UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 25, 2011

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 (State or other jurisdiction of incorporation or organization)	**13-3818604** (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 x 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 x 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 x
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 x

As of October 28, 2011, 34,397,770 shares of the registrant's common stock were outstanding.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 25, 2011

INDEX

Table of Contents

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 26, 2010	September 25, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 10.8	$ 109.4
Restricted cash	8.5	1.0
Accounts receivable, net	125.8	248.7
Inventoried costs	25.9	79.8
Prepaid expenses	7.1	11.6
Other current assets	5.8	3.9
Total current assets	183.9	454.4
Property, plant and equipment, net	28.4	81.6
Goodwill	226.2	547.5
Intangible assets, net	89.1	133.4
Other assets	7.9	24.5
Total assets	$ 535.5	$ 1,241.4
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 45.6	$ 68.5
Accrued expenses	21.4	49.2
Accrued compensation	21.7	47.3
Billings in excess of costs and earnings on uncompleted contracts	17.2	32.8
Other current liabilities	12.0	18.7

Total current liabilities	117.9	216.5
Long-term debt principal, net of current portion	225.0	631.0
Long-term debt premium	—	23.9
Other long-term liabilities	22.7	38.6
Total liabilities	365.6	910.0
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 26, 2010 and 0 shares outstanding at September 25, 2011 (liquidation preference $5.0 million at December 26, 2010) (see note 5)	—	—
Common stock, $.001 par value, 195,000,000 shares authorized; 18,616,023 and 34,395,895 shares issued and outstanding at December 26, 2010 and September 25, 2011, respectively	—	—
Additional paid-in capital	553.5	730.5
Accumulated other comprehensive loss	—	0.1
Accumulated deficit	(383.6)	(399.2)
Total stockholders' equity	169.9	331.4
Total liabilities and stockholders' equity	$ 535.5	$ 1,241.4

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

Table of Contents

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(Unaudited)

	Three months ended		Nine months ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Service revenues	$ 75.8	$ 97.6	$ 211.5	$ 252.7
Product sales	44.1	113.4	76.2	252.2
Total revenues	119.9	211.0	287.7	504.9
Cost of service revenue	60.0	71.8	166.2	190.1
Cost of product sales	35.5	79.0	62.0	181.8
Total costs	95.5	150.8	228.2	371.9
Gross profit	24.4	60.2	59.5	133.0
Selling, general and administrative expenses	16.5	43.2	41.3	96.5
Recovery of legal fees in connection with litigation	(1.4)	—	(1.4)	—
Merger and acquisition expenses	0.4	3.7	1.5	11.3
Research and development expenses	0.5	3.3	1.6	5.1
Operating income from continuing operations	8.4	10.0	16.5	20.1
Other income (expense):				
Interest expense, net	(6.4)	(15.0)	(15.8)	(34.8)
Other income (expense), net	0.2	(0.3)	0.8	—
Total other expense, net	(6.2)	(15.3)	(15.0)	(34.8)
Income (loss) from continuing operations before income taxes	2.2	(5.3)	1.5	(14.7)
Provision (benefit) for income taxes from continuing operations	(1.1)	1.6	(12.5)	1.3
Income (loss) from continuing operations	3.3	(6.9)	14.0	(16.0)
Income (loss) from discontinued operations	(0.1)	—	0.1	0.4
Net income (loss)	$ 3.2	$ (6.9)	$ 14.1	$ (15.6)
Basic income (loss) per common share:				
Income (loss) from continuing operations	$ 0.21	$ (0.22)	$ 0.87	$ (0.63)
Income (loss) from discontinued operations	(0.01)	—	0.01	0.01
Net income (loss) per common share	$ 0.20	$ (0.22)	$ 0.88	$ (0.62)
Diluted income (loss) per common share:				
Income (loss) from continuing operations	$ 0.20	$ (0.22)	$ 0.85	$ (0.63)
Income (loss) from discontinued operations	(0.01)	—	0.01	0.01
Net income (loss) per common share	$ 0.19	$ (0.22)	$ 0.86	$ (0.62)
Weighted average common shares outstanding:				
Basic	16.1	30.8	16.0	25.3
Diluted	16.3	30.8	16.4	25.3
Net income (loss) from above	$ 3.2	$ (6.9)	$ 14.1	$ (15.6)
Other comprehensive income:				
Change in cumulative translation adjustment	—	0.1	—	0.1
Other comprehensive income, net of tax	—	0.1	—	0.1
Comprehensive income (loss)	$ 3.2	$ (6.8)	$ 14.1	$ (15.5)

