

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 29, 2020

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34460

**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**13-3818604**

(I.R.S. Employer Identification No.)

**10680 Treena St., Suite 600  
San Diego, CA 92131  
(858) 812-7300**

(Address, including zip code, and telephone number, including  
area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.001 par value	KTOS	The NASDAQ Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of May 1, 2020, 106,978,328 shares of the registrant's common stock were outstanding.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 29, 2020

INDEX

	<u>Page</u>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<a href="#">Item 1. Financial Statements</a>	<a href="#">3</a>
<a href="#">Condensed Consolidated Balance Sheets at March 29, 2020 and December 29, 2019 (unaudited)</a>	<a href="#">3</a>
<a href="#">Condensed Consolidated Statements of Operations and Comprehensive Income for the Three Months Ended March 29, 2020 and March 31, 2019 (unaudited)</a>	<a href="#">4</a>
<a href="#">Condensed Consolidated Statements of Stockholders' Equity for the Three Months Ended March 29, 2020 and March 31, 2019 (unaudited)</a>	<a href="#">5</a>
<a href="#">Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 29, 2020 and March 31, 2019 (unaudited)</a>	<a href="#">6</a>
<a href="#">Notes to Condensed Consolidated Financial Statements (unaudited)</a>	<a href="#">7</a>
<a href="#">Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	<a href="#">24</a>
<a href="#">Item 3. Quantitative and Qualitative Disclosures About Market Risk</a>	<a href="#">33</a>
<a href="#">Item 4. Controls and Procedures</a>	<a href="#">33</a>
<b><u>PART II. OTHER INFORMATION</u></b>	
<a href="#">Item 1. Legal Proceedings</a>	<a href="#">34</a>
<a href="#">Item 1A. Risk Factors</a>	<a href="#">34</a>
<a href="#">Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</a>	<a href="#">34</a>
<a href="#">Item 3. Defaults Upon Senior Securities</a>	<a href="#">35</a>
<a href="#">Item 4. Mine Safety Disclosures</a>	<a href="#">35</a>
<a href="#">Item 5. Other Information</a>	<a href="#">35</a>
<a href="#">Item 6. Exhibits</a>	<a href="#">36</a>

**PART I. FINANCIAL INFORMATION**
**Item 1. Financial Statements.**
**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in millions, except par value and number of shares)**

	March 29, 2020 (Unaudited)	December 29, 2019
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 158.6	\$ 172.6
Accounts receivable, net	78.3	85.0
Unbilled receivables, net	181.0	179.4
Inventoried costs	62.7	61.1
Prepaid expenses	14.0	9.4
Other current assets	14.5	11.4
Current assets of discontinued operations	1.2	3.3
Total current assets	510.3	522.2
Property, plant and equipment, net	119.6	116.9
Operating lease right-of-use assets	39.8	42.1
Goodwill	463.3	455.6
Intangible assets, net	41.0	39.5
Other assets	9.3	9.7
Total assets	\$ 1,183.3	\$ 1,186.0
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 44.3	\$ 53.8
Accrued expenses	28.4	32.7
Accrued compensation	40.9	37.1
Accrued interest	6.4	1.6
Billings in excess of costs and earnings on uncompleted contracts	38.3	34.3
Current portion of operating lease liabilities	8.7	9.9
Other current liabilities	10.1	10.0
Current liabilities of discontinued operations	3.0	3.3
Total current liabilities	180.1	182.7
Long-term debt	295.3	295.1
Operating lease liabilities, net of current portion	36.0	37.6
Other long-term liabilities	73.9	78.7
Long-term liabilities of discontinued operations	2.8	2.8
Total liabilities	588.1	596.9
Commitments and contingencies (Note 14)		
Redeemable noncontrolling interest	15.0	15.0
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized, 0 shares outstanding at March 29, 2020 and December 29, 2019	—	—
Common stock, \$0.001 par value, 195,000,000 shares authorized; 106,960,828 and 106,635,508 shares issued and outstanding at March 29, 2020 and December 29, 2019, respectively	—	—
Additional paid-in capital	1,292.6	1,286.5
Accumulated other comprehensive loss	(0.2)	(0.4)
Accumulated deficit	(712.2)	(712.0)
Total stockholders' equity	580.2	574.1
Total liabilities and stockholders' equity	\$ 1,183.3	\$ 1,186.0

The accompanying notes are an integral part of these condensed consolidated financial statements.

**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**  
(in millions, except per share amounts)  
(Unaudited)

	Three Months Ended	
	March 29, 2020	March 31, 2019
Service revenues	\$ 63.6	\$ 62.6
Product sales	105.3	97.8
Total revenues	168.9	160.4
Cost of service revenues	45.2	42.0
Cost of product sales	77.9	73.5
Total costs	123.1	115.5
Gross profit	45.8	44.9
Selling, general and administrative expenses	34.9	31.5
Merger and acquisition expenses	0.4	1.2
Research and development expenses	5.7	3.9
Restructuring expenses and other	0.1	0.1
Operating income from continuing operations	4.7	8.2
Other expense:		
Interest expense, net	(5.4)	(5.5)
Other expense, net	(0.5)	(0.5)
Total other expense, net	(5.9)	(6.0)
Income (loss) from continuing operations before income taxes	(1.2)	2.2
Benefit for income taxes from continuing operations	(1.4)	(1.5)
Income from continuing operations	0.2	3.7
Discontinued operations:		
Loss from operations of discontinued component	(0.4)	(0.5)
Income tax expense	—	(0.1)
Loss from discontinued operations	(0.4)	(0.6)
Net income (loss)	(0.2)	3.1
Less: Net income attributable to noncontrolling interest	—	—
Net income (loss) attributable to Kratos	\$ (0.2)	\$ 3.1
Basic income (loss) per common share attributable to Kratos:		
Income from continuing operations	\$ —	\$ 0.04
Loss from discontinued operations	—	(0.01)
Net income per common share	\$ —	\$ 0.03
Diluted income (loss) per common share attributable to Kratos:		
Income from continuing operations	\$ —	\$ 0.03
Loss from discontinued operations	—	—
Net income per common share	\$ —	\$ 0.03
Weighted average common shares outstanding:		
Basic	107.2	104.9
Diluted	110.1	107.8
<b>Comprehensive Income</b>		
Net income (loss) (from above)	\$ (0.2)	\$ 3.1
Change in cumulative translation adjustment	0.2	—
Comprehensive income	—	3.1
Less: Comprehensive income attributable to noncontrolling interest	—	—
Comprehensive income attributable to Kratos	\$ —	\$ 3.1

The accompanying notes are an integral part of these condensed consolidated financial statements.

**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**For the three months ended March 31, 2019 and March 29, 2020**  
(in millions)  
(Unaudited)

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid- In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
<b>Balance, December 30, 2018</b>	\$ —	103.8	\$ —	\$ 1,244.5	\$ (0.7)	\$ (724.5)	\$ 519.3
Stock-based compensation	—	—	—	2.6	—	—	2.6
Issuance of common stock for employee stock purchase plan, options and warrants	—	0.2	—	1.7	—	—	1.7
Restricted stock issued and related taxes	—	0.1	—	(0.8)	—	—	(0.8)
Issuance of common stock for acquisitions	—	1.8	—	27.0	—	—	27.0
Net income	—	—	—	—	—	3.1	3.1
Changes in noncontrolling interest	15.0	—	—	—	—	—	—
<b>Balance, March 31, 2019</b>	<b>\$ 15.0</b>	<b>105.9</b>	<b>\$ —</b>	<b>\$ 1,275.0</b>	<b>\$ (0.7)</b>	<b>\$ (721.4)</b>	<b>\$ 552.9</b>

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid- In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
<b>Balance, December 29, 2019</b>	\$ 15.0	106.6	\$ —	\$ 1,286.5	\$ (0.4)	\$ (712.0)	\$ 574.1
Stock-based compensation	—	—	—	4.7	—	—	4.7
Issuance of common stock for employee stock purchase plan, options and warrants	—	0.2	—	2.6	—	—	2.6
Restricted stock issued and related taxes	—	0.2	—	(1.2)	—	—	(1.2)
Net loss	—	—	—	—	—	(0.2)	(0.2)
Other comprehensive income, net of tax	—	—	—	—	0.2	—	0.2
<b>Balance, March 29, 2020</b>	<b>\$ 15.0</b>	<b>107.0</b>	<b>\$ —</b>	<b>\$ 1,292.6</b>	<b>\$ (0.2)</b>	<b>\$ (712.2)</b>	<b>\$ 580.2</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.

**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)  
(Unaudited)

	Three Months Ended	
	March 29, 2020	March 31, 2019
<b>Operating activities:</b>		
Net income (loss)	\$ (0.2)	\$ 3.1
Loss from discontinued operations	(0.4)	(0.6)
Income from continuing operations	0.2	3.7
Adjustments to reconcile income from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	6.3	5.1
Amortization of lease right-of-use assets	2.9	3.7
Stock-based compensation	4.7	2.6
Deferred income taxes	(1.0)	(3.4)
Amortization of deferred financing costs	0.2	0.2
Provision for doubtful accounts	0.3	—
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	6.6	(9.0)
Unbilled receivables	(1.5)	19.7
Inventoried costs	(1.5)	(10.8)
Prepaid expenses and other assets	(6.8)	(1.1)
Operating lease liabilities	(3.4)	2.8
Accounts payable	(9.6)	(0.8)
Accrued expenses	(4.4)	(2.7)
Accrued compensation	3.7	3.1
Advance payments received on contracts	—	0.1
Accrued interest	4.9	4.9
Billings in excess of costs and earnings on uncompleted contracts	3.4	3.0
Income tax receivable and payable	(0.9)	1.4
Other liabilities	(0.1)	(6.5)
Net cash provided by operating activities from continuing operations	4.0	16.0
<b>Investing activities:</b>		
Cash paid for acquisitions, net of cash acquired	(14.2)	(17.6)
Capital expenditures	(6.4)	(4.0)
Net cash used in investing activities from continuing operations	(20.6)	(21.6)
<b>Financing activities:</b>		
Payments under finance leases	(0.1)	(0.1)
Proceeds from exercise of restricted stock units, employee stock options, and employee stock purchase plan	1.4	0.9
Net cash provided by financing activities from continuing operations	1.3	0.8
Net cash flows of continuing operations	(15.3)	(4.8)
Net operating cash flows of discontinued operations	1.3	0.3
Effect of exchange rate changes on cash, cash equivalents and restricted cash	—	(0.1)
Net decrease in cash, cash equivalents and restricted cash	(14.0)	(4.6)
Cash, cash equivalents and restricted cash at beginning of period	172.6	183.0
Cash, cash equivalents and restricted cash at end of period	\$ 158.6	\$ 178.4

The accompanying notes are an integral part of these condensed consolidated financial statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

All references to the “Company” and “Kratos” refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its subsidiaries.

**(a) Basis of Presentation**

The information as of March 29, 2020 and for the three months ended March 29, 2020 and March 31, 2019 is unaudited. The condensed consolidated balance sheet as of December 29, 2019 was derived from the Company’s audited consolidated financial statements at that date. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of the Company’s financial position, results of operations and cash flows for the interim periods presented. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the U.S. (“GAAP”). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company’s audited annual consolidated financial statements for the fiscal year ended December 29, 2019, included in the Company’s Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the “SEC”) on February 24, 2020 (the “Form 10-K”). Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

**(b) Principles of Consolidation**

The condensed consolidated financial statements include the accounts of the Company, its 100% owned subsidiaries and its majority owned subsidiaries, FTT Inc. and FTT Core, each of which is 80.1% owned. All inter-company transactions have been eliminated in consolidation. Noncontrolling interest consists of the remaining 19.9% interest in FTT Inc. and FTT Core. See Note 12 for further information related to the redeemable noncontrolling interest.

**(c) Fiscal Year**

The Company has a 52/53 week fiscal year ending on the last Sunday of the calendar year. The three month periods ended March 29, 2020 and March 31, 2019 consisted of 13-week periods. There are 52 calendar weeks in the fiscal years ending on December 27, 2020 and December 29, 2019.

**(d) Accounting Estimates**

There have been no significant changes in the Company’s accounting estimates for the three months ended March 29, 2020 as compared to the accounting estimates described in the Form 10-K.

**(e) Accounting Standards Updates**

In June 2016, the FASB issued ASU 2016-13 (“ASU 2016-13”), *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The main objective of this update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company has adopted ASU 2016-13 effective December 30, 2019. The implementation of this guidance did not have a material impact on its unaudited condensed consolidated financial statements.

**(f) Fair Value of Financial Instruments**

The carrying amounts and the related estimated fair values of the Company's long-term debt financial instruments not measured at fair value on a recurring basis at March 29, 2020 and December 29, 2019 are presented in Note 10. The carrying value of all other financial instruments, including cash equivalents, accounts receivable, unbilled receivables, accounts payable, accrued expenses, billings in excess of cost and earnings on uncompleted contracts, income taxes payable and short-term debt, approximated their estimated fair values at March 29, 2020 and December 29, 2019 due to the short-term nature of these instruments.

**Note 2. Acquisitions**

***FTT Entities***

On February 27, 2019, the Company acquired 80.1% of the issued and outstanding shares of capital stock of Florida Turbine Technologies Inc., a Florida corporation ("FTT Inc."), and 80.1% of the membership interests in FTT CORE, LLC, a Delaware limited liability company ("FTT Core" and, together with FTT Inc. and their respective subsidiaries, "FTT"), for an aggregate purchase price of approximately \$60 million. The purchase price was \$33 million in cash, with approximately \$17.7 million paid at close and approximately \$15.3 million to be paid over a three-year period, subject to adjustments for transaction expenses, indebtedness, cash on hand, certain amounts payable or potentially payable to employees of FTT and post-closing working capital adjustments, and 1,825,406 shares of common stock (with a value of approximately \$27 million). During the quarter ended March 29, 2020, approximately \$4.7 million of the remaining purchase price was paid.

FTT is a leading turbomachinery design and manufacturing company specializing in engineering, development, and testing of gas turbines, propulsion components, engine and other systems for military and commercial applications. FTT is now the Kratos Turbine Technologies Division (the "KTT Division"), which is focused on the development and production of small, affordable, high-performance jet engines for the next generation of tactical weapon systems and tactical jet unmanned aerial systems. The KTT Division is included in the KGS segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The goodwill represents the value the Company expects to be created by enabling it to accelerate FTT's small engine development programs, and facilitate integration of these leading-edge engine solutions with evolving Kratos tactical systems.

Simultaneously with the execution of the Purchase Agreement among the Company and the Sellers (as defined in such agreement) (the "Purchase Agreement") and completion of the acquisition, the Company, FTT Inc., FTT Core and the Sellers entered into an exchange agreement (the "Exchange Agreement") pursuant to which, among other things, (i) FTT Core was converted into a Delaware corporation, (ii) beginning in January 2024, the Holders (as defined in the Exchange Agreement) will have an annual right (the "Put Right") to sell all of the minority interests in FTT Inc. and FTT Core (the "Minority Interests") to the Company at a purchase price based on a specified multiple of the trailing 12 months EBITDA of FTT Inc., FTT Core and each of their respective subsidiaries (the "Acquired Companies"), subject to adjustment as set forth in the Exchange Agreement (the "Minority Interest Purchase Price") (provided, however, that following certain events, including a change of control, the Put Right will be accelerated and the Minority Interest Purchase Price will be a specified increased multiple of the trailing 12 months EBITDA of the Acquired Companies), and (iii) beginning in January 2025, the Company will have an annual right to purchase all of the Minority Interests from the Holders at the Minority Interest Purchase Price.

The transaction has been accounted for using the acquisition method of accounting, which requires, among other things, that the assets acquired, the liabilities assumed, and the noncontrolling interest be recognized at their fair values as of the acquisition date. The fair value measurements are based primarily on significant inputs not observable in the marketplace and thus represent Level 3 measurements. The following table summarizes the allocation of the purchase price over the estimated fair values of the major assets acquired, liabilities assumed, and noncontrolling interest (in millions):

Accounts receivable	\$	8.1
Unbilled receivables		4.9
Inventoried costs		7.8
Other current assets		2.1
Property and equipment		5.7
Intangible assets		30.8
Goodwill		23.0
Total identifiable net assets acquired		82.4
Total identifiable net liabilities assumed		(7.5)
Net assets before noncontrolling interest		74.9
Noncontrolling interest		(14.9)
Net assets acquired, excluding cash	\$	60.0

As of February 27, 2019, net liabilities included \$7.5 million of current liabilities. There was no contingent purchase consideration associated with the acquisition of an 80.1% majority interest in FTT. The identifiable intangible assets include customer relationships of \$19.7 million with a useful life of 13 years, in-process research and development of \$8.5 million that will commence amortization at the completion of the development project, backlog of \$2.1 million with a useful life of two years, and trade name of \$0.5 million with a useful life of two years. The Company also established a deferred tax liability of \$7.0 million for the increase in the financial statement basis of the acquired assets of FTT and a corresponding increase in goodwill. The goodwill recorded in this transaction is not expected to be tax-deductible.

The amounts of revenue and operating income of FTT included in the Company's condensed consolidated statement of operations for the three months ended March 31, 2019 were \$4.2 million and \$0.1 million, respectively. Included in the merger and acquisition expenses for the three months ended March 31, 2019 were transaction expenses of \$1.2 million related to the acquisition of FTT.

A summary of the consideration paid for the acquired ownership in FTT is as follow:

Cash paid	\$	20.7
Deferred purchase consideration		15.3
Common stock issued		27.0
		63.0
Less: Cash acquired		(3.0)
Total consideration	\$	60.0

### **Pro Forma Financial Information**

The following tables summarize the supplemental condensed consolidated statements of operations information on an unaudited pro forma basis as if the acquisition of FTT occurred on December 31, 2018 and include adjustments that were directly attributable to the foregoing transactions. There are no material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The pro forma results are for illustrative purposes only for the applicable period and do not purport to be indicative of the actual results that would have occurred had the transaction been completed as of the beginning of the period, nor are they indicative of results of operations that may occur in the future:

For the three months ended March 31, 2019 (all amounts, except per share amounts, are in millions):

Pro forma revenues	\$	168.5
Pro forma net income before tax	\$	1.3
Pro forma net income	\$	2.2
Pro forma net income attributable to Kratos	\$	2.4
Basic pro forma income per share attributable to Kratos	\$	0.02
Diluted pro forma income per share attributable to Kratos	\$	0.02

The weighted average common shares used to calculate income per share also reflects the issuance of 1,825,406 shares of our common stock in conjunction with the acquisition. Comparable amounts for the three months ended March 29, 2020 are not presented as the results for FTT for the quarter were fully included in the condensed consolidated financial statements.

