed fees, our operating results could be seriously harmed.

***We use estimates when accounting for contracts and any changes in such estimates could have an adverse effect on our profitability and our overall financial performance.***

When agreeing to contractual terms, our management makes assumptions and projections about future conditions and events, many of which extend over long periods. These projections assess the productivity and availability of labor, complexity of the work to be performed, cost and availability of materials, impact of delayed performance and timing of product deliveries. Contract accounting requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of total revenues and costs at completion is complicated and subject to many variables. For example, assumptions are made regarding the length of time to complete a contract since costs also include expected increases in wages, prices for materials and allocated fixed costs. Similarly, assumptions are made regarding the future impact of our efficiency initiatives and cost reduction efforts. Incentives, awards or penalties related to performance on contracts are considered in estimating revenue and profit rates and are recorded when there is sufficient information to assess anticipated performance. Suppliers' assertions are also assessed and considered in estimating costs and profit rates.

Because of the significance of the judgment and estimation processes described above, it is possible that materially different amounts could be obtained if different assumptions were used or if the underlying circumstances were to change. Changes in underlying assumptions, circumstances or estimates may have a material adverse effect upon the profitability of one or more of the affected



Table of Contents

contracts, future period financial reporting and performance. See the Critical Accounting Policies and Estimates section in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained within this Annual Report.

***The loss of any member of our senior management could impair our relationships with U.S. Government clients and disrupt the management of our business.***

We believe that the success of our business and our ability to operate profitably depends on the continued contributions of the members of our senior management. We rely on our senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of our senior management team have established and maintain with U.S. Government personnel contribute to our ability to maintain strong client relationships and to identify new business opportunities. We do not have any employment agreements providing for a specific term of employment with any member of our senior management. The loss of any member of our senior management could impair our ability to identify and secure new contracts, to maintain good client relations and to otherwise manage our business.

***If we fail to attract and retain skilled employees or employees with the necessary national security clearances, we might not be able to perform under our contracts or win new business.***

The growth of our business and revenue depends in large part upon our ability to attract and retain sufficient numbers of highly qualified individuals who have advanced IT and/or engineering skills. These employees are in great demand and are likely to remain a limited resource in the foreseeable future. Certain U.S. Government contracts require us, and some of our employees, to maintain national security clearances. Obtaining and maintaining national security clearances for employees involves a lengthy process, and it is difficult to identify, recruit and retain employees who already hold national security clearances. In addition, some of our contracts contain provisions requiring us to staff an engagement with personnel that the client considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutions, the client may terminate the contract and we may lose revenue.

If we are unable to recruit and retain a sufficient number of qualified employees, our ability to maintain and grow our business could be limited. In a tight labor market, our direct labor costs could increase or we may be required to engage large numbers of subcontractor personnel, which could cause our profit margins to suffer. Conversely, if we maintain or increase our staffing levels in anticipation of one or more projects and the projects are delayed, reduced or terminated, we may underutilize the additional personnel, which would increase our general and administrative expenses, reduce our earnings and possibly harm our results of operations.

***If our subcontractors or suppliers fail to perform their contractual obligations, our performance and reputation as a contractor and our ability to obtain future business could suffer.***

As a prime contractor, we often rely upon other companies as subcontractors to perform work we are obligated to perform for our clients. As we secure more work under our GWAC vehicles, we expect to require an increasing level of support from subcontractors that provide complementary and supplementary services to our offerings. Depending on labor market conditions, we may not be able to identify, hire and retain sufficient numbers of qualified employees to perform the task orders we expect to win. In such cases, we will need to rely on subcontracts with unrelated companies. Moreover, even in favorable labor market conditions, we anticipate entering into more subcontracts in the future as we expand our work under our GWACs. We are responsible for the work performed by our subcontractors, even though in some cases we have limited involvement in that work.

Table of Contents

If one or more of our subcontractors fail to satisfactorily perform the agreed-upon services on a timely basis or violate U.S. Government contracting policies, laws or regulations, our ability to perform our obligations as a prime contractor or meet our clients' expectations may be compromised. In extreme cases, performance or other deficiencies on the part of our subcontractors could result in a client terminating our contract for default. A termination for default could expose us to liability, including liability for the agency's costs of reprocurement, could damage our reputation and could hurt our ability to compete for future contracts.

We also are required to procure certain materials and parts from supply sources approved by the U.S. Government. The inability of a supplier to meet our needs or the appearance of counterfeit parts in our products could have a material adverse effect on our financial position, results of operations or cash flows.

***Our contracts and administrative processes and systems are subject to audits and cost adjustments by the U.S. Government, which could reduce our revenue, disrupt our business or otherwise adversely affect our results of operations.***

U.S. Government agencies, including the Defense Contract Audit Agency ("DCAA"), routinely audit and investigate government contracts and government contractors' administrative processes and systems. These agencies review our performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. They also review the adequacy of our compliance with government standards for our accounting and management of internal control systems, including: control environment and overall accounting system, general IT 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. Both contractors and the U.S. Government agencies conducting these audits and reviews have come under increased scrutiny. The current audits and reviews have become more rigorous, and the standards to which contractors are being held are being more strictly interpreted, increasing the likelihood of an audit or review resulting in an adverse outcome.