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

Table of Contents

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Nine months ended September 26, 2010	Nine months ended September 25, 2011
Operating activities:		
Net income (loss)	$ 14.1	$ (15.6)
Less: Income from discontinued operations	0.1	0.4
Income (loss) from continuing operations	14.0	(16.0)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	8.7	31.4
Deferred income taxes	(14.9)	0.2
Stock-based compensation	1.4	2.3
Mark to market on swaps	(0.8)	(0.3)
Amortization of deferred financing costs	4.6	2.5
Provision for doubtful accounts	0.1	0.3
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	8.0	(15.6)
Inventoried costs	1.4	(0.1)
Prepaid expenses and other assets	(3.2)	9.8
Accounts payable	2.7	0.2
Accrued compensation	5.9	1.8
Accrued expenses	(8.6)	(2.8)
Billings in excess of costs and earnings on uncompleted contracts	8.1	(5.0)
Income tax receivable and payable	(0.6)	1.1
Other liabilities	(2.1)	(2.1)
Net cash provided by operating activities from continuing operations	24.7	7.7
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(142.3)	(373.8)
Decrease in restricted cash	—	3.3
Other, net	(1.4)	(5.3)
Net cash used in investing activities from continuing operations	(143.7)	(375.8)
Financing activities:		
Proceeds from the issuance of long-term debt	225.0	427.5
Proceeds from the issuance of common stock	—	61.1
Borrowings under credit facility	61.9	—
Repayment under credit facility	(116.3)	(2.5)
Debt issuance costs	(10.6)	(20.6)
Other	0.7	1.5
Net cash provided by financing activities from continuing operations	160.7	467.0
Net cash flows of continuing operations	41.7	98.9
Net operating cash flows of discontinued operations	(0.3)	(0.1)
Effect of exchange rate changes on cash and cash equivalents	—	(0.2)
Net increase in cash and cash equivalents	41.4	98.6
Cash and cash equivalents at beginning of period	9.9	10.8
Cash and cash equivalents at end of period	$ 51.3	$ 109.4

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

Table of Contents

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

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

(a) Basis of Presentation

The information as of September 25, 2011 and for the three and nine months ended September 26, 2010 and September 25, 2011 is unaudited. The condensed consolidated balance sheet as of December 26, 2010 was derived from the Company's audited consolidated financial statements at that date. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the interim periods presented. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the U.S. ("GAAP"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's audited annual consolidated financial statements for the fiscal year ended December 26, 2010, included in the Company's Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission on March 2, 2011 (the "Form 10-K"). Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

(b) Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries for which all inter-company transactions have been eliminated in consolidation.

(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 nine months ended September 26, 2010 and September 25, 2011 consisted of 39 week periods. There are 52 calendar weeks in the fiscal years ending on December 26, 2010 and December 25, 2011.

(d) Accounting Policies and Accounting Standards Updates

Accounting standards updates ("ASU") issued by the Financial Accounting Standards Board ("FASB") which are not effective until after September 25, 2011, are not expected to have a material effect on the Company's consolidated financial position, results of operations, cash flows or related disclosures.

In June 2011, the FASB issued a new standard, which eliminates the option to present other comprehensive income ("OCI") in the statement of stockholders' equity and instead requires net income, the components of OCI, and total comprehensive income to be presented in either one continuous statement or two separate but consecutive statements. The standard also requires that items reclassified from OCI to net income be presented on the face of the financial statements. As currently issued, the new standard will be effective for the Company beginning with its first quarter 2012 reporting and will be applied retrospectively. However, in October 2011, the FASB announced it would issue an exposure draft in the near term with a proposal to defer the requirement to present reclassifications from OCI to net income on the face of the financial statements and consider whether such reclassification adjustments should be disclosed in the notes to the financial statements, consistent with the existing disclosure requirements. The deferral, if finalized, would not change the requirement to present net income, components of OCI, and total comprehensive income in either one continuous statement or two separate but consecutive statements. The Company does not expect that the adoption of the new standard or exposure draft will have an effect on its results of operations, financial position, or cash flows as it only requires a change in the presentation of OCI in its consolidated financial statements.

In September 2011, the FASB issued a new standard which amends the existing guidance on goodwill impairment testing. The new standard allows an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If this is the case, the entity will need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The standard will be effective for annual or interim goodwill impairment tests performed by the Company after December 31, 2011. The adoption of the standard will not have an effect on the Company's results of operations, financial position, or cash flows.

Table of Contents

There have been no changes in the Company's significant accounting policies for the nine months ended September 25, 2011 as compared to the significant accounting policies described in the Form 10-K with the following exceptions:

Revenue Recognition for Arrangements with Multiple Deliverables

For multi-element arrangements that include hardware products containing software essential to the hardware products' functionality, undelivered software elements that relate to the hardware products' essential software, and undelivered non-software services, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE"), and (iii) best estimate of the selling price ("ESP"). VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable. ESP reflects the Company's best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis.

