Use these links to rapidly review the document
TABLE OF CONTENTS

Table of Contents

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 28, 2010

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

Commission file number 0-27231

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**13-3818604**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4820 Eastgate Mall
San Diego, CA 92121
(858) 812-7300
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

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 o

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

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

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

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

As of April 23, 2010 15,910,361 shares of the registrant's common stock were outstanding.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 28, 2010
INDEX

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)

(Unaudited)

	December 27, 2009	March 28, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 9.9	$ 6.3
Restricted cash	0.4	0.4
Accounts receivable, net	78.6	93.6
Income taxes receivable	1.0	0.7
Prepaid expenses	2.2	6.1
Other current assets	6.7	6.4
Total current assets	98.8	113.5
Property and equipment, net	4.3	4.0
Goodwill	110.2	110.2
Other intangibles, net	26.5	25.2
Other assets	1.8	3.0
Total assets	$ 241.6	$ 255.9
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 18.8	$ 19.2
Accrued expenses	9.0	8.4
Accrued compensation	15.7	18.6
Billings in excess of costs and earnings on uncompleted contracts	5.4	19.6
Current portion of long-term debt	4.5	6.2
Other current liabilities	8.3	6.0
Total current liabilities	61.7	78.0
Long-term debt, net of current portion	50.9	48.3
Other long-term liabilities	4.1	3.4
Total liabilities	116.7	129.7
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized Series B Convertible Preferred Stock, $.001 par value, 10,000 shares outstanding at December 27, 2009 and March 28, 2010 (liquidation preference $5.0 million at March 28, 2010)	—	—
Common stock, $.001 par value, 195,000,000 shares authorized; 15,784,591 and 15,887,820 shares issued and outstanding at December 27, 2009 and March 28, 2010, respectively	—	—
Additional paid-in capital	523.0	524.1
Accumulated deficit	(398.1)	(397.9)
Total stockholders' equity	124.9	126.2
Total liabilities and stockholders' equity	$ 241.6	$ 255.9

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

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(Unaudited)

	Three months ended	
	March 29, 2009	March 28, 2010
Revenues	$ 82.6	$ 68.7
Cost of revenues	65.4	52.2
Gross profit	17.2	16.5
Selling, general and administrative expenses	14.2	12.3
Research and development expenses	0.4	0.6
Impairment of goodwill	41.3	—
Operating income (loss) from continuing operations	(38.7)	3.6
Other income (expense):		
Interest expense, net	(2.5)	(3.9)
Other income	—	0.2
Total other expense, net	(2.5)	(3.7)
Loss from continuing operations before income taxes	(41.2)	(0.1)
Provision for income taxes from continuing operations	0.3	0.3
Loss from continuing operations	(41.5)	(0.4)
Net income (loss) from discontinued operations	(0.6)	0.6
Net income (loss)	$ (42.1)	$ 0.2
Basic income (loss) per common share:		
Loss from continuing operations	$ (3.24)	$ (0.02)
Net income (loss) from discontinued operations	(0.05)	0.04
Net income (loss) per common share:	$ (3.29)	$ 0.02
Diluted loss per common share:		
Loss from continuing operations	$ (3.24)	$ (0.02)
Net income (loss) from discontinued operations	(0.05)	0.04
Net income (loss) per common share:	$ (3.29)	$ 0.02
Weighted average common shares outstanding:		
Basic	12.8	15.9
Diluted	12.8	15.9

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, 2009	Three months ended March 28, 2010
Operating activities:		
Net income (loss)	$ (42.1)	$ 0.2
Less: Income (loss) from discontinued operations	(0.6)	0.6
Loss from continuing operations	(41.5)	(0.4)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities from continuing operations:		
Depreciation and amortization	2.1	1.9
Goodwill impairment charges	41.3	—
Stock-based compensation	0.4	0.4
Mark to market on swaps	—	(0.2)
Change in accrual for unused office space	0.6	(0.4)
Amortization and write-off of deferred financing costs	0.2	2.3
Provision for doubtful accounts	0.1	0.1
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	8.0	(15.1)
Prepaid expenses and other assets	2.7	(5.7)
Accounts payable	3.0	0.3
Accrued compensation	1.2	3.0
Accrued expenses	(4.9)	(0.6)
Billings in excess of costs and earnings on uncompleted contracts	(3.6)	14.2
Income tax receivable and payable	(0.2)	0.3
Other liabilities	(2.3)	(0.8)
Net cash provided by (used in) operating activities from continuing operations	7.1	(0.7)
Investing activities:		
Cash paid for contingent acquisition consideration	(3.0)	—
Cash paid for acquisitions, net of cash acquired	(0.5)	—
Proceeds/(payments) from the disposition of discontinued operations	(1.1)	—
Other, net	(0.1)	(0.3)
Net cash used in investing activities from continuing operations	(4.7)	(0.3)
Financing activities:		
Borrowings under credit facility	2.0	57.9
Repayment under credit facility	(1.3)	(58.8)
Payments of subordinated debt	(2.1)	—
Proceeds from the issuance of common stock	—	0.6
Other	0.1	(1.9)
Net cash used in financing activities from continuing operations	(1.3)	(2.2)
Net cash flows of continuing operations	1.1	(3.2)
Net cash flows of discontinued operations	(1.5)	(0.4)
Net decrease in cash and cash equivalents	(0.4)	(3.6)
Cash and cash equivalents at beginning of period	3.7	9.9
Cash and cash equivalents at end of period	$ 3.3	$ 6.3

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

(a) Basis of Presentation

The information as of and for the three months ended March 29, 2009 and March 28, 2010 is unaudited. The condensed consolidated balance sheet as of December 27, 2009 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 United States of America. 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 year ended December 27, 2009, filed on Form 10-K on March 11, 2010, with the United States Securities and Exchange Commission ("SEC"). 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 consolidated financial statements include the accounts of Kratos and its wholly-owned subsidiaries for which all inter-company transactions have been eliminated in consolidation. Kratos and its subsidiaries are collectively referred to herein as the "Company."

(c) Fiscal Year

The Company has a 52/53 week fiscal year ending on the last Sunday of the year, with interim fiscal periods ending on the last Sunday of the last month of each calendar quarter. The three months ended March 28, 2010 and March 29, 2009 both consisted of 13 weeks. There are 52 calendar weeks in the fiscal years ending on December 26, 2010 and December 27, 2009.

(d) Reverse Stock Split

On September 10, 2009, the Company completed a 1-for-10 reverse split of its common stock. All common stock, stock options, and warrants to purchase common stock and earnings per share amounts have been retroactively restated as if the reverse stock split occurred at the beginning of the periods presented.

(e) Inventory

Inventories which are comprised primarily of supplies including parts and materials are stated at the lower of cost or market. The Company regularly reviews inventory quantities on hand, future purchase commitments with its suppliers, and the estimated utility of its inventory. If the Company review indicates a reduction in utility below carrying value, it reduces its inventory to a new cost basis. As of December 27, 2009 and March 28, 2010, the Company had $1.9 million and $2.3 million, respectively, of inventories which were reflected in other current assets on the condensed consolidated balance sheets.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 1. Summary of Significant Accounting Policies (Continued)

(f) Accounting Policies

There have been no changes in the Company's significant accounting policies for the three months ended March 28, 2010 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 27, 2009 as filed with the SEC on March 11, 2010 with the following exception.

In January 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-06, *Improving Disclosures about Fair Value Measurements* , which, among other things, amends *Accounting Standards Topic 820 Fair Value Measurements and Disclosures (ASC 820)* to require entities to separately present purchases, sales, issuances, and settlements in their reconciliation of Level 3 fair value measurements (i.e., to present such items on a gross basis rather than on a net basis), and which clarifies existing disclosure requirements provided by ASC 820 regarding the level of disaggregation and the inputs and valuation techniques used to measure fair value for measurements that fall within either Level 2 or Level 3 of the fair value hierarchy. ASU No. 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company's adoption of this standard had no impact on our consolidated financial position, results of operations or cash flows.

(g) Reclassifications

Certain amounts in the March 29, 2009 condensed consolidated statement of cash flows have been reclassified to conform to the March 28, 2010 presentation.

(h) Concentrations and Uncertainties

The Company maintains cash balances at various financial institutions and such balances commonly exceed the $100,000 insured (temporarily increased to $250,000 through December 31, 2013) amount by the Federal Deposit Insurance Corporation. The Company has not experienced any losses in such accounts and management believes that the Company is not exposed to any significant credit risk with respect to such cash and cash equivalents.

Financial instruments, which subject the Company to potential concentrations of credit risk, consist principally of the Company's billed and unbilled accounts receivable. The Company's accounts receivable result from sales to customers within the federal government, state and local agencies and with commercial customers in various industries. The Company performs ongoing credit evaluations of its commercial customers. Credit is extended based on evaluation of the customer's financial condition. Collateral is not required. The accounts receivable are recorded at invoiced amount and do not bear interest. See Note 10 for a discussion of our significant customers.

As of March 28, 2010, the Company has $53.5 million of debt outstanding under its Credit Facility with debt service requirements of $3.5 million, excluding interest, in 2010. The Company intends to fund its cash requirements with cash flows from operating activities and borrowings under the its Credit Facility, and management believes these sources of liquidity should be sufficient to meet the Company's cash needs for at least the next 12 months. The Company's quarterly and annual operating results have

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 1. Summary of Significant Accounting Policies (Continued)

fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to its control. If the conditions in its industry deteriorate or its customers cancel or postpone projects or if the Company is unable to sufficiently increase its revenues or further reduce its expenses, the Company may experience, in the future, a significant long-term negative impact to its financial results and cash flows from operations. In such a situation, the Company could fall out of compliance with its financial and other covenants which, if not waived, could limit its liquidity and capital resources.

Note 2. Goodwill and Other Intangible Assets

Goodwill

The Company performs its annual impairment test for goodwill in accordance with Financial Accounting Standards Board Accounting Standards Codification *(FASB ASC) Topic 350 Intangibles—Goodwill and Other* as of the last day of the fiscal year or when evidence of potential impairment exists.

The Company assesses goodwill for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment, referred to as a component. The Company determines its reporting units by first identifying its operating segments, and then assessing whether any components of these segments constitute a business for which discrete financial information is available and where segment management regularly reviews the operating results of that component. The Company aggregates components within an operating segment that have similar economic characteristics. For the annual and, if necessary, interim impairment assessment the Company identified its reporting units to be its operating segments which are Kratos Government Solutions and Public Safety and Security.

The Company's testing approach utilizes a discounted cash flow analysis corroborated by comparative market multiples to determine the fair value of its businesses for comparison to their corresponding book values because there are no observable inputs available (Level 3 hierarchy as defined by *ASC Topic 820*). The Company also considers its market capitalization based upon an average of the stock price prior to and subsequent to the date the analysis is performed and reconciles the fair value of the Company's reporting units to the Company's market capitalization assuming a control premium. If the book value exceeds the estimated fair value for a business, a potential impairment is indicated and *ASC Topic 350,* prescribes the approach for determining the impairment amount, if any.

Given the significant decline in the stock market in general and specifically the Company's stock price and market capitalization in 2009, which declined 39% from an average stock price of $12.90 as of December 28, 2008 to $7.80 as of February 28, 2009, the Company performed an impairment test for goodwill in accordance with *ASC Topic 350* as of February 28, 2009. The test indicated that the book value for the Kratos Government Solutions (KGS) segment exceeded the fair values of these businesses and resulted in the Company recording a charge totaling $41.3 million in its KGS segment in the first quarter of 2009, for the impairment of goodwill. The impairment charge was primarily driven by adverse equity market conditions that caused a decrease in current market multiples and the Company's average stock price as of February 28, 2009, compared with the test performed as of December 28, 2008. The Company's forecasts of growth rates and operating margins had not changed as of February 28, 2009 as compared to the forecasts which were used as of December 28, 2008. The

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 2. Goodwill and Other Intangible Assets (Continued)

Company reconciles the fair value of its reporting units which is calculated using the income approach to the Company's market capitalization. As a result of this reconciliation, it was noted that investors were requiring a higher rate of return, and therefore, the discount factor which is based upon an estimated market participant weighted average cost of capital (WACC) increased 300 basis points from 14% in the Company's year end impairment test in 2008 as compared to 17% in the Company's 2009 first quarter interim impairment test. This change was the key factor contributing to the $41.3 million goodwill impairment charge that was recorded in the first quarter of 2009.

The 2009 annual test did not result in any impairment charge as there was an increase in current market multiples and market capitalization as of December 27, 2009 compared to the 2008 annual test. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value, the Company will evaluate goodwill for impairment between annual tests in accordance with *ASC Topic 350.*

Purchased Intangible Assets

The following tables set forth information for finite-life intangible assets subject to amortization (in millions):

	As of December 27, 2009			As of March 28, 2010		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets						
Customer relationships	$ 22.1	$ (6.5)	$ 15.6	$ 22.1	$ (7.1)	$ 15.0
Contracts and backlog	17.4	(9.8)	7.6	17.4	(10.5)	6.9
Developed technology	3.1	(0.5)	2.6	3.1	(0.5)	2.6
Trade names	1.3	(0.6)	0.7	1.3	(0.6)	0.7
Total	$ 43.9	$ (17.4)	$ 26.5	$ 43.9	$ (18.7)	$ 25.2

Consolidated amortization expense related to intangible assets subject to amortization was $1.5 million and $1.3 million for the three months ended March 29, 2009 and March 28, 2010, respectively.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 3. Stockholders' Equity

A summary of the changes in Stockholders' Equity for the periods ended March 29, 2009 and March 28, 2010 is provided below (in millions):

	Three Months Ended March 29, 2009	Three Months Ended March 28, 2010
Stockholders' equity at beginning of period	$ 146.9	$ 124.9
Stock-based compensation	0.4	0.4
Acquisition adjustment	(0.3)	—
ESPP Plan and RSU settlement in cash	0.1	0.4
Exercise of stock options/warrants	—	0.3
Convertible debt conversion expense	0.1	—
Net income (loss)	(42.1)	0.2
Stockholders' equity at end of period	$ 105.1	$ 126.2

The Company has two classes of outstanding stock, Series B Convertible Preferred Stock and common stock. There was no issuance, redemption or conversion of the Series B Convertible Preferred Stock for the three months ended March 29, 2009 and March 28, 2010. Common stock issued by the Company for the three months ended March 29, 2009, and March 28, 2010, was as follows (in millions):

	Three Months Ended March 29, 2009	Three Months Ended March 28, 2010
Shares outstanding at beginning of the period	12.8	15.8
Stock issued for employee stock purchase plan, stock options and RSUs exercised	—	0.1
Shares outstanding at end of the period	12.8	15.9

Note 4. Net Income (Loss) Per Common Share

The Company calculates net income (loss) per share in accordance with *ASC Topic 260 Earning Per Share* (Topic 260). Under Topic 260, basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. Diluted net income (loss) per common share reflects the effects of potentially dilutive securities (in millions).

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 4. Net Income (Loss) Per Common Share (Continued)

The following shares were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

(In millions)	Three Months Ended March 29, 2009	Three Months Ended March 28, 2010
Shares from stock options and awards	0.2	1.2
Shares from preferred stock	0.1	0.1
Shares of contingently issuable common stock	0.3	—
Shares of common stock from convertible debt	0.1	0.1

Note 5. Income Taxes

As of December 27, 2009, the Company had $12.6 million of unrecognized tax benefits that if recognized would affect the effective tax rate, subject to possible offset by an increase in the valuation allowance. During the three months ended March 28, 2010, this amount was reduced by $0.5 million relating to the expiration of statutes of limitations resulting in unrecognized tax benefits at March 28, 2010 of $12.1 million. The reduction in unrecognized tax benefits was recorded as a tax benefit from discontinued operations of $0.5 million.

The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. There were no material expense amounts recorded during the three-month periods ended March 29, 2009 and March 28, 2010, respectively. The Company recorded a benefit for interest and penalties related to the reversal of prior positions of $0.2 and $0.3 million for the three month periods ended March 29, 2009 and March 28, 2010, respectively.

The Company believes that it is reasonably possible that as much as $3.0 million of the liabilities for uncertain tax positions will expire within 12 months of March 28, 2010 due to the expiration of various applicable statutes of limitations and possible settlement of a pending income tax refund claim.

The Company is subject to taxation in the U.S. and various state tax jurisdictions. The Company's tax years for 2000 and forward are subject to examination by the U.S. and state tax authorities due to the existence of net operating loss carryforwards. Generally, the Company's tax years for 2002 and forward are subject to examination by various foreign tax authorities.

In assessing the realizability of deferred tax assets, management considers on a periodic basis whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. As such, management has determined that it is appropriate to maintain a full valuation allowance against its deferred tax assets, with the exception of an amount equal to its deferred tax liabilities which can be expected to reverse. Management will continue to evaluate the necessity to maintain a valuation allowance against its net deferred tax asset.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5. Income Taxes (Continued)

A reconciliation of the total income tax provision to the amount computed by applying the statutory federal income tax rate of 35% to loss from continuing operations before income tax provision for the three months ended March 29, 2009 and March 28, 2010 is as follows (in millions):

	For the Three Months Ended	
	March 29, 2009	March 28, 2010
Income tax provision (benefit) at federal statutory rate	$ (14.7)	$ 0.0
State taxes, net of federal tax benefit and valuation allowance	0.3	0.3
Nondeductible goodwill impairment charges	14.6	—
Increase in federal valuation allowance	0.1	—
Total	$ 0.3	$ 0.3

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. In general, an ownership change occurs when shareholders owning 5% or more of a "loss corporation" (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation's value (which may be modified for certain recent increases to capital) at the time of the ownership change times the greater of the long-term tax-exempt rate determined by the IRS in the month of the ownership change or the two preceding months. As of March 28, 2010, we believe that an "ownership change" may have occurred which could limit the utilization of the loss carryforwards. We are currently evaluating the extent of the limitation on our annual utilization of the net operating loss carryforwards. Any potential limitation would not impact the income tax provision for the quarter ended March 28, 2010. In addition, future equity offerings on acquisitions that have equity as a component of the purchase price could result in an "ownership change". If and when an "ownership change" occurs, utilization of the net operating loss or other tax attributes may be further limited.

Note 6. Discontinued Operations

On July 7, 2007, the Company entered into a definitive agreement with an affiliate of Platinum Equity to sell the Company's wireless deployment business. Total consideration for the acquisition was $24.0 million including $18.0 million in cash at closing, subject to post closing working capital adjustments, and an aggregate $6.0 million in a three-year earn-out arrangement through 2010.

On July 16, 2008, the Company came to an agreement with Platinum Equity on a working capital adjustment of $5.0 million. In connection with that resolution, the earn-out arrangement was terminated. Payments of $1.0 million were made in August and September of 2008, with an additional $0.5 million paid in December 2008. In March of 2009, the Company paid $1.5 million of the working capital adjustment. On August 4, 2009, the Company paid $1.3 million in full settlement of all amounts due to Platinum Equity.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 6. Discontinued Operations (Continued)

During the due diligence process related to the acquisition of SYS, senior management identified three business units of SYS which were non-core to Kratos' base national security and public security businesses. In accordance with *ASC Topic 205 Presentation of Financial Statements*, these business units were classified as held for sale and reported in discontinued operations. In the quarter ended March 29, 2009, all three of the businesses were sold for an aggregate cash consideration of approximately $0.4 million.

In addition, the plan to sell these businesses included a comprehensive assessment of personnel, relocation of personnel, facility consolidation and exit strategies for certain lines of business. The plan provided for approximately $2.0 million of restructuring costs associated with personnel, and additional costs of $0.6 million for facilities consolidation. The restructuring costs are primarily associated with the businesses sold and are accounted for in discontinued operations in the accompanying Condensed Consolidated Financial Statements. As of March 28, 2010, approximately $1.4 million of severance costs and $0.5 million of facilities costs have been paid. The remaining liabilities for severance and facilities are $0.5 million and $0.1 million, respectively, and are included in other current liabilities in the Condensed Consolidated Balance Sheet. The following table shows a reconciliation of the beginning accrual to the remaining balance as of March 28, 2010 (in millions):

	Severance	Lease Termination	Total
Original accrual recorded in 2008	$ 2.0	$ 0.6	$ 2.6
Payments in 2008	(0.2)	(0.4)	(0.6)
Payments in 2009	(0.9)	(0.1)	(1.0)
Payments in 2010	(0.3)	—	(0.3)
Adjustments	(0.1)	—	(0.1)
Balance March 28, 2010	$ 0.5	$ 0.1	$ 0.6

On June 24, 2009, as a result of the continued operating losses in the Southeast division of the Company's Public Safety and Security segment, the Company's Board of Directors approved a plan to sell and dispose of the Southeast division. In accordance with *ASC Topic 205 Presentation of Financial Statements*, this business unit was classified as held for sale and reported in discontinued operations in the accompanying Condensed Consolidated Financial Statements. The Company recorded a $2.0 million impairment charge in the second quarter of 2009 related to management's estimate of the fair value of the business.