#### **Technical Directions, Inc.**

On February 24, 2020, the Company acquired Technical Directions, Inc. (“TDI”), a turbine technology company focused on tactical unmanned aerial drones, missile and other systems for approximately \$10.5 million in cash, subject to adjustments for transaction expenses, indebtedness, cash on hand, and post-closing working capital adjustments. The allocation of the total consideration for this acquisition to the tangible and identifiable intangible assets acquired and liabilities assumed is preliminary until the Company obtains final information regarding their fair values. However, the Company does not expect any adjustment to such allocations to be material to the Company’s unaudited condensed consolidated financial statements. The operating results of the acquisition have been included in the Company’s results of operations from the effective acquisition date. The amount of net sales and earnings of TDI included in the condensed consolidated statement of operations for the three months ended March 29, 2020 are not material. Had the acquisition occurred as of December 29, 2019, net sales, net income from consolidated operations, net income attributable to Kratos, and basic and diluted net income per share attributable to Kratos on a pro forma basis for the three months ended March 29, 2020 would not have been materially different than the reported amounts.

#### **Note 3. Revenue Recognition**

The Company recognizes revenue in accordance with Accounting Standards Codification 606, *Revenue from Contracts with Customers* (“ASC 606”). Under ASC 606 revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration that the Company expects to be entitled to receive in exchange for these goods or services.

To determine revenue recognition for arrangements that the Company determines are within the scope of ASC 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Once the contract is identified and determined to be within the scope of ASC 606, the Company assesses the goods or services promised within each contract and determines those that are performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in ASC 606. The majority of the Company’s contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. For contracts with multiple performance obligations, the Company allocates the contract’s transaction price to each performance obligation based on relative standalone selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected-cost-plus-margin approach, under which the Company forecasts the expected costs of satisfying a performance obligation and then adds an appropriate margin for that distinct good or service.

### ***Remaining Performance Obligations***

The Company calculates revenues from remaining performance obligations as the dollar value of the remaining performance obligations on executed contracts. On March 29, 2020, the Company had approximately \$646.8 million of remaining performance obligations. The Company expects to recognize approximately 54% of the remaining performance obligations as revenue in 2020, an additional 22% by 2021, and the balance thereafter.

### ***Contract Estimates***

Due to the nature of the work required to be performed on many performance obligations, the estimation of total revenue and cost at completion is complex, subject to many variables and requires significant judgment. On a quarterly basis, the Company conducts its contract cost Estimate at Completion (“EAC”) process by reviewing the progress and execution of outstanding performance obligations within its contracts. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities and the related changes in estimates of revenues and costs. The risks and opportunities include management’s judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly-developed product versus a mature product) and other contract requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the performance obligation (e.g., to estimate increases in wages and prices for materials and related support cost allocations), execution by subcontractors, the availability and timing of funding from customers and overhead cost rates, among other variables.

In addition, certain of the Company’s long-term contracts contain award fees, incentive fees, or other provisions that can either increase or decrease the transaction price. These variable amounts generally are awarded upon achievement of certain performance metrics, program milestones or cost targets and can be based upon customer discretion. Variable consideration is estimated at the most likely amount to which the Company is expected to be entitled. Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the Company’s anticipated performance and all information (historical, current and forecasted) that is reasonably available.

Contracts are often modified to account for changes in contract specifications and requirements. Contract modifications are considered to exist when the modification either creates new or changes the existing enforceable rights and obligations. Most of the Company’s contract modifications are for goods or services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a contract modification on the transaction price, and the measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) on a cumulative catch-up basis.

As a result of the EAC process, any quarterly adjustments to revenues, cost of sales, and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual performance obligations, if it is determined the Company will be successful in mitigating risks surrounding the technical, schedule and cost aspects of those performance obligations or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if it is determined the Company will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, cost of sales and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods. A significant change in one or more of these estimates could affect the profitability of one or more of the Company’s contracts. When estimates of total costs to be incurred on a performance obligation exceed total estimates of revenue to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined. No cumulative catch-up adjustment on any one contract was material to the Company’s unaudited condensed consolidated financial statements for the three-month periods ended March 29, 2020, and March 31, 2019. Likewise, total cumulative catch-up adjustments were not material for the three-month periods ended March 29, 2020, and March 31, 2019.

### ***Contract Assets and Liabilities***

For each of the Company’s contracts, the timing of revenue recognition, customer billings, and cash collections results in a net contract asset or liability at the end of each reporting period. Fixed-price contracts are typically billed to the customer

either using progress payments, whereby amounts are billed monthly as costs are incurred or work is completed, or performance based payments, which are based upon the achievement of specific, measurable events or accomplishments defined and valued at contract inception. Cost-type contracts are typically billed to the customer on a monthly or semi-monthly basis.

Contract assets consist of unbilled receivables, primarily related to long-term contracts where revenue recognized under the cost-to-cost method exceeds amounts billed to customers. Unbilled receivables are classified as current assets and, in accordance with industry practice, include amounts that may be billed and collected beyond one year due to the long term nature of many of the Company's contracts. Accumulated contract costs in unbilled receivables include direct production costs, factory and engineering overhead, production tooling costs, and, for government contracts, recovery of allowable general and administrative expenses. Unbilled receivables also include certain estimates of variable consideration described above. The Company's contracts that give rise to contract assets are not considered to include a significant financing component as the payment terms are intended to protect the customer in the event the Company does not perform on its obligations under the contract.

Contract liabilities include advance payments and billings in excess of revenue recognized. Certain customers make advance payments prior to the satisfaction of the Company's performance obligations on the contract. These amounts are recorded as contract liabilities until such performance obligations are satisfied, either over time as costs are incurred or at a point in time when deliveries are made. The Company's contracts that give rise to contract liabilities do not include a significant financing component as the underlying advance payments received are generally utilized to pay for contract costs within a one-year period or are used to ensure the customer meets contractual requirements.

Net contract assets and liabilities are as follows (in millions):

	March 29, 2020	December 29, 2019	Net Change
Contract assets	\$ 181.0	\$ 179.4	\$ 1.6
Contract liabilities	\$ 38.3	\$ 34.3	\$ 4.0
Net contract assets	\$ 142.7	\$ 145.1	\$ (2.4)

Contract assets increased \$1.6 million during the year ended March 29, 2020, primarily due to the recognition of revenue related to the satisfaction or partial satisfaction of performance obligations during the quarter ended March 29, 2020, for which the Company has not yet billed the customers. There were no significant impairment losses related to any receivables or contract assets arising from the Company's contracts with customers during the three months ended March 29, 2020. Contract liabilities increased \$4.0 million during the quarter ended March 29, 2020, primarily due to payments received in excess of revenue recognized on these performance obligations. For the three months ended March 29, 2020 and March 31, 2019 the Company recognized revenue of \$14.3 million and \$15.9 million, respectively, that was previously included in the beginning balance of contract liabilities.

In November 2019, a large training solutions program was terminated for convenience ("T for C") by the customer. Under a T for C, a contractor is entitled to seek specified costs through a termination settlement process including (1) the contract price for completed supplies and services accepted by the government but not previously paid for; (2) the cost incurred in the performance of work terminated plus a reasonable profit on those costs; and (3) its costs incurred in settling with subcontractors and preparing and settling the termination proposal. Under a T for C, the Company would not be able to collect the total withheld amounts until the settlement terms of the T for C have been negotiated and agreed to with the customer. At March 29, 2020 and December 29, 2019, approximately \$11.5 million in unbilled receivables remained outstanding on this project. In addition, the Company is currently in dispute with an international customer in the US segment over approximately \$10.0 million in unbilled receivables outstanding as of March 29, 2020 and December 29, 2019. The dispute concerns the completion of certain system requirements and certain contractual milestones. Although there could be a delay in billing and collecting amounts due to the Company under the aforementioned contracts, management has evaluated the present facts of the matters and performed a reassessment of the contractual amounts due and has determined that no adjustment to previously recognized revenue, or the corresponding unbilled receivables, is necessary at March 29, 2020.

### Disaggregation of Revenue

The following series of tables presents the Company's revenue disaggregated by several categories. For the majority of contracts, the customer obtains control or receives benefits as work is performed on the contract. Revenue by contract type was as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
<b>Kratos Government Solutions</b>		
Fixed price	\$ 104.4	\$ 109.1
Cost plus fee	14.4	9.2
Time and materials	8.1	7.2
<b>Total Kratos Government Solutions</b>	<b>126.9</b>	<b>125.5</b>
<b>Unmanned Systems</b>		
Fixed price	27.3	27.2
Cost plus fee	14.1	7.4
Time and materials	0.6	0.3
<b>Total Unmanned Systems</b>	<b>42.0</b>	<b>34.9</b>
<b>Total Revenues</b>	<b>\$ 168.9</b>	<b>\$ 160.4</b>

Revenue by customer was as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
<b>Kratos Government Solutions</b>		
U.S. Government <sup>(1)</sup>	\$ 84.7	\$ 86.8
International <sup>(2)</sup>	28.0	24.9
U.S. Commercial and other customers	14.2	13.8
<b>Total Kratos Government Solutions</b>	<b>126.9</b>	<b>125.5</b>
<b>Unmanned Systems</b>		
U.S. Government <sup>(1)</sup>	39.4	30.1
International <sup>(2)</sup>	2.4	4.5
U.S. Commercial and other customers	0.2	0.3
<b>Total Unmanned Systems</b>	<b>42.0</b>	<b>34.9</b>
<b>Total Revenues</b>	<b>\$ 168.9</b>	<b>\$ 160.4</b>

<sup>(1)</sup> Sales to the U.S. Government include sales from contracts for which the Company is the prime contractor, as well as those for which the Company is a subcontractor and the ultimate customer is the U.S. Government. Each of the Company's segments derives substantial revenue from the U.S. Government. These sales include foreign military sales contracted through the U.S. Government.

<sup>(2)</sup> International sales include sales from contracts for which the Company is the prime contractor, as well as those for which the Company is a subcontractor and the ultimate customer is an international customer. These sales include direct sales with governments outside the U.S. and commercial sales with customers outside the U.S.

#### Note 4. Discontinued Operations

On February 28, 2018, the Company entered into a Stock Purchase Agreement to sell the operations of Kratos Public Safety & Security Solutions, Inc., a Delaware corporation and wholly owned subsidiary of the Company ("PSS"), to Securitas Electronic Security, Inc., a Delaware corporation ("Buyer"). On June 11, 2018, the Company completed the sale of all of the issued and outstanding capital stock of PSS to Buyer for a purchase price of \$69 million in cash, subject to a closing net

working capital adjustment (the “Transaction”). The Company and the Buyer are currently in a dispute regarding the closing net working capital adjustment. The amount in dispute is approximately \$8 million.

To date, the Company has collected approximately \$5.6 million of the retained net working capital. The Company currently expects that the remaining net working capital retained by the Company will be collected during 2020 once certain legacy projects are completed and the project close-out process has been completed. The Company currently expects to recognize a net approximate break-even on the sale of the PSS business once the aggregate net proceeds described above have been collected, excluding the impact of the final settlement and determination of the closing net working capital adjustment. Any changes or adjustments to the expected net proceeds will be reflected in future periods.

The following table presents the results of discontinued operations (in millions):

	<b>Three Months Ended</b>	
	<b>March 29, 2020</b>	<b>March 31, 2019</b>
Revenue	\$ —	\$ 0.1
Cost of sales	0.1	0.5
Selling, general and administrative expenses	0.3	0.1
Loss from discontinued operations before income taxes	(0.4)	(0.5)
Income tax expense	—	(0.1)
Loss from discontinued operations	<u>\$ (0.4)</u>	<u>\$ (0.6)</u>

Revenue and operating results for the three months ended March 29, 2020 and March 31, 2019 reflected the performance on contracts, and working capital retained by the Company.

The following is a summary of the assets and liabilities of discontinued operations in the accompanying condensed consolidated balance sheets as of March 29, 2020 and December 29, 2019 (in millions):

	<b>March 29, 2020</b>	<b>December 29, 2019</b>
Accounts receivable, net	\$ 1.2	\$ 3.3
Current assets of discontinued operations	<u>\$ 1.2</u>	<u>\$ 3.3</u>
Accounts payable	\$ 0.2	\$ 0.2
Accrued expenses	0.1	0.3
Other current liabilities	2.7	2.8
Current liabilities of discontinued operations	<u>\$ 3.0</u>	<u>\$ 3.3</u>
Other long-term liabilities of discontinued operations	<u>\$ 2.8</u>	<u>\$ 2.8</u>

**Note 5. Goodwill and Intangible Assets**
**(a) Goodwill**

The carrying amounts of goodwill as of March 29, 2020 and December 29, 2019 by reportable segment are as follows (in millions):

	As of March 29, 2020		
	Kratos Government Solutions	Unmanned Systems	Total
Gross value	\$ 597.8	\$ 118.8	\$ 716.6
Less accumulated impairment	239.5	13.8	253.3
Net	\$ 358.3	\$ 105.0	\$ 463.3

	As of December 29, 2019		
	Kratos Government Solutions	Unmanned Systems	Total
Gross value	\$ 597.8	\$ 111.1	\$ 708.9
Less accumulated impairment	239.5	13.8	253.3
Net	\$ 358.3	\$ 97.3	\$ 455.6

**(b) Purchased Intangible Assets**

The following table sets forth information for finite-lived and indefinite-lived intangible assets (in millions):

	As of March 29, 2020			As of December 29, 2019		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets:						
Customer relationships	\$ 73.0	\$ (54.0)	\$ 19.0	\$ 72.3	\$ (53.3)	\$ 19.0
Contracts and backlog	32.7	(29.0)	3.7	32.0	(28.4)	3.6
Developed technology and technical know-how	26.4	(24.4)	2.0	25.0	(23.8)	1.2
Trade names	1.9	(1.7)	0.2	1.9	(1.6)	0.3
In-process research and development	9.2	—	9.2	8.5	—	8.5
Total finite-lived intangible assets	143.2	(109.1)	34.1	139.7	(107.1)	32.6
Indefinite-lived trade names	6.9	—	6.9	6.9	—	6.9
Total intangible assets	\$ 150.1	\$ (109.1)	\$ 41.0	\$ 146.6	\$ (107.1)	\$ 39.5

Consolidated amortization expense related to intangible assets subject to amortization was \$1.9 million and \$1.5 million for the three months ended March 29, 2020 and March 31, 2019, respectively.

**Note 6. Inventoried Costs**

Inventoried costs, consisted of the following components (in millions):

	March 29, 2020	December 29, 2019
Raw materials	\$ 43.5	\$ 39.1
Work in process	17.4	20.3
Finished goods	1.8	1.7
Total inventoried costs	\$ 62.7	\$ 61.1

**Note 7. Net Income (Loss) per Common Share**

The Company calculates net income (loss) per share in accordance with FASB Accounting Standards Codification Topic 260, *Earnings per Share (Topic 260)*. Under Topic 260, basic net income (loss) per common share attributable to the Kratos shareholders is calculated by dividing net income (loss) attributable to Kratos by the weighted-average number of common shares outstanding during the reporting period. Diluted net income (loss) per common share attributable to the Kratos shareholders reflects the effects of potentially dilutive securities. The dilutive impact of potentially dilutive common shares is determined by applying the treasury stock method.

Shares from stock options and awards, excluded from the calculation of diluted net income (loss) per share because their inclusion would have been anti-dilutive, were 0.9 million for the three months ended March 29, 2020, and 0.0 million for the three months ended March 31, 2019.

**Note 8. Leases**

The Company leases certain facilities, office space, vehicles and equipment. Lease assets and lease liabilities are recognized at the commencement of an arrangement where it is determined at inception that a lease exists. Lease assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make lease payments arising from the lease. These assets and liabilities are initially recognized based on the present value of lease payments over the lease term calculated using an incremental borrowing rate generally applicable to the location of the lease asset, unless the implicit rate is readily determinable. Lease assets also include any upfront lease payments made and exclude lease incentives. Lease terms include options to extend or terminate the lease when it is reasonably certain that those options will be exercised. The Company has operating lease arrangements with lease and non-lease components. The non-lease components in these arrangements are not significant when compared to the lease components. For all operating leases, the Company accounts for the lease and non-lease components as a single component.

Variable lease payments are generally expensed as incurred. Leases with an initial term of 12 months or less are not recorded on the balance sheet, and the expense for these short-term leases is recognized on a straight-line basis over the lease term.

The depreciable life of lease assets and leasehold improvements is limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise.

The components of lease expense were as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
Amortization of right of use assets - finance leases	\$ 0.5	\$ 0.5
Interest on lease liabilities - finance leases	0.6	0.6
Operating lease cost (cost resulting from lease payments)	3.5	3.0
Short-term lease cost	0.2	0.1
Variable lease cost (cost excluded from lease payments)	—	—
Sublease income	(0.8)	(0.8)
<b>Total lease cost</b>	<b>\$ 4.0</b>	<b>\$ 3.4</b>

The components of leases on the balance sheet were as follows (in millions):

	March 29, 2020	December 29, 2019
<b>Operating Leases:</b>		
Operating lease right-of-use assets	\$ 39.8	\$ 42.1
Current portion of operating lease liabilities	\$ 8.7	\$ 9.9
Operating lease liabilities, net of current portion	\$ 36.0	\$ 37.6
<b>Finance leases:</b>		
Property, plant and equipment, net	\$ 37.9	\$ 38.1
Other current liabilities	\$ 0.7	\$ 0.6
Other long-term liabilities	\$ 38.6	\$ 38.4

Cash paid for amounts included in the measurement of lease liabilities was as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
Finance lease - cash paid for interest	\$ 0.6	\$ 0.6
Finance lease - financing cash flows	\$ 0.1	\$ 0.1
Operating lease - operating cash flows (fixed payments)	\$ 4.1	\$ 3.3

Other supplemental noncash information (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
Operating lease liabilities arising from obtaining right-of-use assets, including impact of ASC 842 adoption	\$ 0.5	\$ 41.2
Finance lease liabilities arising from obtaining right-of-use assets, including impact of ASC 842 adoption	\$ 0.4	\$ 39.6

Weighted-average remaining lease term (in years):

Operating leases	5.74	5.10
Finance leases	18.67	19.60

Weighted-average discount rate:

Operating leases	6.50%	6.50%
Finance leases	6.52%	6.53%

The maturity of lease liabilities is (in millions):

	Operating Leases	Finance Leases
2020 <sup>(1)</sup>	\$ 8.6	\$ 2.4
2021	10.1	3.2
2022	8.7	3.3
2023	8.3	3.4
2024	6.3	3.3
Thereafter	11.6	54.5
Total lease payments	53.6	70.1
Less: imputed interest	(8.9)	(30.8)
Total present value of lease liabilities	\$ 44.7	\$ 39.3

<sup>(1)</sup> Excludes the three months ended March 29, 2020.