The Company accounts for multiple element arrangements that consist only of software or software-related products, including the sale of upgrades to previously sold software, in accordance with industry specific software accounting guidance. For such transactions, revenue on arrangements that include multiple elements is allocated to each element based on the relative fair value of each element, and fair value is determined by VSOE. If the Company cannot objectively determine the fair value of any undelivered element included in such multiple-element arrangements, the Company defers revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

Accumulated Other Comprehensive Income (Loss)

Comprehensive income consists of (i) net income (loss) and (ii) other related gains and losses affecting stockholders' equity that, under GAAP, are excluded from net income. For the Company, other comprehensive income (loss) consists solely of unrealized foreign currency translation gains and losses.

(e) Concentrations and Uncertainties

The Company maintains cash balances at various financial institutions and such balances commonly exceed the $250,000 insured 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 and collateral is not required. Accounts receivable are recorded at the invoiced amount and do not bear interest. See Note 12 for a discussion of the Company's significant customers.

The Company has outstanding 10% Senior Secured Notes with an aggregate principal amount of $625.0 million which is due on June 1, 2017. The Company pays interest at the rate of 10% per annum semi-annually, in arrears, on June 1 and December 1 of each year. As of September 25, 2011, the principal amount of $625.0 million is outstanding under these notes. In addition, the Company has $47.4 million available under its existing revolving credit agreement. See Note 9 for a complete description of the Company's debt.

The Company intends to fund its cash requirements with cash on hand, cash flows from operating activities and borrowings under its existing revolving credit facility. 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 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, 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.

(f) Reclassifications

Certain amounts in the September 26, 2010 condensed consolidated statements of operations and condensed consolidated statements of cash flow have been reclassified to conform to the September 25, 2011 presentation.

Table of Contents

Note 2. Acquisitions

(a) Summary of Recent Acquisitions

Integral Systems, Inc.

On May 15, 2011, the Company entered into an Agreement and Plan of Merger (the "Integral Merger Agreement") with Integral Systems, Inc., a Maryland corporation ("Integral"), IRIS Merger Sub Inc., a Maryland corporation and the Company's wholly owned subsidiary ("Integral Merger Sub"), and IRIS Acquisition Sub LLC, a Maryland limited liability company and the Company's wholly owned subsidiary. On July 27, 2011, pursuant to the terms and subject to the conditions set forth in the Integral Merger Agreement, Integral Merger Sub merged with and into Integral, and Integral continued as the surviving corporation and as a wholly owned subsidiary of the Company (the "Merger"). To fund the Merger, on July 27, 2011, the Company issued $115.0 million aggregate principal amount of 10% Senior Secured Notes due 2017. The notes were issued at a premium of 105%, for an effective interest rate of approximately 8.9%. The gross proceeds of approximately $120.8 million, which includes an approximate $5.8 million issuance premium and excludes accrued interest received of $1.8 million, were used to finance, in part, the cash portion of the purchase price for the acquisition of Integral, to refinance existing indebtedness of Integral and its subsidiaries, to pay certain severance payments in connection with the Merger and to pay related fees and expenses.

At the effective time of the Merger (the "Effective Time"), holders of Integral common stock were entitled to receive (i) $5.00 in cash, without interest, and (ii) the issuance of 0.588 shares of the Company's common stock for each share of Integral common stock owned (the "Merger Consideration").

In addition, at the Effective Time, each Integral stock option that had an exercise price less than $13.00 per share was, if the holder thereof elected in writing, cancelled in exchange for an amount in cash, without interest, equal to the product of the total number of shares of Integral common stock subject to such in-the-money option, multiplied by the aggregate value of the excess, if any, of $13.00 over the exercise price per share subject to such option, less the amount of any tax withholding. Each Integral stock option that had an exercise price equal to or greater than $13.00 per share and each Integral in-the-money option of which the holder did not make the election described in the preceding sentence was converted into an option to purchase Kratos common stock, with (i) the number of shares subject to such option adjusted to equal the number of shares of Integral common stock subject to such out-of-the-money option multiplied by 0.9559, rounded up to the nearest whole share, and (ii) the per share exercise price under each such option adjusted by dividing the per share exercise price under such option by 0.9559, rounded up to the nearest whole cent. Each share of restricted stock granted under an Integral equity plan or otherwise, whether vested or unvested, that was outstanding immediately prior to the completion of the Merger was cancelled and the holder thereof was entitled to receive an amount in cash, without interest, equal to the product of the total number of restricted shares of Integral common stock held by such holder, multiplied by $13.00, less the amount of any tax withholding. No fractional shares of the Company's common stock were issued in the Merger. The Merger is intended to qualify as a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended.