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

	For the Three Months Ended	
	March 29, 2009	March 28, 2010
Revenue	$ 1.6	$ 1.1
Net loss before taxes	(1.1)	(0.2)
Benefit for income taxes	(0.5)	(0.8)
Net income (loss) after taxes	$ (0.6)	$ 0.6

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 6. Discontinued Operations (Continued)

The benefit for income taxes for the three months ended March 29, 2009 and March 28, 2010 was primarily due to the expiration of the statute of limitations for certain foreign tax contingencies related to our discontinued wireless services business.

Following is a summary of the assets and liabilities of discontinued operations which are in other current assets, other assets, other current liabilities and other long-term liabilities in the accompanying condensed consolidated balance sheets as of December 27, 2009 and March 28, 2010 (in millions):

	December 27, 2009	March 28, 2010
Cash	$ —	$ 0.1
Accounts receivable, net	2.4	2.1
Other current assets	(0.4)	0.6
Impairment allowance	—	(1.2)
Current assets of discontinued operations	$ 2.0	$ 1.6
Non-current assets of discontinued operations	$ 0.4	$ 0.4
Accounts payable	$ 0.5	$ 0.4
Accrued expenses	2.8	2.3
Unrecognized tax benefits	1.1	0.5
Other current liabilities	0.3	0.3
Current liabilities of discontinued operations	$ 4.7	$ 3.5
Non-current unrecognized tax benefits	$ 0.4	$ 0.2
Other non-current liabilities	0.2	0.1
Non-current liabilities of discontinued operations	$ 0.6	$ 0.3

Note 7. Debt

(a) Credit Agreement

During the fiscal years 2008 and 2009 and through March 3, 2010 the Company had a credit facility of $85.0 million (the "Prior Credit Facility") with KeyBank National Association ("KeyBank") as administrative agent. This Prior Credit Facility provided for two term loans consisting of a first lien term note of $50.0 million and a second lien term note of $10.0 million, as well as a first lien $25.0 million revolving line of credit, and was collateralized by the assets of the Company and its subsidiaries. KeyBank held the revolving line of credit and the second lien term note. Field Point III, Ltd. and SPF CDO I, Ltd., both affiliates of Silverpoint Capital LP ("Silverpoint"), held the first lien term note. The $10.0 million term loan had a five and one half-year term with principal payments of $25,000 required quarterly from March 31, 2008 through March 31, 2013 with the final balance of $9.5 million due on June 30, 2013. The $50.0 million term loan had a five-year term with principal payments of $0.6 million required quarterly beginning on March 31, 2008, $1.3 million in 2009, $2.5 million in 2010, and $4.1 million in 2011 and 2012. The term loans had a provision which stated that once the full amount of the note has been borrowed, the notes could not be paid down and reborrowed again. The revolving line of credit had a five-year term which expired on December 31,

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 7. Debt (Continued)

2012. All loans under the credit facility had an interest rate equal to a base rate defined as a fluctuating rate per annum equal to the higher of (a) the Federal Funds Rate plus 0.5% and (b) the rate of interest in effect for such day as publicly announced from time to time by KeyBank as its "prime rate" plus a margin for the term loans of 6.5% to 7.5% and a margin of 1.0% to 3.25% on the revolving line of credit. All rates were subject to a LIBOR floor of 4.25% and a "prime rate" floor of 5.25%.

On March 3, 2010, the Company entered into a new senior secured credit agreement (the "Credit Agreement") with Key Bank National Association as Administrative Agent and Lender for a new credit facility (the "Credit Facility") in the aggregate principal amount of $60.0 million. The Credit Facility is comprised of (i) a $35.0 million term loan facility and (ii) a $25.0 million revolving line of credit. Bank of America, N.A., is Syndication Agent and Lender, and KeyBanc Capital Markets and Banc of America Securities, LLC acted as Co-Lead Arrangers and Book Runners. Pursuant to the terms of the Credit Agreement, the term loan and revolving credit facility are both three year facilities. The proceeds under the Credit Agreement may be used for general corporate purposes including refinancing of existing bank debt, working capital and acquisitions.

Also on March 3, 2010, the Company entered into two Payoff Letters with KeyBank terminating the Prior Credit Facility. In connection with the refinancing of the Prior Credit Facility, the Company borrowed $57.5 million under the New Credit Facility. Approximately $25.0 million of the proceeds were used to pay in full the remaining balance on the first lien term loan under the Prior Credit Facility held by Silverpoint, at par, with no prepayment penalties, pursuant to a Settlement Agreement that the Company entered into with Silverpoint in October 2009. As a result of the refinance, the Company recorded an interest charge of approximately $2.2 million in the first quarter of 2010 relating to the write-off of previously deferred financing costs.

The Company may borrow funds under the Credit Agreement (i) at the base rate, determined as the greater of (A) the prime loan rate announced by KeyBank and (B) the sum of the weighted average overnight federal funds rate published by the Federal Reserve Bank plus 50 basis points, or (ii) at the offshore rate, determined by the Administrative Agent as the offered rate for U.S. dollar deposits in the approximate amount of the requested loan and having a maturity comparable to such interest period, which rate appears (A) on the British Bankers' Association internet web page (http://www.bba.org.uk/public/libor/), or via (B) Reuters (BBALIBORS), Bloomberg, Moneyline Telerate (Page 3750) or any other information provider of the British Bankers' Association daily Libor rates as of 11:00 A.M., London time, on the date which is the second day on which banks are open for interbank deposits in London prior to the commencement of such interest period; as adjusted for reserve requirements and rounded upwards if necessary to the next higher 1/100%. Borrowings are subject to a Libor floor rate of 2.75% or a Base Rate floor of 5.25%. Term loan borrowings and revolver borrowings may be subject to an additional 450 basis points and 375 basis points, respectively, based on the Company's credit ratings. In addition, the Company must pay a fee ranging from 30 basis points per annum to 75 points per annum, based on its credit ratings, on the daily amount of the unused commitments under the revolving credit facility. The initial interest rate under the Credit Facility for the term loan is 7.25%, compared to the approximate 11.75% interest rate under the Prior Credit Facility term loan. The initial interest under the Credit Facility for the revolving line of credit is

Note 7. Debt (Continued)

approximately 6.50%, compared to the approximate 7.00% rate under the Prior Credit facility revolving line of credit.

Pursuant to certain terms of the Credit Agreement, in certain instances the Company is required to prepay outstanding indebtedness prior to its stated maturity date. Specifically, certain non-recurring cash inflows such as proceeds from asset sales, insurance recoveries, and equity offerings as well as certain annual operating cash flows may have to be used to pay down indebtedness and may not be reborrowed.

The terms of the Credit Agreement include customary representations and warranties, as well as reporting and financial covenants, customary for financings of this type. The financial covenants include a quarterly maximum leverage ratio of 2.75 through December 31, 2010, reducing to 2.50 thereafter, a quarterly fixed charge coverage ratio of 1.10 through December 31, 2010, with an increase to 1.25 thereafter. In addition, the covenants include a monthly asset coverage ratio of Eligible Billed Accounts Receivables, as defined, of 1.25 times for outstanding balances of the revolving credit facility.

The Credit Agreement provides for the ability to increase the revolving line of credit facility by up to $15.0 million to a total not to exceed $40.0 million, in the event that the Administrative Agent elects to secure additional commitments from Existing Lenders or from New Lenders.

As of March 28, 2010, the Company's outstanding balance on the Credit Agreement was $53.5 million with a weighted average interest rate of 6.99%. As of March 28, 2010 the unused line of credit under the revolving line of credit, net of $1.4 million in outstanding letters of credit, was approximately $5.1 million. The only restriction on the use of these funds is that the Company must be in compliance with covenants of this credit agreement. The Company was in compliance with all covenants under the Credit Agreement as of March 28, 2010.

(b) Subordinated Notes

As of March 28, 2010, the Company had outstanding convertible notes payable totaling $1.0 million which were acquired as a result of the SYS acquisition and are due on August 14, 2010. $25,000 of the convertible notes are payable to a related party. The balance of the outstanding notes is convertible into common stock of Kratos at $10.20 per share or approximately 94,000 shares.

Note 8. Fair Value Measurements

ASC Topic 820 Fair Value Measurements and Disclosures (Topic 820) defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. *Topic 820 is* applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements.

The fair value hierarchy established in *Topic 820* prioritizes the inputs used in valuation techniques into three levels as follows:

Level 1—Observable inputs—quoted prices in active markets for identical assets and liabilities;

Note 8. Fair Value Measurements (Continued)

Level 2—Observable inputs other than the quoted prices in active markets for identical assets and liabilities—includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets; and

Level 3—Unobservable inputs—includes amounts derived from valuation models where one or more significant inputs are unobservable and require the Company to develop relevant assumptions.

The following table presents assets and liabilities measured and recorded at fair value on the Company's Condensed Consolidated Balance Sheet on a recurring basis and their level within the fair value hierarchy as of December 27, 2009 and March 28, 2010:

Derivative Liabilities (Interest Rate Swaps)

	Total Carrying Value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
December 27, 2009	$ 1.4	$ —	$ 1.4	$ —
March 28, 2010	$ 1.2	$ —	$ 1.2	$ —

The significant Level 2 observable inputs utilized to value the Company's interest rate swaps are based upon the terminal value of the swaps. The terminal value of the interest rate swaps is calculated by comparing the fixed rate on the swap to the rate that would be received by entering into an identical swap at the rates in effect at the time of termination. The difference in these two rates (in %) is then multiplied by the notational amount of the swap in each remaining period and discounted to present value. The major inputs utilized in the terminal value calculation are valuation date, original swap rate, replacement swap rate, and discount rate. The terminal value calculations are validated with the use of quotes on similar financial instruments from a nationally recognized financial reporting service.

The carrying value of the interest rate swaps is classified as other long-term liabilities in the Condensed Consolidated Balance Sheet. Mark to market adjustments for the interest rate swaps is recorded in other income (expense), net in the Condensed Consolidated Statement of Operations.

Carrying amounts and the related estimated fair values of the Company's financial instruments not measured at fair value on a recurring basis at December 27, 2009 and March 28, 2010 are presented in the following table. The carrying value of all other financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and short-term debt, approximated their estimated fair values at December 27, 2009 and March 28, 2010.

	December 27, 2009		March 28, 2010	
$ in millions	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	$ 55.4	$ 54.1	$ 54.5	$ 54.5

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 8. Fair Value Measurements (Continued)

Long-Term Debt—the fair value of the long-term debt was calculated using present value techniques based on interest rates available for debt with terms and due dates similar to the Company's existing debt arrangements and the Company's current scheduled principal payments.

Note 9. Derivatives

The Company uses derivative financial instruments, in particular, interest rate swaps, to reduce the Company's exposure to its variable rate debt. The primary objective of the interest rate swaps is to eliminate the variability of cash flows and interest rate risk for payments made on variable rate debt, the sole source of which is due to changes in the benchmark three month LIBOR interest rate. Changes in the cash flows of the interest rate swap are expected to exactly offset the changes in cash flows (i.e., changes in interest rate payments) attributable to fluctuations in the three month LIBOR on the variable-rate debt.

The Company records derivatives at their fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the Company's intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives that the Company consider highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments to the hedged items, or reflected net of income taxes in accumulated other comprehensive income (loss) until the hedged transaction is recognized in earnings, to the extent these derivatives are effective hedges. Changes in the fair value of these derivatives that are attributable to the ineffective portion of the hedges, or of derivatives that are not considered to be highly effective hedges, if any, are immediately recognized in earnings. The aggregate notional amount of outstanding interest rate swap contracts at March 28, 2010 was $50.0 million.

The Company's derivative financial instruments, which are cash flow hedges, were considered ineffective as a result of the interest rate floor that occurred with the first amendment of the Company's Prior Credit Facility in March 2008. The effect of marking the derivative instruments to market for the three months ended March 29, 2009 and March 28, 2010 was expense of $0.0 million and income of $0.2 million, respectively; all of which is reflected in other income (expense) net, in the accompanying condensed consolidated statements of operations. The fair value of the Company's derivative liabilities as of December 27, 2009 and March 28, 2010 was $1.4 million and $1.2 million, respectively, and is carried in other long-term liabilities in the accompanying condensed consolidated balance sheets. See Note 8 for further discussion on the fair value measurements related to the Company's derivative instruments.

Note 10. Significant Customers

The following table presents our key customers for the periods presented and the percentage of net sales made to such customers (in millions):

	For the Three Months Ended			
Key Customers	**March 29, 2009**		**March 28, 2010**	
U.S. Navy	$ 25.9	31.4%	$ 16.7	24.3%
U.S. Army	$ 18.4	22.3%	$ 13.4	19.5%

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 10. Significant Customers (Continued)

The customers are all part of the Kratos Government Services segment. The Company's top five customers accounted for approximately 59.8% of total revenue for the three months ended March 29, 2009 and for approximately 57.0% for the three months ended March 28, 2010. Total revenue from the federal government for the three months ended March 29, 2009 was $71.3 million and for the three months ended March 28, 2010 was $58.3 million.

Note 11. Segment Information

The Company operates in two principal business segments: Government Solutions (KGS) and Public Safety and Security (PSS). The Company organizes its business segments based on the nature of the services offered. In the following table, total operating income of the business segments is reconciled to the corresponding consolidated amount. The reconciling item "Unallocated Corporate income (expense), net" includes costs for certain stock-based compensation programs (including stock-based compensation costs for stock options and restricted stock units), the effects of items not considered part of management's evaluation of segment operating performance, corporate costs not allocated to the operating segments, and other miscellaneous corporate activities. Transactions between segments are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts.

Revenues and operating income (loss) generated by the Company's current reporting segments for the three months ended March 29, 2009 and March 28, 2010 are as follows (in millions):

	Three months ended	
	March 29, 2009	March 28, 2010
Revenues:		
Government Solutions	$ 74.4	$ 61.5
Public Safety & Security	8.2	7.2
Total revenues	$ 82.6	$ 68.7
Operating income (loss):		
Government Solutions	$ (37.1)	$ 4.0
Public Safety & Security	(0.4)	—
Unallocated Corporate income (expense), net	(1.2)	(0.4)
Total operating income (loss)	$ (38.7)	$ 3.6

For the three months ended March 29, 2009, the operating loss of the KGS segment includes a non-cash charge of $41.3 million related to goodwill impairment.

Note 12. Legal Matters

IPO Securities Litigation

Beginning in June 2001, the Company and certain of its officers and directors were named as defendants in several parallel class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, In re Wireless

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 12. Legal Matters (Continued)

Facilities, Inc. Initial Public Offering Securities Litigation, Case 01-CV-4779. In the amended complaint, the plaintiffs allege that the Company, certain of its officers and directors, and the underwriters of the Company's initial public offering (IPO) violated section 11 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934 based on allegations that the Company's registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies ("Issuers") that conducted IPOs of their common stock in the late 1990s and 2000. These complaints have been consolidated into an action captioned In re Initial Public Offering Securities Litigation, 21 MC 92 (the IPO Cases).

In June 2004, the Issuers (including the Company) executed a partial settlement agreement with the plaintiffs that would have, among other things, resulted in the dismissal with prejudice of all claims against the Issuers and their officers and directors and the assignment of certain potential Issuer claims to the plaintiffs. On February 15, 2005, the district court issued a decision certifying a class action for settlement purposes and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. On August 31, 2005, the court reaffirmed class certification of the settlement class and preliminary approval of the modified settlement in a comprehensive Order. On February 24, 2006, the court dismissed litigation filed against certain underwriters in connection with certain claims to be assigned under the settlement. On April 24, 2006, the district court held a Final Fairness Hearing to determine whether to grant final approval of the settlement, and the court reserved decision at that time. While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The district court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that had been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling and on December 5, 2006, the Second Circuit Court of Appeals reversed the district court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' rehearing petition, but clarified that the plaintiffs could seek to certify a more limited class in the district court. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the district court that the settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 24, 2007, the district court entered an order terminating the proposed settlement.

Plaintiffs filed second consolidated amended complaints in the six focus cases on August 14, 2007, and, on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the district court denied the motions to dismiss except as to section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. The motion for class certification was withdrawn without prejudice on October 10, 2008. On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing was held on September 10, 2009. On October 6, 2009, the Court entered an opinion

Note 12. Legal Matters (Continued)

granting final approval to the settlement and directing that the Clerk of the Court close the IPO Cases. Notices of appeal of this decision have been filed. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

2004 and 2007 Derivative Securities Litigation

In 2004, two derivative lawsuits were filed in the United States District Court for the Southern District of California against certain of the Company's current and former officers and directors: Pedicini v. Wireless Facilities, Inc., Case 04CV1663; and Roth v. Wireless Facilities, Inc., Case 04CV1810. These actions were consolidated into a single action in In re Wireless Facilities, Inc. Derivative Litigation, Lead Case No 04CV1663-JAH. Plaintiffs in these lawsuits assert claims for breach of fiduciary duty, gross mismanagement, abuse of control, waste of corporate assets, violation of Sarbanes Oxley Act section 304, unjust enrichment and insider trading. The plaintiffs in these lawsuits seek unspecified damages and equitable and/or injunctive relief. The lead plaintiff filed a consolidated complaint on March 21, 2005. On May 3, 2005, the defendants filed motions to dismiss this action, to stay this action pending the resolution of the consolidated non-derivative securities case pending in the Southern District of California, and to dismiss the complaint against certain non-California resident defendants. Pursuant to a request by the court, the defendants' motions were withdrawn without prejudice pending a decision on defendants' motion to dismiss the complaint against the non-California resident defendants. On March 20, 2007, the court ruled that it lacked personal jurisdiction over five of the six non-California defendants and dismissed them from the federal derivative complaint. On March 27, 2007, plaintiffs filed an amended derivative complaint setting forth all of the same allegations from the original complaint and adding allegations regarding the Company's stock option granting practices. The amended complaint names all of the original defendants (including those dismissed for lack of jurisdiction) as well as nine new defendants. On July 2, 2007, the non-California resident defendants moved to dismiss the complaint for lack of personal jurisdiction. On October 17, 2007, the court took the motion under submission without oral argument. On February 26, 2008, the court again ruled that it lacked personal jurisdiction over five of the six non-California defendants and dismissed them from the amended federal derivative complaint. Plaintiffs subsequently moved the court for certification and entry of final judgment of the court's order dismissing the non-residents for lack of personal jurisdiction so that the plaintiffs may seek immediate appellate review of the matter. On July 10, 2008, the court granted plaintiffs' motion for certification, which was not opposed by defendants. On August 12, 2008, the plaintiffs filed a notice of appeal of the personal jurisdictional order. In light of the settlement of all derivative litigation, discussed below, the court stayed all other matters except as necessary to document and consummate the settlement. Similarly, the appellate court stayed all matters related to plaintiffs' notice of appeal of the personal jurisdictional order pending settlement.

In August and September 2004, two virtually identical derivative lawsuits were filed in California Superior Court for San Diego County against certain of the Company's current and former officers and directors. These actions contain factual allegations similar to those of the federal derivative lawsuit, but the plaintiffs in these cases assert claims for violations of California's insider trading laws, breaches of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. The plaintiffs in these actions seek unspecified damages, equitable and/or injunctive relief and disgorgement of all profits, benefits and other compensation obtained by defendants. These

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 12. Legal Matters (Continued)

lawsuits have been consolidated into one action—In re Wireless Facilities, Inc. Derivative Litigation, California Superior Court, San Diego County, Lead Case GIC 834253. The plaintiffs filed a Consolidated Shareholder Derivative Complaint on October 14, 2004. This action has been stayed pending a decision in federal court on a motion to dismiss the federal derivative lawsuit. In October 2009, the parties notified the Court of the status of the federal action and stipulated to stay the matter for an additional six months. The Court subsequently granted the parties' stipulation and stay request and ordered the parties to file an updated status report in April 2010.

In October 2009, following a voluntarily mediation and subsequent negotiations related to all of the above-described derivative litigation, the parties reached an agreement in principle to settle all claims in the federal and state derivative litigation. The district court granted the parties' joint motion for preliminary approval of their proposed settlement in January 2010. In March 2010, the district court granted final approval of the proposed settlement and issued its Final Judgment and Order of Dismissal. Under the terms of the parties' settlement agreement, the district court's judgment becomes "final" upon the latest of: "(a) the date of final affirmance on an appeal of the Judgment, the expiration of the time for a petition for or a denial of a writ of certiorari to review the Judgment and, if certiorari is granted, the date of final affirmance of the Judgment following review pursuant to that grant; (b) the date of final dismissal of any appeal from the Judgment or the final dismissal, denial or withdrawal of any proceeding on certiorari to review the Judgment; or (c) if no appeal is filed, the expiration date of the applicable time to file a notice of appeal from the Judgment." The details of the settlement are set forth in the settlement papers filed with the court. The time to file a notice of appeal has expired and the settlement agreement has become effective.