While we have submitted all applicable incurred cost claims, the actual indirect cost audits by the DCAA have not been completed for fiscal 2005 and subsequent fiscal years. Although we have recorded contract revenues subsequent to fiscal 2004 based upon costs that we believe will be approved upon final audit or review, we do not know the outcome of any ongoing or future audits or reviews and, if future adjustments exceed our estimates, our profitability would be adversely affected.

In addition, CEI's contracts and administrative processes and systems are also subject to audits and cost adjustments by the U.S. Government. In the ordinary course of business, the DCAA conducted an audit of CEI's costs. In 2011, the DCAA issued a report which concluded that costs associated with a proposed effort on a specific prior year contract item had been overestimated by CEI and the U.S. Government is currently seeking reimbursement of approximately \$1.6 million. CEI reviewed the DCAA audit findings and believes that approximately \$138,000 of the questioned costs were estimated properly, while the remaining \$1.4 million may be reimbursed to the U.S. Government. At December 31, 2011, CEI accrued a liability for anticipated refunds for \$1.4 million. CEI recorded the associated reimbursed costs as accrued contract revenue refunds in other expense on its statement of income for the year ended December 31, 2011.

***Our failure to comply with complex procurement laws and regulations could cause us to lose business and subject us to a variety of penalties.***

We must comply with laws and regulations relating to the formation, administration and performance of U.S. Government contracts, which affect how we do business with our clients, prime contractors, subcontractors and vendors and may impose added costs on us. New regulations or

Table of Contents

procurement requirements (including, for example regulations regarding counterfeit parts) or changes to current requirements, could increase our costs and risk of non-compliance. Our role as a contractor to agencies and departments of the U.S. Government results in our being routinely subject to investigations and reviews relating to compliance with various laws and regulations, including those associated with organizational conflicts of interest. These investigations may be conducted without our knowledge. Adverse findings in these investigations or reviews can lead to criminal, civil or administrative proceedings and we could face civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with U.S. Government agencies. In addition, we could suffer serious harm to our reputation and competitive position if allegations of impropriety were made against us, whether or not true. If our reputation or relationship with U.S. Government agencies were impaired, or if the U.S. Government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating profit would decline.

***If we experience systems or service failure, our reputation could be harmed and our clients could assert claims against us for damages or refunds.***

We create, implement and maintain IT solutions that are often critical to our clients' operations. We have experienced, and may in the future experience, some systems and service failures, schedule or delivery delays and other problems in connection with our work. If we experience these problems, we may:

lose revenue due to adverse client reaction;

be required to provide additional services to a client at no charge;

receive negative publicity, which could damage our reputation and adversely affect our ability to attract or retain clients; and

suffer claims for substantial damages.

In addition to any costs resulting from product or service warranties, contract performance or required corrective action, these failures may result in increased costs or loss of revenue if clients postpone subsequently scheduled work or cancel, or fail to renew, contracts.

While many of our contracts limit our liability for consequential damages that may arise from negligence in rendering services to our clients, we cannot ensure that these contractual provisions will be legally sufficient to protect us if we are sued. In addition, our errors and omissions and product liability insurance coverage may not be adequate, may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or the insurer may disclaim coverage as to some types of future claims. The successful assertion of any large claim against us could seriously harm our business. Even if not successful, these claims could result in significant legal and other costs, may be a distraction to our management and may harm our reputation.

***Security breaches in sensitive U.S. Government systems could result in the loss of clients and negative publicity.***

Many of the systems we develop, install and maintain involve managing and protecting information involved in intelligence, national security and other sensitive or classified U.S. Government functions. A security breach in one of these systems could cause serious harm to our business, damage our reputation and prevent us from being eligible for further work on sensitive or classified systems for U.S. Government clients. We could incur losses from such a security breach that could exceed the policy limits under our errors and omissions and product liability insurance. Damage to our reputation or limitations on our eligibility for additional work resulting from a security breach in one of the systems we develop, install and maintain could materially reduce our revenue.

Table of Contents

***Our employees may engage in misconduct or other improper activities, which could cause us to lose contracts.***

We are exposed to the risk that employee fraud or other misconduct could occur. Misconduct by employees could include intentional failures to comply with U.S. Government procurement regulations, engaging in unauthorized activities or falsifying time records. Employee misconduct could also involve the improper use of our clients' sensitive or classified information, which could result in regulatory sanctions against us and serious harm to our reputation and could result in a loss of contracts and a reduction in revenues. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could cause us to lose contracts or cause a reduction in revenues. In addition, alleged or actual employee misconduct could result in investigations or prosecutions of employees engaged in the subject activities, which could result in unanticipated consequences or expenses and management distraction for us regardless of whether we are alleged to have any responsibility.

***Our business is dependent upon our ability to keep pace with the latest technological changes.***

The market for our services is characterized by rapid change and technological improvements. Failure to respond in a timely and cost effective way to these technological developments would result in serious harm to our business and operating results. We have derived, and we expect to continue to derive, a substantial portion of our revenues from providing innovative engineering services and technical solutions that are based upon today's leading technologies and that are capable of adapting to future technologies. As a result, our success will depend, in part, on our ability to develop and market service offerings that respond in a timely manner to the technological advances of our customers, evolving industry standards and changing client preferences.