The acquisition of Integral was completed by issuing approximately 10.4 million shares of Kratos common stock valued at $108.7 million. The cash portion of the acquisition was funded with the gross proceeds of the notes referenced above and more fully described in Note 9. Including the fair value of stock options not exercised of $1.0 million, the total purchase price paid for Integral was $241.0 million.

Integral is a global provider of products, systems and services for satellite command and control, telemetry and digital signal processing, data communications, enterprise network management and communications information assurance. Integral specializes in developing, managing and operating secure communications networks, both satellite and terrestrial, as well as systems and services to detect, characterize and geolocate sources of RF interference. Integral's customers include U.S. and foreign commercial, government, military and intelligence organizations. For almost 30 years, customers have relied on Integral to design and deliver innovative commercial-based products, solutions and services that are cost-effective and reduce delivery schedules and risk. Integral is part of the Company's Kratos Government Solutions ("KGS") segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by Integral's significant expertise with satellite operations, ground systems, signal processing and other areas of satellite command and control, and also advanced technologies for Unmanned Aerial Vehicles, situational awareness, remote management and numerous established electronic attack and electronic warfare platforms, tactical missile systems, and strategic deterrence systems.

Table of Contents

The Integral transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the preliminary estimated fair values of major assets acquired and liabilities assumed (in millions):

Cash	$	6.8
Accounts receivable		68.4
Inventoried costs		10.4
Deferred tax assets		34.8
Other assets		9.7
Property and equipment		20.5
Intangible assets		31.8
Goodwill		175.6
Total assets		358.0
Current liabilities		(79.6)
Deferred tax liabilities		(17.8)
Long-term liabilities		(19.6)
Net assets acquired	$	241.0

The goodwill recorded in this transaction is not tax deductible.

As of July 27, 2011, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $68.5 million, of which $0.1 million is not expected to be collectible. There were no contingent liabilities associated with the acquisition of Integral.

The amounts of revenue and operating income of Integral included in the Company's condensed consolidated statements of operations for both the three and nine months ended September 25, 2011 was $44.9 million and $5.1 million, respectively

Herley Industries, Inc.

On March 25, 2011, pursuant to an Agreement and Plan of Merger dated as of February 7, 2011 (the "Herley Merger Agreement"), by and among the Company, Lanza Acquisition Co. ("Herley Merger Sub") and Herley Industries, Inc. ("Herley"), Herley Merger Sub acquired approximately 13.2 million shares of Herley common stock representing approximately 94% of the total outstanding shares of Herley common stock in a tender offer to purchase all of the outstanding shares of Herley common stock. The fair value of the non-controlling interest related to Herley as of March 25, 2011 was $16.9 million, which represents the market trading price of $19.00 per share multiplied by the approximately 0.9 million shares that were not tendered as of March 25, 2011. On March 30, 2011, following purchases of the non-controlling interest in a subsequent offering period, Herley Merger Sub was merged with and into Herley, with Herley continuing as a wholly owned subsidiary of the Company. The shares of Herley common stock were purchased at a price of $19.00 per share. Accordingly, the Company paid approximately $245.5 million in cash consideration as of March 27, 2011 and as of April 15, 2011 had paid total aggregate cash consideration of $270.7 million in respect of the shares of Herley common stock and certain in-the-money options, which were exercised upon the change in control. In addition, upon completion of the merger, all unexercised options to purchase Herley common stock were assumed by the Company and converted into options to purchase Kratos common stock, entitling the holders thereof to receive 1.3495 shares of Kratos common stock for each share of Herley common stock underlying the options ("Herley Options"). The Company assumed each Herley Option in accordance with the terms (as in effect as of the date of the Herley Merger Agreement) of the applicable Herley equity plan and the option agreement pursuant to which such Herley Option was granted. The Herley Options are exercisable for an aggregate of approximately 0.8 million shares of the Company's common stock. All Herley Options were fully vested upon the change in control and the fair value of the Herley Options assumed was $1.9 million. The total aggregate consideration for the purchase of Herley was $272.6 million. In addition, the Company assumed change in control obligations of $4.0 million related to the transaction, the majority of which will be paid in 2011, and combined transaction expenses of $11.1 million.

To fund the acquisition of Herley, on February 11, 2011, Kratos sold approximately 4.9 million shares of its common stock at a purchase price of $13.25 per share in an underwritten public offering. Kratos received gross proceeds of approximately $64.8 million and net proceeds of approximately $61.1 million after deducting underwriting fees and other offering expenses. Kratos used the net proceeds from this offering to fund a portion of the purchase price for the acquisition of Herley. In addition, Kratos issued $285.0 million in aggregate principal amount of 10% Senior Secured Notes due 2017 (the "Stage I Notes") at a premium of 107% through its wholly owned subsidiary, Acquisition Co. Lanza Parent (the "Stage I Issuer"), on March 25, 2011, in an unregistered offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the "Securities Act"), to finance the acquisition of Herley. On April 4, 2011, after the acquisition of Herley was complete, the Stage I Issuer was merged with and into Kratos, all assets and liabilities of the Stage I Issuer became assets and liabilities of Kratos. See Note 9 for a complete description of the Company's debt.

