

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported) **May 5, 2021**

Kratos Defense & Security Solutions, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation)

001-34460
(Commission File Number)

13-3818604
(IRS Employer Identification No.)

1 Chisholm Trail, Suite 3200
Round Rock, TX 78681
(Address of Principal Executive Offices) (Zip Code)

(512) 238-9840
(Registrant's Telephone Number, Including Area Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

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.

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

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

Item 2.02. Results of Operations and Financial Condition

On May 05, 2021, Kratos Defense & Security Solutions, Inc. (the “Company”) issued a press release regarding the Company’s financial results for the first quarter 2021. The full text of the Company’s press release is attached hereto as Exhibit 99.1.

Item 9.01. Exhibits.

Exhibit No.	Description
99.1	May 05, 2021 Press Release by Kratos Defense & Security Solutions, Inc.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Kratos Defense & Security Solutions, Inc.

Date: May 05, 2021

By: /s/ Deanna H. Lund

Deanna H. Lund

Executive Vice President, Chief Financial Officer



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Kratos Reports First Quarter Financial Results

First Quarter Revenues of \$194.2 Million, Increased 15.0 percent over First Quarter 2020

First Quarter Unmanned Systems Segment Revenues of \$55.9 Million, Increased 33.1 percent over First Quarter 2020

First Quarter Cash Flow from Operations of \$22.7 Million

**First Quarter 2021 Book to Bill Ratio of 0.8 to 1
Last Twelve Months March 2021 Book to Bill Ratio of 1.3 to 1**

SAN DIEGO, CA, May 5, 2021 – Kratos Defense & Security Solutions, Inc. (Nasdaq:KTOS), a leading National Security Solutions provider, today reported its first quarter 2021 financial results. For the first quarter of 2021, Kratos reported Revenues of \$194.2 million, Operating Income of \$4.9 million, Net Income of \$1.9 million and Adjusted EBITDA of \$18.1 million.

First Quarter 2021 Revenues of \$194.2 million increased 15.0 percent, as compared to Revenues of \$168.9 million in the first quarter of 2020, reflecting organic growth in Kratos' Unmanned Systems, Space and Satellite, C5ISR, Microwave Products, Rocket Support Systems and Turbine Technology businesses, offset partially by certain reductions, including in our Training Solutions business, primarily resulting from a previously disclosed reduction in scope of certain international training contracts. Excluding the impact of the ASC Signal, TDI and 5D acquisitions, revenue grew organically 8.9 percent in the first quarter of 2021 as compared to the first quarter of 2020. Revenue grew organically 11.6 percent in the first quarter of 2021 on a proforma basis, excluding the impact of the acquisitions and the reduction of the international training contracts.

Operating Income of \$4.9 million in the first quarter of 2021 increased from \$4.7 million in the first quarter of 2020, with first quarter 2021 Operating Income including increases in non-cash

stock-based compensation expense of \$1.5 million and R&D of \$2.3 million over the first quarter of 2020. First Quarter 2021 Adjusted EBITDA of \$18.1 million increased 11.0 percent, as compared to \$16.3 million in the first quarter of 2020, primarily reflecting the increase in revenues.

First quarter 2021 Cash Flow generated from Operations was \$22.7 million, and Free Cash Flow Generated from Operations was \$13.1 million, after funding \$9.6 million of capital expenditures. Cash on hand at March 28, 2021 was \$383.6 million. Kratos reported first quarter 2021 Net income of \$1.9 million, and GAAP EPS of \$0.02 for the first quarter of 2021, compared to Net Loss of \$0.2 million and GAAP EPS of \$0.00 for the first quarter of 2020. Adjusted EPS was \$0.06 for the first quarter of 2021 compared to \$0.06 for the first quarter of 2020. The Company has approximately \$280 million of net operating loss carryforwards, which are expected to substantially shield Kratos from paying future cash income taxes.

For the first quarter of 2021, Kratos' Unmanned Systems Segment (KUS) Revenues of \$55.9 million increased 33.1 percent, as compared to \$42.0 million in the first quarter of 2020, and KUS operating income increased by 740.0 percent, to \$4.2 million in the first quarter of 2021 from \$0.5 million in the first quarter of 2020. First quarter 2021 KUS Adjusted EBITDA of \$6.4 million increased 178.3 percent, as compared to first quarter 2020 Adjusted EBITDA of \$2.3 million, primarily reflecting increases in certain target drone programs and leverage achieved with the fixed manufacturing, overhead and general and administrative structure, offset by certain development programs, including tactical drone development programs, which typically generate lower margins.