***We may be harmed by intellectual property infringement claims, and our failure to protect our intellectual property could enable competitors to market products and services with similar features.***

We may become subject to claims from our employees or third parties who assert that software and other forms of intellectual property that we use in delivering services and solutions to our clients infringe upon intellectual property rights of such employees or third parties. Our employees develop some of the software and other forms of intellectual property that we use to provide our services and solutions to our clients, but we also license technology from other vendors. If our employees, vendors, or other third parties assert claims that we or our clients are infringing on their intellectual property rights, we could incur substantial costs to defend those claims. If any of these infringement claims are ultimately successful, we could be required to cease selling or using products or services that incorporate the challenged software or technology, obtain a license or additional licenses from our employees, vendors, or other third parties, or redesign our products and services that rely on the challenged software or technology.

We attempt to protect our trade secrets by entering into confidentiality and intellectual property assignment agreements with third parties, our employees and consultants. However, these agreements can be breached and, if they are, there may not be an adequate remedy available to us. In addition, others may independently discover our trade secrets and proprietary information, and in such cases we could not assert any trade secret rights against such party. Enforcing a claim that a party illegally obtained and is using our trade secret is difficult, expensive and time consuming, and the outcome is unpredictable. If we are unable to protect our intellectual property, our competitors could market services or products similar to our services and products, which could reduce demand for our offerings. Any litigation to enforce our intellectual property rights, protect our trade secrets or determine the validity and scope of the proprietary rights of others could result in substantial costs and diversion of resources, with no assurance of success.

Table of Contents

Some of the technology that is developed by us is developed under contract for our DoD customers. Accordingly, such intellectual property and rights to technology development are owned by the U.S. Government.

***If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.***

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our operating results could be misstated, our reputation may be harmed and the trading price of our stock could be negatively affected. Our management has concluded that there are no material weaknesses in our internal controls over financial reporting as of December 25, 2011. However, there can be no assurance that our controls over financial processes and reporting will be effective in the future or that additional material weaknesses or significant deficiencies in our internal controls will not be discovered in the future. Any failure to remediate any future material weaknesses or implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results, cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock. In addition, from time to time we acquire businesses which could have limited infrastructure and systems of internal controls.

***The commercial business arena in which we operate has relatively low barriers to entry, and increased competition could result in margin erosion, which would make profitability even more difficult to sustain.***

Other than the technical skills required in our commercial business, the barriers to entry in this area are relatively low. We do not have any intellectual property rights in this segment of our business to protect our methods, and business start-up costs do not pose a significant barrier to entry. The success of our commercial business is dependent on our employees, customer relations and the successful performance of our services. If we face increased competition as a result of new entrants in our markets, we could experience reduced operating margins and loss of market share and brand recognition.

***Some of our contracts with the U.S. Government are classified, which may limit investor insight into portions of our business.***

We derive a portion of our revenues from programs with the U.S. Government that are subject to security restrictions (classified programs), which preclude the dissemination of information that is classified for national security purposes. We are limited in our ability to provide details about these classified programs, their risks or any disputes or claims relating to such programs. As a result, you might have less insight into our classified programs than our other businesses and therefore less ability to fully evaluate the risks related to our classified business.

***Our business could be negatively impacted by security threats, including cybersecurity threats, and other disruptions.***

As a defense contractor, we face various security threats, including cybersecurity threats to gain unauthorized access to sensitive information; threats to the safety of our directors, officers, and employees; threats to the security of our facilities and infrastructure; and threats from terrorist acts. Although we utilize various procedures and controls to monitor these threats and mitigate our exposure to such threats, there can be no assurance that these procedures and controls will be sufficient in preventing security threats from materializing. If any of these events were to materialize, they could lead to the loss of sensitive information, critical infrastructure, personnel or capabilities essential to our

Table of Contents

operations and could have a material adverse effect on our reputation, financial position, results of operations, or cash flows.

Cybersecurity attacks in particular are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information and corruption of data. These events could damage our reputation and lead to financial losses from remedial actions, loss of business or potential liability.

***We are subject to environmental laws and potential exposure to environmental liabilities. This may affect our ability to develop, sell or rent our property or to borrow money where such property is required to be used as collateral.***

As a result of the acquisition of Gichner Holdings, Inc. ("Gichner"), we use hazardous materials common to the industry in which Gichner operates. We are required to follow federal, state and local environmental laws and regulations regarding the handling, storage and disposal of these materials, including the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), and the Toxic Substances Control Act. We could be subject to fines, suspensions of production, alteration of our manufacturing processes or interruption or cessation of our operations if we fail to comply with present or future laws or regulations related to the use, storage, handling, discharge or disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing processes. These regulations could require us to acquire expensive remediation equipment or to incur significant other expenses to comply with environmental regulations. Our failure to control the handling, use, storage or disposal of, or adequately restrict the discharge of, hazardous substances could subject us to liabilities and production delays, which could cause us to miss our customers' delivery schedules, thereby reducing our sales for a given period. We may also have to pay regulatory fines, penalties or other costs (including remediation costs), which could materially reduce our profits and adversely affect our financial condition. Permits are required for our operations, and these permits are subject to renewal, modification and, in some cases, revocation.