The Company has recorded an accrual for a contingent liability associated with the legal proceedings related to the derivative actions of $0.1 million based on the Company's estimate of the potential amount it would have to pay in relation to the settlement of these derivative lawsuits. The Company deposited the $0.1 million into escrow with the court in January, 2010. The Company expects the majority of any additional costs incurred in connection with the settlement of these lawsuits to be paid by its Directors' and Officers' liability insurer(s).

Other Litigation and Government Reviews and Investigations

In addition to the foregoing matters, from time to time, the Company may become involved in various claims, lawsuits and legal proceedings that arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm the Company's business. The Company is currently not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse affect on our business, financial condition, operating results or cash flows.

Note 13. Subsequent Events

On April 12, 2010, the Company and Gichner Holdings, Inc. ("Gichner") announced the execution of a Stock Purchase Agreement, dated as of April 12, 2010 (the "Purchase Agreement"), by and between the Company and the stockholders of Gichner. As a result of the Purchase Agreement, Gichner will become a wholly-owned subsidiary of the Company (the "Acquisition"). Pursuant to the Purchase Agreement, the purchase price will be approximately $133 million in cash, subject to certain

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 13. Subsequent Events (Continued)

working capital and other adjustments as of the closing date. The completion of the Acquisition is subject to several conditions, including the availability of financing, on terms and conditions acceptable to the Company (in its sole discretion), the absence of any proceeding or event that would cause a material adverse effect on Gichner's business, the receipt of required regulatory approvals, including the expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and other customary conditions. The Board of Directors of each of the Company and Gichner approved the Acquisition and the Purchase Agreement. The Company expects to fund the acquisition and repay its existing indebtedness with notes of approximately $200 million and enter into a new revolving line of credit of approximately $25 million which is expected to be drawn at closing for outstanding letters of credit. As a result of the new notes and revolving line of credit, the Company expects to record an interest charge, in the period the transaction is completed, of approximately $1.9 million reflecting the write-off of the deferred financing costs of its current credit facility.

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

This report contains forward-looking statements. These statements relate to future events or our future financial performance. 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 statements are only predictions. Actual events or results may differ materially. Factors that may cause our results to differ include, but are not limited to: changes in the scope or timing of our projects; changes or cutbacks in spending or the appropriation of funding by the federal government, including the U.S. Department of Defense, which could cause delays or cancellations of key government contracts; the timing, rescheduling or cancellation of significant customer contracts and agreements, or consolidation by or the loss of key customers; risks of adverse regulatory action or litigation; risks associated with debt leverage; failure to successfully consummate acquisitions or integrate acquired operations; and competition in the marketplace which could reduce revenues and profit margins.

Although we believe that the expectations reflected in the forward- looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we, nor any other person, assume responsibility for the accuracy and completeness of the forward- looking statements. We assume no obligation to update any of the forward-looking statements after the filing of this Quarterly Report on Form 10-Q to conform such statements to actual results or to changes in our expectations.

Certain of the information set forth herein, including costs and expenses that exclude the impact of amortization expense, may be considered non-GAAP financial measures. We believe this information is useful to investors because it provides a basis for measuring the operating performance of our business and our cash flow, excluding the effect of items that would normally be included in the most directly comparable measures calculated and presented in accordance with GAAP. Our management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating our 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 non-financial measures as reported by Kratos may not be comparable to similarly titled amounts reported by other companies.

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes and other financial information appearing elsewhere in this Form 10-Q. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the Annual Report filed on Form 10-K for the year ended December 28, 2009 including the disclosures made in Item 1A "Risk Factors" and the audited consolidated financial statements and related notes included therein.

Overview

We are an innovative provider of mission critical engineering, information technology (IT) services and warfighter solutions. We work primarily for the U.S. government and federal government agencies, but we also perform work for state and local agencies and commercial customers. Our principal services are related to, but are not limited to, Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance, and Reconnaissance (C5ISR); weapons systems lifecycle support and sustainment; military weapon range operations and technical services; missile, rocket and weapons system test and evaluation; missile and rocket mission launch services; public safety, security and surveillance systems; modeling and simulation; unmanned aerial vehicle (UAV) systems; and advanced network engineering and information technology services. We offer our customers solutions and expertise to support their mission critical needs by leveraging our skills across our core service areas.

We derive a substantial portion of our revenue from contracts performed for federal government agencies, including the U.S. Department of Defense (DoD), with the majority of our revenue currently generated from the delivery of mission-critical warfighter solutions, advanced engineering services, system integration and system sustainment services to defense and other non-DoD and civilian government agencies. We believe our diversified and stable client base, strong client relationships, broad array of contract vehicles, considerable employee base possessing government security clearances, extensive list of past performance qualifications, and significant management and operational capabilities position us for continued growth.

Current Reporting Segments

We operate in two principal business segments: Kratos Government Solutions (KGS) and Public Safety and Security (PSS). We organize our business segments based on the nature of the services offered. Transactions between segments are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts and these intercompany transactions are eliminated in consolidation. The financial statements in this Quarterly Report are presented in a manner consistent with our operating structure. For additional information regarding our operating segments, see Note 11 of Notes to Consolidated Financial Statements. From a customer and solutions perspective, we view our business as an integrated whole, leveraging skills and assets wherever possible.

Kratos Government Solutions (KGS) Segment

The Kratos Government Solutions segment provides engineering, information technology and weapons systems to federal, state, and local government agencies, but primarily the DoD. Our work includes weapon systems sustainment, lifecycle support and extension; C5ISR services; military range operations and technical services; missile, rocket, and weapons systems test and evaluation; mission launch services; modeling and simulation, unmanned aerial vehicle (UAV) products and technology, and advanced network engineering and information technology services; and public safety, security and surveillance systems integration. Our KGS segment also provides public safety, security and surveillance systems products and services to the homeland security market with products and services aimed at supporting first responders.

Public Safety and Security (PSS) Segment

The Public Safety and Security segment provides system design, deployment, integration, monitoring and support services for public safety, security and surveillance networks for state and local governments and commercial customers. Public safety and security networks have been traditionally segregated into systems such as voice, data, access control, video surveillance, temperature control and fire and life safety. We provide services that combine such systems and offer integrated solutions on both Ethernet and IP based platforms. We also offer solutions that combine voice, data, electronic security and building automation systems with fixed or wireless connectivity solutions. Our target markets are healthcare, government, data centers, large scale industrial and manufacturing, correctional facilities, education and sports and entertainment. Our commitments to these markets and our ability to provide feature-rich, cost-effective solutions have allowed us to become one of the larger independent integrators for these types of systems. We maintain regional office locations comprised of Kratos Mid Atlantic, Kratos Southeast, and Kratos Southwest. On June 24, 2009, as a result of continued losses in the Southeast division of PSS, our Board of Directors approved a plan to sell and dispose of this division. The business unit was classified as held for sale and reported in other assets and liabilities in the accompanying Condensed Consolidated Financial Statements.

For a complete description of our business and a discussion of our critical accounting matters, please refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 11, 2010.

On September 10, 2009, we completed a 1-for-10 reverse split of our common stock. All common stock, stock options, and warrants to purchase common stock and earnings per share amounts have been retroactively restated as if the reverse stock split occurred at the beginning of the periods presented.

As of March 28, 2010, we consider the following factors to be important in understanding our financial statements.

Kratos Government Solutions' business with the U.S. government and prime contractors is generally performed under cost reimbursable, fixed-price or time and materials contracts. Cost reimbursable contracts for the government provide for reimbursement of costs plus the payment of a fee. Some cost reimbursable contracts include incentive fees that are awarded based on performance on the contract. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time and materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and reimbursed for travel and other direct expenses at actual costs plus applied general and administrative expenses. Our Public Safety and Security contracts are primarily fixed-price contracts whereby revenue is recognized using the percentage-of-completion method of accounting under the provisions of *ASC Topic 605 Revenue Recognition*. For contracts offered on a time and material basis, we recognize revenues as services are performed.

Cost of revenues includes direct compensation, living, travel and benefit expenses for project-related personnel, payments to third-party subcontractors, cost of materials, project-related incentive compensation based upon the successful achievement of certain project performance goals, allocation of overhead costs and other direct project-related expenses. Selling, general and administrative expenses include compensation and benefits for corporate service employees and similar costs for billable employees whose time and expenses cannot be assigned to a project (underutilization costs), expendable computer software and equipment, facilities expenses and other operating expenses not directly related and/or allocated to projects. General and administrative costs include all corporate and administrative functions that support existing operations and provide infrastructure to facilitate our future growth. Additionally, our sales personnel and senior corporate executives have, as part of their compensation packages, periodic and annual bonus/commission incentives based on the attainment of specified performance goals.

Comparison of Results for the Three Months Ended March 29, 2009 to the Three Months Ended March 28, 2010

Revenues. Revenues decreased $13.9 million from $82.6 million for the three months ended March 29, 2009 to $68.7 million for the three months ended March 28, 2010. This decrease was primarily due to the planned reductions of lower margin pass through work, other contract work and to a lesser extent reductions of small business set aside contract work in our Government Solutions segment. In addition, reductions in our commercial and lower margin Public Safety & Security system integration business, which was negatively impacted by the current adverse economic environment, also contributed to the revenue decline. Revenues by operating segment for the three months ended March 29, 2009 and March 28, 2010 are as follows (in millions):

	2009	2010	$ change	% change
Government Solutions	$ 74.4	$ 61.5	$ 12.9	17.3%
Public Safety & Security	8.2	7.2	1.0	12.2
Total revenues	$ 82.6	$ 68.7	$ 13.9	16.8%

A portion of our revenue is derived from fixed-price contracts whereby revenue is calculated using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. These estimates are reviewed monthly on a contract-by-contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. Significant management judgments and estimates, including the estimated costs to complete the project, which determine the project's percent complete, must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates.

Cost of Revenues. Cost of revenues decreased from $65.4 million for the three months ended March 29, 2009 to $52.2 million for the three months ended March 28, 2010. The $13.2 million decrease in cost of revenues was primarily a result of the decrease in aggregate cost of revenues related to the reductions in revenues described above. Gross margin increased from 20.8% for the three months ended March 29, 2009 to 24.0% for the three months ended March 28, 2010. The increase in gross margin primarily resulted from the planned reductions of pass through work which has a lower margin and a change in the mix of revenues.

Selling, General and Administrative Expenses. Selling, general and administrative expenses (SG&A) decreased from $14.2 million for the three months ended March 29, 2009 to $12.3 million for the three months ended March 28, 2010. Included in the expenses for the three months ended March 29, 2009 was $0.6 million related to an accrual of unused office space, and $0.3 million in expenses related to now completed government inquiries by the Department of Justice related to our historical stock option granting practices. The balance of the decrease in expenses of $1.0 million from March 29, 2009 to March 28, 2010 was primarily a result of reductions in corporate expenses due to the implementation of cost reduction measures. As a percentage of revenues, SG&A increased from 17.2% to 17.9%. Excluding amortization of intangibles of $1.5 million for the three months ended March 29, 2009 and amortization of intangibles of $1.3 million for the three months ended March 28, 2010, SG&A increased as a percentage of revenues from 15.4% to 16.0% for the three months ended March 29, 2009 and March 28, 2010.

Research and Development Expenses. Research and development expenses (R&D) for the three months ended March 29, 2009 and the three months ended March 28, 2010 were $0.4 million and $0.6 million, respectively.

Impairment of Goodwill. The impairment charge of $41.3 million for the three months ended March 29, 2009, was primarily driven by adverse equity market conditions that caused a decrease in current market multiples and our average stock price as of February 28, 2009, compared with the impairment test performed as of December 28, 2008. In our analysis, we used the income approach and validated its reasonableness by considering our market capitalization based upon an average of our stock price for a period prior to and subsequent to the date we perform our analysis. The average market price of our stock as of February 28, 2009 was $7.80 which equates to a 39% drop in our average stock price and corresponding market capitalization from December 28, 2008 which had an average stock price of $12.90. We reconciled the fair value of our reporting units which is calculated using the income approach to our market capitalization. As a result of this reconciliation, it was noted that investors were requiring a higher rate of return, and therefore, our discount factor which is based upon an estimated market participant weighted average cost of capital increased 300 basis points from 14% in our year end impairment test in 2008 as compared to 17% in our 2009 first quarter interim impairment test. This change was the key factor contributing to the $41.3 million goodwill impairment charge that we recorded in the first quarter of 2009.

Our forecasts of growth rates and operating margins had not changed as of February 28, 2009 as compared to the forecasts which were used as of December 28, 2008. Our historical growth rates and operating results are not indicative of our future growth rates and operating results as a consequence of our transformation from a commercial wireless service provider to a U.S. government defense contractor. The decline in revenues which was expected by us, is primarily due to the impact of the conversion of our work as a prime contractor under certain legacy small business awards to that of a subcontractor. This change resulted in an award of an overall smaller portion of the entire project as the contracts were recompeted and the original term of the small business contracts were completed. The conversion of work as a prime to a subcontractor related to legacy small business contracts awarded to acquired companies is not uncommon in the government defense contractor industry for companies that have been acquisitive. Certain of the contract awards that were legacy small business awards to businesses which we acquired may result in a reduction of revenues when the contracts are completed and recompeted and awarded to us as a subcontractor rather than as a prime contractor. We believe that the expected impact to our revenues will not be material related to this conversion. Our projected growth rates take into consideration this anticipated impact on small business awards.

Our contracts are long-term in nature and are supported by significant backlog. Because our contracts are of a long-term nature, a majority of our receivables are with agencies within the U. S. government or we are a subcontractor to a customer whose receivables are with the agencies within the U.S. government, and as such, we are not subject to significant short term changes in operating cash flow. Moreover, because of the nature of our current business we do not have significant capital expenditure requirements. Additionally, our contract base is highly diversified and the loss of any one contract would not impact revenues by more than 6%. In addition, we did not assume a recovery of the global or national economy in our cash flow projections in either analysis. The charge does not impact our normal business operations.

Other Expense, Net. Other expense, net increased from $2.5 million to $3.7 million for the three months ended March 29, 2009 and March 28, 2010, respectively. The increase in expense of $1.2 million is primarily related to the write-off of deferred financing fees associated with the Prior Credit Facility of $2.2 million as a result of the refinancing of our Credit Facility that occurred in the first quarter of 2010 partially offset by a decrease in interest expense of $0.8 million as a result of our reduced debt balances and an increase of $0.2 million in other income primarily related to the non-cash income recorded to mark the derivative related to the credit facility to market.

Provision (Benefit) for Income Taxes. We recorded an income tax provision of $0.3 million, or a negative 0.7% rate, on loss of $41.2 million before income taxes in the three months ended March 29, 2009. We recorded an income tax provision of $0.3 million, or a negative 300% rate, on loss of $0.1 million before income taxes for the three months ended March 28, 2010. The provision of $0.3 million for both periods was primarily related to state income taxes, which cannot be offset by our net operating losses.

Income (Loss) from Discontinued Operations. Income (loss) from discontinued operations improved from a loss of $0.6 million to income of $0.6 million for the three months ended March 29, 2009 and March 28, 2010, respectively. The income of $0.6 million for the three months ended March 28, 2010 was primarily due to the tax benefit of $0.8 million related to the expiration of the statute of limitations for certain foreign tax contingencies related to our discontinued wireless services business partially offset by the operations of the PSS Southeast division, which our Board of Directors approved to sell in June 2009. Revenues generated by these businesses were approximately $1.6 million and $1.1 million for the three months ended March 29, 2009 and March 28, 2010, respectively. Loss before taxes was $1.1 million and $0.2 million for the three months ended March 29, 2009 and March 28, 2010, respectively. The reduction in net losses in 2010 is primarily a result of the cost reduction actions we have taken. The tax benefit for the three months ended March 29, 2009 and March 28, 2010 of $0.5 million and $0.8 million respectively was primarily due to the expiration of the statute of limitations for certain foreign tax contingencies related to our discontinued wireless services business.

Backlog

As of March 29, 2009, and March 28, 2010, our backlog was approximately $690 million and $583 million respectively, of which $165 million was funded in 2009 and $185 million in 2010. Backlog is our estimate of the amount of revenue we expect to realize over the remaining life of awarded contracts and task orders that we have in hand as of the measurement date. Our total backlog consists of funded and unfunded backlog. 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 our estimate of the future revenue we expect to realize from our commercial contracts that are under firm orders. Our 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.

Unfunded backlog reflects our estimate of future revenue under awarded government contracts and task orders for which either funding has not yet been appropriated or expenditure has not yet been authorized. Our total backlog does not include estimates of revenue from government-wide acquisition contracts, or (GWAC) contracts, or General Services Administration (GSA) schedules beyond awarded or funded task orders, but our unfunded backlog does include estimates of revenue beyond awarded or funded task orders for other types of indefinite delivery, indefinite quantity (IDIQ) contracts, based on our experience under such contracts and similar contracts. Unfunded backlog also includes priced options, which consist of the aggregate contract revenues expected to be earned as a result of a customer exercising an option period that has been specifically defined in the original contract award.

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 which is considered to be firm, we cannot guarantee that cancellations or scope adjustments will not occur. The majority of funded backlog represents contracts under the terms of which cancellation by the customer would entitle us to all or a portion of our costs incurred and potential fees.

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, cancellation 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 United States government contracts included in backlog, whether or not funded, may be terminated at the convenience of the United States government.

Liquidity and Capital Resources

As of March 28, 2010, we had consolidated cash and cash equivalents of $6.3 million, consolidated long-term and short-term debt of $55.3 million, and consolidated stockholders' equity of $126.2 million. Our principal sources of liquidity are cash flows from operations and borrowings under our credit agreement.

Our operating cash flow is used to finance trade accounts receivable, fund capital expenditures, our ongoing operations, litigation and government inquiries, 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. Cash from continuing operations is primarily derived from our customer contracts in progress and associated changes in working capital components.

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

	Three months ended March 29, 2009	Three months ended March 28, 2010
Net cash provided by (used in) operating activities of continuing operations	$ 7.1	$ (0.7)

Cash provided by operating activities from continuing operations for the three months ended March 28, 2010 decreased by $7.8 million from the three months ended March 29, 2009. This was primarily a result of increased days sales outstanding (DSO's) which increased from 87 days for the three months ended March 29, 2009 to 124 days for the three months ended March 28, 2010. The increase in DSOs and accounts receivables is primarily the result of the timing of payments on a significant milestone payment on a weapons system contract which increased DSO's by 22 days. The increase, as a result of the previously mentioned milestone payment, was primarily offset by an increase in billings in excess of costs and earnings on uncompleted contracts. This invoice was collected in April 2010.

Our cash used in investing activities from continuing operations are summarized as follows (in millions):

	Three months ended March 29, 2009	Three months ended March 28, 2010
Investing activities:		
Cash paid for acquisitions, net of cash acquired	$ (0.5)	$ —
Cash paid for contingent acquisition consideration	(3.0)	—
Proceeds/(payments) from the disposition of discontinued operations	(1.1)	—
Other, net	(0.1)	(0.3)
Net cash used in investing activities from continuing operations	$ (4.7)	$ (0.3)

During the three months ended March 28, 2010, the only investing activity was the expenditure of approximately $0.3 million for the acquisition of relatively minor capital expenditures.

Cash paid for acquisitions and contingent acquisition consideration accounted for the most significant outlays for investing activities for the three months ended March 29, 2009 as a result of the implementation of our strategies to diversify our business while focusing on our core competencies. During the three months ended March 29, 2009, we made the final holdback payment of $2.4 million for the Madison Research Corporation acquisition and the first holdback payment of $0.6 million related to our acquisition Haverstick Consulting, Inc. We also paid $1.5 million to Platinum Equity related to the working capital adjustment for the sale of our domestic wireless deployment business which was partially offset by proceeds of $0.4 million related to the sale of the discontinued SYS commercial businesses.

Cash used in financing activities from continuing operations are summarized as follows (in millions):

	Three months ended March 29, 2009	Three months ended March 28, 2010
Financing activities:		
Borrowings under credit facility	$ 2.0	$ 57.9
Repayments under credit facility	(1.3)	(58.8)
Proceeds from sale of common stock	—	0.6
Payments of subordinated debt	(2.1)	—
Debt issuance costs	—	(1.9)
Other	0.1	—
Net cash used in financing activities from continuing operations	$ (1.3)	$ (2.2)

During the three months ended March 28, 2010, cash used by financing activities was primarily related to refinancing of our Prior Credit Facility including payment of $1.9 million of debt issuance costs. See "Contractual Obligations and Commitments" for a further discussion of these credit facilities. Financing activities for the three months ended March 29, 2009 primarily relates to payments of $2.1 million on the subordinated debt we assumed in the SYS acquisition and term note payments of $1.3 million on our Prior Credit Facility.