KUS's book-to-bill ratio for the first quarter of 2021 was 0.7 to 1.0 and 1.2 to 1.0 for the last twelve months ended March 28, 2021, with bookings of \$247.4 million for the twelve months ended March 28, 2021. Total backlog for KUS at the end of the first quarter of 2021 was \$222.4 million, down from \$237.9 million at the end of the fourth quarter of 2020, and up from \$174.4 million at the end of the first quarter of 2020.

For the first quarter of 2021, Kratos' Government Solutions Segment (KGS) reported Revenues of \$138.3 million, an increase of 9.0 percent, as compared to revenues of \$126.9 million in the first quarter of 2020, and operating income of \$7.1 million, down from operating income of \$9.3 million in the first quarter of 2020, reflecting a less favorable revenue mix, including an increase

in development-type programs and product-related revenues primarily resulting from the recent ASC Signal acquisition. Revenues in the first quarter of 2021 include approximately \$8.6 million from the ASC Signal acquisition, offset by reductions of approximately \$5.0 million in our training solutions business resulting primarily from the previously disclosed scope reductions in certain international training programs. First quarter 2021 KGS Adjusted EBITDA of \$11.7 million was down from first quarter 2020 Adjusted EBITDA of \$14.0 million, primarily reflecting a less favorable mix of revenues and increased investments in R&D expenses of approximately \$2.3 million which were incurred in the space and satellite business.

For the first quarter of 2021, KGS reported a book-to-bill ratio of 0.9 to 1.0, including a book-to-bill ratio of 1.3 to 1.0 in Kratos' Space, Satellite and Training business. For the twelve months ended March 28, 2021, KGS reported a book to bill ratio of 1.3 to 1.0, with bookings of \$735.2 million for the twelve months ended March 28, 2021. KGS total backlog at the end of the first quarter of 2021 was \$670.5 million, down from \$684.2 million at the end of the fourth quarter of 2020, and up from \$472.5 million at the end of the first quarter of 2020.

For the first quarter of 2021, Kratos reported consolidated bookings of \$164.9 million and a book-to-bill ratio of 0.8 to 1.0, with consolidated bookings of \$982.6 million and a book-to-bill ratio of 1.3 to 1.0 for the last twelve months ended March 28, 2021. Backlog at March 28, 2021 was \$892.9 million, down sequentially from \$922.2 million at December 27, 2020 and up from \$646.8 million at March 29, 2020, and Kratos' bid and proposal pipeline was \$9.0 billion at March 28, 2021. Backlog at March 28, 2021 was comprised of funded backlog of \$620.7 million and unfunded backlog of \$272.2 million.

Eric DeMarco, Kratos' President and CEO, said, "Since our last report to you, the Fiscal 2022 National Security Budget has been submitted at \$753 billion, better than we expected and we believe a positive sign for our industry and Kratos. Importantly, the Biden Administration has articulated its areas of focus includes retiring legacy systems and driving rapid innovation, affordability and technology into new and fielded systems, areas where Kratos is a clear industry leader." Mr. DeMarco continued, "Representative of this change, affordability and technology focus, Michael Brown, Director of the Defense Innovation Unit (DIU), a key strategic partner and customer of Kratos, has been selected to become the Pentagon's Acquisition Chief, emphasizing Mr. Brown's success as a disruptive DIU change agent and his previous Silicon Valley and commercial company experience."

Mr. DeMarco concluded, “We believe Kratos’ focus on the rapid development and fielding of affordable, disruptive systems, products and solutions, including in unmanned drones, space and satellites, microwave electronics, missile defense, hypersonics, propulsion and lasers is uniquely aligned with today’s National Security requirements and we remain confident in an industry leading, up and to the right organic growth trajectory.”

Financial Guidance

We are providing our second quarter 2021 guidance and reaffirming our previously provided full year 2021 Revenue, Adjusted EBITDA and Cash Flow guidance as follows:

\$M	<u>Q221</u>	<u>FY21</u>
Revenues	\$195 - \$205	\$810 - \$850
R&D	\$8 - \$9	\$31 - \$33
Operating Income	\$0 - \$3	\$30 - \$34
Depreciation	\$5 - \$6	\$20 - \$21
Amortization	\$2 - \$3	\$8
Stock Based Compensation	\$6	\$23 - \$24
Adjusted EBITDA	\$14 - \$18	\$81 - \$87
Operating Cash Flow		\$20 - \$25
Capital Expenditures		\$55 - \$60
Free Cash Flow Use		(\$30 - \$40)