In addition, under environmental laws, ordinances or regulations, a current or previous owner or operator of property may be liable for the costs of removal or remediation of some kinds of petroleum products or other hazardous substances on, under, or in its property, adjacent or nearby property, or offsite disposal locations, without regard to whether the owner or operator knew of, or caused, the presence of the contaminants, and regardless of whether the practices that resulted in the contamination were legal at the time they occurred. We have incurred, and may incur in the future, liabilities under CERCLA and other environmental cleanup laws at our current or former facilities, adjacent or nearby properties or offsite disposal locations. The costs associated with future cleanup activities that we may be required to conduct or finance may be material. The presence of, or failure to remediate properly, petroleum products or other hazardous substances may adversely affect the ability to sell or rent the property or to borrow funds using the property as collateral. Additionally, we may become subject to claims by third parties based on damages, including personal injury and property damage, and costs resulting from the disposal or release of hazardous substances into the environment.

***Litigation may distract us from operating our business.***

Litigation that may be brought by or against us could cause us to incur significant expenditures and distract our management from the operation of our business. Furthermore, there can be no assurance that we would prevail in such litigation or resolve such litigation on terms favorable to us, which may adversely affect our financial results and operations.

Table of Contents

**Risks Related to Investments in our Securities**

*We may allocate the net proceeds from this offering in ways that you and other stockholders may not approve.*

We intend to use the net proceeds from this offering to fund the cash consideration payable to the stockholders of CEI in connection with our proposed acquisition thereof. In the event that the acquisition is not consummated, we intend to use the net proceeds from this offering for general corporate purposes, including the acquisition of or investment in other businesses, services and technologies that are complementary to our own. In general, our management will have broad discretion in the application of the net proceeds from this offering and could spend the net proceeds in ways that do not necessarily improve our operating results or enhance the value of our common stock.

*Our stock price may be volatile, and your investment in our stock could suffer a decline in value.*

Factors which could have a significant impact on the market price of our common stock include, but are not limited to, the following:

- quarterly variations in operating results;
- announcements of new services by us or our competitors;
- the gain or loss of significant customers;
- changes in analysts' earnings estimates;
- rumors or dissemination of false information;
- pricing pressures;
- short selling of our common stock;
- litigation and government inquiries;
- general conditions in the market;
- political and/or military events associated with current worldwide conflicts; and
- events affecting other companies that investors deem comparable to us.

These and other external factors may cause the market price and demand for our common stock to fluctuate substantially, which may limit or prevent investors from readily selling their shares of common stock and may otherwise negatively affect the liquidity of our common stock. Volatility in the market price of our common stock could also subject us to securities class action litigation.

*Future sales of our common stock could cause the market price for our common stock to decline.*

We cannot predict the effect, if any, that market sales of shares of our common stock or the availability of shares of our common stock for sale will have on the market price of our common stock prevailing from time to time. Sales of substantial amounts of shares of our common stock in the public market, or the perception that those sales will occur, could cause the market price of our common stock to decline or be

depressed.

The shares of common stock issued in connection with this offering will be freely tradable without restriction or further registration under the Securities Act. This includes the shares of our common stock that may be acquired by affiliates of Bandal Carano, which affiliates would be among our largest shareholders following this offering. Additionally, pursuant to the terms of the CEI Purchase Agreement, upon completion of the acquisition of CEI we expect to issue (i) the Consideration Shares to CEI Shareholders in the aggregate amount of \$20.0 million and (ii) up to an aggregate of \$10.0 million in restricted stock units to certain key managers of CEI to induce them to accept

S-36

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Table of Contents

employment with the Company (the "Inducement Shares"). The Consideration Shares will have certain piggyback registration rights and will be freely tradable upon exercise of such piggyback registration rights or otherwise in accordance with the terms of Rule 144 under the Securities Act. The Inducement Shares will be registered on a Form S-8 and will be freely tradeable upon vesting thereof.

We and certain of our directors and officers have agreed to a "lock-up", pursuant to which neither we nor they will sell any shares without the prior consent of the underwriter for 90 days after the date of this prospectus supplement, subject to certain exceptions and extensions under certain circumstances. Following the expiration of the applicable lock-up period, all these shares of our common stock will also be eligible for future sale.

***Our charter documents and Delaware law may deter potential acquirers and may depress our stock price.***

Certain provisions of our charter documents and Delaware law, as well as certain agreements we have with our executives, could make it substantially more difficult for a third party to acquire control of us. These provisions include:

authorizing the board of directors to issue preferred stock;

prohibiting cumulative voting in the election of directors;

prohibiting stockholder action by written consent;

establishing advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by stockholders at meetings of our stockholders;

Section 203 of the Delaware General Corporation Law, which prohibits us from engaging in a business combination with an interested stockholder unless specific conditions are met; and

agreements with a number of our executives entitle them to payments in certain circumstances following a change in control.