## Note 9. Income Taxes

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), which, along with earlier issued IRS guidance, provides for the deferral of certain taxes. The CARES Act, among other things, removed the 80% limitation on the utilization of net operating losses in tax years 2018-2020, and contains numerous other provisions which may benefit the Company. The Company will continue to assess the impact of the CARES Act, as well as any ongoing government guidance related to COVID-19 that may be issued.

A reconciliation of the income tax expense (benefit) from continuing operations computed by applying the statutory federal income tax rate of 21% to income from continuing operations before income taxes to the provision for income taxes from continuing operations for the three months ended March 29, 2020 and March 31, 2019 was as follows (in millions):

	For the Three Months Ended	
	March 29, 2020	March 31, 2019
Income tax expense (benefit) at federal statutory rate	\$ (0.3)	\$ 0.5
State and foreign taxes, net of federal tax benefit and valuation allowance	(0.3)	0.2
Release of valuation allowance due to acquisitions	(0.9)	(3.4)
Nondeductible expenses and other	(0.1)	0.1
Impact of deferred tax liabilities for indefinite-lived assets	—	0.1
Increase (decrease) in reserves for uncertain tax positions	(0.2)	1.6
Increase (decrease) in federal valuation allowance	0.4	(0.6)
Benefit for income taxes from continuing operations	\$ (1.4)	\$ (1.5)

In assessing the Company's ability to realize deferred tax assets, management considers, on a periodic basis, whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. In making this assessment, the Company has concluded that negative evidence, including cumulative losses in recent years, continues to outweigh the positive evidence. Accordingly, the Company has maintained a full valuation allowance against the Company's U.S. federal, combined state and certain foreign net deferred tax assets. However, given the Company's more recent earnings history, management believes that it is possible that within the next 12 months, sufficient positive evidence may become available to allow management to reach a conclusion that a significant portion of the valuation allowance will no longer be needed. Release of the valuation allowance would result in the recognition of certain deferred tax assets with a potential corresponding decrease to income tax expense for the period the release is recorded. The exact timing and amount of the valuation allowance release would be predicated on the basis of the level of profitability that the Company is able to actually achieve and believes that it would sustain.

Federal and state income tax laws impose restrictions on the utilization of net operating loss (“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 NOLs or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any three-year period. The annual base Section 382 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 in the month of the ownership change or the two preceding months. This base limitation is subject to adjustments, including an increase for built-in gains recognized in the five-year period after the ownership change.

In March 2010, an “ownership change” occurred that will limit the utilization of NOL carryforwards. In July 2011, another “ownership change” occurred. The March 2010 ownership change limitation is more restrictive. In prior years, the Company acquired corporations with NOL carryforwards at the date of acquisition (“Acquired NOLs”). The Acquired NOLs are subject to separate limitations that may further restrict the use of Acquired NOLs. As a result, the Company’s federal annual utilization of NOL carryforwards was limited to \$27.0 million a year for the five years succeeding the March 2010 ownership change and \$11.6 million for each year thereafter subject to separate limitations for Acquired NOLs. If the entire limitation amount is not utilized in a year, the excess can be carried forward and utilized in future years.

For the three months ended March 29, 2020, 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, future equity offerings or acquisitions that have equity as a component of the purchase price could also cause an “ownership change.” If and when any other “ownership change” occurs, utilization of the NOLs or other tax attributes may be further limited.

As discussed elsewhere, deferred tax assets relating to the NOL and credit carryforwards are offset by a full valuation allowance. In addition, utilization of state tax loss carryforwards is dependent upon sufficient taxable income apportioned to the states.

The Company is subject to taxation in the U.S. and various state and foreign tax jurisdictions. The Company’s tax years for 2000 and later are subject to examination by the U.S. and state tax authorities due to the existence of the NOL carryforwards. Generally, the Company’s tax years for 2002 and later are subject to examination by various foreign tax authorities as well.

During 2018 the Company was notified by the Internal Revenue Service that its federal income tax return for the calendar year ending December 27, 2015 had been selected for examination. In February of 2020, the Company received notification from the IRS that the examination was completed with no changes to the taxes reported.

As of December 29, 2019, the Company had \$24.0 million of unrecognized tax benefits that, if recognized, would impact the Company’s effective income tax rate, subject to possible offset by a change in the deferred tax asset valuation allowance. During the three months ended March 29, 2020, unrecognized tax benefits decreased by \$0.3 million.

The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. For the three months ended March 29, 2020 and March 31, 2019, the Company recorded an expense for interest and penalties of \$0.1 million. For the three months ended March 29, 2020 and March 31, 2019, there was no material benefit recorded related to the removal of interest and penalties. The Company believes that it is reasonably possible that as much as \$0.1 million of the liabilities for uncertain tax positions will expire within the next twelve months due to the expiration of various applicable statutes of limitations.

## **Note 10. Debt**

### **(a) Issuance of 6.5% Senior Secured Notes due 2025**

In November 2017, the Company issued and sold \$300 million aggregate principal amount of 6.5% Senior Secured Notes due 2025 (the “6.5% Notes”) in a private placement conducted pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The Company incurred debt issuance costs of \$6.6 million associated with the 6.5% Notes. The Company utilized the net proceeds from the sale of the 6.5% Notes, as well as cash from its recent equity offering to extinguish its outstanding 7.00% Senior Secured Notes due in 2019 (the “7% Notes”). The total reacquisition price of the 7% Notes was \$385.2 million, including a \$12.0 million call premium, and \$0.3 million of accrued interest.

The 6.5% Notes are governed by the Indenture, dated as of November 20, 2017 (the “Indenture”), among the Company, the Company’s existing and future domestic subsidiaries parties thereto (the “Subsidiary Guarantors”) and Wilmington Trust, National Association, as trustee and collateral agent. A Subsidiary Guarantor can be released from its guarantee if (a) all of the capital stock issued by such Subsidiary Guarantor or all or substantially all of the assets of such Subsidiary Guarantor are sold or otherwise disposed of; (b) the Company designates such Subsidiary Guarantor as an Unrestricted Subsidiary (as defined in the Indenture); (c) the Company exercises its legal defeasance option or its covenant defeasance option; or (d) upon satisfaction and discharge of the Indenture or payment in full in cash of the principal of, premium, if any, and accrued and unpaid interest on the 6.5% Notes.

The 6.5% Notes bear interest at a rate of 6.5% per year from the date of original issuance or from the most recent payment date on which interest has been paid or provided for. Interest on the 6.5% Notes is payable in arrears on May 30 and November 30 of each year, beginning on May 30, 2018. The 6.5% Notes are fully and unconditionally guaranteed by the Subsidiary Guarantors.

The 6.5% Notes and the guarantees (as set forth in the Indenture) are the Company’s senior secured obligations and are equal in right of payment with all other senior obligations of the Subsidiary Guarantors’ existing and future secured debt to the extent of the assets securing that secured debt. The Company’s obligations under the 6.5% Notes are secured by a first priority lien on substantially all of the Company’s assets and the assets of the Subsidiary Guarantors, except with respect to accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property), on which the holders of the 6.5% Notes have a second priority lien, junior to the lien securing the Company’s obligations under the Credit Agreement.

The 6.5% Notes will be redeemable by the Company, in whole or in part, at any time on or after November 30, 2020 at the respective redemption prices specified in the Indenture. In addition, the Company may redeem up to 40% of the 6.5% Notes before November 30, 2020 with the net proceeds of certain equity offerings. The Company may also redeem some or all of the 6.5% Notes before November 30, 2020 at a redemption price of 100% of the principal amount thereof plus accrued and unpaid interest, to, but excluding, the redemption date, if any, plus a “make whole” premium. In addition, during each 12-month period commencing on the issue date and ending on or prior to November 30, 2020, the Company may redeem up to 10% of the original aggregate principal amount of the 6.5% Notes issued under the Indenture at a redemption price of 103.000% of the principal amount thereof, plus accrued and unpaid interest, to, but excluding, the date of redemption, if any. The Company may also be required to make an offer to purchase the 6.5% Notes upon a change of control and certain sales of its assets.

The Indenture contains covenants limiting, among other things, the Company’s ability and the Subsidiary Guarantors’ ability to: (a) pay dividends on or make distributions or repurchase or redeem the Company’s capital stock or make other restricted payments; (b) incur additional debt and guarantee debt; (c) prepay, redeem or repurchase certain debt; (d) issue certain preferred stock or similar equity securities; (e) make loans and investments; (f) sell assets; (g) incur liens; (h) consolidate, merge, sell or otherwise dispose of all or substantially all of the Company’s assets; (i) enter into transactions with affiliates; and (j) enter into agreements restricting the Company’s ability and certain of its subsidiaries’ ability to pay dividends. These covenants are subject to a number of exceptions. As of March 29, 2020, the Company was in compliance with the covenants contained in the Indenture governing the 6.5% Notes.

The terms of the Indenture require that the net cash proceeds from asset dispositions be either utilized to (i) repay or prepay amounts outstanding under the Credit Agreement unless such amounts are reinvested in similar collateral, (ii) permanently reduce other indebtedness, (iii) make an investment in assets that replace the collateral of the 6.5% Notes or (iv) a combination of (i), (ii) and (iii). To the extent there are any remaining net proceeds from the asset disposition after application of (i), (ii) and (iii), such amounts are required to be utilized to repurchase the 6.5% Notes at par.

The Indenture also provides for events of default which, if any such event occurs, would permit or require the principal, premium, if any, interest, if any, and any other monetary obligations on all the then-outstanding 6.5% Notes to become or to be declared due and payable immediately.

As of March 29, 2020, there was \$300.0 million of 6.5% Notes outstanding.

## **(b) Other Indebtedness**

### *Credit and Security Agreement*

On November 20, 2017, the Company entered into an amended and restated credit and security agreement (the “Credit Agreement”), with the lenders from time to time party thereto, SunTrust Bank, as Agent (the “Agent”), PNC Bank, National Association (“PNC Bank”), as Joint Lead Arranger and Documentation Agent, and SunTrust Robinson Humphrey, Inc.

(“SunTrust”), as Joint Lead Arranger and Sole Book Runner. The Credit Agreement established a five-year senior secured revolving credit facility in the aggregate principal amount of \$90.0 million (subject to a potential increase of the aggregate principal amount to \$115.0 million, subject to the Agent’s and applicable lenders’ approval as described therein), consisting of a subline for letters of credit in an amount not to exceed \$50.0 million, as well as a swingline loan in an aggregate principal amount at any time outstanding not to exceed \$10.0 million. The obligations under the Credit Agreement are secured by (i) a first priority lien on the Company’s accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property) and (ii) a second priority lien, junior to the lien securing the Company’s 6.5% Notes, on all of the Company’s other assets.

Borrowings under the revolving credit facility may take the form of a base rate revolving loan, Eurodollar revolving loan or swingline loan. Base rate revolving loans and swingline loans will bear interest at a rate per annum equal to the sum of the Applicable Margin (as defined in the Credit Agreement) from time to time in effect plus the highest of (i) the Agent’s prime lending rate, as in effect at such time, (ii) the federal funds rate, as in effect at such time, plus 0.50% per annum and (iii) the Adjusted LIBO Rate (as defined in the Credit Agreement) determined at such time for an interest period of one month, plus 1.00% per annum. Eurodollar revolving loans will bear interest at a rate per annum equal to the sum of the Applicable Margin from time to time in effect plus the Adjusted LIBO Rate. The Applicable Margin varies between 1.00%-1.50% for base rate revolving loans and swingline loans and 2.00%-2.50% for Eurodollar loans, and is based on several factors including the Company’s then-existing borrowing base and the lenders’ total commitment amount and revolving credit exposure. The calculation of the Company’s borrowing base takes into account several items relating to the Company and its subsidiaries, including amounts due and owing under billed and unbilled accounts receivable, then held eligible raw materials inventory, work-in-process inventory, and applicable reserves.

The Credit Agreement contains certain covenants, which include, but are not limited to, restrictions on indebtedness, liens, and investments, and limits on other various payments, as well as a financial covenant relating to a minimum fixed charge coverage ratio. Events of default under the terms of the Credit Agreement include, but are not limited to: failure of the Company to pay any principal of any loans in full when due and payable; failure of the Company to pay any interest on any loan or any fee or other amount payable under the Credit Agreement within three business days after the date when due and payable; failure of the Company or any of its subsidiaries to comply with certain covenants and agreements, subject to applicable grace periods and/or notice requirements; any representation, warranty or statement made in or pursuant to the Credit Agreement or any related writing or any other material information furnished by the Company or any of its subsidiaries to the Agent or the lenders proving to be false or erroneous; and the occurrence of an event or condition having or reasonably likely to have a material adverse effect, which includes a material adverse effect on the business, operations, condition (financial or otherwise) or prospects of the Company or the ability of the Company to repay its obligations. Where an event of default arises from certain bankruptcy events, the commitments will automatically and immediately terminate and the principal of, and interest then outstanding on, all of the loans will become immediately due and payable. Subject to certain notice requirements and other conditions, upon the occurrence of an event of default, including the occurrence of a condition having or reasonably likely to have a material adverse effect, commitments may be terminated and the principal of, and interest then outstanding on, all of the loans may become immediately due and payable. As of March 29, 2020, no event of default had occurred and the Company believes that events or conditions having a material adverse effect, giving rise to an acceleration of any amounts outstanding under the Credit Agreement, have not occurred and the likelihood of such events or conditions occurring is remote.

The measurement of a minimum fixed charge coverage ratio under the Credit Agreement was modified in November 2017 to require measurement if Excess Availability (as defined in the Credit Agreement) is less than 50% of the lesser of the borrowing base or the total commitment amount.

On June 11, 2018, the Company entered into a first amendment (the “First Amendment”) to the amended and restated Credit Agreement. Among other things, the First Amendment permitted the sale of the PSS business, provided that certain conditions, including application of the proceeds in accordance with the terms of documents governing the Company’s outstanding indebtedness, were satisfied.

As of March 29, 2020, there were no borrowings outstanding on the Credit Agreement and \$5.7 million was outstanding on letters of credit, resulting in net borrowing base availability of \$64.8 million. The Company was in compliance with the financial covenants of the Credit Agreement and its amendments as of March 29, 2020.

*Fair Value of Long-term Debt*

Carrying amounts and the related estimated fair values of the Company's long-term debt financial instruments not measured at fair value on a recurring basis at March 29, 2020 and December 29, 2019 are presented in the following table:

\$ in millions	As of March 29, 2020			As of December 29, 2019		
	Principal	Carrying Amount	Fair Value	Principal	Carrying Amount	Fair Value
Total long-term debt including current portion	\$ 300.0	\$ 295.3	\$ 264.0	\$ 300.0	\$ 295.1	\$ 322.1

The fair value of the Company's long-term debt was based upon actual trading activity (Level 1, Observable inputs -quoted prices in active markets).

As of March 29, 2020, the difference between the carrying amount of \$295.3 million and the principal amount of \$300.0 million presented in the table above is the unamortized debt issuance costs of \$4.7 million, which are being accreted to interest expense over the term of the related debt. As of December 29, 2019, the difference between the carrying amount of \$295.1 million and the principal amount of \$300.0 million presented in the table above is the unamortized debt issuance costs of \$4.9 million, which are being accreted to interest expense over the term of the related debt.

**Note 11. Segment Information**

The Company operates in two reportable segments. The KGS reportable segment is comprised of an aggregation of KGS operating segments, including the microwave electronic products, satellite, training, and cybersecurity, modular systems, defense and rocket support services, and turbine technologies operating segments. The Unmanned Systems ("US") reportable segment consists of its unmanned aerial system and unmanned ground and seaborne system businesses. The KGS and US segments provide products, solutions and services for mission critical national security programs. KGS and US customers primarily include national security related agencies, the U.S. Department of Defense (the "DoD"), intelligence agencies and classified agencies, and to a lesser degree, international government agencies and domestic and international commercial customers.

The Company organizes its reportable segments based on the nature of the products, solutions and services offered. Transactions between segments are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts. This presentation is consistent with the Company's operating structure. In the following table total operating income from continuing operations of the reportable business segments is reconciled to the corresponding consolidated amount. The reconciling item *Corporate activities* includes costs for certain stock-based compensation programs (including stock-based compensation costs for stock options, employee stock purchase plan and restricted stock units), the effects of items not considered part of management's evaluation of segment operating performance, merger and acquisition expenses, corporate costs not allocated to the segments, and other miscellaneous corporate activities.

Revenues, depreciation and amortization, and operating income generated by the Company's reportable segments for the three month periods ended March 29, 2020 and March 31, 2019 are as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
<b>Revenues:</b>		
Kratos Government Solutions		
Service revenues	\$ 63.6	\$ 62.6
Product sales	63.3	62.9
Total Kratos Government Solutions	126.9	125.5
Unmanned Systems product sales	42.0	34.9
Total revenues	\$ 168.9	\$ 160.4
<b>Depreciation &amp; amortization:</b>		
Kratos Government Solutions		
	\$ 4.7	\$ 3.9
Unmanned Systems	1.6	1.2
Total depreciation and amortization	\$ 6.3	\$ 5.1
<b>Operating income from continuing operations:</b>		
Kratos Government Solutions		
	\$ 9.3	\$ 11.4
Unmanned Systems	0.5	0.6
Corporate activities	(5.1)	(3.8)
Total operating income from continuing operations	\$ 4.7	\$ 8.2

Included in *Corporate activities* for the three months ended March 31, 2019 is \$1.2 million of transaction expenses related to the acquisition of FTT.

#### **Note 12. Redeemable Noncontrolling Interest**

As discussed in "Acquisition" in Note 2, in connection with the Company's acquisition of FTT, (i) beginning in January 2024, the Holders will have an annual Put Right to sell all of the Minority Interests to the Company at a purchase price based on a specified multiple of the trailing 12 months EBITDA of the Acquired Companies, subject to adjustment as set forth in the Exchange Agreement (provided, however, that following certain events, including a change of control, the Put Right will be accelerated and the Minority Interest Purchase Price will be a specified increased multiple of the trailing 12 months EBITDA of the Acquired Companies as set forth in the Exchange Agreement); and (ii) beginning in January 2025, the Company will have an annual right to purchase all of the Minority Interests from the Holders at the Minority Interest Purchase Price.

The Company adjusts the carrying value of such redeemable noncontrolling interest based on an allocation of subsidiary earnings based on ownership interest. Redeemable noncontrolling interest is recorded outside of permanent equity at the higher of its carrying value or management's estimate of the amount (the "Redemption Amount") that the Company could be required to pay in connection with the Put Right. Adjustments to the Redemption Amount will have a corresponding effect on net income per share attributable to Kratos shareholders. As of March 29, 2020, no adjustment of the carrying value of the redeemable noncontrolling interest was required.