Cash used in discontinued operations are summarized as follows (in millions):

	Three months ended March 29, 2009	Three months ended March 28, 2010
Net cash flows used in discontinued operations	$ (1.5)	$ (0.4)

The cash flows used by discontinued operations decreased by $1.1 million primarily as a result of the sale of the SYS commercial businesses which were sold during the first quarter of 2009.

Contractual Obligations and Commitments

From December 31, 2007 through March 3, 2010 we had a credit facility of $85.0 million with KeyBank National Association ("KeyBank") as administrative agent (the "Prior Credit Facility"). This Prior Credit Facility provided for two term loans consisting of a first lien term note of $50.0 million and a second lien term note of $10.0 million, as well as a first lien $25.0 million revolving line of credit, and was collateralized by the assets of the Company and its subsidiaries. KeyBank held the revolving line of credit and the second lien term note. Field Point III, Ltd. and SPF CDO I, Ltd., both affiliates of Silverpoint Capital LP ("Silverpoint"), held the first lien term note. The $10.0 million term loan had a five and one half-year term with principal payments of $25,000 required quarterly from March 31, 2008 through March 31, 2013 with the final balance of $9.5 million due on June 30, 2013. The $50.0 million term loan had a five-year term with principal payments of $0.6 million required quarterly beginning on March 31, 2008, $1.3 million in 2009, $2.5 million in 2010, and $4.1 million in 2011 and 2012. The term loans had a provision which stated that once the full amount of the note has been borrowed, the notes could not be paid down and reborrowed again. The revolving line of credit had a five-year term which expired on December 31, 2012. All loans under the credit facility had an interest rate equal to a base rate defined as a fluctuating rate per annum equal to the higher of (a) the Federal Funds Rate plus 0.5% and (b) the rate of interest in effect for such day as publicly announced from time to time by KeyBank as its "prime rate" plus a margin for the term loans of 6.5% to 7.5% and a margin of 1.0% to 3.25% on the revolving line of credit. All rates were subject to a LIBOR floor of 4.25% and a "prime rate" floor of 5.25%.

On March 3, 2010, we entered into a new senior secured credit agreement (the "Credit Agreement") with Key Bank National Association as Administrative Agent and Lender for a new credit facility (the "Credit Facility") in the aggregate principal amount of $60.0 million. The Credit Facility is comprised of (i) a $35.0 million term loan facility and (ii) a $25.0 million revolving line of credit. Bank of America, N.A., is Syndication Agent and Lender, and KeyBanc Capital Markets and Banc of America Securities, LLC acted as Co-Lead Arrangers and Book Runners. Pursuant to the terms of the Credit Agreement, the term loan and revolving credit facility are both three year facilities. The proceeds under the Credit Agreement may be used for general corporate purposes including refinancing of existing bank debt, working capital and acquisitions.

Also on March 3, 2010, we entered into two Payoff Letters with KeyBank terminating the Prior Credit Facility. In connection with the refinancing of the Prior Credit Facility, we borrowed $57.5 million under the Credit Facility. Approximately $25.0 million of the proceeds were used to pay in full the remaining balance on the first lien term loan under the Prior Credit Facility held by Silverpoint, at par, with no prepayment penalties, pursuant to the Settlement Agreement that we entered into with Silverpoint in October 2009. As a result of the refinance, we recorded an interest charge of approximately $2.2 million in the first quarter of 2010 relating to the write-off of previously deferred financing costs.

We may borrow funds under the Credit Agreement (i) at the base rate, determined as the greater of (A) the prime loan rate announced by KeyBank and (B) the sum of the weighted average overnight federal funds rate published by the Federal Reserve Bank plus 50 basis points, or (ii) at the offshore rate, determined by the Administrative Agent as the offered rate for U.S. dollar deposits in the approximate amount of the requested loan and having a maturity comparable to such interest period, which rate appears (A) on the British Bankers' Association internet web page (http://www.bba.org.uk/public/libor/), or via (B) Reuters (BBALIBORS), Bloomberg, Moneyline Telerate (Page 3750) or any other information provider of the British Bankers' Association daily Libor rates as of 11:00 A.M., London time, on the date which is the second day on which banks are open for interbank deposits in London prior to the commencement of such interest period; as adjusted for reserve requirements and rounded upwards if necessary to the next higher 1/100%. Borrowings are subject to a Libor floor rate of 2.75% or a Base Rate floor of 5.25%. Term loan borrowings and revolver borrowings may be subject to an additional 450 basis points and 375 basis points, respectively, based on our credit ratings. In addition, we must pay a fee ranging from 30 basis points per annum to 75 points per annum, based on its credit ratings, on the daily amount of the unused commitments under the revolving credit facility. The initial interest rate under the Credit Facility for the term loan is 7.25%, compared to the approximate 11.75% interest rate under the Prior Credit Facility term loan. The initial interest under the Credit Facility for the revolving line of credit is approximately 6.50%, compared to the approximate 6.75% rate under the Prior Credit facility revolving line of credit.

Pursuant to certain terms of the Credit Agreement, in certain instances we are required to prepay outstanding indebtedness prior to its stated maturity date. Specifically, certain non-recurring cash inflows such as proceeds from asset sales, insurance recoveries, and equity offerings as well as certain annual operating cash flows may have to be used to pay down indebtedness and may not be reborrowed.

The terms of the Credit Agreement include customary representations and warranties, as well as reporting and financial covenants, customary for financings of this type. The financial covenants include a quarterly maximum leverage ratio of 2.75 through December 31, 2010, reducing to 2.50 thereafter, a quarterly fixed charge coverage ratio of 1.10 through December 31, 2010, with an increase to 1.25

thereafter. In addition, the covenants include a monthly asset coverage ratio of Eligible Billed Accounts Receivables, as defined, of 1.25 times for outstanding balances of the revolving credit facility.

The Credit Agreement provides for the ability to increase the revolving line of credit facility by up to $15.0 million to a total not to exceed $40.0 million, in the event that the Administrative Agent elects to secure additional commitments from Existing Lenders or from New Lenders.

As of March 28, 2010 our outstanding balance on the credit agreement was $53.5 million with a weighted average interest rate of 6.99%. As of March 28, 2010 the unused line of credit under the revolving line of credit, net of $1.4 million in outstanding letters of credit, was approximately $5.1 million. The only restriction on the use of these funds is that we must be in compliance with covenants of this credit agreement. We were in compliance with all covenants under the credit agreement as of March 28, 2010.

As of March 28, 2010, we had outstanding convertible notes payable totaling $1.0 million which were acquired as a result of the SYS acquisition and are due on August 14, 2010. $25,000 of the convertible notes are payable to a related party. The balance of the outstanding notes is $1.0 million and is potentially convertible into common stock of Kratos at $10.20 per share or approximately 94,000 shares.

Other Liquidity Matters

On April 12, 2010, we announced the execution of a Stock Purchase Agreement, dated as of April 12, 2010 (the "Purchase Agreement"), by and between Kratos and the stockholders of Gichner Holdings, Inc. ("Gichner") As a result of the Purchase Agreement, Gichner will become a wholly-owned subsidiary of Kratos (the "Acquisition"). Pursuant to the Purchase Agreement, the purchase price will be approximately $133 million in cash, subject to certain working capital and other adjustments as of the closing date. The completion of the Acquisition is subject to several conditions, including the availability of financing, on terms and conditions acceptable to us (in our sole discretion), the absence of any proceeding or event that would cause a material adverse effect on Gichner's business, the receipt of required regulatory approvals, including the expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and other customary conditions.

We intend to fund our cash requirements with cash flows from operating activities, and borrowings under our existing credit facility and any future senior secured notes and credit facility. We believe these sources should be sufficient to meet our cash needs for at least the next 12 months. As discussed in Part II, Item 1A, "Risk Factors" section of our 2009 Annual Report on 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 Form 10-Q, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these 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.

For the three months ended March 28, 2010 there have been no significant changes to our Critical Accounting Policies or Estimates compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 27, 2009 as filed with the SEC on March 11, 2010 with the following exception:

In January 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-06, *Improving Disclosures about Fair Value Measurements* , which, among other things, amends *Accounting Standards Topic 820 Fair Value Measurements and Disclosures (ASC 820)* to require entities to separately present purchases, sales, issuances, and settlements in their reconciliation of Level 3 fair value measurements (i.e., to present such items on a gross basis rather than on a net basis), and which clarifies existing disclosure requirements provided by ASC 820 regarding the level of disaggregation and the inputs and valuation techniques used to measure fair value for measurements that fall within either Level 2 or Level 3 of the fair value hierarchy. ASU No. 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Our adoption of this standard had no impact on our consolidated financial position, results of operations or cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk in connection with changes in interest rates, primarily in connection with outstanding balances under our credit agreement with KeyBanc Capital Markets. Based on our average outstanding balances during the three months ended March 28, 2010, a 1% change in the LIBOR rate would not impact our financial position and results of operations as a result of the 2.75% LIBOR floor rate on our credit facility. We manage exposure to these risks through our operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. Derivative financial instruments are viewed as risk management tools and are not used for speculation or for trading purposes. Derivative financial instruments are contracted with investment grade counterparties to reduce exposure to nonperformance on such instruments.

Cash and cash equivalents as of March 28, 2010 were $6.3 million and are primarily invested in money market interest bearing accounts. A hypothetical 10% adverse change in the average interest rate on our money market cash investments and short-term investments would have had no material effect on net income for the three month period ended March 28, 2010.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities and 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 Securities and Exchange Commission'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(e) 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 28, 2010.

There was no change in our internal control over financial reporting during the quarter ended March 28, 2010 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

IPO Securities Litigation

Beginning in June 2001, the Company and certain of its officers and directors were named as defendants in several parallel class action shareholder complaints filed in the United States District Court for the Southern District of New York, now consolidated under the caption, In re Wireless Facilities, Inc. Initial Public Offering Securities Litigation, Case 01-CV-4779. In the amended complaint, the plaintiffs allege that the Company, certain of its officers and directors, and the underwriters of the Company's initial public offering (IPO) violated section 11 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934 based on allegations that the Company's registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The plaintiffs seek unspecified monetary damages and other relief. Similar complaints were filed in the same court against hundreds of other public companies ("Issuers") that conducted IPOs of their common stock in the late 1990s and 2000. These complaints have been consolidated into an action captioned In re Initial Public Offering Securities Litigation, 21 MC 92 (the IPO Cases).

In June 2004, the Issuers (including the Company) executed a partial settlement agreement with the plaintiffs that would have, among other things, resulted in the dismissal with prejudice of all claims against the Issuers and their officers and directors and the assignment of certain potential Issuer claims to the plaintiffs. On February 15, 2005, the district court issued a decision certifying a class action for settlement purposes and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. On August 31, 2005, the court reaffirmed class certification of the settlement class and preliminary approval of the modified settlement in a comprehensive Order. On February 24, 2006, the court dismissed litigation filed against certain underwriters in connection with certain claims to be assigned under the settlement. On April 24, 2006, the district court held a Final Fairness Hearing to determine whether to grant final approval of the settlement, and the court reserved decision at that time. While the partial settlement was pending approval, the plaintiffs continued to litigate against the underwriter defendants. The district court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that had been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the district court certified the focus cases as class actions. The underwriter defendants appealed that ruling and on December 5, 2006, the Second Circuit Court of Appeals reversed the district court's class certification decision. On April 6, 2007, the Second Circuit denied plaintiffs' rehearing petition, but clarified that the plaintiffs could seek to certify a more limited class in the district court. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the district court that the settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 24, 2007, the district court entered an order terminating the proposed settlement.

Plaintiffs filed second consolidated amended complaints in the six focus cases on August 14, 2007, and, on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the district court denied the motions to dismiss except as to section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. The motion for class certification was withdrawn without prejudice on October 10, 2008. On April 2, 2009, a stipulation and agreement of settlement among the plaintiffs, issuer defendants and underwriter defendants was submitted to the Court for preliminary approval. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement fairness hearing was held on September 10, 2009. On October 6, 2009, the Court entered an opinion granting final approval to the settlement and directing that the Clerk of the Court close the IPO Cases. Notices of appeal of this decision have been filed. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

2004 and 2007 Derivative Securities Litigation

In 2004, two derivative lawsuits were filed in the United States District Court for the Southern District of California against certain of the Company's current and former officers and directors: Pedicini v. Wireless Facilities, Inc., Case 04CV1663; and Roth v. Wireless Facilities, Inc., Case 04CV1810. These actions were consolidated into a single action in In re Wireless Facilities, Inc. Derivative Litigation, Lead Case No 04CV1663-JAH. Plaintiffs in these lawsuits assert claims for breach of fiduciary duty, gross mismanagement, abuse of control, waste of corporate assets, violation of Sarbanes Oxley Act section 304, unjust enrichment and insider trading. The plaintiffs in these lawsuits seek unspecified damages and equitable and/or injunctive relief. The lead plaintiff filed a consolidated complaint on March 21, 2005. On May 3, 2005, the defendants filed motions to dismiss this action, to stay this action pending the resolution of the consolidated non-derivative securities case pending in the Southern District of California, and to dismiss the complaint against certain non-California resident defendants. Pursuant to a request by the court, the defendants' motions were withdrawn without prejudice pending a decision on defendants' motion to dismiss the complaint against the non-California resident defendants. On March 20, 2007, the court ruled that it lacked personal jurisdiction over five of the six non-California defendants and dismissed them from the federal derivative complaint. On March 27, 2007, plaintiffs filed an amended derivative complaint setting forth all of the same allegations from the original complaint and adding allegations regarding the Company's stock option granting practices. The amended complaint names all of the original defendants (including those dismissed for lack of jurisdiction) as well as nine new defendants. On July 2, 2007, the non-California resident defendants moved to dismiss the complaint for lack of personal jurisdiction. On October 17, 2007, the court took the motion under submission without oral argument. On February 26, 2008, the court again ruled that it lacked personal jurisdiction over five of the six non-California defendants and dismissed them from the amended federal derivative complaint. Plaintiffs subsequently moved the court for certification and entry of final judgment of the court's order dismissing the non-residents for lack of personal jurisdiction so that the plaintiffs may seek immediate appellate review of the matter. On July 10, 2008, the court granted plaintiffs' motion for certification, which was not opposed by defendants. On August 12, 2008, the plaintiffs filed a notice of appeal of the personal jurisdictional order. In light of the settlement of all derivative litigation, discussed below, the court stayed all other matters except as necessary to document and consummate the settlement. Similarly, the appellate court stayed all matters related to plaintiffs' notice of appeal of the personal jurisdictional order pending settlement.

In August and September 2004, two virtually identical derivative lawsuits were filed in California Superior Court for San Diego County against certain of the Company's current and former officers and directors. These actions contain factual allegations similar to those of the federal derivative lawsuit, but the plaintiffs in these cases assert claims for violations of California's insider trading laws, breaches of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. The plaintiffs in these actions seek unspecified damages, equitable and/or injunctive relief and disgorgement of all profits, benefits and other compensation obtained by defendants. These lawsuits have been consolidated into one action—In re Wireless Facilities, Inc. Derivative Litigation, California Superior Court, San Diego County, Lead Case GIC 834253. The plaintiffs filed a Consolidated Shareholder Derivative Complaint on October 14, 2004. This action has been stayed pending a decision in federal court on a motion to dismiss the federal derivative lawsuit. In October 2009, the parties notified the Court of the status of the federal action and stipulated to stay the matter for an additional six months. The Court subsequently granted the parties' stipulation and stay request and ordered the parties to file an updated status report in April 2010.

In October 2009, following a voluntarily mediation and subsequent negotiations related to all of the above-described derivative litigation, the parties reached an agreement in principle to settle all claims in the federal and state derivative litigation. The district court granted the parties' joint motion for preliminary approval of their proposed settlement in January 2010. In March 2010, the district court granted final approval of the proposed settlement and issued its Final Judgment and Order of Dismissal. Under the terms of the parties' settlement agreement, the district court's judgment becomes "final" upon the latest of: "(a) the date of final affirmance on an appeal of the Judgment, the expiration of the time for a petition for or a denial of a writ of certiorari to review the Judgment and, if certiorari is granted, the date of final affirmance of the Judgment following review pursuant to that grant; (b) the date of final dismissal of any appeal from the Judgment or the final dismissal, denial or withdrawal of any proceeding on certiorari to review the Judgment; or (c) if no appeal is filed, the expiration date of the applicable time to file a notice of appeal from the Judgment." The details of the settlement are set forth in the settlement papers filed with the court. The time to file a notice of appeal has expired and the settlement agreement has become effective.

The Company has recorded an accrual for a contingent liability associated with the legal proceedings related to the derivative actions of $0.1 million based on the Company's estimate of the potential amount it would have to pay in relation to the settlement of these derivative lawsuits. The Company deposited the $0.1 million into escrow with the court in January, 2010. The Company expects the majority of any additional costs incurred in connection with the settlement of these lawsuits to be paid by its Directors' and Officers' liability insurer(s).

Other Litigation and Government Reviews and Investigations

In addition to the foregoing matters, from time to time, the Company may become involved in various claims, lawsuits and legal proceedings that arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm the Company's business. The Company is currently not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse affect on our business, financial condition, operating results or cash flows.

Item 1A. Risk Factors

While we attempt to identify, manage, and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our 2009 Form 10-K (pages 11 through 22) describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, projected results, and future prospects. We do not believe that there have been any material changes to the risk factors previously disclosed in our 2009 Form 10-K except as follows:

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

Federal and state income tax laws impose restrictions on the utilization of 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. In general, an ownership change occurs when shareholders owning 5% or more of a "loss corporation" (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation's value at the time of the ownership change times the greater of the long-term tax-exempt rate determined by the IRS in the month of the ownership change or the two preceding months. We believe that an "ownership change" may have occurred which could limit the utilization of the loss carryforwards. We are currently evaluating the extent of the limitation on our annual utilization of the net operating loss carryforwards. Any potential limitation would not impact the income tax provision for the quarter ended March 28, 2010. In addition, future equity offerings or acquisitions that have equity as a component of the purchase price could result in an "ownership change". If and when an "ownership change" occurs, utilization of the net operating loss or other tax attributes may be further limited.

Risks Related to the Proposed Acquisition of Gichner

We may not realize the anticipated benefits of our acquisition of Gichner because of integration difficulties.

Integrating the operations of the businesses of Gichner successfully or otherwise realizing any of the anticipated benefits of the acquisition of Gichner, including anticipated cost savings and additional revenue opportunities, involves a number of potential challenges. The failure to meet these integration challenges could seriously harm our financial condition and results of operations. Realizing the benefits of the acquisition will depend in part on the integration of information technology, or IT, operations and personnel. These integration activities are complex and time-consuming and we may encounter unexpected difficulties or incur unexpected costs, including:

- our inability to achieve the operating synergies anticipated in the acquisition;
- diversion of management attention from ongoing business concerns to integration matters;
- difficulties in consolidating and rationalizing IT platforms and administrative infrastructures;
- complexities associated with managing the geographic separation of the combined businesses and consolidating multiple physical locations where management may determine consolidation is desirable;
- difficulties in integrating personnel from different corporate cultures while maintaining focus on providing consistent, high quality customer service;
- challenges in demonstrating to customers of Kratos and to customers of Gichner that the acquisition will not result in adverse changes in customer service standards or business focus; and
- possible cash flow interruption or loss of revenue as a result of change of ownership transitional matters.

We may not successfully integrate the operations of the businesses of Gichner in a timely manner, and we may not realize the anticipated benefits and synergies of the merger with Gichner to the extent, or in the time frame, anticipated.

Failure to complete the acquisition could adversely affect our stock prices and our future business and financial results.

Completion of the acquisition is conditioned upon, among other things, our obtaining sufficient financing on terms and conditions acceptable to us, in our sole discretion. If we do not obtain financing on terms acceptable to us, or the other conditions to the acquisition are not satisfied, we may not complete the acquisition or realize the anticipated benefits of the acquisition. In addition, the market price of our common stock may reflect various market assumptions as to whether the financing and acquisition will occur. Consequently, the failure to complete the financing and acquisition could result in a significant change in the market price of our common stock.

We expect to significantly increase our leverage in connection with our financing of our acquisition of Gichner.