Herley is a leading provider of microwave technologies for use in command and control systems, flight instrumentation, weapons sensors, radar, communication systems, electronic warfare and electronic attack systems. Herley has served the defense industry for approximately 45 years by designing and manufacturing microwave devices for use in high-technology defense electronics applications. It has established relationships, experience and expertise in the military electronics, electronic warfare and electronic attack industry. Herley's products represent key components in the national security efforts of the U.S., as they are employed in mission-critical electronic warfare, electronic attack, electronic warfare threat and radar simulation, command and control network, and cyber warfare/cyber security applications. Herley is part of the Company's KGS segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by Herley's significant expertise in numerous established electronic attack and electronic warfare platforms, tactical missile systems, and strategic deterrence systems which complement the Company's existing business in manned and unmanned aircraft, missile systems and certain other programs.

The Herley transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the preliminary estimated fair values of major assets acquired and liabilities assumed (in millions):

Cash	$	21.8
Accounts receivable		39.1
Inventoried costs		43.3
Deferred tax assets		17.1
Other assets		7.3
Property and equipment		34.2
Intangible assets		37.0
Goodwill		145.7
Total assets		345.5
Current liabilities		(40.2)
Deferred tax liabilities		(17.0)
Debt		(9.5)
Long-term liabilities		(6.2)
Net assets acquired	$	272.6

The goodwill recorded in this transaction is not tax deductible.

As of March 25, 2011, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $39.3 million, of which $0.2 million is not expected to be collectible. There were no contingent liabilities associated with the acquisition of Herley. The Company initially recorded $47.9 million of inventory and $30.4 million in property and equipment. The Company decreased the value of acquired inventory to $43.3 million and increased the value of acquired property and equipment to $34.2 million based on its updated preliminary valuations.

The amounts of revenue and operating income of Herley included in the Company's condensed consolidated statements of operations for both the three and nine months ended September 25, 2011 are $48.7 million and $3.4 million, and $100.6 million and $9.9 million, respectively.

Henry Bros. Electronics, Inc.

On December 15, 2010, the Company acquired Henry Bros. Electronics, Inc. ("HBE") in a cash merger for a purchase price of $56.6 million, of which $54.9 million was paid in cash and $1.7 million reflects the fair value of options to purchase common stock of HBE that were assumed by the Company and converted into options to purchase common stock of the Company. Upon completion of the merger, holders of HBE common stock received $8.20 in cash for each share of HBE common stock held by them immediately prior to the closing of the merger. In addition, upon completion of the merger, all options to purchase HBE common stock were assumed by the Company (the "HBE Options") and converted into options to purchase common stock of the Company, entitling the holders thereof to receive 0.7715 shares of common stock of the Company for each share of HBE common stock underlying the HBE Options. The HBE Options will be exercisable for an aggregate of approximately 0.4 million shares of common stock of the Company. The fair value of unvested HBE Options which are related to future service will be expensed as the service is performed over a weighted average vesting period of 2.5 years.

HBE is a leading provider of homeland security solutions, products, and system integration services, including the design, engineering and operation of command and control systems for the protection of strategic assets and critical infrastructure in the U.S. HBE also has particular expertise in the design, engineering, deployment and operation of specialized surveillance, thermal imaging, analytics, radar, and biometrics technology based security systems. Representative HBE programs and customers include Department of Defense ("DoD") agencies, nuclear power generation facilities, state government and municipality related agencies, major national airports, major harbors, railways, tunnel systems, energy centers, power plants, and related infrastructure. HBE is part of the Company's Public Safety & Security ("PSS") segment.

HBE has been in business for over 50 years and has established relationships with manufacturing partners, industry colleagues, and customers demanding some of the most sophisticated security solutions available. The Company has a national footprint that includes offices in New York, New Jersey, Virginia, Maryland, Texas, Arizona, Colorado and California. The combination of the Company's existing PSS businesses, with one of the leading homeland security solutions and high end security system design and engineering services providers in the industry today, strategically strengthens the Company's overall capabilities and enhances its customer offerings and overall contract portfolio.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by enabling it to strategically expand its strengths in the areas of homeland security solutions and will also enable the Company to realize significant cross selling opportunities, and increase its sales of higher margin, fixed price products.