#### **Note 13. Significant Customers**

Revenue from the U.S. Government, which includes foreign military sales contracted through the U.S. Government, includes revenue from contracts for which the Company is the prime contractor as well as those for which the Company is a subcontractor and the ultimate customer is the U.S. Government. The KGS and US segments have substantial revenue from the U.S. Government. Sales to the U.S. Government amounted to approximately \$124.1 million and \$116.9 million, or 73% and 73% of total Kratos revenue, for the three months ended March 29, 2020 and March 31, 2019, respectively.

#### **Note 14. Commitments and Contingencies**

In addition to commitments and obligations in the ordinary course of business, the Company is subject to various claims, pending and potential legal actions for damages, investigations relating to governmental laws and regulations and other

matters arising out of the normal conduct of the Company's business. The Company assesses contingencies to determine the degree of probability and range of possible loss for potential accrual in its unaudited condensed consolidated financial statements. An estimated loss contingency is accrued in the unaudited condensed consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing litigation contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, the Company may be unable to provide a meaningful estimate due to a number of factors, including but not limited to the procedural status of the matter in question, the presence of complex or novel legal theories, and the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against it may be unsupported, exaggerated or unrelated to possible outcomes and, as such, are not meaningful indicators of its potential liability. The Company regularly reviews contingencies to determine the adequacy of its accruals and related disclosures. The amount of ultimate loss may differ from these estimates. It is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies. Whether any losses finally determined in any claim, action, investigation or proceeding could reasonably have a material effect on the Company's business, financial condition, results of operations or cash flows will depend on a number of variables, including the timing and amount of such losses; the structure and type of any remedies; the monetary significance any such losses, damages or remedies may have on the condensed consolidated financial statements; and the unique facts and circumstances of the particular matter that may give rise to additional factors.

## **Legal and Regulatory Matters**

### *U.S. Government Cost Claims*

The Company's contracts with the DoD are subject to audit by the Defense Contract Audit Agency ("DCAA"). As a result of these audits, from time to time the Company is advised of claims concerning potential disallowed, overstated or disputed costs. For example, during the course of recent audits of the Company's contracts, the DCAA is closely examining and questioning certain of the established and disclosed practices that it had previously audited and accepted. The Company's personnel regularly scrutinizes costs incurred and allocated to contracts with the U.S. Government for compliance with regulatory standards. For those Company subsidiaries and fiscal years which have not yet been audited by the DCAA or for those audits which are in process which have not been completed by the DCAA, the Company cannot reasonably estimate the range of loss, if any, that may result from audits and reviews in which it is currently involved given the inherent difficulty in predicting regulatory action, fines and penalties, if any, and the various remedies and levels of judicial review available to the Company in the event of an adverse finding. As a result, the Company has not recorded any liability related to these matters.

### *Other Litigation Matters*

The Company is subject to normal and routine litigation arising from the ordinary course and conduct of business and, at times, as a result of acquisitions and dispositions. Such disputes include, for example, commercial, employment, intellectual property, environmental and securities matters. The aggregate amounts accrued related to these matters are not material to the total liabilities of the Company. The Company intends to defend itself in any such matters and does not currently believe that the outcome of any such matters will have a material adverse impact on the Company's financial condition, results of operations or cash flows.

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

*This Quarterly Report on Form 10-Q (this "Quarterly Report") contains "forward-looking statements" relating to our future financial performance, the market for our services and our expansion plans and opportunities. 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. These forward-looking statements reflect our current beliefs, expectations and projections, are based on assumptions, and are subject to known and unknown risks and uncertainties that could cause our actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of these factors are beyond our ability to control or predict. As a result, you should not place undue reliance on forward-looking statements. Important risks and uncertainties that could cause our actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements include, but are not limited to: changes or cutbacks in spending or the appropriation of funding by the federal government, including the U.S. Department of Defense (the "DoD"), which could cause delays, cancellations or reductions of key government contracts; bid protests; changes in the scope or timing of our projects; the timing, rescheduling or cancellation of significant customer contracts and agreements; failure by our*

*subcontractors or suppliers to perform their contractual obligations; our failure to meet performance obligations; if the unmanned systems markets do not experience significant growth, or if we cannot expand our customer base or if our products do not achieve broad acceptance which could impact our ability to achieve our anticipated level of growth; or consolidation by or the loss of key customers; risks of adverse regulatory action or litigation; risks associated with debt leverage; failure to successfully achieve our integration, cost reduction or divestiture strategies; risks related to security breaches, cybersecurity attacks or other significant disruptions of our information systems; risks associated with pandemics, epidemics or other public health emergencies, such as the recent outbreak of coronavirus disease 2019 (COVID-19); risks related to unknown defects or errors in our products; and competition in the marketplace, which could reduce revenues and profit margins, as well as the additional risks and uncertainties described in this Quarterly Report, in “Item 1A-Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 29, 2019 filed with the U.S. Securities and Exchange Commission (the “SEC”) on February 24, 2020 (the “Form 10-K”), and in other reports that we have filed with the SEC. These forward-looking statements reflect our views and assumptions only as of the date such forward-looking statements are made. Except as required by law, we assume no responsibility for updating any forward-looking statements, whether as a result of new information, future events or otherwise.*

*All references to “us,” “we,” “our,” the “Company” and “Kratos” refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its subsidiaries.*

## **Overview**

Kratos is a government contractor at the forefront of the DoD’s recapitalization of strategic weapon systems to address peer and near peer threats and its related Rapid Innovation Initiatives. Kratos is a leading technology, intellectual property, proprietary product and system company focused on the U.S. and its allies’ national security. Kratos is a recognized industry leader in the rapid development, demonstration and fielding of high technology systems and products at an affordable cost. Kratos’ primary focus areas are unmanned systems, space and satellite communications, microwave electronics, cyber security/warfare, training systems, rocket systems and missile defense, turbine technologies, and C5ISR. We believe that our technology, intellectual property, proprietary products and designed-in positions on our customers’ programs, platforms and systems, and our ability to rapidly develop, demonstrate and field affordable leading technology systems gives us a competitive advantage and creates a high barrier to entry into our markets. Our workforce is primarily engineering and technically oriented with a significant number of Kratos employees holding national security clearances. Much of our work is performed at customer locations, or in a secure manufacturing facility. Our primary end customers are national security related agencies. Our entire organization is focused on executing our strategy of becoming the leading technology and intellectual property based product and system company in our industry.

## **Industry Update**

On December 18, 2019, President Trump signed two 2020 spending bills totaling \$1.4 trillion. The bills allocate \$738 billion to National Defense and \$632 billion to non-defense agencies, representing increases over fiscal 2019 of \$22 billion and \$27 billion, respectively. The National Defense Authorization Act grants a base budget of approximately \$666.5 billion (including the establishment of a new, sixth armed service for space) and an additional \$71.5 billion for overseas contingency operations funding, a.k.a. the war budget. The federal budget and debt ceiling are expected to continue to be the subject of considerable debate, which could have a significant impact on defense spending broadly and the Company’s programs in particular.

The overall Federal Government budget environment, including budget caps mandated by the Budget Control Act of 2011 (“BCA”) for fiscal years 2020 and 2021, and uncertainty surrounding the debt ceiling and the appropriations process, remain significant short and long-term risks. Considerable uncertainty exists regarding how future federal budget and program decisions will unfold, including the defense spending priorities of the current Trump or potential future Administration(s) and Congress and what challenges budget reductions (required by the BCA and otherwise) could present for the defense industry. If annual appropriations bills are not timely enacted for the U.S. Government’s fiscal year 2021 or future years, the U.S. Government may again operate under a Continuing Resolution Authorization (“CRA”), restricting new contract or program starts and restricting planned increases on existing production contracts, presenting resource allocation challenges and placing limitations on future planned program budgets, and we may also face another government shutdown of unknown duration. If a prolonged CRA or government shutdown of the DoD were to occur, either could result in program cancellations, disruptions and/or stop work orders and could limit the U.S. Government’s ability to effectively progress programs and to make timely payments, and could also impact our ability to perform on our U.S. Government contracts and successfully compete for new work.

We believe continued budget pressures would have serious negative consequences for the security of our country, the defense industrial base, including the Company and the customers, employees, suppliers, investors, and communities that rely on companies in the defense industrial base. It is likely budget and program decisions made in such an uncertain environment would have long-term implications for our Company and the entire defense industry.

Additionally, funding for certain programs in which we currently participate may be reduced, delayed or cancelled, and budget uncertainty or cuts globally could adversely affect the viability of our subcontractors and suppliers, and our employee base. While we believe that our business is well-positioned in areas that the DoD and other customers have indicated are priorities for future defense spending, the short and long-term impact of federal budgetary uncertainty, CRAs, the BCA, other defense spending cuts, challenges in the appropriations process, the debt ceiling and the ongoing fiscal debates remain uncertain. Such a challenging federal and DoD budgetary environment 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 nature of our operations expose us to risks associated with pandemics, epidemics or other public health emergencies, such as the recent outbreak of coronavirus disease 2019 (COVID-19) which has spread from China to many other countries across the globe, including the United States. In March 2020, the World Health Organization categorized COVID-19 as a pandemic, and the President of the United States declared the COVID-19 outbreak a national emergency. The outbreak has resulted in governments around the world implementing increasingly stringent measures to help control the spread of the virus, including quarantines, “shelter in place” and “stay at home” orders, travel restrictions, business curtailments, school closures, and other measures. In addition, governments and central banks in several parts of the world have enacted fiscal and monetary stimulus measures to counteract the impacts of COVID-19.

We are a company operating in a critical infrastructure industry, as defined by the U.S. Department of Homeland Security. Consistent with federal guidelines and with state and local orders to date, we currently continue to operate. Notwithstanding our continued operations, COVID-19 has begun to have and may have further negative impacts on our operations, supply chain, transportation networks and customers, which may compress our sales and our margins, including as a result of preventative and precautionary measures that we, other businesses and governments are taking. The COVID-19 outbreak is a widespread public health crisis that is adversely affecting the economies and financial markets of many countries. Any resulting economic downturn could adversely affect demand for our products. The progression of this matter could also negatively impact our business or results of operations through the temporary closure of our operating locations or those of our customers or suppliers.

The ability of our employees and our suppliers’ and customers’ employees to work may be significantly impacted by individuals contracting or being exposed to COVID-19, or as a result of the control measures noted above, which may significantly hamper our production, including throughout the supply chain. On March 27, 2020, the President of the United States signed and enacted into law the CARES Act, a \$2 trillion economic relief bill. We are evaluating the impact of the CARES Act including related stimulus and economic relief actions on our business.

Since the end of our first quarter, COVID-19 has continued to impact our markets and operations, including supply chain disruptions, delays of certain supplier deliveries, difficulties gaining access to certain locations, difficulties gaining access to customers related to previously scheduled demonstrations and exercises, and decreased demand requirements of certain of our commercial aero and power customers. The extent to which COVID-19 may further impact our business depends on future developments, which are highly uncertain and unpredictable, including new information concerning the severity of the outbreak and the effectiveness of actions globally to contain or mitigate its effects. While we currently do not expect this matter to have a material impact on our results of operations, cash flows and financial position, the current level of uncertainty over the economic and operational impacts of COVID-19 means the related financial impact cannot be reasonably estimated at this time. Our consolidated financial statements and discussion and analysis of financial condition and results of operations reflect estimates and assumptions made by management as of March 29, 2020. Events and changes in circumstances arising after March 29, 2020, including those resulting from the impacts of COVID-19, will be reflected in management’s estimates for future periods.

## **Reportable Segments**

The Company operates in two reportable segments. The Kratos Government Solutions (“KGS”) reportable segment is comprised of an aggregation of KGS operating segments, including our microwave electronic products, space, training, and cybersecurity, modular systems, rocket systems and missile defense, and turbine technologies operating segments. The

Unmanned Systems (“US”) reportable segment consists of our unmanned aerial system and unmanned ground and seaborne system businesses.

We organize our business segments based primarily on the nature of the products, solutions and services offered. Transactions between segments are negotiated and accounted for under terms and conditions similar to other government and commercial contracts, and these intercompany transactions are eliminated in consolidation. For additional information regarding our reportable segments, see Note 11 of the accompanying Condensed Consolidated Financial Statements. From a customer and solutions perspective, we view our business as an integrated whole, leveraging skills and assets wherever possible.

### Comparison of Results for the Three Months Ended March 29, 2020 to the Three Months Ended March 31, 2019

*Revenues.* Revenues by operating segment for the three months ended March 29, 2020 and March 31, 2019 are as follows (dollars in millions):

	March 29, 2020	March 31, 2019	\$ change	% change
<b>Kratos Government Solutions</b>				
Service revenues	\$ 63.6	\$ 62.6	\$ 1.0	1.6%
Product sales	63.3	62.9	0.4	0.6%
<b>Total Kratos Government Solutions</b>	<b>126.9</b>	<b>125.5</b>	<b>1.4</b>	<b>1.1%</b>
Unmanned Systems product sales	42.0	34.9	7.1	20.3%
<b>Total revenues</b>	<b>\$ 168.9</b>	<b>\$ 160.4</b>	<b>\$ 8.5</b>	
<hr/>				
Total service revenues	\$ 63.6	\$ 62.6	\$ 1.0	1.6%
Total product sales	105.3	97.8	7.5	7.7%
<b>Total revenues</b>	<b>\$ 168.9</b>	<b>\$ 160.4</b>	<b>\$ 8.5</b>	<b>5.3%</b>

Revenues increased \$8.5 million to \$168.9 million for the three months ended March 29, 2020 from \$160.4 million for the three months ended March 31, 2019. Revenues in our KGS segment increased \$1.4 million due to the acquisition of FTT, which contributed approximately \$9.8 million of additional revenue in the first quarter of 2020 compared to the first quarter of 2019, and increases in our microwave products, rocket system and cyber businesses with aggregate increased revenue of \$4.3 million, partially offset by reductions in our training solutions business primarily as a result of the completion of a large foreign material sales contract, reduced revenues in our satellite communications business as a result of the transition to a software-based solution, and the continued contraction of our legacy government services business, which resulted in aggregate reductions of \$13.4 million. Revenues in our US segment increased primarily due to new aerial target awards from the U.S. Army and work on new tactical drone development awards.

Product sales increased \$7.5 million to \$105.3 million for the three months ended March 29, 2020 from \$97.8 million for the three months ended March 31, 2019 primarily due to increased production in our US business and our microwave products business partially offset by reductions in our space and satellite business. As a percentage of total revenue, product sales were 62.3% for the three months ended March 29, 2020 as compared to 61.0% for the three months ended March 31, 2019. Service revenues increased by \$1.0 million to \$63.6 million for the three months ended March 29, 2020 from \$62.6 million for the three months ended March 31, 2019. The increase was primarily related to work performed in our recently acquired FTT business.

*Cost of Revenues.* Cost of revenues increased \$7.6 million to \$123.1 million for the three months ended March 29, 2020 from \$115.5 million for the three months ended March 31, 2019. The increase in cost of revenues was primarily a result of the increase in revenues discussed above.

Gross margin decreased to 27.1% for the three months ended March 29, 2020 from 28.0% for the three months ended March 31, 2019. Margins on services decreased to 28.9% for the three months ended March 29, 2020 from 32.9% for the three months ended March 31, 2019, due primarily to a less favorable mix of revenues, primarily in our Space, Training & Cyber business and our recently acquired FTT business. Margins on products increased to 26.0% for the three months ended March 29, 2020 from 24.8% for the three months ended March 31, 2019, primarily due to the mix of products produced. Margins in the KGS segment decreased slightly to 30.1% for the three months ended March 29, 2020 from 30.3% for the three months ended March 31, 2019. Margins in the US segment decreased to 18.1% for the three months ended March 29, 2020

from 19.8% for the three months ended March 31, 2019, primarily due to a less favorable mix of products being produced as well as a less favorable mix of revenues reflecting an increase in lower margin development programs during the three months ended March 29, 2020.

*Selling, General and Administrative (“SG&A”) Expenses.* SG&A expense was \$34.9 million for the three months ended March 29, 2020 and \$31.5 million for the three months ended March 31, 2019. As a percentage of revenues, SG&A increased to 20.7% at March 29, 2020 from 19.6% at March 31, 2019, due primarily to an increase in stock compensation expense of \$2.1 million and an increase in depreciation and amortization expense of \$0.6 million in the three months ended March 29, 2020 compared to the three months ended March 31, 2019.

*Research and Development (“R&D”) Expenses.* R&D expenses increased \$1.8 million to \$5.7 million for the three months ended March 29, 2020 from \$3.9 million for the three months ended March 31, 2019, with the primary increases in our space and satellite communications business. As a percentage of revenues, R&D increased to 3.4% for the three months ended March 29, 2020 from 2.4% for the three months ended March 31, 2019. R&D expenditures are primarily related to investments we are making in conjunction with our customers, with the objectives of our products being the new platform for or “designed-in” to certain new long-term program opportunities and our ownership of certain intellectual property rights for products that support these programs as well as investments we are making in our space and satellite communications business related to new software based and open space platforms and technologies.

*Restructuring Expenses and Other.* The expense of \$0.1 million for the three months ended March 29, 2020 was primarily due to employee termination costs related to personnel reduction actions taken in the first quarter of 2020. The expense of \$0.1 million for the three months ended March 31, 2019 was primarily due to employee termination costs related to personnel reduction actions taken in the first quarter of 2019.

*Total Other Expense, Net.* Total other expense, net decreased to \$5.9 million from \$6.0 million for the three months ended March 29, 2020 and March 31, 2019, respectively.

*Benefit for Income Taxes from Continuing Operations.* The income tax benefit from continuing operations for the three months ended March 29, 2020 and March 31, 2019 was \$1.4 million and \$1.5 million, respectively. For the three months ended March 29, 2020 the benefit was primarily related to the acquisition of TDI. In accordance with ASC Topic 805 *Business Combinations* (“ASC Topic 805”), we established deferred tax liabilities of approximately \$0.9 million for the increase in the financial statement basis of the acquired assets of TDI. As a result of our ability to recognize deferred tax assets for these deferred tax liabilities, we released valuation allowance against our deferred tax assets and recognized an income tax benefit of \$0.9 million. The additional \$0.5 million benefit was a function of the estimated effective tax rate for the year. The estimated effective tax rate is driven by estimated foreign taxes, estimated federal and state taxes, permanent book/tax differences, tax amortization of intangible assets that have an indefinite life under GAAP and the projected income or loss for the year. The benefit for the three months ended March 31, 2019 was primarily related to the acquisition of FTT. In accordance with ASC Topic 805, we established deferred tax liabilities of approximately \$4.4 million for the increase in the financial statement basis of the acquired assets of FTT. As a result of our ability to recognize deferred tax assets for these deferred tax liabilities, we released the valuation allowance against our deferred tax assets and recognized an income tax benefit of \$3.4 million. This benefit was partially offset by current federal, foreign and state taxes of \$0.3 million and uncertain tax position liabilities of \$1.6 million.