Additionally, we have a stockholder rights plan, which may discourage certain types of transactions involving an actual or potential change in control and may limit our stockholders' ability to approve transactions that they deem to be in their best interests. As a result, these provisions may depress our stock price.

***Enacted and proposed changes in securities laws and regulations have increased our costs and may continue to increase our costs in the future.***

In recent years, there have been several changes in laws, rules, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and various other new regulations promulgated by the SEC and rules promulgated by the national securities exchanges.

The Dodd-Frank Act, enacted in July 2010, expands federal regulation of corporate governance matters and imposes requirements on publicly held companies, including us, to, among other things, provide stockholders with a periodic advisory vote on executive compensation and also adds compensation committee reforms and enhanced pay-for-performance disclosures. While some provisions of the Dodd-Frank Act are effective upon enactment, others will be implemented upon the SEC's adoption of related rules and regulations. The scope and timing of the adoption of such rules and regulations is uncertain and accordingly, the cost of compliance with the Dodd-Frank Act is also uncertain.

Sarbanes-Oxley required changes in some of our corporate governance and securities disclosure and compliance practices. Under Sarbanes-Oxley, publicly held companies, including us, are required



Table of Contents

to, among other things, furnish independent annual audit reports regarding the existence and reliability of their internal control over financial reporting and have their chief executive officer and chief financial officer certify as to the accuracy and completeness of their financial reports.

These and other new or changed laws, rules, regulations and standards are, or will be, subject to varying interpretations in many cases due to their lack of specificity. As a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. Our efforts to comply with evolving laws, regulations and standards are likely to continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. Further, compliance with new and existing laws, rules, regulations and standards may make it more difficult and expensive for us to maintain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Members of our board of directors and our principal executive officer and principal financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified directors and executive officers, which could harm our business. We continually evaluate and monitor regulatory developments and cannot estimate the timing or magnitude of additional costs we may incur as a result.

Table of Contents

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein and therein contain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Forward-looking statements may include, but are not limited to, statements relating to our future financial performance, the growth of the market for our services, expansion plans and opportunities and statements regarding our intended uses of the proceeds of the securities offered hereby. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," the negative of such terms or other comparable terminology. The statements we make regarding the following subject matters are forward-looking by their nature:

the proposed acquisition of CEI, including the amount of synergies that we expect to realize and the timing of their realization;

our estimates of the net present value and anticipated annual benefits expected from the pending 338(h)(10) election;

our estimates of the preliminary purchase price valuations of amortizable purchased intangibles related to the acquisition of CEI; and

the unaudited pro forma financial information set forth herein.

The forward-looking statements contained in this prospectus supplement reflect our current views about future events, are based on assumptions, and are subject to known and unknown risks and uncertainties. Many important factors could cause actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements, including the factors listed below. Many of the factors that will determine future events or achievements are beyond our ability to control or predict. Certain of these are important factors that could cause actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements, including, but not limited to:

our high level of indebtedness;

our ability to make interest and principal payments on our debt and satisfy the other covenants contained in the indenture that governs the Notes, our credit facility and other debt agreements;

general economic conditions and inflation, interest rate movements and access to capital;

changes or cutbacks in spending or the appropriation of funding by the U.S. Government;

changes in the scope or timing of our projects;

our ability to realize the benefits of our acquisitions, including our ability to achieve anticipated opportunities and operating synergies, and accretion to reported earnings estimated to result from acquisitions in the time frame expected by management or at all;

our revenue projections; and

the effect of competition.

The forward-looking statements contained in this prospectus supplement reflect our views and assumptions only as of the date of this prospectus supplement. You should not place undue reliance on forward-looking statements. Except as required by law, we assume no responsibility for updating any

S-39

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Table of Contents

forward-looking statements nor do we intend to do so. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. The risks included in this section are not exhaustive. Additional factors that could cause actual results to differ materially from those described in the forward-looking statements are set forth in the section entitled "Risk Factors" beginning on page S-16.

**USE OF PROCEEDS**

We expect the net proceeds from this offering to be approximately \$      million (or \$      million if the underwriter exercises its option to purchase additional shares in full), after deducting underwriting discounts and commissions, as described in "Underwriting," and estimated offering expenses payable by us. We intend to use the net proceeds from this offering to fund the cash consideration payable to the stockholders of CEI in connection with our proposed acquisition thereof. In the event that the acquisition is not consummated, we intend to use the net proceeds from this offering for general corporate purposes, including the acquisition of or investment in other businesses, services and technologies that are complementary to our own and other general corporate expenses.

As of the date of this prospectus supplement, we cannot specify with certainty all of the particular uses of the proceeds from this offering. Accordingly, we will retain broad discretion over the use of such proceeds. Pending the use of the net proceeds from this offering as described above, we intend to invest the net proceeds in short-term, investment-grade securities.