The second quarter and full year 2021 estimated revenues and operating performance reflects the expected hardware, product and software mix based on current shipment and execution schedules. The second quarter and full year 2021 estimated revenues also include the impact of the recent loss of a large international training contract, which contributed approximately \$34.5 million to the Company’s full year 2020 revenues. Our full year 2021 guidance range includes our current forecasted business mix, and our most recent assumptions of the expected impact of COVID-19, of which Kratos experienced increased employee cases at the end of 2020, which continued into 2021, including in California and at certain of our drone, space & satellite and C5ISR locations, and recent supplier delays. In addition, estimated second quarter and full year 2021 Operating Income and Adjusted EBITDA reflect the expected mix of development-type contracts and expected investments, primarily in our Space and Satellite, Unmanned, C5ISR and Engine businesses, where we have received or are pursuing a number of large

opportunities, including Ground Based Strategic Deterrent (“GBSD”), Over Head Persistent Infrared (OPIR) and Skyborg.

The full year 2021 estimated Operating Cash Flow includes approximately \$10 million of planned investments in our rocket system and engine businesses for new products, including in the Hypersonic area, and to increase Kratos’ market share, as well as approximately \$5 million of the required payback of the 2020 deferred employer related payroll taxes. The 2021 capital expenditure forecast currently includes expected outlays of \$20 to \$25 million associated with the continued production of Valkyrie aircraft prior to receipt of expected customer award(s); therefore, these aircraft are currently reflected as Company-owned assets until receipt of the related customer award(s). Kratos will adjust the forecasted capital expenditure outlays and the ultimate balance sheet classification of these investments once expected customer orders and the nature of the contract terms can be determined. In addition, the capital expenditure forecast includes investments in the Company’s space and satellite business secure facilities and the Company-owned space domain awareness network, capital investments related to the recent GBSD award, and investments related to the Company’s turbine and rocket system businesses.

Management will discuss the Company’s first quarter 2021 financial results, as well as its second quarter and full year 2021 guidance on a conference call beginning at 2:00 p.m. Pacific (5:00 p.m. Eastern) today. Analysts and institutional investors may participate in the conference call by dialing (866) 393-0674, and referencing the call by ID number 5570066. The general public may access the conference call by dialing (877) 344-3935 or on the day of the event by visiting www.kratosdefense.com for a simultaneous webcast. A replay of the webcast will be available on the Kratos web site approximately two hours after the conclusion of the conference call.

About Kratos Defense & Security Solutions

Kratos Defense & Security Solutions, Inc. (NASDAQ:KTOS) develops and fields transformative, affordable technology, platforms, and systems for United States National Security related customers, allies, and commercial enterprises. Kratos is changing the way breakthrough technologies for these industries are rapidly brought to market through proven commercial and venture capital backed approaches, including proactive research, and streamlined development processes. At Kratos, affordability is a technology, and we specialize in unmanned systems, satellite communications, cyber security/warfare, microwave electronics, missile defense,

hypersonic systems, training and combat systems and next generation turbo jet and turbo fan engine development. For more information go to www.kratosdefense.com.

Notice Regarding Forward-Looking Statements

This news release contains certain forward-looking statements that involve risks and uncertainties, including, without limitation, express or implied statements concerning the Company's expectations regarding its future financial performance, including the Company's expectations for its second quarter and full year 2021 revenue, R&D, operating income, depreciation, amortization, stock based compensation expense, and Adjusted EBITDA, and full year 2021 operating cash flow, capital expenditures and other investments, and free cash flow, the Company's future growth trajectory and ability to achieve improved revenue mix and profit in certain of its business segments and the expected timing of such profit, the Company's expectation of ramp on projects and that investments in its business will result in an increase in the Company's market share and total addressable market and position the Company for significant future organic growth, profitability, cash flow and shareholder value, the Company's bid and proposal pipeline, demand for its products and services, including the Company's alignment with today's National Security requirements, ability to successfully compete in the tactical unmanned aerial system area and expected new customer awards, including the magnitude and timing of funding and expected contract awards related to the Company's Valkyrie program and other new tactical unmanned programs, performance of key contracts and programs, including the timing of production and demonstration related to certain of the Company's contracts and product offerings, the impact of the Company's restructuring efforts and cost reduction measures, including its ability to improve profitability and cash flow in certain business units as a result of these actions, benefits to be realized from the Company's net operating loss carry forwards, the availability and timing of government funding for the Company's offerings, including the strength of the future funding environment, the short-term delays that may occur as a result of Continuing Resolutions or delays in DoD budget approvals, timing of LRIP and full rate production related to the Company's unmanned aerial target system offerings, as well as the level of recurring revenues expected to be generated by these programs once they achieve full rate production, market and industry developments, and the current estimated impact of COVID-19 on our financial projections, industry, business and operations, including projected growth. Such statements are only predictions, and the Company's actual results may differ materially from the results expressed or implied by these statements. Investors are cautioned not to place undue reliance on any such forward-looking statements. All such

forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update or revise these statements, whether as a result of new information, future events or otherwise. Factors that may cause the Company's results to differ include, but are not limited to: risks to our business and financial results related to the reductions and other spending constraints imposed on the U.S. Government and our other customers, including as a result of sequestration and extended continuing resolutions, the Federal budget deficit and Federal government shut-downs; risks of adverse regulatory action or litigation; risks associated with debt leverage and cost savings and cash flow improvements expected as a result of the refinancing of our Senior Notes; risks that our cost-cutting initiatives will not provide the anticipated benefits; risks that changes, cutbacks or delays in spending by the U.S. DoD may occur, which could cause delays or cancellations of key government contracts; risks of delays to or the cancellation of our projects as a result of protest actions submitted by our competitors; risks that changes may occur in Federal government (or other applicable) procurement laws, regulations, policies and budgets; risks of the availability of government funding for the Company's products and services due to performance, cost growth, or other factors, changes in government and customer priorities and requirements (including cost-cutting initiatives, the potential deferral of awards, terminations or reduction of expenditures to respond to the priorities of Congress and the Administration, or budgetary cuts resulting from Congressional committee recommendations or automatic sequestration under the Budget Control Act of 2011, as amended); risks that the UAS and UGS markets do not experience significant growth; risks that we cannot expand our customer base or that our products do not achieve broad acceptance which could impact our ability to achieve our anticipated level of growth; risks of increases in the Federal government initiatives related to in-sourcing; risks related to security breaches, including cyber security attacks and threats or other significant disruptions of our information systems, facilities and infrastructures; risks related to our compliance with applicable contracting and procurement laws, regulations and standards; risks related to the new DoD Cybersecurity Maturity Model Certification (CMMC); risks relating to contract performance; risks related to failure of our products or services; risks associated with our subcontractors' or suppliers' failure to perform their contractual obligations, including the appearance of counterfeit or corrupt parts in our products; changes in the competitive environment (including as a result of bid protests); failure to successfully integrate acquired operations and competition in the marketplace, which could reduce revenues and profit margins; risks that potential future goodwill impairments will adversely affect our operating results; risks that anticipated tax benefits will not be realized in accordance with our expectations; risks that a

change in ownership of our stock could cause further limitation to the future utilization of our net operating losses; risks that we may be required to record valuation allowances on our net operating losses which could adversely impact our profitability and financial condition; risks that the current economic environment will adversely impact our business; currently unforeseen risks associated with COVID-19 and risks related to natural disasters or severe weather. These and other risk factors are more fully discussed in the Company's Annual Report on Form 10-K for the period ended December 27, 2020, and in our other filings made with the Securities and Exchange Commission.

Note Regarding Use of Non-GAAP Financial Measures and Other Performance Metrics

This news release contains non-GAAP financial measures, including Adjusted earnings per share (computed using income from continuing operations before income taxes, excluding income (loss) from discontinued operations, excluding income (loss) attributable to non-controlling interest, excluding depreciation, amortization of intangible assets, amortization of capitalized contract and development costs, stock-based compensation expense, acquisition and restructuring related items and other, which includes but is not limited to legal related items and foreign transaction gains and losses, less the estimated impact to income taxes) and including Adjusted EBITDA (which includes net income (loss) attributable to noncontrolling interest and excludes, among other things, losses and gains from discontinued operations, acquisition and restructuring related items, stock compensation expense, foreign transaction gains and losses, and the associated margin rates). Additional non-GAAP financial measures include Free Cash Flow from Operations computed as Cash Flow from Operations less Capital Expenditures and Adjusted EBITDA related to our KUS and KGS businesses. Kratos believes this information is useful to investors because it provides a basis for measuring the Company's available capital resources, the actual and forecasted operating performance of the Company's business and the Company's cash flow, excluding non-recurring items and non-cash items that would normally be included in the most directly comparable measures calculated and presented in accordance with GAAP. The Company's management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating the Company's actual and forecasted operating performance, capital resources and cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and investors should carefully evaluate the Company's financial results calculated in accordance with GAAP and reconciliations to those financial statements. In addition, non-GAAP financial measures as

reported by the Company may not be comparable to similarly titled amounts reported by other companies. As appropriate, the most directly comparable GAAP financial measures and information reconciling these non-GAAP financial measures to the Company's financial results prepared in accordance with GAAP are included in this news release.