The HBE transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the estimated fair values of major assets acquired and liabilities assumed (in millions):

Cash	$	2.0
Accounts receivable		27.7
Inventoried costs		1.2
Deferred tax assets		1.0
Other assets		1.2
Property and equipment		1.8
Intangible assets		18.6
Goodwill		32.4
Total assets		85.9
Current liabilities		(21.8)
Deferred tax liabilities		(6.8)
Long-term liabilities		(0.7)
Net assets acquired	$	56.6

The goodwill recorded in this transaction is not tax deductible.

As of December 15, 2010, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $28.6 million, of which $0.9 million is not expected to be collectible.

There were no contingent liabilities associated with the acquisition of HBE other than contingent liabilities of $0.4 million associated with HBE's acquisition of Professional Security Technologies LLC ("PST") in September 2010. The agreement with PST provides that the former shareholders of PST receive a 5% payment for achievement of revenue amounts from certain customers for the period from June 1, 2010 through December 31, 2012.

The amounts of revenue and operating income of HBE included in the Company's condensed consolidated statements of operations for the three and nine months ended September 25, 2011 are $23.5 million and $3.5 million, and $56.9 million and $6.1 million, respectively.

Southside Container & Trailer, LLC

On December 7, 2010, the Company acquired Southside Container & Trailer, LLC ("SCT") for $13.7 million of which $12.2 million in cash was paid at closing, $0.3 million was paid in March 2011 as SCT's indemnification obligations as set forth in the applicable acquisition agreement (the "SCT Agreement") were met and approximately $1.2 million of which represents the acquisition date fair value of additional performance based consideration. SCT is a privately held provider of national security related command and control center, law enforcement, military aviation and data center products, shelters and solutions for the DoD, National Security agencies and related customers. SCT also provides products and solutions for specialized war fighter and critical asymmetric warfare related missions. SCT is part of the KGS segment.

Founded in 2002 and headquartered in Walterboro, South Carolina, SCT designs, engineers, manufactures and delivers various products, shelters and solutions used primarily by the war fighter and first responder in fulfilling their respective national security missions. Representative end customers and program locations include the United States Army, Marine Corps, Special Operations Command, Space and Naval Warfare Systems Center, Fort Bragg, Fort Lewis, Fort Bliss, Fort McGregor, Fort Irwin, Fort Stewart, the Border Patrol and the National Guard. SCT is known for its superior design, engineering, construction and on schedule and on budget delivery of cost effective products and solutions that meet critical and special mission national security and asymmetric warfare requirements.

Pursuant to the terms of the SCT Agreement, upon achievement of certain earnings before interest, taxes, depreciation, and amortization ("EBITDA") amounts in 2011, 2012 and 2013, the Company will pay the former stockholders of SCT certain additional performance-based consideration ("SCT Contingent Consideration"). The potential undiscounted amount of all future SCT Contingent Consideration that may be payable by the Company under the SCT Agreement is between zero and $3.5 million.

The fair value of the SCT Contingent Consideration of $1.2 million was estimated by applying the income approach, which is based on significant inputs that are not observable in the market, which *FASB Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurements and Disclosures ("Topic 820")* refers to as Level 3 inputs. Key assumptions include a discount rate of 6.1%, a market participant cost of debt at the date of acquisition, and probability-adjusted levels for EBITDA. The fair value of the SCT Contingent Consideration was decreased by $0.1 million and recognized in earnings during the three month period ended September 25, 2011 and the $1.1 million balance as of September 25, 2011 is reflected in long-term liabilities in the condensed consolidated balance sheet.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by enabling it to strategically expand its products and solutions that meet critical and special mission national security and asymmetric warfare requirements. It will also enable the Company to realize significant cross selling opportunities, and increase its sales of higher margin, fixed price products.

The SCT transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the estimated fair values of major assets acquired and liabilities assumed (in millions):

Cash	$	0.4

Accounts receivable		0.2
Other current assets		0.5
Property and equipment		2.8
Intangible assets		3.6
Goodwill		6.9
Total assets		14.4
Current liabilities		(0.7)
Net assets acquired	$	13.7

The goodwill recorded in this transaction is tax deductible.

As of December 7, 2010, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $0.2 million, all of which is expected to be collectible.

The amounts of revenue and operating income of SCT included in the Company's condensed consolidated statements of operations for the three and nine months ended September 25, 2011 are $0.6 million and $(0.2) million, and $5.2 million and $0.7 million, respectively.

DEI Services Corporation

On August 9, 2010, the Company acquired DEI Services Corporation ("DEI"), in a cash merger valued at approximately $14.0 million, of which $9.0 million was paid in cash at closing and approximately $5.0 million of which represented the acquisition date fair value of additional performance-based consideration, of which $0.4 million was achieved and paid in September 2010. DEI is part of the KGS segment.