**UNAUDITED PRO FORMA COMBINED AND CONDENSED COMBINED FINANCIAL DATA**

The following unaudited pro forma combined financial data is intended to show how the acquisition of CEI, Herley and Integral might have affected historical financial statements of Kratos if such acquisitions had been completed at an earlier time and was prepared based on the historical financial results reported by Kratos, CEI, Herley and Integral. The following should be read in connection with the audited and unaudited financial statements of CEI, set forth in Annex B of this prospectus supplement, and the audited and unaudited consolidated financial statements of Kratos, which are incorporated by reference into this prospectus supplement. See "Where You Can Find Additional Information" beginning on page S-58.

The unaudited pro forma combined financial statements were prepared in accordance with the regulations of the SEC. The pro forma adjustments reflecting the completion of the acquisition of CEI are based upon the acquisition method of accounting in accordance with U.S. generally accepted accounting principles ("GAAP"), and upon the assumptions set forth in the notes to the unaudited pro forma combined and condensed combined financial statements.

During 2011, Kratos acquired Herley, Integral and SecureInfo. The acquisition of each of Herley, Integral and SecureInfo was completed on March 25, 2011, July 27, 2011, and November 15, 2011, respectively.

The unaudited pro forma condensed combined balance sheet as of March 25, 2012 combines the historical condensed consolidated balance sheets of Kratos as of March 25, 2012 and CEI as of March 31, 2012.

The unaudited pro forma condensed combined statements of operations for the three months ended March 25, 2012 combine the historical condensed consolidated statements of operations of Kratos and CEI for their respective three months ended March 25, 2012 and March 31, 2012. The unaudited pro forma combined statements of operations for the year ended December 25, 2011 combine the historical consolidated statements of operations of Kratos and CEI for their respective twelve months ended December 25, 2011 and December 31, 2011, respectively, of Herley for the three month period ended January 30, 2011, and of Integral for the six month period ended July 1, 2011 and

Table of Contents

gives effect to the Transactions as if they had occurred on December 27, 2010. The pro forma results do not include the acquisition made in the critical infrastructure business in January 2012, SecureInfo operating results from December 27, 2010 to November 15, 2011, Herley operating results from January 31, 2011 to March 25, 2011, and Integral operating results from July 2, 2011 to July 27, 2011.

The unaudited pro forma combined and condensed combined financial information also gives effect to this offering and related draw on Kratos' revolving credit facility.

The historical consolidated financial data has been adjusted to give effect to pro forma events that are (i) directly attributable to the acquisition of each of CEI, Herley and Integral, (ii) factually supportable, and (iii) with respect to the statement of operations, expected to have a continuing impact on the combined results. The pro forma adjustments are preliminary and based on management's estimates of the fair value and useful lives of the assets acquired and liabilities assumed and have been prepared to illustrate the estimated effect of the acquisitions and certain other adjustments. The unaudited pro forma combined and condensed combined financial statements do not reflect revenue opportunities, synergies or cost savings that the Company expects to realize after the acquisitions. No assurance can be given with respect to the estimated revenue opportunities and operating cost savings that are expected to be realized as a result of the acquisitions. The unaudited pro forma combined and condensed combined financial statements also do not reflect non-recurring charges related to integration activities or exit costs that may be incurred by Kratos, Herley or Integral in connection with the acquisitions thereof. There were no material transactions between Kratos, Herley or Integral during the periods presented in the unaudited pro forma combined financial statements that would need to be eliminated.

The unaudited pro forma combined and condensed combined financial data is presented for illustrative purposes only and is not necessarily indicative of the financial condition or results of operations of future periods or the financial condition or results of operations that actually would have been realized had the entities been combined during the periods presented. The unaudited pro forma combined and condensed combined financial statements do not give effect to the potential impact of current financial conditions, regulatory matters or any anticipated synergies, operating efficiencies or cost savings that may be associated with the acquisition of CEI. These financial statements also do not include any integration costs, synergies or estimated future transaction costs, except for fixed contractual transaction costs, that the companies may incur as a result of the acquisition of CEI. In addition, as explained in more detail in the accompanying notes to the unaudited pro forma combined and condensed combined financial statements, the preliminary acquisition-date fair value of the identifiable assets acquired and liabilities assumed reflected in the unaudited pro forma combined and condensed combined financial statements is subject to adjustment and may vary significantly from the actual amounts that will be recorded upon completion of the acquisition of CEI. CEI is a historical customer of Kratos and Herley. The pro forma adjustments record the elimination of receivable from CEI and corresponding payable by CEI to the Company at December 25, 2011 and the elimination of revenue and related cost of goods sold by Kratos to CEI for the twelve months then ended.