We expect to incur approximately $200 million of indebtedness in connection with our financing of our acquisition of Gichner. As a result of this indebtedness, our interest payment obligations will increase. The degree to which we will be leveraged could have adverse effects on our business, including the following:

- it may make it difficult for us to satisfy our obligations under the notes and our other indebtedness and contractual and commercial commitments;
- it may require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- it may limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;
- it may restrict us from making strategic acquisitions or exploiting business opportunities;
- it may place us at a competitive disadvantage compared to our competitors that have less debt;
- it may limit our ability to borrow additional funds;
- it may prevent us from raising the funds necessary to repurchase notes tendered to us if there is a change of control, which would constitute a default under the indenture governing the notes and under our credit facility; and
- it may decrease our ability to compete effectively or operate successfully under adverse economic and industry conditions.

Additionally, we expect that the terms governing any financing will not prevent us from incurring additional indebtedness. If new debt is incurred, these risks may intensify. Our ability to meet our debt service obligations will depend upon our future performance, which may be subject to the financial, business and other factors affecting our operations, many of which are beyond our control.

Any increase in our debt service obligations may adversely affect our cash flow.

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

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

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

If we are unable to manage our growth profitably after the acquisition is completed, our business and financial results could suffer.

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

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

The announcement and pendency of the transaction could cause disruptions in the business of Gichner. Specifically:

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

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

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

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

If the acquisition of Gichner is completed, we will become subject to environmental laws and potential exposure to environmental liabilities. This may affect our ability to develop, sell or rent our property or to borrow money where such property is required to be used as collateral.

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

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

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

None

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Reserved

Item 5. Other Information.

On March 29, 2010, the U.S. District Court for the Southern District of California entered a Final Judgment and Order of Dismissal (the "Judgment") approving a proposed settlement of the previously disclosed shareholder derivative claims in *In re Wireless Facilities, Inc. Derivative Litigation*, Case No. 04-CV-1663 JAH (NLS), as described in Part II, Item 1 of this quarterly report and in Note 12 to our financial statements. The terms of settlement approved by the Judgment are contained in the Stipulation and Agreement of Settlement of Derivative Claims (the "Settlement Agreement") dated January 5, 2010, between the Company; Plaintiffs, including Federal Plaintiffs Rosario Pedicini and Michael Roth, and State Plaintiffs Mary Beth Joseph and Robert Casden, individually and on behalf of their successors, spouses, heirs, executors, administrators, and assigns, and on behalf of the Company; and Individual Defendants, including Masood Tayebi, Thomas A. Munro, Terry M. Ashwill, Daniel G. Stokely, Eric DeMarco, David A. Garrison, Frankie Farjood, Massih Tayebi, David Lee, William A. Owners, Bandel L. Carano, James R. Edwards, Scott Fox, Deanna H. Lund, Andrew M. Leitch, Laura Siegal, Naomi D. Whitacre, William Bradford Weller, George Wozencraft, William Mazilly, and the Specially Appearing Defendants Farzad Ghassemi, Gerogery Jacobsen, Scott I. Anderson, Scot Jarvis, and William Hoglund. The time to file a notice of appeal has expired and the Settlement Agreement has become effective.

Under the terms of the Settlement Agreement, the Board has agreed to adopt certain corporate governance enhancements. The Company has already effectuated many of the Settlement Agreement's corporate governance measures, including re-instituting the Board's Nominating and Corporate Governance Committee and continuing to follow certain stock option related controls. In addition, among other things, these corporate governance enhancements require the Board to increase the size of the Board and appoint two independent directors within eighteen months from the Judgment becoming final and provide that the directors of the Company be elected by a majority vote. The Settlement Agreement also requires that certain former and current directors and employees forfeit certain shares of the Company's common stock and options to purchase the Company's common stock within 30 days of the date the Judgment becomes final.

The above description of the material terms of the Settlement Agreement is qualified in its entirety by reference to the text of the Settlement Agreement, which is filed herewith as Exhibit 10.6 to this Form 10-Q.

Item 6. Exhibits

		Incorporated by Reference		
Exhibit Number	Exhibit Description	Form	Filing Date/ Period End Date	Filed— Furnished Herewith
10.1	Sublease Agreement, dated as of December 17, 2009, by and between Amylin Pharmaceuticals, Inc. (Sublessor) and Kratos Defense & Security Solutions, Inc. (Sublessee)	10-K	12/27/2009	
10.2	Separation Agreement and General Release, dated as of December 31, 2009, by and between Kratos Defense & Security Solutions, Inc. and Howard Bates			*
10.3	Credit Agreement, dated as of March 3, 2010, among Kratos Defense & Security Solutions, Inc., KeyBank National Association, as Administrative Agent and Lender, Bank of America, N.A., as Syndication Agent and Lender and the other financial institutions parties thereto with Keybanc Capital Markets and Banc of America Securities, LLC, as Co-Lead Arrangers and Book Runners	8-K	3/8/2010	
10.4	Payoff Letter (First Lien Credit Agreement), dated as of March 3, 2010, between Kratos Defense & Security Solutions, Inc. and KeyBank National Association as Administrative Agent	8-K	3/8/2010	
10.5	Payoff Letter (Second Lien Credit Agreement), dated as of March 3, 2010, between Kratos Defense & Security Solutions, Inc. and KeyBank National Association as Administrative Agent	8-K	3/8/2010	
10.6	Stipulation and Agreement of Settlement of Derivative Claims dated as of January 5, 2010			*
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002			*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002			*

Exhibit Number	Exhibit Description	Incorporated by Reference		Filed—Furnished Herewith
		Form	Filing Date/ Period End Date	
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			*
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			*

* Filed-Furnished Herewith

SIGNATURES

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

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

By: /s/ ERIC M. DEMARCO

Eric M. DeMarco
Chief Executive Officer, President
(Principal Executive Officer)

By: /s/ DEANNA H. LUND, CPA

Deanna H. Lund
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

By: /s/ LAURA L. SIEGAL

Laura L. Siegal
Vice President, Corporate Controller
(Principal Accounting Officer)

Date: April 29, 2010

QuickLinks -- Click here to rapidly navigate through this document

EXHIBIT 10.2

Mr. Howard W. Bates
15960 Bridgewater Club Blvd.
Carmel, IN 46033

Re: Separation Agreement and General Release

Dear Howard:

This letter when signed by you will constitute the full agreement between you and Haverstick Consulting, Inc., (the "Company") on the terms of your separation from employment ("Agreement"). By entering into this Agreement, neither you nor the Company makes any admission of any failing or wrongdoing. Rather, the parties have merely agreed to resolve amicably your employment relationship with the Company and the separation thereof. You understand and agree that the terms, conditions and restrictions set forth in this Agreement inure to the benefit of the Company's affiliates and parent corporations, including without limitation Kratos Defense & Security Solutions, Inc. ("Kratos") and Kratos Government Solutions, Inc. ("KGS"), and "Company" shall be interpreted as appropriate to include one or all of these named entities.

1. If you accept this Agreement, you will no longer be authorized or required to perform any duties or professional services on behalf of the Company for the third and final year of your Amended Employment Agreement dated December 31, 2007 (the "Employment Agreement"), and your active employment with the Company will be considered voluntarily terminated effective 11:59 P.M. December 31, 2009 ("Separation Date"). You agree to work in whatever capacity as directed by the Company until the Separation Date, and you agree also to cooperate thereafter in providing assistance to the Company or its affiliates as needed in its operations and in connection with litigation, as provided in paragraph 10 below.

2. In consideration of your acceptance of this Agreement, you will be entitled to the following items:

   (a) The Company will provide you with an annual salary from January 1, 2010 through December 31, 2010 (the "Salary Continuation Period") at your present base salary of $300,000.00, less ordinary and necessary payroll deductions, payable periodically in accordance with the Company's pay schedule. Concurrent with each salary payment described in the immediately preceding sentence, the Company shall pay you an additional amount equal to the amount of paid time off that you would have earned in the corresponding salary period had you remained an employee during such period at your current compensation level.

(b) You will receive a bonus for fiscal year 2009 in the amount of $57,552, which amount will be paid on or about April 30, 2010.

(c) Your Separation Date shall be considered a "qualifying event" for purposes of triggering your right to continue your group health and dental insurance pursuant to federal law (commonly referred to as "COBRA"). However, as additional consideration for your acceptance of this Agreement, the Company will pay to you in monthly installments an amount equal to the sum of the premiums for (i) group health and dental insurance benefits and (ii) disability insurance, in both cases equal to the amounts paid (or payable) during 2009 for you and, if applicable, your dependents, for the duration of the Salary Continuation Period. After said Salary Continuation Period, you will have the right to continue COBRA coverage at your own expense for the remaining duration, if any, of the COBRA eligibility period. You will receive, under separate cover, information regarding your rights to such continuation coverage. During the Salary Continuation Period, the Company will pay for the Priority Medical Family Access program upon your submission of appropriate invoices therefor to the Company's Vice President, Human Resources.

(d) As additional consideration, the Company will continue to pay you a vehicle allowance of $250 per pay period, less applicable deductions for taxes, during the Salary Continuation Period.

(e) Except as otherwise provided in next sentence, your rights to all unvested stock options granted pursuant to Notices of Grant of Restricted Stock Units (RSUs) prior to your Separation Date will be governed by that Restricted Stock Unit Agreement (Executive Form) made a part of your employment contract, and by the Company's 2005 Equity Incentive Plan (the "Equity Plan"). Effective on the effective date of this Agreement (but subject to Section 6(f) of the Employment Agreement), all RSUs granted to you prior to the date of this Agreement shall be immediately vested in full. You will not be granted any additional RSUs that would otherwise have been granted on January 1, 2010, regardless of any representations to the contrary made prior hereto.

(f) Except as stated above or below, all other benefits, bonuses and compensation end on the Separation Date. Specifically, you will not receive or be eligible for payment of a bonus in 2010, regardless of whether Company meets or exceeds revenue and profit numbers targeted in the annual operating plan, and you will not receive any additional RSUs. However, this Agreement does not affect any existing vested rights that you may have in accrued paid time off, the Company's Equity Plan, or its pension, retirement and/or 401(k) plans. You will receive, under separate cover, information regarding your rights and options, if any, under said plans.

3. In consideration of the payments and benefits provided to you above, the sufficiency of which you acknowledge, you do, on behalf of yourself and your heirs, administrators, executors and assigns, hereby fully, finally and unconditionally release and forever discharge the Company and its parent, subsidiary and affiliated entities and all their former and present officers, directors, shareholders, employees, trustees, fiduciaries, administrators, attorneys, consultants, agents, and other representatives, and all their respective predecessors, successors and assigns (collectively "Released Parties"), in their corporate, personal and representative capacities, from any and all obligations, rights, claims, damages, costs, attorneys' fees, suits and demands, of any and every kind, nature and character, known or unknown, liquidated or unliquidated, absolute or contingent, in law or in equity, enforceable under any local, state or federal common law, constitution, statute or ordinance, arising prior to or through the date you execute this Agreement, including but not limited to obligations, rights, claims, damages, costs, attorneys' fees, suits and demands which arise from or relate to your past employment with the Company or the termination thereof, including (other than as expressly provided below) any rights you have under the Amended Employment Agreement with the Company, or any past actions or omissions of the Company or any of the Released Parties, including without limitation, rights and claims arising under the Family and Medical Leave Act, Title VII of the Civil Rights Act of 1964, as amended, the Americans with Disabilities Act of 1990, as amended, the Age Discrimination in Employment Act of 1967, as amended, the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended, the Employee Retirement Income Security Act of 1974, as amended, and section 806 of the Sarbanes-Oxley Act of 2002. YOU SPECIFICALLY AGREE AND ACKNOWLEDGE THAT YOU ARE WAIVING ANY RIGHT TO RECOVERY BASED ON STATE OR FEDERAL AGE, SEX, RACE, COLOR, NATIONAL ORIGIN, MARITAL STATUS, RELIGION, VETERAN STATUS, DISABILITY, SEXUAL ORIENTATION, MEDICAL CONDITION OR OTHER ANTI-DISCRIMINATION LAWS. Subject to applicable law, you also warrant that you have not filed or sued and will not sue or file any actions against the Company or any of the Released Parties with respect to claims covered by this release.

You recognize and understand that the foregoing is a general release by which you are giving up the opportunity to obtain compensation, damages, and other forms of relief for yourself. By signing this Agreement you waive any right to personally recover against the Released Parties, and you give up the opportunity to obtain compensation, damages or other forms of relief other than that provided in this Agreement.

4. Notwithstanding the release set forth in Section 3 above, the Indemnification Agreement between you and the Company dated April 13, 2009 shall continue in full force and effect and the release set forth in Section 3 shall not apply to, and shall not release, any obligations, rights, claims, damages, costs, attorneys' fees, suits or demands under the Company's Certificate of Incorporation or Bylaws or any applicable statute related to indemnification or the advancement or reimbursement of expenses thereunder. For purposes of clarity and to avoid any dispute, the Company acknowledges and agrees that any involvement of the type described in Section 7 of the Employment Agreement in a MBE, a WBE, a Section 8(a) company, a Service Disabled Organization, a Hub Zone business or any other preferentially treated business will not constitute or be deemed to be involvement in a business that is engaged in a business substantially similar to the Restricted Business (as defined in Section 7 of the Employment Agreement) ; provided, however, that the foregoing shall not be deemed to permit you to pursue any «full and open» contract awards on behalf of any of the businesses listed in the foregoing proviso nor to directly compete with similar businesses that have teamed with the Company to pursue an individual contract award . In addition, Sections 6(f) (with respect to section 2(e) above), 7, 8, 9, 10 and 11 of the Employment Agreement shall survive and continue in full force and effect. Within seven (7) days following the date of this Agreement, the Company shall provide you with a favorable letter of reference executed by Eric DeMarco regarding your performance as an officer of the Company. You shall have the opportunity to review and comment on the letter, and the Company shall make such revisions as you may reasonably request.

5. You agree to return to the Company on or before December 31, 2009 all of the Company's property, including, without limitation, any electronic or paper documents and records and copies thereof that you received or acquired during your employment regarding the Company's practices, procedures, trade secrets, customer lists, or product marketing, and that you will not use the same for your own purpose. Subject to applicable law, in the event that you breach any of your obligations under this Agreement, the Company is entitled to stop your salary continuation payments and to obtain all other relief provided by law or equity.

6. You understand and agree that this Agreement contemplates and memorializes an unequivocal, complete and final dissolution of your employment relationship with the Company, and that, therefore, you have no right to be reinstated to employment with or rehired by the Company, and that in the future, the Company and its affiliated and related entities and their successors and assigns shall have no obligation to consider you for employment.

7. It is agreed that neither you nor the Company, nor any of its officers, directors or employees, makes any admission of any failing or wrongdoing or violation of any local, state or federal law by entering into this Agreement, and that the parties have entered into this Agreement simply to resolve your employment relationship in an amicable manner.

8. Subject to the limitations set forth below, throughout the Salary Continuation Period and thereafter, you agree, upon reasonable notice, to advise and assist the Company and its counsel in preparing such operational, financial and other reports, or other filings and documents, as the Company may reasonably request, and otherwise cooperate with the Company and its affiliates with any request for information. Subject to the limitations set forth below, upon reasonable notice, you also agree during the Salary Continuation Period and at any time thereafter to assist the Company and its counsel in prosecuting or defending against any litigation, proceeding, inquiry or investigation arising from any charge or other action that has been or may be filed by or against the Company or any of its subsidiaries or affiliates, including without limitation all pending and future litigation that involves any aspect of the operation of the Company's business overseen by or involving you or any other litigation involving the Company. The Company shall pay your necessary travel costs and expenses in the event it requires you to assist it under this paragraph. The obligations to provide services described above without further compensation shall be limited to a maximum of 120 hours during the Salary Continuation Period and, subject to such maximum, a futher maximum of 30 hours in any month during the Salary Continuation Period. The obligation to provide services described above after the Salary Continuation Period shall be subject to the agreement of you and the Company, both acting reasonably in good faith, upon an hourly rate that will be paid to you for such services.

9. You hereby resign all of your positions as a director and/or officer in the Company and any of its subsidiaries, and without further compensation, you agree to sign any documents reasonably requested by the Company to accomplish such purpose.

10. You acknowledge and agree that this Agreement sets forth the entire understanding between the parties concerning the matters discussed herein, that no promise or inducement has been offered to you to enter into this Agreement except as expressly set forth herein, and that the provisions of this Agreement are severable such that if any part of the Agreement is found to be unenforceable, the other parts shall remain fully valid and enforceable.

11. This Agreement supersedes and replaces all prior agreements regarding the same subject matter.

12. This Agreement will be governed and interpreted in accordance with Indiana law.

13. You are hereby advised in writing to consult an attorney prior to executing this Agreement. You have twenty-one (21) days from your receipt of this letter to accept the terms of this Agreement. You may accept and execute this Agreement within those 21 days.

If you accept the terms of this Agreement, please date and sign this letter and return it to me. Once you execute this Agreement, you have seven (7) days in which to revoke in writing your acceptance by providing the same to me, and such revocation will render this Agreement null and void. If you do not revoke your acceptance in writing and provide it to me by midnight on the seventh day, this Agreement shall be effective the day after the seven-day revocation period has elapsed.

Sincerely,

____

Name: ____________________________________

Title: ____________________________________
Kratos Defense & Security Solutions, Inc.

By signing this letter, I represent and warrant that I have not been the victim of age or other discrimination or wrongful treatment in my employment and the termination thereof. I further acknowledge that the Company advised me in writing to consult with an attorney, that I had at least twenty-one (21) days to consider this Agreement, that I received all information necessary to make an informed decision and I had the opportunity to request and receive additional information, that I understand and agree to the terms of this Agreement, that I have seven (7) days in which to revoke my acceptance of this Agreement, and that I am signing this Agreement voluntarily with full knowledge and understanding of its contents.

Dated: ____________________________________

Name: ____________________________________
Howard W. Bates

QuickLinks

[EXHIBIT 10.2](#)

Exhibit 10.6

SEAN T. PROSSER (CA SBN 163903)
TYSON E. MARSHALL (CA SBN 222488)
MORRISON & FOERSTER LLP
12531 High Bluff Drive, Suite 100
San Diego, California 92130-2040
Telephone: (858) 720-5100
Facsimile: (858) 720-5125
sprosser@mofo.com

JORDAN ETH (CA SBN 121617)
DOROTHY L. FERNANDEZ (CA SBN 184266)
MORRISON & FOERSTER LLP
425 Market Street
San Francisco, California 94105-2482
Telephone: (415) 268-7000
Facsimile: (415) 268-7522
jeth@mofo.com

Attorneys for Nominal Defendant WIRELESS FACILITIES, INC.; Individual Defendants THOMAS A. MUNRO, DANIEL STOKELY, ERIC DEMARCO, DAVID A. GARRISON, FRANKIE FARJOOD, DAVID LEE, WILLIAM A. OWENS, BANDEL CARANO, JAMES R. EDWARDS, SCOTT FOX, DEANNA H. LUND, ANDREW M. LEITCH, LAURA SIEGAL, NAOMI D. WHITACRE, GEORGE WOZENCRAFT, and WILLIAM MAZILLY; and Specially Appearing Defendants FARZAD GHASSEMI, GREGORY JACOBSEN, SCOTT I. ANDERSON, SCOT JARVIS, and WILLIAM HOGLUND

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

IN RE WIRELESS FACILITIES, INC., DERIVATIVE LITIGATION This Document Relates to: ALL ACTIONS.	Case No. 04-CV-1663 JAH (NLS) **STIPULATION AND AGREEMENT OF SETTLEMENT OF DERIVATIVE CLAIMS**

This Stipulation and Agreement of Settlement of Derivative Claims ("Stipulation"), to be effective as of January 5, 2010, is made and entered into pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. This Stipulation contains the terms of a settlement (the "Settlement") among Settling Defendants and Plaintiffs(1), for themselves and derivatively on behalf of Kratos Defense & Security Solutions, Inc. (formerly known as Wireless Facilities, Inc.) ("Kratos" or the "Company"), in connection with *In re Wireless Facilities, Inc. Derivative Litigation*, Master File No. 04-CV-1663 JAH (NLS) (the "Federal Action"), currently pending in this Court, and *In re Wireless Facilities, Inc. Derivative Litigation*, GIC 834253 (the "State Action"), currently pending in the Superior Court of the State of California, County of San Diego (collectively, the "Derivative Actions").

---

(1) Unless otherwise defined herein, capitalized words or terms have the meaning as set forth below in the "Definitions" section.

The Stipulation is intended by the Settling Parties to fully, finally, and forever resolve, discharge, and settle the Released Claims and the Derivative Actions upon and subject to the terms and conditions hereof and subject to the approval of the Court.