Another Performance Metric the Company believes is a key performance indicator in our industry is our Book to Bill Ratio as it provides investors with a measure of the amount of bookings or contract awards as compared to the amount of revenues that have been recorded during the period, and provides an indicator of how much of the Company's backlog is being burned or utilized in a certain period. The Book to Bill Ratio is computed as the number of bookings or contract awards in the period divided by the revenues recorded for the same period. The Company believes that the rolling or last twelve months Book to Bill Ratio is meaningful since the timing of quarter to quarter bookings can vary.

Kratos Defense & Security Solutions, Inc.
Unaudited Condensed Consolidated Statements of Operations
(in millions, except per share data)

	Three Months Ended	
	March 28, 2021	March 29, 2020
Service revenues	\$ 57.3	\$ 63.6
Product sales	136.9	105.3
Total revenues	<u>194.2</u>	<u>168.9</u>
Cost of service revenues	42.5	45.2
Cost of product sales	100.7	77.9
Total costs	<u>143.2</u>	<u>123.1</u>
Gross profit - service revenues	14.8	18.4
Gross profit - product sales	36.2	27.4
Total gross profit	<u>51.0</u>	<u>45.8</u>
Selling, general and administrative expenses	35.3	31.5
Acquisition and restructuring related items	0.2	0.5
Research and development expenses	8.0	5.7
Depreciation	1.2	1.5
Amortization of intangible assets	1.4	1.9
Operating income	<u>4.9</u>	<u>4.7</u>
Interest expense, net	(5.9)	(5.4)
Other income (expense), net	0.2	(0.5)
Loss from continuing operations before income taxes	<u>(0.8)</u>	<u>(1.2)</u>
Benefit for income taxes from continuing operations	(2.7)	(1.4)
Income from continuing operations	<u>1.9</u>	<u>0.2</u>
Loss from discontinued operations, net of income taxes	—	(0.4)
Net income (loss)	<u>\$ 1.9</u>	<u>\$ (0.2)</u>
Less: Net income attributable to noncontrolling interest	—	—
Net income (loss) attributable to Kratos	<u>\$ 1.9</u>	<u>\$ (0.2)</u>
Basic income per common share attributable to Kratos:		
Income from continuing operations	\$ 0.02	\$ —
Loss from discontinued operations	—	—
Net income	<u>\$ 0.02</u>	<u>\$ —</u>
Diluted income per common share attributable to Kratos:		
Income from continuing operations	\$ 0.01	\$ —
Loss from discontinued operations	—	—
Net income	<u>\$ 0.01</u>	<u>\$ —</u>
Weighted average common shares outstanding:		
Basic weighted average common shares outstanding	<u>124.1</u>	<u>107.2</u>
Diluted weighted average common shares outstanding	<u>127.7</u>	<u>110.1</u>
Adjusted EBITDA (1)	<u>\$ 18.1</u>	<u>\$ 16.3</u>

Unaudited Reconciliation of GAAP to Non-GAAP Measures

Note: (1) Adjusted EBITDA is a non-GAAP measure defined as GAAP net income (loss) attributable to Kratos adjusted for net income (loss) attributable to noncontrolling interest, income (loss) from discontinued operations, net interest expense, provision for income taxes, depreciation and amortization expense of intangible assets, amortization of capitalized contract and development costs, stock-based compensation, acquisition and restructuring related items and other, and foreign transaction gain (loss).

Adjusted EBITDA as calculated by us may be calculated differently than Adjusted EBITDA for other companies. We have provided Adjusted EBITDA because we believe it is a commonly used measure of financial performance in comparable companies and is provided to help investors evaluate companies on a consistent basis, as well as to enhance understanding of our operating results. Adjusted EBITDA should not be construed as either an alternative to net income or as an indicator of our operating performance or an alternative to cash flows as a measure of liquidity. The adjustments to calculate this non-GAAP financial measure and the basis for such adjustments are outlined below. Please refer to the following table below that reconciles GAAP net income (loss) to Adjusted EBITDA.