Table of Contents**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.****Unaudited Pro Forma Condensed Combined Balance Sheet****(in millions, except par value and number of shares)**

|  | Kratos<br>Historical<br>March 25,<br>2012 | CEI<br>Historical<br>March 31,<br>2012 | CEI<br>Pro Forma<br>Adjustments* | Pro Forma<br>Combined |
|--|---|--|----------------------------------|-----------------------|
| <b>Assets</b>  |   |  |                                  |                       |
| Current assets:  |   |  |                                  |                       |
| Cash and cash equivalents  | \$ 74.8                                   | \$ 6.9                                 | \$ 1.4 (a)(b)                    | \$ 83.1               |
| Restricted cash  | 0.7                                       | 3.8                                    | (3.8)(b)                         | 0.7                   |
| Accounts receivable, net   | 259.6                                     | 16.6                                   | (2.5)(c)                         | 273.7                 |
| Inventoried costs  | 87.4                                      | 11.8                                   |                                  | 99.2                  |
| Prepaid expenses   | 11.7                                      | 2.4                                    |                                  | 14.1                  |
| Other current assets   | 14.4                                      |  | 0.2 (d)                          | 14.6                  |
| <b>Total current assets</b>  | <b>448.6</b>                              | <b>41.5</b>                            | <b>(4.7)</b>                     | <b>485.4</b>          |
| Property and equipment, net  | 72.7                                      | 6.0                                    |                                  | 78.7                  |
| Goodwill   | 577.0                                     |  | 97.4 (e)                         | 674.4                 |
| Intangibles, net   | 116.1                                     |  | 39.5 (f)                         | 155.6                 |
| Other assets   | 23.0                                      | 2.5                                    | (0.5)(b)(d)                      | 25.0                  |
| <b>Total assets</b>  | <b>\$ 1,237.4</b>                         | <b>\$ 50.0</b>                         | <b>\$ 131.7</b>                  | <b>\$ 1,419.1</b>     |
| <b>Liabilities and Stockholders' Equity</b>  |   |  |                                  |                       |
| Current liabilities:   |   |  |                                  |                       |
| Accounts payable   | \$ 80.3                                   | \$ 5.5                                 | \$ (2.5)(c)                      | \$ 83.3               |
| Accrued expenses   | 50.4                                      | 8.5                                    |                                  | 58.9                  |
| Accrued compensation   | 42.0                                      | 2.9                                    |                                  | 44.9                  |
| Billings in excess of costs and earnings on uncompleted contracts  | 39.8                                      | 12.2                                   |                                  | 52.0                  |
| Other current liabilities  | 26.3                                      | 0.9                                    | (0.9)(a)(g)                      | 26.3                  |
| <b>Total current liabilities</b>   | <b>238.8</b>                              | <b>30.0</b>                            | <b>(3.4)</b>                     | <b>265.4</b>          |
| Long-term debt, net of current portion   | 630.5                                     | 1.7                                    | 38.3 (a)(g)                      | 670.5                 |
| Long-term debt premium   | 21.8                                      |  |                                  | 21.8                  |
| Other long-term liabilities  | 35.6                                      |  |                                  | 35.6                  |
| <b>Total liabilities</b>   | <b>926.7</b>                              | <b>31.7</b>                            | <b>34.9</b>                      | <b>993.3</b>          |
| Commitments and contingencies  |   |  |                                  |                       |
| Stockholders' equity:  |   |  |                                  |                       |
| Preferred stock, 5,000,000 shares authorized, \$.001 par value, 0 shares outstanding at March 25, 2012                       |   |  |                                  |                       |
| Common stock, \$.001 par value, 195,000,000 shares authorized;<br>32,511,287 shares issued and outstanding at March 25, 2012 |   |  |                                  |                       |
|  |   | 0.3                                    | (0.3)(h)                         |                       |
| Additional paid-in capital   | 721.7                                     | 1.0                                    | 117.0 (i)                        | 839.7                 |
| Accumulated other comprehensive loss   | (0.2)                                     |  |                                  | (0.2)                 |
| Accumulated deficit  | (410.8)                                   | 17.0                                   | (19.9)(j)                        | (413.7)               |
| <b>Total stockholders' equity</b>  | <b>310.7</b>                              | <b>18.3</b>                            | <b>96.8</b>                      | <b>425.8</b>          |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 1,237.4</b>                         | <b>\$ 50.0</b>                         | <b>\$ 131.7</b>                  | <b>\$ 1,419.1</b>     |



\*

See Note 6 for an explanation of the preliminary pro forma adjustments.

See accompanying notes to unaudited pro forma combined and  
condensed combined financial information

S-42

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Table of Contents**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.****Unaudited Pro Forma Condensed Combined Statement of Operations**

(in millions, except per share data)