I. THE DERIVATIVE ACTIONS

On August 4, 2004, Kratos announced, following an extensive analysis of its contingent tax liabilities, its intention to restate its financial statements for fiscal years ended 2000 through 2003 to accrue for certain foreign tax contingencies. Kratos preliminarily estimated an aggregate increase of expenses between $10 and $12 million for those three years. Kratos also announced that it would consider other adjustments related to issues identified as immaterial in prior years.(2)

---

(2) On September 20, 2004, Kratos filed its FY:03 Form 10-K/A, which detailed the announced restatement. In the restatement, Kratos made an approximately $11 million adjustment for tax contingencies, in line with its August 4, 2004 estimate, as well as additional adjustments totaling approximately $30 million over the three-year period.

The day after the Company's August 4 announcement, and roughly a month before it released further details of the restatement, the first of fourteen lawsuits—ten federal securities class actions, two federal derivative actions, and two state derivative actions—was filed. The ten securities class actions were subsequently consolidated into a single action before this Court—*In re Wireless Facilities, Inc. Securities Litigation*, Master File No. 04-CV-1589 JAH (NLS) (S.D. Cal) (the "2004 Federal Class Action").(3) Similarly, in 2005 the two federal derivative lawsuits, brought separately by Federal Plaintiffs Michael Roth and Rosario Pedicini, were consolidated into the Federal Action. The two state derivative lawsuits, brought separately by State Plaintiffs Mary Beth Joseph and Robert Casden, were consolidated into the State Action.(4)

---

(3) On September 3, 2008, this Court preliminarily approved settlement of the 2004 Federal Class Action. On January 13, 2009, following a motion by the parties, this Court granted final approval of the proposed settlement terms, issued its final judgment on the matter, and entered an order dismissing the case with prejudice.

(4) Prior to any response by the defendants to the State Action, the matter was stayed (and remains so) by the San Diego Superior Court pending resolution of the Federal Action.

In March 2005, Federal Plaintiffs filed their Consolidated Verified Shareholder Derivative Complaint ("Consolidated Complaint") against sixteen current or former officers, directors, and employees of Kratos.(5) Federal Plaintiffs alleged that these individuals failed to properly account for foreign tax contingencies, failed to exercise appropriate oversight, engaged in unlawful insider trading, and breached their fiduciary duties to the Company. Federal Plaintiffs asserted eight causes of action in their original Consolidated Complaint, which were related to the Company's announcement that it would restate its financial statements for fiscal years 2000 to 2003. The claims were also related to Federal Plaintiffs' allegation that the defendants knew about material misstatements in the Company's accounting.

---

(5) In addition, Kratos was named as a nominal defendant.

In May 2005, six of the individual defendants named in the Consolidated Complaint—Messrs. Gregory ("Jacobsen"), Farzad Ghassemi ("Ghassemi"), William Hoglund ("Hoglund"), Scott I. Anderson ("Anderson"), Scot Jarvis ("Jarvis"), and William Owens ("Owens")—filed a motion to dismiss for lack of personal jurisdiction. The other individual defendants moved to dismiss the Consolidated Complaint for failure to allege adequately the elements of the causes of action. Additionally, Kratos moved to dismiss based on Federal Plaintiffs' purported failure to either make a pre-suit demand or plead with particularity why demand was excused. The Company also moved for a temporary stay pending resolution of the 2004 Federal Class Action. At the request of this Court, in March 2006, all of the defendants withdrew their respective motions without prejudice so that the Court could first determine its jurisdiction over the Specially Appearing Defendants.

Federal Plaintiffs deposed and propounded interrogatories upon those defendants who moved to dismiss for lack of personal jurisdiction. On March 20, 2007, the Court granted the motion as to Messrs. Jacobsen, Ghassemi, Hoglund, Anderson, and Jarvis, dismissing them from the case. However, the Court determined that it had jurisdiction over Mr. Owens.

On March 12, 2007, Kratos announced that it was conducting an internal investigation into its historical stock option grant practices going back to 1998. Kratos also announced that it had identified some option "grants issued between 1998 and 2003 that require[d] further review because their historical measurement dates appear[ed] incorrect and [were] expected to result in adjustments affecting previously issued financial statements." The announcement stated that it was likely that Kratos would restate its financial statements for fiscal years 2000 to 2005.

On March 27, 2007, two weeks after the Company's public announcement that it was conducting the internal stock option review, Federal Plaintiffs filed their Verified Consolidated Amended Shareholder Derivative Complaint for violations of California Corporations Code, Breach of Fiduciary Duty, Abuse of Control, Gross Mismanagement, Waste of Corporate Assets, Unjust Enrichment, Violations of the Sarbanes-Oxley Act of 2002, Accounting, Recission and Constructive Trust ("Amended Complaint") against all of the individuals originally named in the prior Consolidated Complaint, including those previously dismissed for lack of jurisdiction. Federal Plaintiffs also added nine new defendants, including William Mazilly ("Mazilly"), who asserted that he was a resident of Louisiana.

The Amended Complaint contains the original financial reporting and accounting allegations regarding the 2004 restatement and added new allegations that certain defendants "backdated" or "springloaded" employee stock option grants so that the options were granted at less than fair market value. Federal Plaintiffs asserted five new causes of action in the Amended Complaint, each relating to the Company's announcement that it was conducting an internal investigation into its stock option grant practices.(6)

---

(6) In April 2007, purported Kratos stockholder Eamen Hameed filed a federal derivative complaint purportedly on behalf of Kratos and against a subset of the same current and/or former officers and directors named in the Federal and State Actions—*Hameed v. Tayebi*, No. 07-CV-0680 BTM (RBB) (S.D. Cal.) (the "Hameed Action"). The Hameed Action arose from Kratos' March 2007 announcement that it was conducting the internal stock option review and alleged that certain defendants allowed company insiders to backdate stock option grants, so that stock options were priced below fair market value on the day they were actually granted, and that as a result, Kratos' relevant U.S. Securities and Exchange Commission ("SEC") filings were false and misleading. On August 18, 2008, Hameed voluntarily dismissed the Hameed Action pursuant to Federal Rule of Civil Procedure 41(a). Additionally, in November 2007, a consolidated federal class action securities lawsuit—*In re Wireless Facilities, Inc. Securities Litigation II*, Master File No. 07-CV-00482-BTM (NLS) (S.D. Cal.) (the "2007 Federal Class Action")—was filed in this Court, alleging that Kratos backdated or springloaded employee stock option grants. On September 3, 2008, this Court preliminarily approved settlement of the 2007 Federal Class Action. On December 19, 2008, this Court granted final approval of the proposed settlement terms, issued its final judgment on the matter, and entered an order dismissing the case with prejudice.

On July 2, 2007, the five defendants previously dismissed for lack of personal jurisdiction, joined now by Mr. Mazilly, moved to dismiss the Amended Complaint on the ground that the Court still lacked jurisdiction over them despite the new stock option allegations. Again, the remaining defendants were not required to respond to the Amended Complaint until the Court determined the jurisdictional issues. Federal Plaintiffs opposed the motion to dismiss on September 25, 2007.

On February 26, 2008, the Court granted the jurisdictional motion to dismiss as to the previously-dismissed defendants. However, the Court determined that it had jurisdiction over Mr. Mazilly. Federal Plaintiffs subsequently moved the Court, pursuant to Federal Rule of Civil Procedure 54(b), for certification and entry of final judgment of the Court's February 2008 Order so that Federal Plaintiffs might appeal the Order to the Ninth Circuit Court of Appeals. The defendants to the Federal Action took no position with respect to Federal Plaintiffs' Rule 54(b) motion, but instead requested that in the event the Court granted the motion and certified the jurisdictional Order, that the Court stay all proceedings in the matter unrelated to personal jurisdiction pending the appeal.

On July 10, 2008, the Court granted Federal Plaintiffs' motion for certification, but held that a stay of all unrelated proceedings was premature at that time. On August 12, 2008, Federal Plaintiffs filed a notice of appeal of the jurisdictional order.

On August 25, 2008, in an effort to resolve the Derivative Actions, the Settling Parties mediated the matters before Judge Daniel Weinstein (Ret.) of JAMS. While a settlement agreement was not reached during the mediation, the Settling Parties, along with the assistance of the mediator, continued to pursue extensive good-faith settlement negotiations. In addition, certain of the Settling Parties participated in further in-person meetings with the mediator in February 2009. While a settlement agreement was not reached following the February 2009 meetings, the Settling Parties, along with the assistance of the mediator, continued to pursue additional extensive good-faith settlement negotiations. In October 2009, the Settling Parties agreed in principle to settle the Derivative Actions on terms set forth in this Stipulation and subject to Court approval.

II. PLAINTIFFS' CLAIMS AND BENEFITS OF SETTLEMENT

Plaintiffs believe that the claims asserted in the Derivative Actions have merit. However, Plaintiffs' Counsel recognize and acknowledge the expense and length of continued proceedings necessary to prosecute the Derivative Actions on behalf of Kratos through at least one appeal and potentially through trial. Plaintiffs' Counsel have conducted an investigation of the claims asserted in the Derivative Actions, including research of publicly available information and review of certain documents requested by and provided to Plaintiffs' Counsel by Kratos and certain defendants. Plaintiffs' Counsel also have taken into account the uncertain outcome and the risk of any litigation, especially in complex actions such as the Derivative Actions, as well as the difficulties and delays inherent in such litigation. Plaintiffs' Counsel also are mindful of the inherent problems of proof of, and possible defenses to, the causes of action asserted in the Derivative Actions. Plaintiffs' Counsel believe that the Settlement set forth in this Stipulation confers substantial benefits upon, and is in the best interest of, Kratos, its shareholders, and Plaintiffs.

III. SETTLING DEFENDANTS' DENIAL OF WRONGDOING AND LIABILITY

The Settling Defendants have denied and continue to deny each and all of the claims and contentions alleged in the Derivative Actions. The Individual Defendants expressly have denied and continue to deny all charges of wrongdoing or liability against them or any of them arising out of any of the conduct, statements, acts, or omissions alleged, or that could have been alleged, in the Derivative Actions. The Individual Defendants also have denied and continue to deny, *inter alia*: (i) that they violated the federal securities laws, violated state law, or breached their fiduciary duties; (ii) the allegations that Kratos has suffered damage; (iii) that the price of Kratos securities was artificially inflated by reason of alleged misrepresentations, non-disclosures, or otherwise; (iv) that Kratos was harmed by any of the conduct alleged in the Derivative Actions; and (v) that a majority of the Board of Kratos was not independent and disinterested during the relevant periods.

Nonetheless, the Settling Defendants have concluded that further conduct of the Derivative Actions would be protracted, expensive, and distracting to themselves, Kratos, and its management, and that it is desirable and beneficial to them that the Derivative Actions be fully and finally settled in the manner and upon the terms and conditions set forth in this Stipulation, in order to limit further expense, inconvenience, and distraction, and to dispose of the burden of protracted litigation. The Settling Defendants have also taken into account the uncertainty and risks inherent in any litigation, especially in complex cases like these Derivative Actions. Kratos has determined that it is in its best interest to enter into this Stipulation because Kratos will receive substantial benefits from the agreed-upon Settlement.

IV. TERMS OF STIPULATION AND AGREEMENT OF SETTLEMENT

NOW, THEREFORE, IT IS HEREBY STIPULATED AND AGREED by and among Plaintiffs (on behalf of themselves and derivatively on behalf of Kratos), nominal defendant Kratos, and the Individual Defendants, by and through their respective counsel or attorneys of record, that, subject to the approval of the Court, the Derivative Actions and the Released Claims shall be finally and fully compromised, settled, and released, and the Derivative Actions shall be dismissed with prejudice as to the Settling Parties, upon and subject to the terms and conditions of the Stipulation, as follows:

1. Definitions

As used in this Stipulation, the following terms have the meanings specified below:

1.1 "Court" means the United States District Court for the Southern District of California.

1.2 "Current Kratos Stockholders"—for purposes of publication of the Summary Notice of Pendency and Settlement of Derivative Actions and the Notice of Pendency and Settlement of Derivative Actions—means all record and beneficial owners of Kratos capital stock of all classes and series on the date the Stipulation is executed.

1.3 "D&O Insurers" means Kratos' applicable director and officer liability coverage insurance providers.

1.4 "Effective Date" means the first date by which all of the events and conditions specified in ¶8.1 of this Stipulation have been met and have occurred.

1.5 "Federal Plaintiffs" means Rosario Pedicini and Michael Roth.

1.6 "Fees and Expenses Payment" means the payment of Plaintiffs' Counsels' attorneys' fees and expenses as contemplated by ¶¶5.1-5.3 of the Stipulation.

1.7 "Final" means the latest of: (a) the date of final affirmance on an appeal of the Judgment, the expiration of the time for a petition for or a denial of a writ of certiorari to review the Judgment and, if certiorari is granted, the date of final affirmance of the Judgment following review pursuant to that grant; (b) the date of final dismissal of any appeal from the Judgment or the final dismissal, denial or withdrawal of any proceeding on certiorari to review the Judgment; or (c) if no appeal is filed, the expiration date of the applicable time to file a notice of appeal from the Judgment.

1.8 "Independent Director" means a member of Kratos' Board of Directors (the "Board") that: (a) has not been employed by the Company or its subsidiaries or affiliates within the last three calendar years; (b) has not received, during the current calendar year or any of the three immediately preceding calendar years, remuneration, other than *de minimis* remuneration, as a result of service as or compensation paid to an entity affiliated with an individual who serves as an advisor, consultant, or legal counsel to the Company or to a member of its senior management, except for such compensation received in his or her capacity as a director of the Company;(7) (c) has no personal service contract(s) with the Company, or with any member of its senior management; (d) is not a current executive officer of a customer of the Company; (e) is not a director, trustee, or officer with a not-for-profit entity that receives significant contributions from the Company; (f) during the current calendar year or any of the three immediately preceding calendar years, has not had any business relationship with the Company for which the Company has been required to make disclosure under Regulation S-K of the Securities and Exchange Commission, other than for service as a director or for which relationship no more than *de minimis* remuneration was received in any one such year; provided, however, that the need to disclose any relationship that existed prior to a director joining the Board shall not in and of itself render the director non-independent; (g) is not employed by a public company at which an executive officer of the Company is a member of such other company's compensation committee; (h) has not had any of the relationships described above, with any controlled affiliate of the Company; and (i) is not a member of the immediate family of any person who fails to satisfy the criteria described above.

---

(7) A director is deemed to have received remuneration (other than as a director, including remuneration provided to a non-executive Chairman of the Board or Committee Chairman) if remuneration, other than *de minimis* remuneration, was paid by the Company, its subsidiaries or affiliates, to any entity, in which the director has a beneficial ownership interest of 5% or more, or to an entity by which the director is employed or self-employed other than as a director. Remuneration is deemed *de minimis* if such remuneration is less than $60,000 in any calendar year, or if such remuneration is paid to an entity, it: (i) did not for the calendar year exceed the lesser of $1 million, or 5% of the gross revenues of the entity; and (ii) did not directly result in a material increase in the compensation received by the director from that entity.

1.9 "Individual Defendants" means Masood Tayebi, Thomas A. Munro, Terry M. Ashwill, Daniel G. Stokely, Eric Demarco, David A. Garrison, Frankie Farjood, Massih Tayebi, David Lee, William A. Owens, Bandel L. Carano, James R. Edwards, Scott Fox, Deanna H. Lund, Andrew M. Leitch, Laura Siegal, Naomi D. Whitacre, William Bradford Weller, George Wozencraft, and William Mazilly. "Individual Defendants" includes Specially Appearing Defendants Farzad Ghassemi, Gregory Jacobsen, Scott I. Anderson, Scot Jarvis, and William Hoglund.(8)

---

(8) In March 2007 and again in February 2008, the Court dismissed Specially Appearing Defendants Gregory Jacobsen, Farzad Ghassemi, William Hoglund, Scott Anderson, and Scot Jarvis from the Federal Action for lack of personal jurisdiction. Federal Plaintiffs subsequently moved the Court, pursuant to Federal Rule of Civil Procedure 54(b), for certification and entry of final judgment of the Court's February 2008 Order dismissing the non-residents for lack of personal jurisdiction. On July 10, 2008, the Court granted Federal Plaintiffs' motion for certification. On August 12, 2008, Federal Plaintiffs filed their Notice of Appeal of the February 2008 Order. Due to the ongoing efforts to resolve this matter, and under the direction and supervision of the assigned Ninth Circuit mediator, Federal Plaintiffs have not yet filed their opening appellate brief. By entering into this Stipulation, the Specially Appearing Defendants do not waive, and explicitly reserve, any argument that they might have or that they have made that California federal or state courts lack personal jurisdiction over them as to the Derivative Actions or any other matter. For purposes of this Stipulation, the Specially Appearing Defendants will waive personal jurisdiction for the limited purpose to effectuate the Settlement and Judgment.

1.10 "Individual Defendant Releasees" means Individual Defendants and each of their past, present, or future directors, officers, employees, partners, insurers, co-insurers, reinsurers, principals, agents, controlling shareholders, attorneys, accountants or auditors, advisors, investment advisors, personal or legal representatives, predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities, immediate family, and any trusts in which Individual Defendant Releasees, or any of them, are the settlors or which are for the benefit of any Individual Defendant Releasees and/or members of their/his/her immediate family, and any entities in which Individual Defendants, or any of them, have a controlling interest (directly or indirectly).

1.11 "Judgment" means the Final Judgment and Order of Dismissal to be rendered by the Court, substantially in the form attached hereto as Exhibit A, or as modified pursuant to the written agreement of the Settling Parties.

1.12 "Kratos" or the "Company" means nominal defendant Kratos Defense & Security Solutions, Inc. (formally known as Wireless Facilities, Inc.), a Delaware corporation with its principal place of business in San Diego, California, including any of its predecessors, successors, parents, subsidiaries, divisions, affiliates or related affiliates, and assigns.

1.13 "Kratos' Counsel" means the law firm of Morrison & Foerster LLP.

1.14 "Kratos Releasees," which does not include Individual Defendant Releasees, means Kratos and each of its past, present, or future directors, officers, employees, partners, insurers,(9) co-insurers, reinsurers, principals, agents, controlling shareholders, attorneys, accountants or auditors, advisors, investment advisors, personal or legal representatives, predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities, immediate family, and any trusts in which the Kratos Releasees, or any of them, are the settlors or which are for the benefit of any Kratos Releasees and/or members of their/his/her immediate family, and any entities in which Kratos has a controlling interest (directly or indirectly).

---

(9) In April 2009, Kratos commenced litigation against Federal Insurance Company ("Federal") for breach of contract, breach of implied warranty, tortious breach of the covenant of good faith and fair dealing, and declaratory relief—*Kratos Defense & Security, Inc. v. Federal Insurance Co*., 2:09-cv-03462-FMC-PJWx (C.D. Cal.). That case, which arose out of Federal's alleged wrongful refusal to cover defense costs and other losses suffered by Kratos resulting from several lawsuits and government investigations, including the Derivative Actions, is currently pending in the United States District Court, Central District of California. Notwithstanding this Stipulation, Kratos and its insurance carriers issuing policies for Kratos for the policy period of November 3, 2003 to November 3, 2004 do not waive or in any way release Federal, whether based on the litigation currently against it or otherwise, or any other insurance carrier issuing policies for Kratos for the period of December 3, 2006 to December 3, 2007, for any matter whatsoever.

1.15 "Kratos Stockholders" means all past or present record and beneficial owners of Kratos capital stock of all classes and series through the date the Judgment become Final.

1.16 "Person" means a natural person, individual, corporation, partnership, limited partnership, limited liability company, association, joint venture, joint venturer, joint stock company, estate, legal representative, trust, unincorporated association, government or any political subdivision or agency thereof, and any business or legal entity and, as applicable, their/its respective spouses, heirs, executors, administrators, predecessors, successors, representatives, or assignees.

1.17 "Plaintiffs" collectively means Federal Plaintiffs Rosario Pedicini and Michael Roth, and State Plaintiffs Mary Beth Joseph and Robert Casden, individually and on behalf of their successors, spouses, heirs, executors, administrators, and assigns, and on behalf of Kratos.

1.18 "Plaintiffs' Counsel" means the law firms of Robbins Umeda LLP and Faruqi & Faruqi, LLP. Plaintiffs' Counsel is Co-Lead Counsel for both State and Federal Plaintiffs in the Derivative Actions.

1.19 "Plaintiff Releasees" means each of Plaintiffs and each of their past, present, or future directors, officers, employees, partners, insurers, co-insurers, reinsurers, principals, agents, controlling shareholders, attorneys, accountants or auditors, advisors, investment advisors, personal or legal representatives, predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities, immediate family, and any trust of which any Plaintiff Releasees, or any of them, are the settlors or which is for the benefit of any Plaintiff Releasees and/or members of their/his/her immediate family, and any entity in which Plaintiffs, or any of them, have a controlling interest (directly or indirectly).