*Loss from Discontinued Operations.* The loss from discontinued operations was \$0.4 million for the three months ended March 29, 2020, primarily reflecting the work performed in relation to outstanding tasks on legacy projects retained by us following the sale of the PSS business. The loss from discontinued operations was \$0.6 million for the three months ended March 31, 2019.

## **Backlog**

On March 29, 2020, we had approximately \$646.8 million of total backlog, of which \$549.8 million was funded. We expect to recognize approximately 54% of the remaining total backlog as revenue in 2020, an additional 22% by 2021 and the balance thereafter. Our comparable total backlog balance as of March 31, 2019, was approximately \$620.2 million of which \$539.5 million was funded.

Total backlog is our estimate of the amount of revenue expected to be realized over the remaining life of awarded contracts and task orders that we have in hand as of the measurement date. Total backlog can include award fees, incentive fees, or other variable consideration estimated based on the most likely amount we expect to be entitled to receive, to the extent that it is probable that a significant reversal of cumulative revenue recognized will not occur. Total backlog can include both funded and unfunded future revenue under government contracts. Total backlog does not include orders for which neither party has performed and which each party has the unilateral right to terminate a wholly unperformed contract without compensating the other party. As such, total backlog generally does not include options for additional performance obligations which have not been executed unless they are considered a material right of the base agreement/contract. For indefinite delivery or indefinite quantity contracts, only awarded or funded task orders are included for backlog purposes.

We define funded backlog as 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 an estimate of the future revenue expected to be realized from commercial contracts that are under firm orders. Funded backlog does not include the full potential value of our contracts because Congress often appropriates funds to be used by an agency for a particular program of a contract on a yearly or quarterly basis even though the contract may call for performance over a number of years. As a result, contracts typically are only partially funded at any point during their term, and all or some of the work to be performed under the contracts may remain unfunded unless and until Congress makes subsequent appropriation and the procuring agency allocates funding to the contract.

Contracts undertaken by us may extend beyond one year. Accordingly, portions are carried forward from one year to the next as part of backlog. Because many factors affect the scheduling of projects, no assurance can be given as to when revenue will be realized on projects included in our backlog. Although funded backlog represents only business that is considered to be firm, we cannot guarantee that cancellations or scope adjustments will not occur. The majority of funded backlog represents contracts with terms that would entitle us to all or a portion of our costs incurred and potential fees upon cancellation by the customer.

A significant number of the programs that Kratos' systems, products and solutions support are multi-year/multi-decade in nature. Accordingly, based on historical customer usage or operational tempo, we have reasonable expectations or visibility of what ultimate orders for Kratos' systems, products and solutions will be. We do not include these expected amounts in its backlog until a related contract award is received.

Management believes that year-to-year comparisons of backlog are not necessarily indicative of future revenues. The actual timing of receipt of revenues, if any, on projects included in backlog could change because many factors affect the scheduling of projects. In addition, cancellations or adjustments to contracts may occur. Backlog is typically subject to large variations from quarter-to-quarter as existing contracts are renewed or new contracts are awarded. Additionally, all U.S. Government contracts included in backlog, whether or not funded, may be terminated at the convenience of the U.S. Government.

## **Liquidity and Capital Resources**

As of March 29, 2020, we had cash and cash equivalents of \$158.6 million compared with cash and cash equivalents of \$172.6 million as of December 29, 2019, which includes \$27.0 million and \$24.6 million, respectively, of cash and cash equivalents held by our foreign subsidiaries. We are not presently aware of any restrictions on the repatriation of these funds, however, earnings of these foreign subsidiaries are essentially considered permanently invested in these foreign subsidiaries. If these funds were needed to fund our operations or satisfy obligations in the U.S. they could be repatriated, and their repatriation into the U.S. may cause us to incur additional foreign withholding taxes. We do not currently intend to repatriate these earnings.

Our total long-term debt, including principal due on our 6.5% Notes (as defined below), increased from \$295.1 million at December 29, 2019 to \$295.3 million at March 29, 2020, due to the amortization of debt issuance costs.

We use our operating cash flow to finance trade accounts receivable, fund necessary increases in inventory, fund capital expenditures, our internal research and development investments and our ongoing operations, service our debt and make strategic acquisitions. Financing trade accounts receivable is necessary because, on average, our customers do not pay us as quickly as we pay our vendors and employees for their goods and services since a number of our receivables are contractually billable and due to us only when certain contractual milestones are achieved. Financing increases in inventory balances is necessary to fulfill shipment requirements to meet delivery schedules of our customers. Cash from continuing operations is primarily derived from our customer contracts in progress and associated changes in working capital components. Our days sales outstanding ("DSO") have increased from 134 days as of December 29, 2019 to 140 days at March 29, 2020, primarily as a result of certain contractual billing milestones that have not yet been achieved and collected. Our DSOs are impacted by the

achievement of contractual billing milestones such as equipment shipments and deliveries on certain products, and for certain flight requirements that must be fulfilled on certain aerial target programs, or final billings which are not due until completion on certain projects, and therefore we are unable to contractually bill for amounts outstanding related to those milestones at this time. We are currently in dispute with an international customer in our US segment over approximately \$10.0 million in unbilled receivables outstanding as of March 29, 2020. The dispute concerns the completion of certain system requirements and contractual milestones. Although there could be a delay in billing and collecting amounts due to us under the aforementioned contracts, we have evaluated the present facts of the matters and performed a reassessment of the contractual amounts due and have determined that no adjustment to previously recognized revenue, or the corresponding unbilled receivables, is necessary at March 29, 2020.

A summary of our net cash provided by (used in) operating activities from continuing operations, investing activities from continuing operations, and financing activities from continuing operations and our cash flows from discontinued operations from our condensed consolidated statements of cash flows is as follows (in millions):

	Three Months Ended	
	March 29, 2020	March 31, 2019
Net cash provided by operating activities from continuing operations	\$ 4.0	\$ 16.0
Net cash used in investing activities from continuing operations	(20.6)	(21.6)
Net cash provided by financing activities from continuing operations	1.3	0.8
Net operating cash flows of discontinued operations	1.3	0.3

Net cash provided by operating activities from continuing operations for the three months ended March 29, 2020 was impacted by working capital requirements as well as certain investments we are making in our ballistic missile business.

Net cash used in investing activities from continuing operations for the three months ended March 29, 2020 is comprised of the acquisition of TDI, a payment due under the FTT acquisition agreement, and capital expenditures, which consist primarily of investments in machinery, computer hardware and software and improvement of our physical properties in order to maintain suitable conditions in which to conduct our business. Net cash used in investing activities from continuing operations for the three months ended March 31, 2019 is comprised of the acquisition of FTT and capital expenditures, which consist primarily of investments in machinery, computer hardware and software and improvement of our physical properties in order to maintain suitable conditions in which to conduct our business. During the three months ended March 29, 2020, capital expenditures of approximately \$3.0 million were incurred in our US business, primarily related to our unmanned combat target initiative. We expect our capital expenditures for our calendar year 2020 to continue to be significant for investments we are making, specifically in our US business totaling approximately \$25 to \$30 million, including approximately \$20 to \$23 million for capital aerial targets and related support equipment.

Net cash provided by financing activities from continuing operations was \$1.3 million for the three months ended March 29, 2020. Net cash provided by financing activities from continuing operations was \$0.8 million for the three months ended March 31, 2019.

The operating cash flows from discontinued operations for the three months ended March 29, 2020 is substantially related to the loss from operations from our discontinued PSS business unit of \$0.4 million which was offset by approximately \$1.9 million collected on amounts due related to the legacy projects retained by us. The operating cash flows from discontinued operations for the three months ended March 31, 2019 is substantially related to the discontinued operations of our PSS business unit.

## Contractual Obligations and Commitments

### Issuance of 6.5% Senior Secured Notes due 2025

In November 2017, we issued and sold \$300 million aggregate principal amount of 6.5% Senior Secured Notes due 2025 (the “6.5% Notes”) in a private placement conducted pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. We incurred debt issuance costs of \$6.6 million associated with the 6.5% Notes. We utilized the net proceeds from the sale of the 6.5% Notes, as well as cash from its recent equity offering to extinguish the outstanding 7.00% Senior Secured Notes due in 2019 (the “7% Notes”). The total reacquisition price of the 7% Notes was \$385.2 million, including a \$12.0 million call premium, and \$0.3 million of accrued interest.

The 6.5% Notes are governed by the Indenture, dated as of November 20, 2017 (the “Indenture”), among the Company, our existing and future domestic subsidiaries parties thereto (the “Subsidiary Guarantors”) and Wilmington Trust, National Association, as trustee and collateral agent. A Subsidiary Guarantor can be released from its guarantee if (a) all of the capital stock issued by such Subsidiary Guarantor or all or substantially all of the assets of such Subsidiary Guarantor are sold or otherwise disposed of; (b) we designate such Subsidiary Guarantor as an Unrestricted Subsidiary (as defined in the Indenture); (c) we exercise our legal defeasance option or our covenant defeasance option; or (d) upon satisfaction and discharge of the Indenture or payment in full in cash of the principal of, premium, if any, and accrued and unpaid interest on the 6.5% Notes.

The 6.5% Notes bear interest at a rate of 6.5% per year from the date of original issuance or from the most recent payment date on which interest has been paid or provided for. Interest on the 6.5% Notes is payable in arrears on May 30 and November 30 of each year, beginning on May 30, 2018. The 6.5% Notes are fully and unconditionally guaranteed by the Subsidiary Guarantors.

The 6.5% Notes and the guarantees (as set forth in the Indenture) are our senior secured obligations and are equal in right of payment with all other senior obligations of the Subsidiary Guarantors’ existing and future secured debt to the extent of the assets securing that secured debt. Our obligations under the 6.5% Notes are secured by a first priority lien on substantially all of our assets and the assets of the Subsidiary Guarantors, except with respect to accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property), on which the holders of the 6.5% Notes have a second priority lien, junior to the lien securing our obligations under the Credit Agreement (as defined below).

The 6.5% Notes will be redeemable, in whole or in part, at any time on or after November 30, 2020 at the respective redemption prices specified in the Indenture. In addition, we may redeem up to 40% of the 6.5% Notes before November 30, 2020 with the net proceeds of certain equity offerings. We may also redeem some or all of the 6.5% Notes before November 30, 2020 at a redemption price of 100% of the principal amount thereof plus accrued and unpaid interest, to, but excluding, the redemption date, if any, plus a “make whole” premium. In addition, during each 12-month period commencing on the issue date and ending on or prior to November 30, 2020, we may redeem up to 10% of the original aggregate principal amount of the 6.5% Notes issued under the Indenture at a redemption price of 103.000% of the principal amount thereof, plus accrued and unpaid interest, to, but excluding, the date of redemption, if any. We may also be required to make an offer to purchase the 6.5% Notes upon a change of control and certain sales of its assets.

The Indenture contains covenants limiting, among other things, our ability and the Subsidiary Guarantors’ ability to: (a) pay dividends on or make distributions or repurchase or redeem our capital stock or make other restricted payments; (b) incur additional debt and guarantee debt; (c) prepay, redeem or repurchase certain debt; (d) issue certain preferred stock or similar equity securities; (e) make loans and investments; (f) sell assets; (g) incur liens; (h) consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; (i) enter into transactions with affiliates; and (j) enter into agreements restricting our ability and certain of its subsidiaries’ ability to pay dividends. These covenants are subject to a number of exceptions. As of March 29, 2020, we were in compliance with the covenants contained in the Indenture governing the 6.5% Notes.

The terms of the Indenture require that the net cash proceeds from asset dispositions be either utilized to (i) repay or prepay amounts outstanding under the Credit Agreement unless such amounts are reinvested in similar collateral, (ii) permanently reduce other indebtedness, (iii) make an investment in assets that replace the collateral of the 6.5% Notes or (iv) a combination of (i), (ii) and (iii). To the extent there are any remaining net proceeds from the asset disposition after application of (i), (ii) and (iii), such amounts are required to be utilized to repurchase the 6.5% Notes at par.

The Indenture also provides for events of default which, if any such event occurs, would permit or require the principal, premium, if any, interest, if any, and any other monetary obligations on all the then-outstanding 6.5% Notes to become or to be declared due and payable immediately.

As of March 29, 2020, there was \$300.0 million of 6.5% Notes outstanding.

## Other Indebtedness

### *Credit and Security Agreement*

On November 20, 2017, we entered into an amended and restated credit and security agreement (the “Credit Agreement”), with the lenders from time to time party thereto, SunTrust Bank, as Agent (the “Agent”), PNC Bank, National Association (“PNC Bank”), as Joint Lead Arranger and Documentation Agent, and SunTrust Robinson Humphrey, Inc. (“SunTrust”), as Joint Lead Arranger and Sole Book Runner. The Credit Agreement established a five-year senior secured revolving credit facility in the aggregate principal amount of \$90.0 million (subject to a potential increase of the aggregate principal amount to \$115.0 million, subject to the Agent’s and applicable lenders’ approval as described therein), consisting of a subline for letters of credit in an amount not to exceed \$50.0 million, as well as a swingline loan in an aggregate principal amount at any time outstanding not to exceed \$10.0 million. The obligations under the Credit Agreement are secured by (i) a first priority lien on our accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property) and (ii) a second priority lien, junior to the lien securing our 6.5% Notes, on all of our other assets.

Borrowings under the revolving credit facility may take the form of a base rate revolving loan, Eurodollar revolving loan or swingline loan. Base rate revolving loans and swingline loans will bear interest at a rate per annum equal to the sum of the Applicable Margin (as defined in the Credit Agreement) from time to time in effect plus the highest of (i) the Agent’s prime lending rate, as in effect at such time, (ii) the federal funds rate, as in effect at such time, plus 0.50% per annum and (iii) the Adjusted LIBO Rate (as defined in the Credit Agreement) determined at such time for an interest period of one month, plus 1.00% per annum. Eurodollar revolving loans will bear interest at a rate per annum equal to the sum of the Applicable Margin from time to time in effect plus the Adjusted LIBO Rate. The Applicable Margin varies between 1.00%-1.50% for base rate revolving loans and swingline loans and 2.00%-2.50% for Eurodollar loans, and is based on several factors including our then-existing borrowing base and the lenders’ total commitment amount and revolving credit exposure. The calculation of our borrowing base takes into account several items relating to us and our subsidiaries, including amounts due and owing under billed and unbilled accounts receivable, then held eligible raw materials inventory, work-in-process inventory, and applicable reserves.

As of March 29, 2020, there were no borrowings outstanding on the Credit Agreement and \$5.7 million was outstanding on letters of credit, resulting in net borrowing base availability of \$64.8 million. We were in compliance with the financial covenants of the Credit Agreement and its amendments as of March 29, 2020.

## Other Liquidity Matters

We believe that our cash on hand, together with funds available under the Credit Agreement and cash expected to be generated from operating activities, will be sufficient to fund our anticipated working capital and other cash needs for at least the next 12 months. As discussed below and in Part I, Item 1A, “Risk Factors” of the Form 10-K, our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to our control. If the conditions in our industry deteriorate or our customers cancel or postpone projects or if we are unable to sufficiently increase our revenues or further reduce our expenses, we may experience, in the future, a significant long-term negative impact to our financial results and cash flows from operations. In such a situation, we could fall out of compliance with our financial and other covenants, which, if not waived, could limit our liquidity and capital resources.

## Critical Accounting Principles and Estimates

The foregoing discussion of our financial condition and results of operations is based on the condensed consolidated financial statements included in this Quarterly Report. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and the related disclosures of contingencies. We base these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

Effective December 30, 2019, we adopted the requirements of ASC 326, Measurement of Credit Losses on Financial Instruments, as discussed in Note 1 to the accompanying Condensed Consolidated Financial Statements. Other than the adoption of ASC 326, there have been no significant changes to our “Critical Accounting Policies or Estimates” as compared to the significant accounting policies described in the Form 10-K.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Since December 29, 2019, there have been no material changes in the quantitative or qualitative aspects of our market risk profile. For additional information regarding the Company's exposure to certain market risks, see "Item 7A. Quantitative and Qualitative Disclosures About Market Risk" included in the Form 10-K.

**Item 4. Controls and Procedures.**

*Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) promulgated under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report.

Based on the foregoing, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of March 29, 2020.

*Changes in Internal Control Over Financial Reporting*

We operate under the COSO (Committee of Sponsoring Organizations) 2013 Framework. There was no change in our internal control over financial reporting during the three months ended March 29, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

See Note 14 of the Notes to the Condensed Consolidated Financial Statements contained within this Quarterly Report for a discussion of our legal proceedings.

### Item 1A. Risk Factors.

In evaluating us and our common stock, we urge you to carefully consider the risks and other information in this Quarterly Report, as well as the risk factors disclosed in Item 1A. to Part I of the Form 10-K, and other reports that we have filed with the SEC. Any of the risks discussed in such reports, as well as additional risks and uncertainties not currently known to us or that we currently deem immaterial, could materially and adversely affect our results of operations, financial condition or prospects. The following risk factor is in addition to those previously disclosed in the Form 10-K .

***Our operations expose us to risks associated with pandemics, epidemics or other public health emergencies, such as the recent outbreak of coronavirus disease 2019 (COVID-19) which has spread from China to many other countries across the globe, including the United States.***

In March 2020, the World Health Organization categorized COVID-19 as a pandemic, and the President of the United States declared the COVID-19 outbreak a national emergency. The outbreak has resulted in governments around the world implementing increasingly stringent measures to help control the spread of the virus, including quarantines, “shelter in place” and “stay at home” orders, travel restrictions, business curtailments, school closures, and other measures. In addition, governments and central banks in several parts of the world have enacted fiscal and monetary stimulus measures to counteract the impacts of COVID-19.

We are a company operating in a critical infrastructure industry, as defined by the U.S. Department of Homeland Security. Consistent with federal guidelines and with state and local orders to date, we currently continue to operate. Notwithstanding our continued operations, COVID-19 has begun to have and may have further negative impacts on our operations, supply chain, transportation networks and customers, which may compress our sales and our margins, including as a result of preventative and precautionary measures that we, other businesses and governments are taking. The COVID-19 outbreak is a widespread public health crisis that is adversely affecting the economies and financial markets of many countries. Any resulting economic downturn could adversely affect demand for our products. The progression of this matter could also negatively impact our business or results of operations through the temporary closure of our operating locations or those of our customers or suppliers.

The ability of our employees and our suppliers’ and customers’ employees to work may be significantly impacted by individuals contracting or being exposed to COVID-19, or as a result of the control measures noted above, which may significantly hamper our production, including throughout the supply chain. On March 27, 2020, the President of the United States signed and enacted into law the CARES Act, a \$2 trillion economic relief bill. We are evaluating the impact of the CARES Act including related stimulus and relief actions on our business.