|   | Kratos<br>Historical<br>Three Months<br>Ended<br>March 25,<br>2012 | CEI Historical<br>Three Months<br>Ended March 31,<br>2012 | Preliminary Pro<br>Forma<br>Adjustments* | Pro Forma<br>Combined |
|---|--|---|--|-----------------------|
| Service revenues  | \$ 105.2   | \$  | \$                                       | \$ 105.2              |
| Product sales   | 109.8  | 24.9  | (2.0)(a)                                 | 132.7                 |
| <b>Total revenues</b>   | <b>215.0</b>   | <b>24.9</b>   | <b>(2.0)</b>                             | <b>237.9</b>          |
| Cost of service revenue   | 81.8   |   |  | 81.8                  |
| Cost of product sales   | 75.3   | 17.6  | (2.0)(a)                                 | 90.9                  |
| <b>Total costs</b>  | <b>157.1</b>   | <b>17.6</b>   | <b>(2.0)</b>                             | <b>172.7</b>          |
| <b>Gross profit</b>   | <b>57.9</b>  | <b>7.3</b>  |  | <b>65.2</b>           |
| Selling, general and administrative expenses                        | 45.0   | 5.3   | 3.7 (b)(c)                               | 54.0                  |
| Merger and acquisition expenses                                     | 0.9  |   |  | 0.9                   |
| Research and development expenses                                   | 3.8  |   |  | 3.8                   |
| <b>Operating income (loss) from continuing operations</b>           | <b>8.2</b>   | <b>2.0</b>  | <b>(3.7)</b>                             | <b>6.5</b>            |
| Other expense:  |  |   |  |                       |
| Interest expense, net   | (16.1)   | (0.1)   | (0.3)(d)                                 | (16.5)                |
| Other income, net   | 0.5  |   |  | 0.5                   |
| <b>Total other expense, net</b>                                     | <b>(15.6)</b>  | <b>(0.1)</b>  | <b>(0.3)</b>                             | <b>(16.0)</b>         |
| <b>Income (loss) from continuing operations before income taxes</b> | <b>(7.4)</b>   | <b>1.9</b>  | <b>(4.0)</b>                             | <b>(9.5)</b>          |
| Provision (benefit) for income taxes from continuing operations     | (4.2)  |   | 0.2 (f)                                  | (4.0)                 |
| <b>Income (loss) from continuing operations</b>                     | <b>\$ (3.2)</b>  | <b>\$ 1.9</b>   | <b>\$ (4.2)</b>                          | <b>\$ (5.5)</b>       |
| <b>Basic income per common share:</b>                               |  |   |  |                       |
| Income from continuing operations                                   | \$ (0.10)  |   |  | \$ (0.10)             |
| <b>Diluted income per common share:</b>                             |  |   |  |                       |
| Income from continuing operations                                   | \$ (0.10)  |   |  | \$ (0.10)             |
| <b>Weighted average common shares outstanding:</b>                  |  |   |  |                       |
| Basic   | 32.5   |   | 23.5 (h)                                 | 56.0                  |
| Diluted   | 32.5   |   | 23.5 (h)                                 | 56.0                  |

\*

See Note 7 for an explanation of the preliminary pro forma adjustments.

See accompanying notes to unaudited pro forma combined and condensed combined financial information



Table of Contents**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.****Unaudited Pro Forma Combined Statement of Operations**

(in millions, except per share data)

|   | <b>Kratos<br/>Historical<br/>Twelve<br/>Months<br/>Ended<br/>December 25,<br/>2011</b> | <b>Herley<br/>Historical<br/>Three<br/>Months<br/>Ended<br/>January 30,<br/>2011</b> | <b>Integral<br/>Systems<br/>Six<br/>Months<br/>Ended<br/>July 1,<br/>2011</b> | <b>Pro<br/>Forma<br/>Adjustments*</b> | <b>Subtotal<br/>Pro<br/>Forma<br/>Combined</b> | <b>CEI<br/>Historical<br/>Twelve<br/>Months<br/>Ended<br/>December 31,<br/>2011</b> | <b>Preliminary<br/>Pro<br/>Forma<br/>Adjustments<br/>CEI*</b> | <b>Pro<br/>Forma<br/>Combined</b> |
|---|--|--|---|---------------------------------------|--|---|---|-----------------------------------|
| Service revenues                                  | \$ 353.6   | \$   | \$ 49.1   | \$                                    | \$ 402.7                                       | \$  | \$  | \$ 402.7                          |
| Product sales                                     | 369.5  | 50.7   | 59.7  |                                       | 479.9  | 94.1  | (5.6)(a)  | 568.4                             |
| <b>Total revenues</b>                             | <b>723.1</b>   | <b>50.7</b>  | <b>108.8</b>  |                                       | <b>882.6</b>                                   | <b>94.1</b>   | <b>(5.6)</b>  | <b>971.1</b>                      |
| Cost of service revenue                           | 263.1  |  | 36.8  |                                       | 299.9  |   |   | 299.9                             |
| Cost of product sales                             | 267.8  | 34.2   | 39.3  |                                       | 341.3  | 66.5  | (5.6)(a)  | 402.2                             |
| <b>Total costs</b>                                | <b>530.9</b>   | <b>34.2</b>  | <b>76.1</b>   |                                       | <b>641.2</b>                                   | <b>66.5</b>   | <b>(5.6)</b>  | <b>702.1</b>                      |
| <b>Gross profit</b>                               | <b>192.2</b>   | <b>16.5</b>  | <b>32.7</b>   |                                       | <b>241.4</b>                                   | <b>27.6</b>   |   | <b>269.0</b>                      |
| Selling, general and administrative expenses      | 142.5  | 8.8  | 25.2  | 10.2(b)(c)                            | 186.7  | 13.4  | 14.9(b)(c)  | 215.0                             |
| Research and development expenses                 | 9.0  |  | 8.5   |                                       | 17.5   |   |   | 17.5                              |
| Litigation costs and settlements, net of recovery |  | 0.2  |   |                                       | 0.2  |   |   | 0.2                               |
| Merger and acquisition expenses                   | 12.5   | 0.1  |   |                                       | 12.6   |   |   | 12.6                              |