The adjustments to calculate this non-GAAP financial measure, and the basis for such adjustments, are outlined below:

Interest income and interest expense, net. The Company receives interest income on investments and incurs interest expense on loans, capital leases and other financing arrangements, including the amortization of issue discounts and deferred financing costs. These amounts may vary from period to period due to changes in cash and debt balances.

Income taxes. The Company's tax expense can fluctuate materially from period to period due to tax adjustments that may not be directly related to underlying operating performance or to the current period of operations and may not necessarily reflect the impact of utilization of our NOLs.

Depreciation. The Company incurs depreciation expense (recorded in cost of revenues and in operating expenses) related to capital assets purchased, leased or constructed to support the ongoing operations of the business. The assets are recorded at cost or fair value and are depreciated over the estimated useful lives of individual assets.

Amortization of intangible assets. The Company incurs amortization of intangible expense related to acquisitions it has made. These intangible assets are valued at the time of acquisition and are amortized over the estimated useful lives.

Amortization of capitalized contract and development costs. The Company incurs amortization of previously capitalized software development and non-recurring engineering costs related to certain targets in its Unmanned Systems and ballistic missile target businesses as these units are sold.

Stock-based compensation expense. The Company incurs expense related to stock-based compensation included in its GAAP presentation of selling, general and administrative expense. Although stock-based compensation is an expense of the Company and viewed as a form of compensation, these expenses vary in amount from period to period, and are affected by market forces that are difficult to predict and are not within the control of management, such as the market price and volatility of the Company's shares, risk-free interest rates and the expected term and forfeiture rates of the awards. Management believes that exclusion of these expenses allows comparison of operating results to those of other companies that disclose non-GAAP financial measures that exclude stock-based compensation.

Foreign transaction (gain) loss. The Company incurs transaction gains and losses related to transactions with foreign customers in currencies other than the U.S. dollar. In addition, certain intercompany transactions can give rise to realized and unrealized foreign currency gains and losses.

Acquisition and transaction related items. The Company incurs transaction related costs, such as legal and accounting fees and other expenses, related to acquisitions and divestiture activities. Management believes these items are outside the normal operations of the Company's business and are not indicative of ongoing operating results.

Restructuring costs. The Company incurs restructuring costs for cost reduction actions which include employee termination costs, facility shut-down related costs and remaining lease commitment costs for excess or exited facilities. Management believes that these costs are not indicative of ongoing operating results as they are either non-recurring and/or not expected when full capacity and volumes are achieved.

Legal related items. The Company incurs costs related to pending legal settlements and other legal related matters. Management believes these items are outside the normal operations of the Company's business and are not indicative of ongoing operating results.

Adjusted EBITDA is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. The Company expects to continue to incur expenses similar to the Adjusted EBITDA financial adjustments described above, and investors should not infer from the Company's presentation of this non-GAAP financial measure that these costs are unusual, infrequent, or non-recurring.

Reconciliation of Net income (loss) attributable to Kratos to Adjusted EBITDA is as follows:

	Three Months Ended	
	March 28, 2021	March 29, 2020
Net income (loss) attributable to Kratos	\$ 1.9	\$ (0.2)
Loss from discontinued operations, net of income taxes	—	0.4
Interest expense, net	5.9	5.4
Benefit for income taxes from continuing operations	(2.7)	(1.4)
Depreciation (including cost of service revenues and product sales)	4.9	4.4
Stock-based compensation	6.2	4.7
Foreign transaction loss	0.1	0.4
Amortization of intangible assets	1.4	1.9
Amortization of capitalized contract and development costs	0.2	0.2
Acquisition and restructuring related items and other	0.2	0.5
Plus: Net income attributable to noncontrolling interest	—	—
Adjusted EBITDA	<u>\$ 18.1</u>	<u>\$ 16.3</u>

Reconciliation of acquisition and restructuring related items and other included in Adjusted EBITDA:

	Three Months Ended	
	March 28, 2021	March 29, 2020
Acquisition and transaction related items	\$ 0.2	\$ 0.4
Restructuring costs	—	0.1
	<u>\$ 0.2</u>	<u>\$ 0.5</u>

Kratos Defense & Security Solutions, Inc.
Unaudited Segment Data
(in millions)

	Three Months Ended	
	March 28, 2021	March 29, 2020
Revenues:		
Unmanned Systems	\$ 55.9	\$ 42.0
Kratos Government Solutions	138.3	126.9
Total revenues	<u>\$ 194.2</u>	<u>\$ 168.9</u>
Operating income (loss)		
Unmanned Systems	\$ 4.2	\$ 0.5
Kratos Government Solutions	7.1	9.3
Unallocated corporate expense, net	(6.4)	(5.1)
Total operating income	<u>\$ 4.9</u>	<u>\$ 4.7</u>

Note: Unallocated corporate expense, net 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, and acquisition and restructuring related items, corporate costs not allocated to the segments, legal related items, and other miscellaneous corporate activities.