Since the end of our first quarter, COVID-19 has continued to impact our markets and operations, including supply chain disruptions, delays of certain supplier deliveries, difficulties gaining access to certain locations, difficulties gaining access to customers related to previously scheduled demonstrations and exercises, and decreased demand requirements of certain of our commercial aero and power customers. The extent to which COVID-19 may further impact our business depends on future developments, which are highly uncertain and unpredictable, including new information concerning the severity of the outbreak and the effectiveness of actions globally to contain or mitigate its effects. While we currently do not expect this matter to have a material impact on our results of operations, cash flows and financial position, the current level of uncertainty over the economic and operational impacts of COVID-19 means the related financial impact cannot be reasonably estimated at this time.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed-Furnished Herewith
		Form	Filing Date/Period End Date	Exhibit	
2.1#*	<a href="#">Purchase Agreement, dated February 27, 2019, by and among Kratos Defense &amp; Security Solutions, Inc., Shirley Brostmeyer, (“SB”), Joseph Brostmeyer (“JB”), certain trusts established by SB, JB and members of their immediate family, and JB, as the Sellers Representative.</a>	10-Q	05/08/2019 (001-34460)	2.3	
3.1	<a href="#">Amended and Restated Certificate of Incorporation of Kratos Defense &amp; Security Solutions, Inc., as amended.</a>	10-K	02/27/2017 (001-34460)	3.1	
3.2	<a href="#">Second Amended and Restated Bylaws of Kratos Defense &amp; Security Solutions, Inc., as amended.</a>	10-K	02/27/2017 (001-34460)	3.2	
4.1	<a href="#">Specimen Stock Certificate.</a>	10-K	02/27/2017 (001-34460)	4.1	
4.2	<a href="#">Indenture, dated as of November 20, 2017, among Kratos Defense &amp; Security Solutions, Inc., as Issuer, the Guarantors party thereto, and Wilmington Trust, National Association, as Trustee and Collateral Agent.</a>	8-K	11/21/2017 (001-34460)	4.1	
4.3	<a href="#">First Supplemental Indenture, dated as of December 21, 2017, among Kratos Defense &amp; Security Solutions, Inc., as Issuer, the Guarantor as party thereto, and Wilmington Trust, National Association, as Trustee.</a>	10-K	02/28/2018 (001-34460)	4.5	
10.1	<a href="#">Employment Agreement, effective January 1, 2018 by and between Kratos Defense and Security Systems, Inc. and Steven Fendley</a>				*
10.2	<a href="#">Employment Agreement, effective January 1, 2018 by and between Kratos Defense and Security Systems, Inc. and Phil Carrai</a>				*
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.</a>				*
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.</a>				*
32.1	<a href="#">Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Eric M. DeMarco.</a>				*
32.2	<a href="#">Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Deanna Lund.</a>				*
101.INS	<a href="#">XBRL Instance Document-the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document</a>				*
101.SCH	<a href="#">XBRL Taxonomy Extension Schema Document</a>				*

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed-Furnished Herewith
		Form	Filing Date/ Period End Date	Exhibit	
101.CAL	<a href="#">XBRL Taxonomy Extension Calculation Linkbase Document</a>				*
101.DEF	<a href="#">XBRL Taxonomy Extension Definition Linkbase Document</a>				*
101.LAB	<a href="#">XBRL Taxonomy Extension Label Linkbase Document</a>				*
101.PRE	<a href="#">XBRL Taxonomy Extension Presentation Linkbase Document</a>				*
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)				*

# Certain schedules and exhibits referenced in this document have been omitted in accordance with Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule and/or exhibit will be furnished supplementally to the Securities and Exchange Commission upon request.

\* Certain confidential information contained in this Exhibit has been omitted because it is both (i) not material and (ii) would be competitively harmful if publicly disclosed.



**EMPLOYMENT AGREEMENT**

**THIS EMPLOYMENT AGREEMENT** (“Agreement”) is entered into by and between Kratos Defense & Security Solutions, Inc., a Delaware corporation (“Company”), and Steven Fendley, an individual (“Executive”), effective as of January 1, 2018 (“Effective Date”). Certain terms used in this Agreement denoted by initial capital letters are defined in Section 17, to the extent not defined elsewhere in the Agreement.

**RECITALS**

The Company wishes to continue to employ Executive upon the terms and conditions contained in this Employment Agreement and Executive wishes to enter into this Agreement and agrees to perform his obligations hereunder in consideration of his employment, salary, benefits and other terms described herein .

**NOW, THEREFORE**, in consideration of the mutual covenants and agreements set forth herein, the Company and Executive, intending to be legally bound, hereby agree as follows:

**AGREEMENT**

1. **Employment.** The Company shall employ Executive as Senior Vice President and Division President of the Company’s Unmanned Systems Division (the “Position”), and Executive accepts such employment and agrees to perform services for the Company for the period and upon the other terms and conditions set forth in this Agreement.

2. **Term.** The term of Executive’s employment hereunder shall be for a period commencing on the Effective Date and ending on December 31, 2020 (the “Term”), subject to earlier termination as hereinafter specified. Upon expiration of the Term, this Agreement may be renewed upon agreement of the parties for an additional term of one (1) year.

3. **Position and Duties.** During the term of this Agreement, Executive shall perform all duties and functions customarily performed by the Position of a business of the size and nature similar to that of the Company, and such other related employment duties as the President & CEO of the Company or his designee (the “President”) shall reasonably assign to Executive from time to time. Executive shall perform his duties principally in the State of Texas, with such travel to such other locations as the President may reasonably require. Except as may otherwise be approved in advance by the President, and except during vacation periods and reasonable periods of absence due to sickness, personal injury or other disability, Executive shall devote his working time as needed to the services required of him hereunder. Executive shall use his reasonable best efforts, judgment and energy to improve and advance the business and interest of the Company and its subsidiaries, if applicable, in a manner consistent with the duties of his position and with the Company’s Code of Legal and Ethical Conduct. Executive hereby confirms that he is under no contractual commitments inconsistent with his obligations set forth in this Agreement, and that during his employment, he will not render or perform services, or enter into any contract to do so, for any other corporation, firm, entity or person which are inconsistent with the provisions of this Agreement. To the extent that Executive remains an employee of 5D Systems, Inc., Executive acknowledges and agrees that such employment will not interfere or conflict with his obligations set forth in this Agreement. Executive will refrain from influencing or making any decisions regarding 5D Systems, which decisions shall rest with the President.

4. **Compensation.**

4.1 **Base Salary.** As compensation for all services to be rendered by Executive under this Agreement, the Company shall pay to Executive a base annual salary of One Hundred Forty Thousand Dollars (\$140,000) (the “Base Salary”), which shall be paid on a regular basis in accordance with the Company’s customary payroll procedures and policies. Executive will be eligible for annual increases to the Base Salary in accordance with the Company’s then current compensation policies

4.2 Equity Incentives. Executive will be eligible for equity incentive grants at the discretion of the President and the Compensation Committee of the Board of Directors.

4.3 Participation in Benefit Plans. Executive and eligible family members shall be eligible to participate in, subject to his affirmative election to enroll in such plans requiring enrollment, and to the extent eligible thereunder, in any and all plans of the Company providing general benefits for the Company's employees, including, but not limited to, any group life insurance, hospitalization, disability, paid time off, medical, dental, pension, profit sharing, savings and stock bonus plans. Executive's participation in any such plan or program shall be subject to the provisions, rules, and regulations applicable thereto. Nothing in this Agreement shall impose on the Company any affirmative obligation to establish any benefit plan. The Company reserves the right to prospectively terminate or change benefit plans and programs it offers to its employees at any time.

4.4 Expenses. In accordance with the Company's policies established from time to time, the Company will pay or reimburse Executive for all reasonable and necessary out-of-pocket expenses incurred by him in the performance of the Position, subject to the presentment of appropriate receipts or expense reports in connection with the Company's policies and procedures. The following provisions shall be in effect for any reimbursements (and in-kind benefits) to which Executive otherwise becomes entitled under this Agreement, in order to assure that such reimbursements (and benefits) do not create a deferred compensation arrangement subject to Section 409A of the Internal Revenue Code of 1986, as amended ("Code"):

(a) The amount of reimbursements (or in-kind benefits) to which Executive may become entitled in any one calendar year shall not affect the amount of expenses eligible for reimbursement (or in-kind benefits) hereunder in any other calendar year.

(b) Each reimbursement to which Executive becomes entitled shall be made by the Company as soon as administratively practicable following Executive's submission of the supporting documentation, but in no event later than the close of business of the calendar year following the calendar year in which the reimbursable expense is incurred.

(c) Executive's right to reimbursement (or in-kind benefits) cannot be liquidated or exchanged for any other benefit or payment.

4.5 Taxes and Other Withholding. The Company may withhold from any benefits or amounts payable (including any Severance Payment, as defined below) under this Agreement all federal, state, city or other taxes and other amounts as shall be required pursuant to any law or governmental regulation or ruling or as elected by Executive.

5. Annual Leave. Executive shall earn paid time off and shall maintain paid time off balances in accordance with the Company's standard policies.

6. Compensation upon Termination. Executive shall be entitled to the following payments, if any, upon the termination of his employment by the Company. The compensation described in this Section 6 shall be in lieu of any separation or severance compensation offered to Executive under any general policies of the Company.

6.1 For Cause. In the event Executive is terminated by the Company for Cause pursuant to Section 11.1, Executive shall not be entitled to any compensation other than Base Salary accrued through the date of termination, plus accrued but unused paid time off.

6.2 Resignation. In the event Executive resigns from the Company voluntarily pursuant to Section 11.2, Executive shall be entitled to receive Executive's Base Salary accrued through the effective date of termination, plus accrued but unused paid time off. Should Executive resign his employment upon thirty (30) days' advance written notice, Company reserves the right to immediately relieve Executive of all job duties and provide Executive with payment of thirty (30) days Base Salary in lieu of any portion of the remaining notice period.

6.3 Without Cause. In the event Executive is terminated by the Company Without Cause pursuant to Section 11.3, the Company shall pay to Executive (i) any Base Salary accrued through the date of termination, (ii) any accrued but unused paid time off, (iii) any Incentive Compensation accrued and earned but not yet paid and (iv) continued payment of the Base Salary for six (6) months (the "Severance Period"). Subsection (iv) of this Section 6.3 shall be referred to as a "Severance Payment." Except as otherwise provided herein, the Severance Payment shall be paid to Executive on a regular basis in accordance with the company's regular payroll procedures and policies.

6.4 Disability. If Executive becomes physically or mentally disabled during the term of this Agreement and such disability continues for a consecutive period of one hundred and twenty (120) days or 120 days in any 365 day period, the Company may, to the extent permitted by applicable law after the expiration of such period, terminate this Agreement by giving written notice to Executive. For purpose of this Agreement, the term "disabled" shall be defined as Executive's inability, through physical or mental illness, to perform all of the duties which Executive is required to perform under this Agreement with or without reasonable accommodation as such terms are defined under the Americans with Disabilities Act. In the event that the Executive is terminated pursuant to this section, the Company shall pay to Executive (i) Executive's Base Salary through the date that he is terminated; (ii) any earned and accrued Incentive Compensation; and (iii) any accrued but unused paid time off.

6.5 Release. The receipt of the Severance Payment or other benefits pursuant to this Section 6 will be subject to Executive signing and not revoking a release of claims agreement in a form prescribed by the Company, and such release becoming effective and irrevocable within forty-five (45) days of Executive's termination. No severance or other benefits will be paid or provided until the release of claims agreement becomes effective, and any severance amounts or benefits otherwise payable between the date of Executive's termination and the date such release becomes effective shall be paid on the effective date of such release, subject to the delay in the following paragraph. If the termination occurs after November 15, no payments shall be made until the first payroll date of the following calendar year, after the release has become effective, subject to the delay in the following paragraph.

6.6 Delay of Payment; Other Section 409A Matters. For the sake of clarity, no severance benefit that is paid on account of Executive's termination of employment will be paid unless and until Executive incurs a "separation from service" under the default rules of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"). Notwithstanding any other provision of this Agreement whatsoever, the Company, in its sole discretion, shall have the right to construe this Agreement in a manner that complies with Section 409A of the Code (relating to deferred compensation arrangements) and any related administrative guidance issued by the Internal Revenue Service. Notwithstanding any inconsistent provision of this Agreement, if Executive is a "specified employee" within the meaning of Section 409A of the Code at the time of Executive's termination, then only that portion of the Severance Payment, together with any other severance payments or benefits that, in each case, are non-qualified deferred compensation under Code Section 409A, which (a) do not exceed the Section 409A Limit (as defined below), and (b) which qualify as separation pay under Treasury Regulation Section 1.409A-1(b)(9)(iii), may be paid within the first six (6) months following Executive's termination. Otherwise, the portion of the Severance Payment, together with any other severance payments or benefits that, in each case, are non-qualified deferred compensation under Section 409A, that would otherwise be payable within the six (6) month period following Executive's termination will instead be paid in a lump sum on the date six (6) months and one (1) day following the date of Executive's termination (or the next business day if such date is not a business day), provided Executive has complied with the requirements for such payment. For purposes of this Agreement, "Section 409A Limit" means the lesser of two (2) times: (i) Executive's "annualized compensation" as determined under Treasury Regulation Section 1.409A-1(b)(9)(iii)(A)(1), or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year of the termination, or such successor limit as may apply. Each payment specified hereunder is designated a separate payment for purposes of Section 409A. The Company shall have no liability to Executive for any adverse tax or other consequences related to the payments provided hereunder and to the extent any payment or benefit would

result in adverse or other tax consequences under Section 409A, Executive shall have no legally enforceable right to such payment or benefit. For purposes of this Agreement, termination of employment and similar phrases mean a "separation from service" within the meaning of Section 409A.

## 7. Proprietary Matter; Ownership.

7.1 Except as permitted or directed by the Company or as required by law, Executive shall not during the term of his employment or at any time thereafter knowingly divulge, furnish, disclose or make accessible (other than in the ordinary course of the business of the Company) to anyone for use in any way any confidential, secret, or proprietary knowledge or information of the Company or its Affiliates that is not in the public domain ("Proprietary Matter") which Executive has acquired or become acquainted with or will acquire or become acquainted with during his employment, whether developed by himself or by others, including, but not limited to, any trade secrets, confidential or secret designs, processes, formulae, software or computer programs, plans, devices, or material (whether or not patented or patentable, copyrighted or copyrightable) directly or indirectly useful in any aspect of the business of the Company and its Affiliates, any confidential customer, distributor or supplier lists of the Company or its Affiliates, any confidential or secret development or research work of the Company or its Affiliates, or other confidential, secret or non-public aspects of the business of the Company or its Affiliates. Executive acknowledges that the Proprietary Matter constitutes a unique and valuable asset of the Company or its Affiliates, acquired at great time and expense by the Company or such Affiliates, and that any disclosure or other use of the Proprietary Matter other than for the sole benefit of the Company or such Affiliates would be wrongful and could cause irreparable harm to the Company or such Affiliates. The foregoing obligations of confidentiality, however, shall not apply to any knowledge or information which is now published or which subsequently becomes generally publicly known, other than as a direct or indirect result of the breach of this Agreement by Executive or the breach of any obligation of confidentiality by any other person.

7.2 Executive agrees that he will fully inform and disclose to the Company from time to time all inventions, designs, improvements, enhancements, developments and discoveries which he now has, or may hereafter have, during the Term which pertain or relate to the business of the Company or its Affiliates or to any experimental work carried on by the Company or its Affiliates. All such inventions, designs, improvements, enhancements, developments and discoveries shall be the exclusive property of the Company or its Affiliates. Executive hereby assigns the rights to all such inventions, designs, improvements, enhancements, developments and discoveries to the Company or its Affiliates. Executive shall reasonably assist the Company or its Affiliates in obtaining patents on all such inventions, designs, improvements, enhancements, developments and discoveries deemed patentable by the Company or its Affiliates and shall execute all documents (including assignments and related affidavits) and do all things reasonably necessary to obtain such patents. This provision shall not apply to any inventions for which no equipment, supplies, facilities or trade secret information of the Company or its Affiliates was used and which was developed on Executive's own time without using any of the Company's or its Affiliates' equipment, supplies, facilities or trade secret information, except for those inventions which either: (a) related at the time of conception or reduction to practice of the invention to the Company's or its Affiliates' respective businesses, or actual or demonstrably anticipated research or development of the Company or its Affiliates, or (b) resulted from any work performed by Executive for the Company or its Affiliates.

7.3 Executive acknowledges and understands that, pursuant to the Defend Trade Secrets Act, an individual shall not be held criminally or civilly liable under any federal or state trade secret law for the disclosure of a trade secret that (A) is made (i) in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. Further, if an employee files a lawsuit for retaliation by the Company for reporting a suspected violation of law, the employee may disclose the trade secret to the employee's attorney and use the trade secret information in the court proceeding, if the employee (A) files any document containing the trade secret under seal; and (B) does not disclose the trade secret, except pursuant to court order. In the event that disclosure of Company trade secrets was not done in good faith

pursuant to the above, the employee may be subject to substantial damages, including punitive damages and attorneys' fees.

8. Ventures. If, during the term of this Agreement, Executive is engaged in or associated with the planning or implementing of any project, program or venture directly related to the business of the Company or its Affiliates and a third party or parties, all rights in the project, program or venture shall belong to the Company and shall constitute a corporate opportunity belonging exclusively to the Company. Except as expressly approved in writing by the Company, Executive shall not be entitled to any interest in such project, program or venture or to any commission, finder's fee or other compensation in connection therewith, other than the compensation to be paid to Executive as provided in this Agreement.

#### 9. Noninterference With Business.

9.1 During his employment, Executive agrees not to, whether on his own behalf or as a partner, officer, director, employee, agent or consultant of any other person or entity, directly or indirectly, engage or attempt to engage in an employment or business activity which competes against the Company or its Affiliates, any activity the Company or its Affiliates are considering undertaking or is otherwise in conflict with the Company's or its Affiliates' business interests, unless the President consents in writing in advance.

9.2 Executive understands and agrees that Company's and its Affiliates' employees and customers and any information regarding Company and its Affiliates employees and/or customers is confidential and constitutes trade secrets. Accordingly, Executive agrees that during his employment and thereafter, Executive will not, either directly or indirectly, separately or in association with others use Company or Affiliate trade secret or confidential information for any reason including, but not limited to, to interfere with, impair, disrupt or damage Company's or its Affiliates relationship with any of its customers or customer prospects by soliciting or encouraging others to solicit any of them for the purpose of diverting or taking away business from Company or its Affiliates.

9.3 For a period of six (6) months following Executive's separation from employment for any other reason, Executive agrees not to:

9.3.1 interfere with, impair, disrupt, damage or attempt to damage the Company's or its Affiliates' relationship with any of its then Customers or Prospective Customers;

9.3.2 knowingly directly or indirectly solicit, induce or attempt to induce any employee, consultant or independent contractor to terminate or breach an employment, contractual or other relationship with the Company or its Affiliates, to leave the Company's or its Affiliates' employ for a position involving work in direct competition to that of the Company or its Affiliates.