1.20 "Released Claims" means any and all claims or causes of action, demands, rights, liabilities, suits, debts, obligations, and causes of action of every nature and description whatsoever, known or unknown (including Unknown Claims as defined herein), contingent or absolute, mature or unmature, discoverable or undiscoverable, whether concealed or hidden asserted derivatively on behalf of Kratos, or that could have been asserted directly by the Settling Parties, derivatively on behalf of Kratos, or by Kratos itself based upon, arising out of, or related to the allegations, facts, transactions, or claims in the Derivative Actions, and any claims in connection with, based upon, or arising out of, or relating to the Settlement.

1.21 "Settlement" means the terms and conditions set forth in the Stipulation.

1.22 "Settling Defendants" means Kratos and each of Individual Defendants.

1.23 "Settling Parties" means Kratos, Plaintiffs (on behalf of themselves and Kratos), and each of Individual Defendants.

1.24 "Specially Appearing Defendants" means dismissed defendants Farzad Ghassemi, Gregory Jacobsen, Scott I. Anderson, Scot Jarvis, and William Hoglund.

1.25 "State Plaintiffs" means Mary Beth Joseph and Robert Casden.

1.26 "Stipulation" means this Stipulation and Agreement of Settlement of Derivative Claims, including any recitals and/or exhibits attached hereto.

1.27 "Unknown Claims" means any Released Claims that a Person, including Plaintiffs, may not know or suspect to exist in his, her, or its favor at the time of the release of Kratos and Individual Defendants which, if known by him, her or it, might have affected his, her, or its settlement and release, or might have affected his, her, or its decision not to object to this Settlement. With respect to any and all Released Claims, the Settling Parties stipulate and agree that, upon the Effective Date, Plaintiffs, Kratos Stockholders, and Kratos shall waive and by operation of the Judgment shall have waived, the provisions, rights, and benefits of California Civil Code §1542, which provides:

> **A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.**

Plaintiffs, Kratos Stockholders, and Kratos shall expressly waive, and by operation of the Judgment shall have expressly waived, any and all provisions, rights, and benefits conferred by any law of any state or territory of the United States, or principle of common law, which is similar, comparable, or equivalent to California Civil Code §1542. Plaintiffs, Kratos Stockholders, and Kratos may hereafter discover facts in addition to or different from those which they now know or believe to be true with respect to the Released Claims, but Plaintiffs, Kratos Stockholders, and Kratos shall expressly fully, finally, and forever settle and release and, upon the Effective Date, shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever settled and released, any and all Released Claims, known or unknown, suspected or unsuspected, contingent or non-contingent, whether or not concealed or hidden, which now exist, or have existed, upon any theory of law or equity now existing or coming into existence in the future, including, but not limited to, conduct which is negligent, intentional, with or without malice, or a breach of any duty, law, or rule, without regard to the subsequent discovery or existence of such different or additional facts. Plaintiffs acknowledge that the foregoing waiver was separately bargained for and a key element of the Settlement of which this release is a part.

2. Return of Stock Options

In connection with the Settlement of the Derivative Actions, the individuals identified immediately below agree to provide the following consideration to Kratos within thirty days from the date the Judgment become Final.

2.1 Masood Tayebi and Massih Tayebi agree to forfeit, collectively, a total of 50,000 shares of Kratos stock to Kratos.

2.2 Scott I. Anderson agrees to forfeit a total of 2,000 shares of Kratos stock to Kratos.

2.3 Scot Jarvis agrees to forfeit a total of 2,000 shares of Kratos stock to Kratos.

2.4 Farhad Farjood agrees to forfeit to Kratos any and all claims relating to 10,000 options to purchase shares of Kratos stock.

2.5 To the extent that William Bradford Weller still owns or controls any options to purchase shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if Mr. Weller holds less than 10,000 options.

2.6 To the extent that Thomas Munro still owns or controls any options to purchase shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if Mr. Munro holds less than 10,000 options.

2.7 To the extent that Terry Ashwill still owns or controls any options to purchase shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if Mr. Ashwill holds less than 10,000 options.(10)

---

(10) In negotiating the Settlement, the Settling Parties originally had agreed upon forfeitures of stock or options to purchase shares of Kratos stock in amounts equal to ten times, respectively, those amounts enumerated in ¶¶2.1-2.7 herein. In August 2009, however, Kratos announced that its Board had approved a 1-for-10 reverse split of its common stock, following approval by Kratos stockholders on June 4, 2009. The record date established for the reverse stock split was September 10, 2009. Proportional adjustments also were made to Kratos' stock options and other equity incentive awards, equity compensation plans, outstanding warrants and convertible notes. Accordingly, the amounts of stock or options to purchase shares of Kratos stock set forth in ¶¶2.1-2.7 herein reflect this 1-for-10 reverse split.

3. Corporate Governance Measures

In full and final settlement of the Derivative Actions, the Kratos Board has agreed to adopt, or to maintain where already implemented, the corporate governance measures outlined below within thirty days from the date the Judgment becomes Final and will keep such measures in force and effect for a period of no less than four years from the date from the date the Judgment becomes Final, except as stated otherwise in ¶3.10(b) below. Kratos acknowledges that Plaintiffs' actions, including the institution and prosecution of the Derivative Actions, were a direct and material factor in the corporate governance policies that have been enacted since the filing of the Derivative Actions and were a material factor in the enactment of the measures that will be adopted within thirty days from the date the Judgment becomes Final. The various measures include:

3.1 *The Board of Directors*

(a) The Board shall adopt a resolution that requires all directors, including the current Board, to attend annually at least one corporate governance class that is designed to keep corporate directors abreast of trends in governance and aware of their fiduciary, legal, and ethical responsibilities.

(b) The Board shall adopt the appropriate resolutions to implement the following corporate governance reforms:

(i) the Company's Board shall be increased by two Independent Directors within eighteen months from the date the Judgment becomes Final;

(ii) each director of the Company shall be elected to the Board by majority vote;

(iii) no individual member of the Board shall be the Chairman of more than one Board committee;

(iv) each director of the Company shall be required to certify in writing annually that he or she has received, read, and understands the guidelines for directors set forth in the Company's Code of Legal and Ethical Conduct;

(v) the performance of the Chairman of the Board shall be evaluated by the Board annually. Should the remaining directors determine that the Board Chairman is not sufficiently active or successful in providing meaningful leadership for the Board, he or she shall be replaced as the Chairman;

(vi) the Company's independent registered public auditing firm may not perform any consulting work for the Company, other than tax consulting work;

(vii) the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") shall be responsible for ensuring that the Company's revenue recognition policy, which conforms to the requirements of GAAP as currently in effect or as amended, is implemented and utilized throughout the Company. The CEO and CFO shall report to the Board on an annual basis regarding the implementation and operation of this policy. The CEO and CFO shall distribute the Company's revenue recognition policy to each such Company employee who records or reviews the recording of revenue and ensure that each such Company employee completes an employee training program concerning the Company's policy on revenue recognition. Any questions regarding that policy or training program, or the application of the policy, shall be directed to the Company's CFO, who shall inform the CEO; and

(viii) at each regularly scheduled Board meeting, the Company's CFO (or his or her designee) shall provide a report as to the Company's financial condition and prospects, including, but not limited to, a discussion of any material decreases in revenues and earnings, if any, management plans for ameliorating or reversing such negative trends and the success or failure of any such plans presented in the past.

3.2 *Responsibilities of the Independent Directors*

(a) The Board shall adopt a resolution requiring that a majority of the members of the Board shall be Independent Directors.

(b) The Independent Directors shall meet separately from the rest of the Board on a quarterly basis.

3.3 *Board Committees*

(a) The Board will re-institute its Nominating and Corporate Governance Committees consisting of no less than two Independent Directors to oversee the nomination of the additional director(s), and to implement and oversee appropriate corporate governance reforms.

(b) The Board's committees shall have standing authorization, in their own discretion, to retain legal or other advisors of their choice, who shall report directly to the Board or committee.

(c) The Bylaws of the Company shall be revised to include specific limits on outside board memberships. The CEO of the Company shall not participate on the board of directors of any more than one additional for-profit corporation (either publicly traded or privately held) for a period of two years,(11) and a majority of Independent Directors shall not serve on more than three boards of directors of publicly held companies, including the Company. Any CEO or other full-time senior corporate officer of another company serving on the Company's Board shall be limited to not more than two public company boards of directors in total, including the boards of directors of such person's own employer and the Company.

---

(11) The CEO will be permitted to serve on the board of directors of not more than one additional company with advance consent of the Nominating and Corporate Governance Committee. In general, however, the CEO shall devote his or her full energies to running the Company.

3.4 *Compensation Committee*

(a) The Company shall have a Compensation Committee Charter that expressly vests in the Compensation Committee the responsibility and obligation to:

(i) approve the Company's stock option grants, including the approval of employees and parties who are to receive stock option grants and the details of those option grants; and

(ii) prevent the granting, issuance, or approval of any stock options that have been or can be market-timed, backdated, or otherwise manipulated.

(b) The Compensation Discussion and Analysis written for the Company's annual Proxy Statement shall address efforts undertaken by the Compensation Committee to design and implement systems and controls to prevent the granting, issuance, and/or approval of market-timed, backdated, or manipulated stock option grants.

(c) The Compensation Committee shall not delegate its authority to grant stock options to a Stock Option Administrator unless the delegated Stock Option Administrator is a member of the Compensation Committee of the Board. If a Stock Option Administrator is delegated the authority to grant stock options, any stock option grant by the Stock Option Administrator must be approved by the entire Compensation Committee.

(d) The Compensation Committee shall select and retain an independent compensation consultant to provide advice and guidance to the Committee as needed. In addition, the consultant shall, at such times as requested by the Committee, conduct a comparative market study of the Company's executive compensation policies, practices, and procedures. This study shall be delivered to the Compensation Committee for its use in evaluating and revising, if necessary, the compensation structure for the Company's executives.

3.5 *Enhanced Internal Audit Function*

(a) The Company shall implement and maintain an enhanced internal audit function. The Company's outside auditor shall not provide this service. The Internal Auditor, who shall be approved by the Board and report directly to the Audit Committee at least annually, shall review the Company's internal control environment. The Internal Auditor shall be responsible for devising an Internal Audit Plan for each fiscal year that will be presented to the Audit Committee.

(b) A written report shall be prepared for each internal audit performed describing the internal audit's findings, opinions, and recommendations, if any. These written reports shall be directed to the CEO, CFO, and the Audit Committee for review and, if necessary, remedial action.

3.6 *Audit Committee*

(a) The Audit Committee shall use its best efforts to have at least two members with an accounting or financial management background. If an Audit Committee member possessing such accounting or financial background resigns, is terminated, or otherwise is removed from his or her directorship on the Audit Committee, the Board shall use its best efforts to replace such director within ninety days of his or her departure with another director that has an accounting or financial management background. These best efforts shall include the commencement of a search to locate an additional Board member with an accounting or financial management background.

(b) The Audit Committee shall have a charter which includes the following provisions:

(i) meetings to be held, among other times, prior to the commencement and prior to the completion of the annual audit;

(ii) each meeting shall include a meeting with appropriate Company management, followed by an executive session with no management present; and

(iii) each meeting shall have a written agenda.

(c) The Audit Committee's responsibilities shall include:

(i) meeting with the Company's independent registered public accounting firm concerning:

(1) the reliability of the Company's forward-looking statements contained in interviews with media agencies, investor conference calls, committee reports, quarterly and annual reports, proxy statements, and press releases disseminated by the Company; and

(2) the reliability of the Company's statements relating to internal financial control mechanisms contained in interviews with media agencies, investor conference calls, committee reports, quarterly and annual reports, proxy statements, and press releases disseminated by the Company.

(ii) meeting with management to ascertain the Company's primary business exposure risks; and

(iii) meeting with the Company's Internal Auditors at year-end regarding:

(1) the nature of the internal audit plan, including the effectiveness and continued use of the policies and procedures of the internal audit plan;

(2) the appropriate staffing levels for the internal audit function;

(3) whether the Company's financial reporting policies and practices are sufficiently transparent; and

(4) whether the Company's financial reporting policies and practices are unusually aggressive.

3.7 *Stock Option Granting Policies and Procedures*

(a) The following stock-option related controls, that already have been implemented by the Company, will be maintained for a period of no less than four years from the date of entry of the Judgment:

(i) segregating certain responsibilities related to option granting and the execution of stock option exercise transactions, including, but not limited to, the Director of Financial Reporting being required to approve exercises and the Assistant Controller/Director of Financial Reporting being required to separately review all entries to the Company's Equity Edge database by the Stock Option Administrator;

(ii) documenting and assessing the design and operating effectiveness of key internal controls over the stock administration function;

(iii) establishing processes and procedures to increase communications between the stock administration, human resources, and accounting functions, including but not limited to, requiring communications between human resources and accounting/finance related to any separation agreement that might result in a modification of terms;

(iv) adding independent reviews and reconciliations of stock option activity separate from the stock administration function;

(v) establishing a consistent, formalized procedure for stock option award procedures including limiting the authority to approve stock option grants;

(vi) upgrading the equity tracking software program and system controls that support the processes and continuing to maintain the most current version of the option tracking software;

(vii) requiring and arranging for training for those employees who utilize the Company's equity tracking software program, as well as all those involved in the stock option granting process, to enhance awareness and understanding of legal, tax, and accounting implications;

(viii) requiring that only an employee independent of the stock administration function be allowed to communicate stock option exercise instructions to the Company's transfer agent;

(ix) requiring quarterly reconciliation of exercises according to transfer agent records versus exercises according to the Equity Edge database to identify any discrepancies;

(x) requiring approval by the Company's Compensation Committee during meetings rather than by use of Unanimous Written Consents;

(xi) requiring the development of an annual option granting plan and option granting matrix;

(xii) dissolving the Company's non-officer stock option committee; and

(xiii) the grant date of all stock options shall be the fifteenth trading day of the month after which they are approved.

(b) All stock option plans adopted by the Company shall clearly define the exercise price, grant date, and the fair market value of stock. The exercise price or value of any equity award shall be determined by fair market value of the Company's stock on the date of the grant. The fair market value of the Company's stock shall be the closing price (or closing bid, if no sales were reported) for a share of the Company's stock on such days as quoted by the exchange or over-the-counter market on which the stock is listed.

(c) Any and all stock option plans that permit market timing or backdating of stock options are void and shall be without force or effect.

(d) Any substitute stock option plan(s) adopted by the Company in the future must expressly prohibit market timing and backdating of stock options.

(e) Any stock option plans shall give the Compensation Committee the sole and exclusive power and duty to administer the Company's stock option plans.

(f) Any and all disclosure requirements concerning executive compensation and stock option grants, including the Sarbanes-Oxley Act of 2002 disclosure requirements, shall be followed by the Company.

(g) All requirements of the Internal Revenue Code as they relate to the granting, issuance, timing, pricing, and treatment of stock options shall be observed and followed by the Company.

(h) The substance of the following clauses shall be included in any current and/or subsequent equity incentive plan, whether subject to stockholder approval or not:

(i) The exercise price for each stock option grant shall be at least 100% of the fair market value on the date of the grant;

(ii) the Company shall give notice of the determination to each employee or consultant to whom a stock option is so granted as soon as reasonably practicable, but in no event shall such notice be given more than thirty days after the date of such grant; and

(iii) authority to grant stock option awards shall be limited to the full Board or the Compensation Committee, consisting of three or more independent directors, and shall not be delegated to any other person or body.

3.8 *Insider Trading Policy*

The Company shall adopt an Insider Trading Policy that provides as follows:

(a) The Insider Trading Policy shall specifically prohibit all Company directors, officers and employees from trading in Company securities while in possession of material, non-public information regarding the Company, including, but not limited to: (i) material, non-public information regarding actual or estimated results of operations and earnings; (ii) material, non-public proposals or agreements relating to mergers, acquisitions or divestitures; and (iii) material, non-public information regarding significant contracts, patents, or new product development.

(b) The Insider Trading Policy shall encourage all directors and Section 16 officers who wish to trade in Company securities to adopt a valid trading plan pursuant to SEC Rule 10b5-1, 17 C.F.R. § 240.10b5-1.

(c) The Insider Trading Policy shall require all other Company employees who wish to trade in Company securities to do so only within prescribed trading windows, to be established by the Board. All Company employees who have not adopted a valid Rule 10b5-1 trading plan shall be prohibited from trading in Company securities, except during open trading windows.

3.9 *Related-Party Transactions*

(a) The Company shall maintain its policy entitled "Conflict of Interest and Related Party Transactions," which became effective on October 9, 2007.

(b) Any material changes to the Conflict of Interest and Related Party Transactions Policy may be made only with the approval of the Board.

3.10 *Additional Controls*

(a) The following additional controls that already have been implemented by the Company will be maintained for a period of no less than four years from the date of entry of the Judgment:

(i) The Company shall continue to maintain its internal Contracts Administration Department, which has been established to ensure that complete contract files are maintained to support the project estimate-at-completion computation. This is accomplished using a database in which all relevant contract administration documents are maintained. As a part of the revised revenue recognition procedures, the database is accessed to update information needed in the period-end estimate-at-completion.

(ii) In conjunction with the Company's month-end and year-end closing procedures, the Company has implemented additional monitoring and review controls over its estimate-at-completion calculations, as well as its invoicing/customer billings procedures and its valuation of accounts receivable balances.

(iii) Shareholder Nominated Director Process. The Independent Directors shall consider and evaluate recommendations for director nominees proposed by a qualified stockholder. The stockholder must submit its director nominee recommendation to the Corporate Secretary in writing and provide the following information:

(1) a statement by the stockholder that: (i) the stockholder is the holder of at least 1% of the Company's capital stock; (ii) the stock has been held for at least one year prior to the date of the submission; and (iii) the stockholder will continue to hold the shares through the date of the annual stockholder meeting;

(2) the candidate's name, age, contact information, and current principal occupation or employment;

(3) a description of the candidate's qualifications and business experience during, at a minimum, the last five years, including the candidate's principal occupation or employment, and the name and principal business of any corporation or other organization in which the candidate was employed;

(4) the candidate's resume; and

(5) three references.

(iv) to be evaluated in connection with the Company's established procedures for evaluating potential director nominees, the qualifying stockholder must provide the stockholder's director nominee recommendation to the Company at least 120 days prior to the anniversary of the date proxy statements were mailed to stockholders in connection with the prior year's annual stockholder meeting.

(b) The Chairman of the Board must not simultaneously hold the position of CEO. Given the importance of finding an appropriate Chairman of the Board, the Company will have four years from the date the Judgment becomes Final to begin complying with this provision. This provision shall remain in effect for a period of no less than four years from the date on which the provision is first implemented.

4. Restriction of Voting Rights

In connection with the Settlement of the Derivative Actions, Masood Tayebi and Massih Tayebi hereby agree that for a period of no less than three years from the date the Judgment becomes Final, they will not exercise any of the voting rights associated with any of the shares of Kratos stock that they personally own or that they control through any trust or other entity. Masood Tayebi and Massih Tayebi shall provide the Company with a signed certification each year stating that they did not exercise any of the voting rights associated with any of the shares they own or control and did not make any material recommendations to anyone exercising voting rights in Kratos stock with respect to the exercise of those rights.

5. Attorneys' Fees and Reimbursement of Expenses

5.1 Subject to Court approval and in recognition of the benefits conferred on Kratos as a direct and material factor resulting from the Derivative Actions, Kratos agrees to pay and/or to cause its D&O Insurer(s) to pay to Plaintiffs' Counsel $2,000,000, based upon an agreement reached between and among Kratos and its D&O Insurer(s) concurrently with this Settlement, for Plaintiffs' Counsel's attorneys' fees and reimbursement of expenses. Kratos also agrees to cause its D&O Insurer(s) to pay to Kratos a substantial portion of past and anticipated future legal fees and related costs, incurred by Defendants' counsel in connection with the Derivative Actions based upon a separate agreement reached between and among Kratos and its D&O Insurer(s) concurrently with this Settlement. Plaintiffs' Counsel shall not seek a fee in excess of $2,000,000 and Kratos will not oppose a fee request by Plaintiffs' Counsel of $2,000,000. Kratos shall cause to be transferred to an account maintained by Plaintiffs' Counsel $2,000,000 within five business days of entry of the order preliminarily approving the Settlement and providing for notice to Current Kratos Stockholders of the hearing on this Settlement. The Fees and Expenses Payment is subject to the obligation of Plaintiffs' Counsel and their law firms (or their successors) to refund that amount plus interest thereon at the then-current ninety-day T-Bill rate, in the event of a reversal or modification on appeal or if the Effective Date does not occur. Said refund shall be paid to Kratos within ten business days of written notification of that event.