Reconciliation of Segment Operating Income to Adjusted EBITDA is as follows:

	Three Months Ended	
	March 28, 2021	March 29, 2020
Unmanned Systems		
Operating income	\$ 4.2	\$ 0.5
Other income	0.1	—
Depreciation	1.6	1.6
Amortization of intangible assets	0.3	—
Amortization of capitalized contract and development costs	0.2	0.2
Adjusted EBITDA	<u>\$ 6.4</u>	<u>\$ 2.3</u>
% of revenue	11.4 %	5.5 %
Kratos Government Solutions		
Operating income	\$ 7.1	\$ 9.3
Other income (expense)	0.2	(0.1)
Depreciation	3.3	2.8
Amortization of intangible assets	1.1	1.9
Acquisition and restructuring related items and other	—	0.1
Adjusted EBITDA	<u>\$ 11.7</u>	<u>\$ 14.0</u>
% of revenue	8.5 %	11.0 %
Total Adjusted EBITDA	<u>\$ 18.1</u>	<u>\$ 16.3</u>
% of revenue	9.3 %	9.7 %

Kratos Defense & Security Solutions, Inc.
Unaudited Condensed Consolidated Balance Sheets
(in millions)

	March 28, 2021	December 27, 2020
Assets		
Current assets:		
Cash and cash equivalents	\$ 383.6	\$ 380.8
Restricted cash	—	0.7
Accounts receivable, net	264.6	272.3
Inventoried costs	85.7	81.2
Prepaid expenses	13.5	12.0
Other current assets	21.2	17.8
Total current assets	768.6	764.8
Property, plant and equipment, net	146.9	143.8
Operating lease right-of-use assets	40.8	42.9
Goodwill	483.7	483.9
Intangible assets, net	41.6	43.0
Other assets	83.6	84.4
Total assets	<u>\$ 1,565.2</u>	<u>\$ 1,562.8</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 51.9	\$ 55.4
Accrued expenses	32.0	34.7
Accrued compensation	54.2	48.1
Accrued interest	6.4	1.5
Billings in excess of costs and earnings on uncompleted contracts	41.1	34.0
Current portion of operating lease liabilities	8.9	8.9
Other current liabilities	13.0	11.9
Other current liabilities of discontinued operations	2.7	3.1
Total current liabilities	210.2	197.6
Long-term debt	300.3	301.0
Operating lease liabilities, net of current portion	36.4	38.6
Other long-term liabilities	72.0	83.0
Other long-term liabilities of discontinued operations	2.5	2.5
Total liabilities	621.4	622.7
Commitments and contingencies		
Redeemable noncontrolling interest	14.8	14.8
Stockholders' equity:		
Additional paid-in capital	1,557.9	1,556.3
Accumulated other comprehensive loss	1.6	1.4
Accumulated deficit	(630.5)	(632.4)
Total Kratos stockholders' equity	929.0	925.3
Total liabilities and stockholders' equity	<u>\$ 1,565.2</u>	<u>\$ 1,562.8</u>

Kratos Defense & Security Solutions, Inc.
Unaudited Condensed Consolidated Statements of Cash Flows
(in millions)