Founded in 1996 and headquartered in Orlando, Florida, DEI designs, manufactures and markets full-scale training simulation products. In addition to the engineering and construction of physical simulators for air and ground military vehicles, DEI provides instructional design, courseware creation, learning application programming and other supporting services. Among DEI's most successful products are training and simulation solutions for fixed-wing aircraft (including the Tiger, Harrier and Prowler aircraft), rotor-wing aircraft (including Blackhawk, Chinook and Sea Stallion helicopters) and Ground Combat Vehicles (including the M1 Abrams Main Battle Tank and M2 Bradley Fighting Vehicle).

Pursuant to the terms of the agreement and plan of merger (the "DEI Agreement"), upon achievement of certain cash receipts, revenue, EBITDA and backlog amounts in 2010, 2011 and 2012, the Company will be obligated to pay certain additional contingent consideration (the "DEI Contingent Consideration"). As of September 25, 2011, the potential undiscounted amount of all future DEI Contingent Consideration that may be payable by the Company under the DEI Agreement is between zero and $8.0 million. The DEI Contingent Consideration will be reduced in the event certain anticipated cash receipts are not collected within agreed upon time periods, which could decrease the future payments by approximately $6.0 million.

The fair value of the DEI Contingent Consideration was originally estimated as $5.0 million by applying the income approach, which is based on significant inputs that are not observable in the market, which *Topic 820* refers to as Level 3 inputs. Key assumptions include a discount rate of 5.8%, a market participant cost of debt at the date of acquisition, and probability-adjusted levels of cash receipts, revenue, EBITDA and backlog. The fair value of the DEI Contingent Consideration was increased by $0.4 million and recognized in earnings during the three month period ended September 25, 2011. The balance as of September 25, 2011is $5.0 million and $2.5 million is reflected in other current liabilities and long-term liabilities, respectively, in the condensed consolidated balance sheet.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by enabling it to strategically expand the Company's workforce learning, performance and training solutions to support the warfighter as well as its other defense, security and government customers.

The DEI transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the estimated fair values of major assets acquired and liabilities assumed as part of the DEI transaction (in millions):

Cash	$	—
Accounts receivable		6.9
Inventoried costs		1.0
Other current assets		0.1
Property and equipment		0.9
Intangible assets		3.4
Goodwill		8.5
Other assets		0.1
Total assets		20.9
Current liabilities		(5.2)
Long-term liabilities		(0.3)
Deferred tax liabilities		(1.4)
Net assets acquired	$	14.0

The goodwill recorded in this transaction is not tax deductible.

As of August 9, 2010, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $6.9 million, all of which is expected to be collectible.

The amounts of revenue and operating income of DEI included in the Company's condensed consolidated statements of operations for the three and nine months ended September 25, 2011 are $6.9 million and $1.4 million, and $17.4 million and $3.8 million, respectively.

Gichner Holdings, Inc.

On May 19, 2010, the Company acquired Gichner Holdings, Inc. ("Gichner") pursuant to the Stock Purchase Agreement (the "Gichner Agreement"), dated as of April 12, 2010, by and between the Company and the stockholders of Gichner, in a cash for stock transaction valued at approximately $133.0 million. Gichner has manufacturing and operating facilities in Dallastown and York, Pennsylvania and Charleston, South Carolina, and is a manufacturer of tactical military products, combat support facilities, subsystems, modular systems and shelters primarily for the DoD and leading defense system providers. Representative programs for which Gichner provides products and solutions include the MQ—1C Sky Warrior, Gorgon Stare, MQ—8B Fire Scout and RQ—7 Shadow Unmanned Aerial Vehicles, the Command Post Platform and Joint Light Tactical Vehicles, Combat Tactical Vehicles, DDG-1000 Modular C5 Compartments and the Persistent Threat Detection System ISR Platform. Gichner is part of the KGS segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by enabling it to strategically expand its strengths in the areas of weapons system sustainment; Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance ("C5ISR"); military preset/reset; and foreign military sales. It will also enable the Company to realize significant cross selling opportunities, pursue new and larger contracts and increase its sales of higher margin, fixed price products.

Upon completion of the Gichner transaction, the Company deposited $8.1 million of the purchase price ("the holdback") into an escrow account as security for Gichner's indemnification obligations as set forth in the Gichner Agreement. In addition, the Gichner Agreement provided that the purchase price would be (i) increased on a dollar for dollar basis if the working capital on the closing date (as defined in the Gichner Agreement) exceeded $17.5 million or (ii) decreased on a dollar for dollar basis if the working capital was less than $17.1 million. The Company and Altus Capital Partners, Inc., the sellers' representative under the Gichner Agreement, have agreed to a working capital adjustment of $0.6 million owed to the Company. In May 2011 the Company paid $7.1 million of the holdback and paid the remaining amount of the holdback owed of $0.4 million in August 2011.