5.2 In the event the Stipulation shall terminate, or be canceled, or shall not become effective for any reason, or if the Judgment or the order awarding fees and expenses is reversed or modified on appeal, within ten business days after written notification of such event is sent by Kratos' Counsel to Plaintiffs' Counsel, the Fees and Expenses Payment (including any accrued interest), or portion thereof, shall be refunded by Plaintiffs' Counsel to Kratos in an amount consistent with such reversal or modification. Plaintiffs' Counsel, as a condition of receiving such fees and reimbursement of expenses, on behalf of itself and each of its partners and/or shareholders, agrees that the law firm and its partners and/or shareholders are subject to the jurisdiction of the Court for the purpose of enforcing the Stipulation. Without limitation, each such law firm and its partners and/or shareholders agree that the Court may, upon application of Kratos or Individual Defendants and on notice to Plaintiffs' Counsel, summarily issue orders, including but not limited to, judgments and attachment orders, and may make appropriate findings of or sanctions for contempt, against them or any of them should such law firm fail to timely repay the Fees and Expenses Payment it received.

5.3 Plaintiffs' Counsel shall have sole responsibility for apportioning and distributing the Fees and Expenses Payment, and in no event shall Individual Defendants or Kratos have any obligations or liability with respect to that apportionment or distribution, and/or to any Person who may assert some claim thereto.

5.4 Any order or proceedings relating to the Fees and Expenses Payment, or any appeal from any order relating thereto or reversal or modification thereof, shall not operate to terminate, modify or cancel the Stipulation, or affect or delay the finality of the Judgment approving the Stipulation and the settlement of the Action.

5.5 Except as expressly provided for in ¶¶5.1-5.3 above, Plaintiffs and Plaintiffs' Counsel shall bear their own attorneys' fees and costs incurred in connection with the matters set forth in this Stipulation.

6. Preliminary Approval, Notice Orders, and Settlement Hearing

6.1 Within thirty calendar days after the execution of this Stipulation, counsel for the Settling Parties, or any of them, shall submit this Stipulation together with its Exhibits to the Court and shall apply for entry of an order, substantially in the form of Exhibit B attached hereto, preliminarily approving the Settlement set forth in the Stipulation, and providing for notice of Current Kratos Stockholders of the hearing on this Settlement (the "Preliminary Approval Order"). Such order shall specifically include provisions that will:

(a) preliminarily approve this Stipulation and the Settlement set forth herein;

(b) approve the Summary Notice of Pendency and Settlement of Derivative Actions (the "Summary Notice"), substantially in the form of Exhibit B-1 attached hereto, for publication in a national financial newspaper, such as *Investor's Business Daily*, and a nationally recognized newswire, such as PR Newswire;

(c) approve the Notice of Pendency and Settlement of Derivative Actions (the "Notice"), substantially in the form of Exhibit B-2 attached hereto, for posting on the websites of Kratos and Robbins Umeda LLP, and for filing by Kratos with the SEC via a Form 8-K;

(d) find that the Notice and Summary Notice given pursuant to subparagraph (b) above constitutes the best notice practicable under the circumstances and is valid, due, and sufficient notice to all such Persons under California and/or Delaware law, the United States Constitution, and any other applicable law;

(e) schedule a hearing (the "Settlement Hearing") to be held by the Court to determine whether the proposed Settlement as contained in this Stipulation should be approved as fair, just, reasonable, and adequate and the Judgment approving the Settlement should be entered;

(f) provide that any objections by Current Kratos Stockholders to: (i) the proposed Settlement contained in this Stipulation, or (ii) the entry of the Judgment approving the Settlement shall be heard, and any papers submitted in support of said objections shall be received and considered by the Court at the hearing only if, on or before a date to specified in the Notice, Persons making objections file notice of their intention to appear and copies of any papers in support of their position with the Clerk of the Court and serve such notice and papers on counsel as identified in the Notice;

(g) provide that pending final determination of whether the Settlement contained in this Stipulation should be approved, neither Plaintiffs, nor any Kratos Stockholder, either directly, representatively, derivatively, or in any other capacity, shall commence or prosecute any action or proceeding in any court or tribunal asserting any of the claims released in this Stipulation against Settling Defendants;

(h) provide that the Settlement Hearing may, from time to time and without further notice to the Current Kratos Stockholders, be continued or adjourned by order of the Court;

(i) provide that Kratos shall be solely responsible for, and shall cause to be paid, the cost of printing and dissemination of the Notice.

7. Releases and Bar

7.1 Upon the Effective Date, Plaintiffs, on behalf of themselves and, to the fullest extent permitted by law, on behalf of Kratos Stockholders, shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished, and discharged all Released

Claims (including Unknown Claims), and any and all claims relating to or arising out of or connected with the Settlement or resolution of the Derivative Actions, against Individual Defendant Releasees and Kratos Releasees, except for obligations imposed by the Stipulation in connection with the Settlement.

7.2 Upon the Effective Date, Kratos and the Individual Defendants shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished, and discharged Plaintiff Releasees from all claims (including Unknown Claims), arising out of, based upon or related to the institution, prosecution, assertion, settlement, or resolution of the Derivative Actions and/or the Released Claims, except for obligations imposed by the Stipulation in connection with the Settlement.

7.3 Upon the Effective Date, each of the Individual Defendants shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished, and discharged Kratos Releasees from all claims (including all Unknown Claims) arising out of, based upon or related to the institution, prosecution, assertion, settlement, or resolution of the Derivative Actions, except that the Individual Defendants, by virtue of this Stipulation, have not released, relinquished, or discharged Kratos Releasees from any rights, claims, or causes of action for indemnification, including, but not limited to, insurance indemnification, and/or advancement of attorneys' fees and expenses (or other defense costs), for any matter whatsoever, required or permitted to the fullest extent under Kratos' Certificate of Incorporation or Bylaws, California or Delaware law, or any indemnification or similar agreement between Kratos and any such Individual Defendants.

7.4 Upon the Effective Date, Kratos shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished, and discharged all Released Claims (including Unknown Claims), and any and all claims relating to or arising out of or connected with the Settlement or resolution of the Derivative Actions, against the Individual Defendant Releasees.

7.5 Upon the Effective Date, each of the Individual Defendants shall be deemed to have, and by operation of the Judgment shall have, fully, finally, and forever released, relinquished, and discharged all Released Claims (including Unknown Claims), and any and all claims relating to or arising out of or connected with the Settlement or resolution of the Derivative Actions against the other Individual Defendant Releasees, except that Individual Defendants by virtue of this Stipulation have not released, relinquished, or discharged Kratos Releasees from any rights, claims, or causes of action for indemnification, including, but not limited to, insurance indemnification, and/or advancement of attorneys' fees and expenses (or other defense costs), for any matter whatsoever required or permitted to the fullest extent under Kratos' Certificate of Incorporation or Bylaws, California or Delaware law, or any indemnification or similar agreement between Kratos Releasees and any such Individual Defendants.

7.6 Pending final determination of whether the Settlement should be approved, neither Plaintiffs, Kratos, nor any Kratos Stockholders shall commence, maintain, or prosecute against any of Settling Defendants, whether directly or derivatively on behalf of Kratos, any action or proceeding in any court or tribunal asserting any of the Released Claims, and all proceedings and further activity between the Settling Parties in the Derivative Actions, except for those activities and proceedings relating to the Stipulation and the Settlement, shall be stayed.

8. Effective Date and Conditions of Settlement

8.1 The Effective Date shall be the first date by which all the following events and conditions shall have occurred or been met:

(a) execution of the Stipulation;

(b) entry of the Preliminary Approval Order;

(c) entry of the Judgment;

(d) payment of Plaintiffs' Counsel's attorneys' fees and reimbursement of expenses in accordance with ¶5.1;

(e) the Judgment has become Final; and

(f) dismissal of the State Action with prejudice in accordance with ¶8.4.

8.2 If all of the conditions specified in ¶8.1 are not met, then this Stipulation shall be canceled and terminated, and the Fees and Expenses Payment (plus any interest that has accrued thereon) shall be returned subject to ¶5.2, unless Plaintiffs' Counsel, counsel for the Individual Defendants, and Kratos' Counsel mutually agree in writing to waive or modify any conditions that are not satisfied and otherwise agree to proceed with this Stipulation.

8.3 In the event that the Stipulation or Settlement is not approved by the Court, the State Action is not dismissed with prejudice, or the Settlement set forth in the Stipulation is terminated for any reason, the Settling Parties shall be restored to their respective positions in the Derivative Actions as of January 5, 2010, and all negotiations, proceedings, documents prepared, and statements made in connection herewith shall be without prejudice to the Settling Parties, shall not be deemed or construed to be an admission by any Settling Party of any act, matter, or proposition and shall not be used in any manner or for any purpose in any subsequent proceeding in the Derivative Actions or in any other action or proceeding. In such event, the terms and provisions of the Stipulation, with the exception of ¶¶5.2, 6.1(i), 8.2-8.3, 10.1-10.16 herein, shall have no further force and effect with respect to the Settling Parties and shall not be used in the Derivative Actions or in any other proceeding for any purpose, and any Judgment or order entered by the Court in accordance with the terms of the Stipulation shall be treated as vacated, *nunc pro tunc*.

8.4 Within five business days from the date on which the Judgment becomes Final, Plaintiffs' Counsel, on behalf of State Plaintiffs, shall file a Stipulation of Dismissal with prejudice in the State Action, signed by all parties to the State Action, and request an order dismissing the State Action. Plaintiffs' Counsel, on behalf of State Plaintiffs, shall file and serve notice of any dismissal order within five business days of entry by the State Court.

9. Bankruptcy

9.1 In the event that a case is commenced in respect to any Individual Defendant or Kratos under Title 11 of the United States Code (Bankruptcy), or a trustee, receiver, or conservator is appointed under any similar law, the Settling Parties agree to use their reasonable best efforts to obtain all necessary orders, consents, releases, and approvals for effectuation of this Stipulation in a timely and expeditious manner. By way of example only, the Settling Parties agree to cooperate in making applications and motions to the bankruptcy court for relief from any stay, approval of the settlement, authority to release funds, authority for Kratos' insurer to disburse insurance proceeds consistent with this Stipulation, authority to release claims and indemnify officers and directors, and authority for the Court to enter all necessary orders and judgments, and any other actions reasonably necessary to effectuate the terms of this Stipulation.

9.2 In the event that a case is commenced in respect to any Individual Defendant or Kratos under Title 11 of the United States Code (Bankruptcy), or a trustee, receiver, or conservator is appointed under any similar law, the Settling Parties agree that all dates and deadlines set forth herein will be extended for such periods of time as are necessary to obtain necessary orders, consents, releases, and approvals from the bankruptcy court for effectuation of this Stipulation.

10. Miscellaneous Provisions

10.1 The Settling Parties (a) acknowledge that it is their intent to consummate this Settlement; and (b) agree to cooperate to the extent necessary to effectuate and implement all terms and conditions of the Stipulation and to exercise their reasonable best efforts to accomplish the foregoing terms and conditions of the Stipulation.

10.2 Except as to any existing obligation of Kratos to the Individual Defendants, the Settling Parties intend this Settlement to be a final and complete resolution of all disputes between them with respect to the claims made in the Derivative Actions.

10.3 Neither this Stipulation nor the Settlement contained herein, nor any act performed or document executed pursuant to or in furtherance of the Stipulation or the Settlement: (a) is or may be deemed to be or may be used as an admission of, or evidence of, the validity of any claims released therein or by virtue of the releases attached thereto, including any of the Released Claims; or (b) may be deemed to be or may be used as an admission or evidence of any fault, wrongdoing, omission, or liability of any of the Settling Defendants, in any civil, criminal, or administrative proceeding in any court, administrative agency or other tribunal. Settling Defendants may file the Stipulation, the Judgment, and/or any document executed pursuant to or in furtherance of the Stipulation, in any action that may be brought against them in order to support a defense or counterclaim based on principles of *res judicata*, collateral estoppel, full faith and credit, release, judgment bar reduction, or any theory of claim preclusion or issue preclusion or similar defense or counterclaim. The Individual Defendants have denied and continue to deny each and all of the claims alleged or threatened or suggested against them in or relating to the Derivative Actions. While Individual Defendants deny that the claims advanced in the Derivative Actions were meritorious, Individual Defendants agree and the Judgment in the Federal Action will state, that the Derivative Actions were filed in good faith and in accordance with the applicable California and/or Delaware law and the Federal Rules of Civil Procedure, including Rule 11 of the Federal Rules of Civil Procedure, and are being settled voluntarily after consultation with competent legal counsel.

10.4 In the event that any part of the Settlement is found to be unlawful, void, unconscionable, or against public policy by a court of competent jurisdiction, the Settling Parties agree that the remaining terms and conditions of the Settlement shall remain intact. Further, the waiver by one party of any breach of this Stipulation by any other party shall not be deemed a waiver of any other prior or subsequent breach of this Stipulation.

10.5 The Settling Parties, and each of them, agree, to the extent permitted by law, that all agreements made and orders entered during the course of the Derivative Actions relating to the confidentiality of information shall survive this Stipulation.

10.6 All confidential discovery materials produced during the Derivative Actions shall, within thirty days after the Effective Date, be destroyed by the party obtaining the materials, provided, however, that counsel's work product need not be destroyed. A letter certifying compliance with this provision shall be provided to counsel for the producing party.

10.7 The Exhibits attached hereto are material and integral parts hereof and are hereby incorporated by reference as though fully set forth herein.

10.8 The Stipulation may be amended or modified only by a written instrument signed by or on behalf of all Settling Parties or their successors-in-interest.

10.9 Each counsel or other person executing the Stipulation or its Exhibits on behalf of any Settling Party hereto warrants that such person has the full authority to do so and are expressly authorized by their client(s) to take all appropriate action required or permitted to be taken pursuant to the Stipulation to effectuate its terms and also are expressly authorized to enter into any modifications or amendments to the Stipulation on behalf of their client(s) that they deem appropriate.

10.10 Except as provided herein, the Stipulation and the Exhibits attached hereto constitute the entire agreement among the Settling Parties, and no representations, warranties or inducements have been made to any Settling Party concerning the Stipulation or its Exhibits other than the representations, warranties and covenants contained and memorialized in such documents.

10.11 The headings herein are used for the purpose of convenience only and are not meant to have legal effect.

10.12 The Court shall retain jurisdiction with respect to implementation and enforcement of the Stipulation, and all parties hereto submit to the jurisdiction of the Court for purposes of implementing and enforcing the Settlement.

10.13 The Stipulation may be executed in one or more counterparts. All executed counterparts and each of them shall be deemed to be one and the same instrument. Counsel for the Settling Parties to the Stipulation shall exchange among themselves signed counterparts, and a complete set of original executed counterparts shall be filed with the Court.

10.14 The Stipulation shall be binding upon, and inure to the benefit of, the successors and assigns of the Settling Parties hereto. Plaintiffs and Plaintiffs' Counsel represent and warrant that none of the claims or causes of action asserted by them, or that could have been asserted by them, in the Derivative Actions have been assigned, encumbered, or in any manner transferred, in whole or in part.

10.15 The Stipulation and the Exhibits thereto shall be considered to have been negotiated, executed, and delivered, and to be wholly performed, in the State of California, and the rights and obligations of the parties to the Stipulation, and the construction, interpretation, operation, effect, and validity of this Stipulation, and all documents necessary to effectuate it, shall be governed by the internal laws of the State of California without regard to conflict of law principles.

10.16 This Stipulation shall not be construed more strictly against one party than another merely by virtue of the fact that it, or any part of it, may have been prepared by counsel for one of the parties, it being recognized that it is the result of arm's-length negotiations between the parties and all parties have contributed substantially and materially to the preparation of this Stipulation.

IN WITNESS WHEREOF, the Settling Parties hereto have caused the Stipulation to be executed, by their duly authorized attorneys.

Dated: January 5, 2010

MORRISON & FOERSTER LLP

By: /s/ Sean T. Prosser

MORRISON & FOERSTER LLP
SEAN T. PROSSER (CA SBN 163903)
TYSON E. MARSHALL (CA SBN 222488)
12531 High Bluff Drive, Suite 100
San Diego, California 92130-2040
Telephone: (858) 720-5100
Facsimile: (858) 720-5125
sprosser@mofo.com

Attorneys for Nominal Defendant WIRELESS FACILITIES, INC.; Individual Defendants THOMAS A. MUNRO, DANIEL STOKELY, ERIC DEMARCO, DAVID A. GARRISON, FRANKIE FARJOOD, DAVID LEE, WILLIAM A. OWENS, BANDEL CARANO, JAMES R. EDWARDS, SCOTT FOX, DEANNA H. LUND, ANDREW M. LEITCH, LAURA SIEGAL, NAOMI D. WHITACRE, GEORGE WOZENCRAFT, and WILLIAM MAZILLY; and Specially Appearing Defendants FARZAD GHASSEMI, GREGORY JACOBSEN, SCOTT I. ANDERSON, SCOT JARVIS, and WILLIAM HOGLUND

Dated: January 5, 2010

ALLEN MATKINS LECK GAMBLE MALLORY & NATSIS LLP

By: /s/ Keith P. Bishop

ALLEN MATKINS LECK GAMBLE MALLORY &
NATSIS LLP
KEITH P. BISHOP
LAWRENCE D. LEWIS
1900 Main Street, 5th Floor
Irvine, CA 92614
Telephone: (949) 553-1313
Facsimile: (949) 553-8354
Email: kbishop@allenmatkins.com

Attorneys for Individual Defendant William Bradford Weller

Dated: January 5, 2010

HOWREY LLP

By: /s/ Robert E. Gooding, Jr.

HOWREY LLP
ROBERT E. GOODING, JR.
ROMAN E. DARMER
NATHAN C. KLEIN
4 Park Plaza, Suite 1700
Irvine, CA 92614
Telephone: (949) 721-6900
Facsimile: (949) 721-6910
Email: goodingr@howrey.com

Attorneys for Defendants Masood Tayebi and Massih Tayebi

Dated: January 5, 2010

ORRICK, HERRINGTON & SUTCLIFFE LLP

By: /s/ James N. Kramer

ORRICK, HERRINGTON & SUTCLIFFE LLP
JAMES N. KRAMER
SHIRLEY CHANG
The Orrick Building
405 Howard Street
San Francisco, CA 94105
Telephone: (415) 773-5700
Facsimile: (415) 773-5759
Email: jkramer@orrick.com

Attorneys for Defendant Terry Ashwill

Dated: January 5, 2010

ROBBINS UMEDA LLP

By: /s/ Brian J. Robbins

ROBBINS UMEDA LLP
BRIAN J. ROBBINS
KEVIN A. SEELY
REBECCA A. PETERSON
600 B Street, Suite 1900
San Diego, CA 92101
Telephone: (619) 525-3990
Facsimile: (619) 525-3991
Email: brobbins@robbinsumeda.com

FARUQI & FARUQI, LLP
NADEEM FARUQI
DAVID H. LEVENTHAL
369 Lexington Avenue, 10th Floor
New York, NY 10017-6531
Telephone: (212) 983-9330
Facsimile: (212) 983-9331
Email: dleventhal@faruqilaw.com

Co-Lead Counsel for Federal Plaintiffs and State Plaintiffs

CERTIFICATE OF SERVICE

I hereby certify that on January 8, 2010, the foregoing document was filed with the Clerk of the Court for the U.S. District Court, using the electronic case filing system of the court. The electronic case filing system sent a "Notice of Electronic Filing" to all attorneys of record who have consented in writing to accept this Notice as service of documents by electronic means. I hereby certify that I have served the foregoing document to all individuals who have not consented to electronic notification by mail, and to counsel not on the Court's list to receive e-mail notices, as indicated in the attached service list.

/s/ Brian J. Robbins

BRIAN J. ROBBINS

EXHIBIT 31.1

**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 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:

   (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: April 29, 2010

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ ERIC M. DEMARCO

Eric M. DeMarco
Chief Executive Officer, President
(Principal Executive Officer)

EXHIBIT 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL 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-(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 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:

   (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: April 29, 2010

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

Deanna H. Lund
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

QuickLinks

EXHIBIT 32.1

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 28, 2010 (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) of the Securities Exchange Act of 1934; 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: April 29, 2010

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ ERIC M. DEMARCO

Eric M. DeMarco
Chief Executive Officer, President
(Principal Executive Officer)

QuickLinks -- Click here to rapidly navigate through this document

EXHIBIT 32.2

**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 28, 2010 (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) of the Securities Exchange Act of 1934; 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: April 29, 2010

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

Deanna H. Lund
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)