	Three Months Ended	
	March 28, 2021	March 29, 2020
Operating activities:		
Net income (loss)	\$ 1.9	\$ (0.2)
Less: loss from discontinued operations	—	(0.4)
Income from continuing operations	1.9	0.2
Adjustments to reconcile income from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	6.3	6.3
Amortization of lease right-of-use-assets	2.2	2.9
Deferred income taxes	0.1	(1.0)
Stock-based compensation	6.2	4.7
Amortization of deferred financing costs	0.2	0.2
Provision for doubtful accounts	(0.1)	0.3
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	9.8	6.6
Unbilled receivables	(1.8)	(1.5)
Inventoried costs	(4.2)	(1.5)
Prepaid expenses and other assets	(2.0)	(6.8)
Operating lease liabilities	(2.2)	(3.4)
Accounts payable	(2.0)	(9.6)
Accrued compensation	6.2	3.7
Accrued expenses	(2.7)	(4.4)
Accrued interest	4.9	4.9
Billings in excess of costs and earnings on uncompleted contracts	7.1	3.4
Income tax receivable and payable	(2.2)	(0.9)
Other liabilities	(5.0)	(0.1)
Net cash provided by operating activities from continuing operations	22.7	4.0
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(5.1)	(14.2)
Capital expenditures	(9.6)	(6.4)
Net cash used in investing activities from continuing operations	(14.7)	(20.6)
Financing activities:		
Payments under finance leases	(0.2)	(0.1)
Payments of employee taxes withheld from share-based awards	(7.1)	(1.2)
Proceeds from shares issued under equity plans	2.5	2.6
Net cash provided by (used in) financing activities from continuing operations	(4.8)	1.3
Net cash flows from continuing operations	3.2	(15.3)
Net operating cash flows of discontinued operations	(0.5)	1.3
Effect of exchange rate changes on cash and cash equivalents	(0.6)	—
Net increase (decrease) in cash, cash equivalents and restricted cash	2.1	(14.0)
Cash, cash equivalents and restricted cash at beginning of period	381.5	172.6
Cash, cash equivalents and restricted cash at end of period	\$ 383.6	\$ 158.6

Kratos Defense & Security Solutions, Inc.
Unaudited Non-GAAP Measures
Computation of Adjusted Earnings Per Share
(in millions, except per share data)

Adjusted income from continuing operations and adjusted income from continuing operations per diluted common share (Adjusted EPS) are non-GAAP measures for reporting financial performance and exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. Management believes that exclusion of these items assists in providing a more complete understanding of the Company's underlying continuing operations results and trends and allows for comparability with our peer company index and industry. The Company uses these measures along with the corresponding GAAP financial measures to manage the Company's business and to evaluate its performance compared to prior periods and the marketplace. The Company defines adjusted income from continuing operations before amortization of intangible assets, depreciation, stock-based compensation, foreign transaction gain/loss, and acquisition and restructuring related items and other. The estimated impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision, and excludes the impact of discrete items, including transaction related expenses and release of valuation allowance, or benefit related to the add-backs.* Adjusted EPS expresses adjusted income on a per share basis using weighted average diluted shares outstanding.

The following table reconciles the most directly comparable GAAP financial measures to the non-GAAP financial measures.

	Three Months Ended	
	March 28, 2021	March 29, 2020
Net income (loss) attributable to Kratos	\$ 1.9	\$ (0.2)
Less: GAAP benefit for income taxes	(2.7)	(1.4)
Less: Net income attributable to noncontrolling interest	—	—
Less: Loss from discontinued operations, net of income taxes	—	0.4
Loss from continuing operations before taxes	(0.8)	(1.2)
Add: Amortization of intangible assets	1.4	1.9
Add: Amortization of capitalized contract and development costs	0.2	0.2
Add: Depreciation	4.9	4.4
Add: Stock-based compensation	6.2	4.7
Add: Foreign transaction loss	0.1	0.4
Add: Acquisition and restructuring related items and other	0.2	0.5
Non-GAAP Adjusted income from continuing operations before income taxes	12.2	10.9
Income taxes on Non-GAAP measure Adjusted income from continuing operations*	4.5	4.3
Non-GAAP Adjusted net income	\$ 7.7	\$ 6.6
Diluted earnings per common share	\$ 0.01	\$ —
Less: GAAP benefit for income taxes	(0.02)	(0.01)
Less: Net income attributable to noncontrolling interest	—	—
Less: Loss from discontinued operations, net of income taxes	—	—
Add: Amortization of intangible assets	0.01	0.02
Add: Amortization of capitalized contract and development costs	—	—
Add: Depreciation	0.04	0.04
Add: Stock-based compensation	0.05	0.04
Add: Foreign transaction loss	—	—
Add: Acquisition and restructuring related items and other	—	0.01
Income taxes on Non-GAAP measure Adjusted income from continuing operations*	(0.03)	(0.04)
Adjusted income from continuing operations per diluted common share	\$ 0.06	\$ 0.06
Weighted average diluted common shares outstanding	127.7	110.1

*The impact to income taxes is calculated by recasting income before income taxes to include the add-backs involved in determining Adjusted income from continuing operations before income taxes and recalculating the income tax provision (benefit), including current and deferred income taxes, using the Adjusted income from continuing operations before income taxes. The recalculation also adjusts for any discrete tax expense, including transaction related expenses and the release of valuation allowance, or benefit related to the add-backs.

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