9.3.3 Executive acknowledges that the restraints imposed under this Section 9 are reasonable and not unduly harsh or oppressive and that, in the event that Executive is subject to any of the restrictions set forth in Section 9 following his separation from the Company, he would be able to find gainful employment in the general field of manufacturing of unmanned systems related products.

10. Non-Disparagement. Executive expressly agrees that during his employment by the Company and after the termination of such employment for any reason, he will make no statement and take no actions of any kind, verbal or written, that directly or indirectly disparages the Company or the Related Parties, injures their general reputation or interferes with the Company's or its Affiliates' operations, except as required by applicable law. Nothing in this Section 10 shall restrict the Executive from cooperating or communicating with any governmental or listing entity.

#### 11. Termination Prior to Expiration of the Term.

11.1 Termination for Cause. The Company may terminate Executive's employment at any time for "Cause" (as defined in Section 17) immediately upon written notice to Executive. Such written notice shall set forth with reasonable specificity the Company's basis for such termination.

11.2 Resignation. Executive's employment shall be terminated on the earlier of the date that is thirty (30) days following the submission of Executive's written resignation to the Company or the date such resignation is accepted by the Company.

11.3 Termination Without Cause. The Company may terminate Executive's employment Without Cause upon written notice to Executive. Termination "Without Cause" shall mean termination of employment by the Company on any basis other than termination of Executive's employment hereunder pursuant to Section 11.1 or 11.2, including on account of a disability.

12. Surrender of Records and Property. Upon termination of his employment for any reason, Executive shall deliver promptly to the Company all records, manuals, books, blank forms, documents, letters, licenses, briefings, memoranda, notes, notebooks, reports, data, tables, and calculations or copies thereof, which are the property of the Company and which relate in any way to the business, customers, products, practices or techniques of the Company, and all other property of the Company and Proprietary Matter, including, but not limited to, all documents which in whole or in part, contain any trade secrets or confidential information of the Company, which in any of these cases are in his possession or under his control. If Executive purchases any record book, ledger, or similar item to be used for keeping records of or information regarding the business of the Company or its customers, Executive shall immediately notify the Company and provide documentation of such purchase, which shall then immediately reimburse Executive for the expense of such purchase.

13. Assignment. This Agreement shall not be assignable, in whole or in part, by the Executive. The Company may, upon notice to Executive, assign its rights and obligations under this Agreement to any corporation, firm or other business entity (i) owned or controlled by the Company or to any entity which is or may own or control the Company, or (ii) with which the Company may merge into or consolidate, or (iii) to which the Company may sell or transfer all or substantially all of its assets or to which fifty percent (50%) or more of the equity investment and of the voting control is owned, directly or indirectly, by, or is under the common ownership with, the Company.

Upon such assignment by Kratos or the Company, this Agreement shall be enforceable by the Executive and the Assignee respectively. After any such assignment by Kratos or the Company, the Executive and Kratos or the Company, as the case may be, shall be discharged from all further liability hereunder to each other.

14. Injunctive Relief. Executive agrees that it would be difficult to compensate the Company fully for damages for any violation of the provisions of this Agreement, including, without limitation, the provisions of Sections 7, 9, 10 and 12. Accordingly, Executive specifically agrees that the Company shall be entitled to temporary and permanent injunctive relief to enforce the provisions of this Agreement. This provision with respect to injunctive relief shall not, however, diminish the right of the Company to claim and recover damages in addition to injunctive relief.

15. Arbitration.

15.1 Claims Covered. The parties shall resolve by arbitration all statutory, contractual and/or common law claims or controversies ("Claims") that the Company may have against Executive, or that Executive may have against the Company or any of its officers, directors, employees or agents in their capacity as such or otherwise. Claims subject to arbitration include claims for breach of any contract (express or implied).

15.2 Claims Not Covered. The arbitration of Claims shall not apply to (i) claims by Executive for workers' compensation or unemployment insurance; (ii) claims which even in the absence of these arbitration provisions could not have been litigated in court or before any administrative proceeding under applicable federal, state or local law; (iii) claims by the Company for injunctive and/or other equitable relief; (iv) claims for which arbitration is prohibited under applicable rules in the Federal Acquisition Regulation or the Defense Federal Acquisition Regulation Supplement and (v) claims for employee benefits under any employee benefit plan subject to ERISA.

15.3 Procedures. Claims shall be settled by arbitration by a single, neutral arbitrator in accordance with the employment arbitration rules then in effect of Judicial Arbitration and Mediation Services (JAMS), which can be found at [www.jamsadr.com/rules-employment-arbitration](http://www.jamsadr.com/rules-employment-arbitration). The arbitrator shall determine all questions of fact and law relating to any Claim, including but not limited to, whether or not any such Claim is subject to the arbitration provisions contained herein. The parties shall be permitted to engage in such pre-hearing discovery as the arbitrator shall permit. The arbitrator shall issue a written arbitration decision which shall include essential findings and conclusions on which any award is based. The decision shall remain confidential between the parties and shall not be published by the arbitrator or JAMS. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. Each party shall pay the fees of its own attorneys, the expenses of its witnesses and all other expenses connected with presenting its case, except insofar as such fees or expenses are otherwise recoverable pursuant to a statutory claim or cause of action. The Company shall bear the other costs of the arbitration, including the cost of any record or transcript of the arbitration, administrative fees, the fee of the arbitrator, and all other fees and costs.

15.4 Remedies; Waiver of Jury Trial. Executive understands that Executive is waiving the right to seek certain remedies in court, including the right to a jury trial. The arbitrator shall be empowered to award any relief which might have been available in a court of law or equity.

15.5 Required Notice and Statute of Limitations. Arbitration shall be initiated by serving or mailing a written notice to the other party within the applicable statutory limitations period. Any notice to be sent to the Company shall be delivered to the President with a mandatory copy to Kratos' General Counsel, 4820 Eastgate Mall, Ste. 200, San Diego, CA 92121, facsimile 858-812-7303. The notice shall identify and describe the nature of all claims asserted and the facts upon which such claims are based.

## 16. Miscellaneous.

16.1 Governing Law and Venue. This Agreement is made under and shall be governed by and construed in accordance with the laws of the State of Texas, without regard to its conflicts of law provisions, and all proceedings shall be brought in the courts or arbitral forums located in the State of Texas or some other location as agreed by the parties.

16.2 Prior Agreements. This Agreement, coupled with Executive's Proprietary Information Agreement, contains the entire agreement of the parties relating to the subject matter hereof and supersedes all prior agreements and understandings with respect to such subject matter. The parties have made no agreements, representations or warranties relating to the subject matter of this Agreement which are not set forth herein.

16.3 Successors. The terms of this Agreement and all rights of Executive hereunder shall inure to the benefit of, and be enforceable by, Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees on the one hand, and by any successor or assignee of the Company on the other hand.

16.4 Amendments. No amendment or modification of this Agreement shall be deemed effective unless made in writing signed by the parties.

16.5 No Waiver. No term or condition of this Agreement shall be deemed to have been waived nor shall there be any estoppel to enforce any provisions of this Agreement, except by a statement in writing signed by the party against whom enforcement of the waiver or estoppel is sought. Any written waiver shall not be deemed a continuing waiver unless specifically stated, shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition waived and shall not constitute a waiver of such term or condition for the future or as to any act other than that specifically waived.

16.1 Severability and Reformation. To the extent any provision of this Agreement shall be considered by a court or arbitrator to be invalid or unenforceable, the provision shall be considered deleted herefrom and the remainder of such provision and of this Agreement shall be unaffected and shall continue in full force and effect. Each of the parties recognizes that the restrictions contained in this Agreement are properly required for the adequate protection of the Company's business and that in the event any covenant or other provision contained herein shall be deemed to be illegal, unenforceable or unreasonable by a court or other

tribunal of competent jurisdiction, each of the parties agrees and submits to the reduction of said restrictions to such duration and/or scope as said court or tribunal shall deem reasonable.

16.2 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original and all which together shall be deemed to be one and the same instrument.

16.3 Notices. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given or received: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed facsimile if sent during normal business hours of the recipient upon confirmed receipt, if not, then on the next business day, (c) five (5) business days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) business day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the Company and Executive at their respective addresses as set forth on the signature page hereof or at such other address as the Company or Executive may designate by ten (10) days advance written notice to the other party.

17. Definition of Terms. The following terms referred to in this Agreement shall have the following meanings:

17.1 Affiliate. "Affiliate" with respect to any person or entity, means a person or entity that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with, such person or entity.

17.2 Cause. Termination for "Cause" means termination due to any of the following reasons: (i) Executive's Misconduct; (ii) Executive's violation of posted policy or rules of the Company; (iii) Executive's willful refusal to follow the lawful directions given by Executive's direct supervisor or the President of the Company from time to time or breach of any material covenant or obligation under this Agreement or other agreement with the Company; (iv) Executive's breach of the duty of loyalty to the Company that causes or is reasonably likely to cause injury to the Company; or (v) failure to timely secure or loss of any security clearance the Company deems necessary or desirable for Executive to perform the duties of the Position.

17.3 Customer or Prospective Customer means a person or entity for which the Company or its Affiliate provided or actively sought to provide any products or services, and with whom Executive was involved, consulted or engaged on behalf of the Company or its Affiliate during the previous two (2) years of his employment with the Company or its Affiliate. With respect to the United States Government, the term "entity" shall apply to the Command Level of the organizational or operational unit, branch, or division that initiated, managed or administered the contract (but not the entire agency itself).

17.4 Misconduct. "Misconduct" means:

17.4.1 Indictment or conviction of a felony or for an act of fraud, embezzlement or other act of gross misconduct against the Company in the performance of duties hereunder.

17.4.2 Misuse, misappropriation or disclosure of any of the Proprietary Matter, directly or indirectly, or use of it in any way, except as required or permitted in the course of Executive's employment.

17.4.3 Knowing misappropriation, concealment, or conversion of any money or property of the Company that causes or could cause injury to the Company.

17.4.4 Reckless conduct which endangers or is reasonably likely to endanger the safety of persons or property during the course of employment or while on Company premises.

17.4.5 A material violation of the Company's Code of Legal and Ethical Conduct.

17.5 Related Parties. "Related Parties" means each of the Company's present and former directors, officers, employees, trustees, agents, attorneys, insurers, shareholders, representatives, predecessors, successors and assigns, and if any, its parent corporations, subsidiaries, divisions, related and affiliated companies and entities.



## EMPLOYMENT AGREEMENT

**THIS EMPLOYMENT AGREEMENT** (“Agreement”) is entered into by and between Kratos Defense & Security Solutions, Inc., a Delaware corporation (“Company”) and Phil Carrai, an individual (“Executive”), effective as of January 1, 2020 (“Effective Date”). Certain terms used in this Agreement denoted by initial capital letters are defined in Section 17, to the extent not defined elsewhere in the Agreement.

### **RECITALS**

A. The Company wishes to continue to employ Executive upon the terms and conditions contained in this Agreement, and Executive wishes to enter into the Agreement and agrees to perform his obligations hereunder in consideration of his employment and salary, benefits and other terms described herein.

**NOW, THEREFORE**, in the consideration of the mutual covenants and agreements set forth herein, the Company and Executive, intending to be legally bound, hereby agree as follows:

### **AGREEMENT**

1. **Employment.** The Company shall employ Executive as President of the Company’s Space, Training & Cyber (“STC”) Division (the “Position”), and Executive accepts such employment and agrees to perform services for the Company, for the period and upon the terms and conditions set forth in this Agreement.

2. **Term.** The term of Executive’s employment hereunder shall be for a period commencing on the Effective Date and ending on December 31, 2022 (the “Term”), subject to earlier termination as hereinafter specified.

3. **Position and Duties.** During the term of this Agreement, Executive shall perform all duties and functions customarily performed by the Position of a business of the size and nature similar to that of the Company, and such other related employment duties as the President and CEO of the Company or his designee (the “President”) shall reasonably assign to him from time to time. Executive shall perform his duties principally at the executive offices of STC, with such travel to such other locations from time to time as the President may reasonably require. Except as may otherwise be approved in advance by the President, and except during vacation periods and reasonable periods of absence due to sickness, personal injury or other disability, Executive shall devote his full working time to the services required of him hereunder. Executive shall use his reasonable best efforts, judgment and energy to improve and advance the business and interest of the Company and its subsidiaries and Affiliates, if applicable, in a manner consistent with the duties of the Position and with the Company’s Code of Legal and Ethical Conduct. Executive hereby confirms that he is under no contractual commitments inconsistent with his obligations set forth in this Agreement, and that during his employment, he will not render or perform services, or enter into any contract to do so, for any other corporation, firm, entity or person which are inconsistent with the provisions of this Agreement.

4. **Compensation.**

4.1 **Base Salary.** As compensation for all services to be rendered by Executive under this Agreement, the Company shall pay to Executive a base annual salary of Four Hundred Fifty Thousand Dollars (\$450,000.00) (the “Base Salary”), which shall be paid on a regular basis in accordance with the Company’s customary payroll procedures and policies. Executive will be eligible for annual increases to the Base Salary in accordance with the Company’s then current compensation policies.

4.2 **Incentive Compensation.** As incentive compensation for services rendered hereunder, Executive may, at the sole and absolute discretion of the Company, be entitled to receive additional annual compensation of up to sixty percent (60%) of the Base Salary (“Incentive Compensation”).

4.3 **Equity Incentives.** Executive will be eligible for equity incentive grants at the discretion of Kratos’ President and the Compensation Committee of the Board of Directors.

4.4 Participation in Benefit Plans. Executive and eligible family members shall be eligible to participate in, subject to his affirmative election to enroll in such plans requiring enrollment and to the extent eligible thereunder, any and all plans of the Company providing general benefits for the Company's employees, including, but not limited to, any group life insurance, hospitalization, disability, paid time off, medical, dental, pension, profit sharing, savings and stock bonus plans. Executive's participation in any such plan or program shall be subject to the provisions, rules, and regulations applicable thereto. Nothing in this Agreement shall impose on the Company any affirmative obligation to establish any benefit plan. The Company reserves the right to prospectively terminate or change benefit plans and programs it offers to its employees at any time.

4.5 Expenses. In accordance with the Company's policies established from time to time, the Company will pay or reimburse Executive for all reasonable and necessary out-of-pocket expenses incurred by him in the performance of the Position, subject to the presentment of appropriate receipts or expense reports in connection with the Company's policies and procedures. The following provisions shall be in effect for any reimbursements (and in-kind benefits) to which Executive otherwise becomes entitled under this Agreement, in order to assure that such reimbursements (and benefits) do not create a deferred compensation arrangement subject to Section 409A of the Internal Revenue Code of 1986, as amended ("Code"):

- (a) The amount of reimbursements (or in-kind benefits) to which Executive may become entitled in any one calendar year shall not affect the amount of expenses eligible for reimbursement (or in-kind benefits) hereunder in any other calendar year.
- (b) Each reimbursement to which Executive becomes entitled shall be made by the Company as soon as administratively practicable following Executive's submission of the supporting documentation, but in no event later than the close of business of the calendar year following the calendar year in which the reimbursable expense is incurred.
- (c) Executive's right to reimbursement (or in-kind benefits) cannot be liquidated or exchanged for any other benefit or payment.

4.6 Taxes and Other Withholding. The Company may withhold from any benefits or amounts payable (including any Severance Payment or Change in Control Severance Payment, as defined below) under this Agreement all federal, state, city or other taxes and other amounts as shall be required pursuant to any law or governmental regulation or ruling or as elected by Executive.

5. Annual Leave. Executive shall earn paid time off and shall maintain paid time off balances in accordance with the Company's standard policies.

6. Compensation upon Termination. Executive shall be entitled to the following payments, if any, upon the termination of his employment by the Company. The compensation described in this Section 6 shall be in lieu of any separation or severance compensation offered to Executive under any general policies of the Company.

6.1 Cause. In the event Executive is terminated by the Company for Cause pursuant to Section 11.1, Executive shall not be entitled to any compensation other than Base Salary accrued through the date of termination, plus accrued but unused paid time off.

6.2 Resignation. In the event Executive resigns from the Company voluntarily pursuant to Section 11.2, Executive shall be entitled to receive Executive's Base Salary accrued through the effective date of termination, plus accrued but unused paid time off. Should Executive resign his employment upon thirty (30) days' advance written notice, Company reserves the right to immediately relieve Executive of all job duties and provide Executive with payment of thirty (30) days Base Salary in lieu of any portion of the notice period.

6.3 Without Cause. In the event Executive is terminated by the Company Without Cause pursuant to Section 11.3, the Company shall pay to Executive (i) any Base Salary accrued through the date of termination, (ii) any accrued but unused paid time off; (iii) continued payment of the Base Salary for a period of twelve (12) months (the "Severance Period"); and (iv) any Incentive Compensation which is earned as of the date of termination pursuant to the terms of any then existing Incentive Compensation Agreement. The payment provided by Subsection (iii) of this Section 6.3

shall be referred to as a “Severance Payment.” Except as otherwise provided herein, the Severance Payment shall be paid to Executive on a regular basis in accordance with the Company’s regular payroll procedures and policies.

6.4 Disability. If Executive becomes physically, mentally disabled during the term of this Agreement and such disability continues for a period of three hundred and sixty five (365) days, the Company may, to the extent permitted by applicable law after the expiration of such period, terminate this Agreement by giving written notice to Executive. For purpose of this Agreement, the term “disabled” shall be defined as Executive’s inability through physical, or mental illness, to perform all of the duties which Executive is required to perform under this Agreement with or without reasonable accommodation as such terms are defined under the Americans with Disabilities Act. In the event that the Executive is terminated pursuant to this section, the Company shall pay to Executive (i) Executive’s Base Salary through the date that he is terminated; and (ii) any accrued but unused paid time off.

6.5 Upon Change of Control. In the event Executive’s employment is terminated by the Company without Cause upon a Change of Control of the Company as defined in the Company’s Restricted Stock Agreement, the Company shall pay to Executive: (i) any Base Salary accrued through the date of termination, (ii) any accrued but unused vacation time; and (iii) continued payment of the Base Salary for a period of twelve (12) months (the “Change of Control Severance Period”). Subsection (iii), above, of this Section 6.5 shall be referred to as a “Change in Control Severance Payment.”

6.6 Release. The receipt of the Severance Payment, Change in Control Severance Payment or other benefits pursuant to this Section 6 will be subject to Executive signing and not revoking a customary and standard employee release of claims agreement in a form prescribed by the Company, and such release becoming effective and irrevocable within forty-five (45) days of Executive’s termination. No severance or other benefits will be paid or provided until the release of claims agreement becomes effective, and any severance amounts or benefits otherwise payable between the date of Executive’s termination and the date such release becomes effective shall be paid on the effective date of such release, subject to the delay in the following paragraph. If the termination occurs after November 15, no payments shall be made until the first payroll date of the following calendar year, after the release has become effective, subject to the delay in the following paragraph.

6.7 Delay of Payment; Other 409A Matters. Notwithstanding any other provision of this Agreement whatsoever, the Company, in its sole discretion, shall have the right to construe this Agreement in a manner that complies with Section 409A of the Code (relating to deferred compensation arrangements) and any related administrative guidance issued by the Internal Revenue Service. Notwithstanding any inconsistent provision of this Agreement, if Executive is a “specified employee” within the meaning of Section 409A of the Code at the time of Executive’s termination, then only that portion of the Severance Payment or Change in Control Severance Payment, together with any other severance payments or benefits that, in each case, are non-qualified deferred compensation under Code Section 409A, which (a) do not exceed the Section 409A Limit (as defined below), and (b) which qualify as separation pay under Treasury Regulation Section 1.409A-1(b)(9)(iii), may be paid within the first six (6) months following Executive’s termination. Otherwise, the portion of the Severance Payment or Change in Control Severance Payment, together with any other severance payments or benefits that, in each case, are non-qualified deferred compensation under Section 409A, that would otherwise be payable within the six (6) month period following Executive’s termination will instead be paid in a lump sum on the date six (6) months and one (1) day following the date of Executive’s termination (or the next business day if such date is not a business day), provided Executive has complied with the requirements for such payment. For purposes of this Agreement, “Section 409A Limit” means the lesser of two (2) times: (i) Executive’s “annualized compensation” as determined under Treasury Regulation Section 1.409A-1(b)(9)(iii)(A)(1), or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year of the termination, or such successor limit as may apply. Each payment specified hereunder is designated a separate payment for purposes of Section 409A. The Company shall have no liability to Executive for any adverse tax or other consequences related to the payments provided hereunder and to the extent any payment or benefit would result in adverse or other tax consequences under Section 409A, Executive shall have no legally enforceable right to such payment or benefit. For purposes of this Agreement, termination of employment and similar phrases mean a “separation from service” within the meaning of Section 409A.

## 7. Proprietary Matter; Ownership.

7.1 Except as permitted or directed by the Company or as required by law, Executive shall not during the term of his employment or at any time thereafter knowingly divulge, furnish, disclose or make accessible (other than in the ordinary course of the business of the Company) to anyone for use in any way any confidential, secret, or proprietary knowledge or information of the Company or its Affiliates that is not in the public domain ("Proprietary Matter") which Executive has acquired or become acquainted with or will acquire or become acquainted with during his employment with the Company and its Affiliates, whether developed by himself or by others, including, but not limited to, any trade secrets, confidential or secret designs, processes, formulae, software or computer programs, plans, devices, or material (whether or not patented or patentable, copyrighted or copyrightable) directly or indirectly useful in any aspect of the business of the Company and its Affiliates, any confidential customer, distributor or supplier lists of the Company or its Affiliates, any confidential or secret development or research work of the Company or its Affiliates, or other confidential, secret or non-public aspects of the business of the Company or its Affiliates. Executive acknowledges that the Proprietary Matter constitutes a unique and valuable asset of the Company or its Affiliates, acquired at great time and expense by the Company or such Affiliates, and that any disclosure or other use of the Proprietary Matter other than for the sole benefit of the Company or such Affiliates would be wrongful and could cause irreparable harm to the Company or such Affiliates. The foregoing obligations of confidentiality, however, shall not apply to any knowledge or information which is now published or which subsequently becomes generally publicly known, other than as a direct or indirect result of the breach of this Agreement by Executive or the breach of any obligation of confidentiality by any other person.

7.2 Executive agrees that he will fully inform and disclose to the Company from time to time all inventions, designs, improvements, enhancements, developments and discoveries which he now has, or may hereafter have, during the Term which pertain or relate to the business of the Company or its Affiliates or to any experimental work carried on by the Company or its Affiliates. All such inventions, designs, improvements, enhancements, developments and discoveries shall be the exclusive property of the Company or its Affiliates. Executive hereby assigns the rights to all such inventions, designs, improvements, enhancements, developments and discoveries to the Company or its Affiliates. Executive shall reasonably assist the Company or its Affiliates in obtaining patents on all such inventions, designs, improvements, enhancements, developments and discoveries deemed patentable by the Company or its Affiliates and shall execute all documents (including assignments and related affidavits) and do all things reasonably necessary to obtain such patents. This provision shall not apply to any inventions for which no equipment, supplies, facilities or trade secret information of the Company or its Affiliates was used and which was developed on Executive's own time without using any of the Company's or its Affiliates' equipment, supplies, facilities or trade secret information, except for those inventions which either: (a) related at the time of conception or reduction to practice of the invention to the Company's or its Affiliates' respective businesses, or actual or demonstrably anticipated research or development of the Company or its Affiliates, or (b) resulted from any work performed by Executive for the Company or its Affiliates.

7.3 Executive acknowledges and understands that, pursuant to the Defend Trade Secrets Act, an individual shall not be held criminally or civilly liable under any federal or state trade secret law for the disclosure of a trade secret that (A) is made (i) in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. Further, if an employee files a lawsuit for retaliation by the Company for reporting a suspected violation of law, the employee may disclose the trade secret to the employee's attorney and use the trade secret information in the court proceeding, if the employee (A) files any document containing the trade secret under seal; and (B) does not disclose the trade secret, except pursuant to court order. In the event that disclosure of Company trade secrets was not done in good faith pursuant to the above, the employee may be subject to substantial damages, including punitive damages and attorneys' fees.

8. Ventures. If, during the term of this Agreement, Executive is engaged in or associated with the planning or implementing of any project, program or venture directly related to the business of the Company or its Affiliates and a third party or parties, all rights in the project, program or venture shall belong to the Company and shall constitute a corporate opportunity belonging exclusively to the Company. Except as expressly approved in writing by the Company, Executive shall not be entitled to any interest in such project, program or venture or to any commission,

finder's fee or other compensation in connection therewith, other than the compensation to be paid to Executive as provided in this Agreement.

#### 9. Noninterference With Business.

9.1 During his employment and for the Restricted Period (as defined in Section 17.5), Executive agrees not to, whether on his own behalf or as a partner, officer, director, employee, agent or consultant of any other person or entity, directly or indirectly, engage or attempt to engage in any business that is similar to the type of business conducted by the STC Division for the purpose of improperly diverting or taking away business from the STC Division or the Company in any geographic area in which the STC Division was engaged in business as of the date of termination of Executive's employment with the Company (except by ownership of five percent (5%) or less of the outstanding stock of any publicly held corporation).

9.2 During his employment and for the Restricted Period, Executive agrees not to (a) directly or indirectly contact any of the STC Division's then current customers or prospective customers with whom the STC Division is then engaged in discussions or proposal negotiations for the purpose of improperly diverting or taking away business from the STC Division or the Company; or (b) otherwise interfere with, impair, disrupt or damage the STC Division or the Company's relationship with any of its then current or prospective customers with whom the STC Division was engaged in discussions or proposal negotiations during Executive's employment with the Company.

9.3 During his employment and for two (2) years following the termination of his employment for any reason, Executive agrees not to knowingly directly or indirectly solicit, induce or encourage any employee of the Company to terminate or breach an employment relationship with the Company.

9.4 Executive and the Company agree that the restrictions in this Section 9 are reasonably necessary to protect the Company's legitimate business interests, including, without limitation, the preservation of its valuable trade secret and confidential information and the preservation of its goodwill and customer relationships. Executive and the Company further agree that the geographic scope stated herein is reasonable because the STC Division operates throughout the United States and in various places throughout the world.

10. Non-Disparagement. Executive expressly agrees that during his employment by the Company and for two (2) years following the termination of such employment for any reason, he will make no statement and take no actions of any kind, verbal or written, that directly or indirectly disparages the Company or the Related Parties, injures their general reputation or interferes with the Company's or its Affiliates' operations, except as required by applicable law. Nothing in this Section 10 shall restrict Executive from cooperating or communicating with any government or listing entity.

#### 11. Termination Prior to Expiration of the Term.

11.1 Termination for Cause. The Company may terminate Executive's employment at any time for "Cause" (each as defined in Section 17) immediately upon written notice to Executive. Such written notice shall set forth with reasonable specificity the Company's basis for such termination.

11.2 Resignation. Executive's employment shall be terminated on the earlier of the date that is thirty (30) days following the submission of Executive's written resignation to the Company or the date such resignation is accepted by the Company.

11.3 Termination Without Cause. The Company may terminate Executive's employment Without Cause upon written notice to Executive. Termination "Without Cause" shall mean termination of employment by the Company on any basis other than termination of Executive's employment hereunder pursuant to 11.1 or 11.2.

12. Surrender of Records and Property. Upon termination of his employment for any reason, Executive shall deliver promptly to the Company all records, manuals, books, blank forms, documents, letters, licenses, briefings, memoranda,

notes, notebooks, reports, data, tables, and calculations or copies thereof, which are the property of the Company and which relate in any way to the business, customers, products, practices or techniques of the Company, and all other property of the Company and Proprietary Matter, including, but not limited to, all documents which in whole or in part, contain any trade secrets or confidential information of the Company, which in any of these cases are in his possession or under his control. If Executive purchases any record book, ledger, or similar item to be used for keeping records of or information regarding the business of the Company or its customers, Executive shall immediately notify the Company and provide documentation of such purchase, which shall then immediately reimburse Executive for the expense of such purchase.

13. Assignment. This Agreement shall not be assignable, in whole or in part, by Executive. The Company may, upon notice to Executive, assign its rights and obligations under this Agreement to an Affiliate of the Company or any purchaser of substantially all of the Company's assets.

Upon such assignment by the Company, this Agreement shall be enforceable by the Executive and the assignee respectively. After any such assignment by the Company, Executive and the Company shall be discharged from all further liability hereunder to each other.

14. Injunctive Relief. Executive agrees that it would be difficult to compensate the Company fully for damages for any violation of the provisions of this Agreement, including, without limitation, the provisions of Sections 7, 9, 10 and 12. Accordingly, Executive specifically agrees that the Company shall be entitled to temporary and permanent injunctive relief to enforce the provisions of this Agreement. This provision with respect to injunctive relief shall not, however, diminish the right of the Company to claim and recover damages in addition to injunctive relief.

15. Arbitration.

15.1 Claims Covered. The parties shall resolve by arbitration all statutory, contractual and/or common law claims or controversies ("Claims") that the Company may have against Executive, or that Executive may have against the Company or any of its officers, directors, employees or agents in their capacity as such or otherwise. Claims subject to arbitration include claims for breach of any contract (express or implied).

15.2 Claims Not Covered. The arbitration of Claims shall not apply to (i) claims by Executive for workers' compensation or unemployment insurance; (ii) claims which even in the absence of these arbitration provisions could not have been litigated in court or before any administrative proceeding under applicable federal, state or local law; (iii) claims by the Company for injunctive and/or other equitable relief; (iv) claims for which arbitration is prohibited under applicable rules in the Federal Acquisition Regulation or the Defense Federal Acquisition Regulation Supplement and (v) claims for employee benefits under any employee benefit plan subject to ERISA.

15.3 Procedures. Claims shall be settled by arbitration by a single, neutral arbitrator in accordance with the employment arbitration rules then in effect of Judicial Arbitration and Mediation Services (JAMS) which can be found at [www.jamsadr.com/rules-employment-arbitration](http://www.jamsadr.com/rules-employment-arbitration). The arbitrator shall determine all questions of fact and law relating to any Claim, including but not limited to, whether or not any such Claim is subject to the arbitration provisions contained herein. The parties shall be permitted to engage in such pre-hearing discovery as the arbitrator shall permit. The arbitrator shall issue a written arbitration decision which shall include essential findings and conclusions on which any award is based. The decision shall remain confidential between the parties and shall not be published by the arbitrator or JAMS. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. Each party shall pay the fees of its own attorneys, the expenses of its witnesses and all other expenses connected with presenting its case, except insofar as such fees or expenses are otherwise recoverable pursuant to a statutory claim or cause of action. The Company shall bear the other costs of the arbitration, including the cost of any record or transcript of the arbitration, administrative fees, the fee of the arbitrator, and all other fees and costs.

15.4 Remedies; Waiver of Jury Trial. Executive understands that Executive is waiving the right to seek certain remedies in court, including the right to a jury trial. The arbitrator shall be empowered to award any relief which might have been available in a court of law or equity.

15.5 Required Notice and Statute of Limitations. Arbitration shall be initiated by serving or mailing a written notice to the other party within the applicable statutory limitations period. Any notice to be sent to the Company shall be delivered to the Company President with a mandatory copy to Kratos' General Counsel, 10680 Trenea Street, 6th Floor, San Diego, CA 92131, facsimile 858-812-7303. The notice shall identify and describe the nature of all claims asserted and the facts upon which such claims are based.

## 16. Miscellaneous.

16.1 Governing Law and Venue. This Agreement is made under and shall be governed by and construed in accordance with the laws of the State of Delaware, without regard to its conflicts of law provisions, and all proceedings shall be brought in the courts or arbitral forums located in Northern Virginia (Washington, D.C. metropolitan area), San Diego, California, or some other location as agreed by the parties.

16.2 Prior Agreements. This Agreement, coupled with Executive's Proprietary Information Agreement, contains the entire agreement of the parties relating to the subject matter hereof and supersedes all prior agreements and understandings with respect to such subject matter. The parties have made no agreements, representations or warranties relating to the subject matter of this Agreement which are not set forth herein.

16.3 Successors. The terms of this Agreement and all rights of Executive hereunder shall inure to the benefit of, and be enforceable by, Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees on the one hand, and by any successor or assignee of the Company on the other hand.

16.4 Amendments. No amendment or modification of this Agreement shall be deemed effective unless made in writing signed by the parties.

16.5 No Waiver. No term or condition of this Agreement shall be deemed to have been waived nor shall there be any estoppel to enforce any provisions of this Agreement, except by a statement in writing signed by the party against whom enforcement of the waiver or estoppel is sought. Any written waiver shall not be deemed a continuing waiver unless specifically stated, shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition waived and shall not constitute a waiver of such term or condition for the future or as to any act other than that specifically waived.

16.6 Severability and Reformation. To the extent any provision of this Agreement shall be considered by a court or arbitrator to be invalid or unenforceable, the provision shall be considered deleted here from and the remainder of such provision and of this Agreement shall be unaffected and shall continue in full force and effect. Each of the parties recognizes that the restrictions contained in this Agreement are properly required for the adequate protection of the Company's business and that in the event any covenant or other provision contained herein shall be deemed to be illegal, unenforceable or unreasonable by a court or other tribunal of competent jurisdiction, each of the parties agrees and submits to the reduction of said restrictions to such duration and/or scope as said court or tribunal shall deem reasonable.

16.7 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original and all which together shall be deemed to be one and the same instrument.

16.8 Notices. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given or received: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed facsimile if sent during normal business hours of the recipient upon confirmed receipt, if not, then on the next business day, (c) five (5) business days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) business day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the Company and Executive at their respective

addresses as set forth on the signature page hereof or at such other address as the Company or Executive may designate by ten (10) days advance written notice to the other party.

17. Definition of Terms. The following terms referred to in this Agreement shall have the following meanings:

17.1 Affiliate. "Affiliate" with respect to any person or entity, means a person or entity that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with, such person or entity.

17.2 Cause. Termination for "Cause" means termination due to any of the following reasons: (i) Executive's Misconduct; (ii) Executive's willful violation of posted policy or rules of the Company; (iii) Executive's willful refusal to follow the lawful directions given by Executive's direct supervisor or the President of the Company from time to time or breach of any material covenant or obligation under this Agreement or other agreement with the Company; or (iv) Executive's breach of the duty of loyalty to the Company that causes or is reasonably likely to cause injury to the Company.

17.3 Misconduct. "Misconduct" means:

17.3.1 Indictment or conviction of a felony or for an act of fraud, embezzlement or other act of gross misconduct against the Company in the performance of duties hereunder.

17.3.2 Misuse, misappropriation or disclosure of any of the Proprietary Matter, directly or indirectly, or use of it in any way, except as required or permitted in the course of Executive's employment.

17.3.3 Knowing misappropriation, concealment, or conversion of any money or property of the Company that causes or could cause injury to the Company.

17.3.4 Reckless conduct which endangers or is reasonably likely to endanger the safety of persons or property during the course of employment or while on Company premises.

17.3.5 A material violation of the Company's Code of Legal and Ethical Conduct.

17.4 Related Parties. "Related Parties" means each of the Company's present and former directors, officers, employees, trustees, agents, attorneys, insurers, shareholders, representatives, predecessors, successors and assigns, and if any, its parent corporations, subsidiaries, divisions, related and affiliated companies and entities.

17.5 Restricted Period. The "Restricted Period" means a period of (a) two (2) years after the termination of Executive's employment for Cause or (b) one (1) year after the termination of Executive's employment for any other reason.

(Signatures on following page)

**IN WITNESS WHEREOF**, the parties have executed this Employment Agreement as of the Effective Date.

**THE COMPANY:**                      **EXECUTIVE:**  
**Kratos Defense & Security Solutions, Inc.**

By: /s/ Eric DeMarco                      /s/ Phil Carrai  
Name: Eric DeMarco                      Phil Carrai  
Title: President and CEO                      Title: President, STC

Date: 12/11/2019

Address for Notice:                      Address for Notice:  
  
10680 Treena Street, 6th Floor                      1259 Cobble Pond Way  
San Diego, CA 92131                      Vienna, VA 22182  
Attn: Law Department

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Eric M. DeMarco, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kratos Defense & Security Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2020

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ ERIC M. DEMARCO

Eric M. DeMarco

*Chief Executive Officer, President*

*(Principal Executive Officer)*

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Deanna H. Lund, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kratos Defense & Security Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2020

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

Deanna H. Lund

*Executive Vice President, Chief Financial Officer*

*(Principal Financial Officer and Acting Principal Accounting Officer)*

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the accompanying Quarterly Report of Kratos Defense & Security Solutions, Inc. (the "Company") on Form 10-Q for the quarter ended March 29, 2020 (the "Report"), I, Eric M. DeMarco, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 7, 2020

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ ERIC M. DEMARCO

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Eric M. DeMarco

*Chief Executive Officer, President*

*(Principal Executive Officer)*

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the accompanying Quarterly Report of Kratos Defense & Security Solutions, Inc. (the "Company") on Form 10-Q for the quarter ended March 29, 2020 (the "Report"), I, Deanna H. Lund, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 7, 2020

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

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Deanna H. Lund

*Executive Vice President, Chief Financial Officer*

*(Principal Financial Officer and Acting Principal Accounting Officer)*