The Gichner transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. Due to the working capital adjustment discussed above, the Company retrospectively recorded purchase price adjustments at the acquisition date to decrease current liabilities by $0.6 million and reduce net deferred tax assets by $0.4 million, resulting in a $0.2 million reduction to the original goodwill recorded of $68.4 million. The following table summarizes the fair values of major assets acquired and liabilities assumed, including the retrospective adjustments, as part of the Gichner transaction (in millions):

Cash	$	0.1
Accounts receivable		15.2
Inventoried costs		24.2
Other current assets		8.3
Property and equipment		19.0
Intangible assets		46.3
Goodwill		68.2
Other assets		1.8
Total assets		183.1
Current liabilities		(29.1)
Other liabilities		(21.0)
Net assets acquired	$	133.0

The goodwill recorded in this transaction is not tax deductible.

As of May 19, 2010, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $15.6 million, of which $0.4 million is not expected to be collectible.

Gichner has two primary areas of contingent liabilities: environmental and uncertain tax liabilities. Additionally, Gichner is involved in various commercial disputes and employment matters. The majority of the contingent liabilities have been recorded at fair value in the allocation of acquired assets and liabilities or purchase price, aside from those pertaining to uncertainty in income taxes which are an exception to the fair value basis of accounting; however certain environmental matters that are inherently legal contingencies in nature are recorded at the probable and estimable amount. As of the acquisition date approximately $0.2 million has been recorded for probable and estimable environmental and employment liabilities.

The amounts of revenue and operating income of Gichner included in the Company's condensed consolidated statements of operations for the three and nine months ended September 25, 2011 are $31.7 million and $1.3 million, and $97.4 million and $4.1 million, respectively. For the three and nine months ended September 26, 2010, the amounts of revenue and operating income included in the condensed consolidated statements of operations were $3.7 million and $2.1 million, and $57.7 million and $4.5 million, respectively.

In accordance with *FASB ASC Topic 805, Business Combinations*, ("Topic 805") the allocation of the purchase price for the Company's acquisitions of SCT, HBE, Herley and Integral are subject to adjustment during the measurement period after the respective closing dates when additional information on asset and liability valuations become available. The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the respective acquisition dates to estimate the fair value of assets acquired and liabilities assumed. Measurement period adjustments reflect new information obtained about facts and circumstances that existed as of the respective acquisition dates. The Company believes that information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed but the Company is waiting for additional information necessary to finalize those fair values. The Company has not finalized its valuation of certain assets and liabilities recorded in connection with these transactions, including, intangible assets, inventory, property and equipment and deferred taxes. Thus, the provisional measurements recorded are subject to change and any changes will be recorded as adjustments to the fair value of those assets and liabilities and residual amounts will be allocated to goodwill. The final valuation adjustments may also require adjustment to the consolidated statements of operations.

Pro Forma Financial Information

The following tables summarize the supplemental statements of operations information on an unaudited pro forma basis as if the acquisitions of Integral, Herley, HBE, SCT, DEI, and Gichner had occurred on December 28, 2009, and include adjustments that were directly attributable to the foregoing transactions or were not expected to have a continuing impact on the Company. All acquisitions except Integral were included in the Company's results of operations for the full three months ended September 25, 2011. The acquisition of Integral was included in the Company's results of operations as of July 28, 2011. There are no material, nonrecurring pro forma adjustments directly attributable to the business combinations included in the reported pro forma revenue and earnings for 2010 or 2011. The pro forma results are for illustrative purposes only for the applicable period and do not purport to be indicative of the actual results which would have occurred had the transaction been completed as of the beginning of the period, nor are they indicative of results of operations which may occur in the future (all amounts, except per share amounts are in millions):

	For the Three Months Ended		For the Nine Months Ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Pro forma revenues	$ 270.1	$ 225.2	$ 664.5	$ 677.3
Pro forma net loss before tax	(16.2)	(18.6)	(50.8)	(63.9)
Pro forma net loss	(15.3)	(20.2)	(39.1)	(64.3)
Net income (loss) attributable to the registrant	3.3	(6.9)	14.0	(16.0)
Basic and diluted pro forma loss per share	$ (0.45)	$ (0.59)	$ (1.16)	$ (1.88)

The pro forma results for the three and nine month periods ended September 26, 2010 include $0.4 million, and $9.2 million of acquisition related expenses, respectively. The pro forma results for the three and nine months ended September 25, 2011 include $12.4 million and $32.2 million of acquisition related expenses, respectively. The pro forma financial information also reflects pro forma adjustments for the additional amortization associated with finite lived intangible assets acquired, additional incremental interest expense, deferred financing costs related to the financing undertaken for the Integral, Herley and Gichner transactions, the change in stock compensation expense as a result of the exercise of stock options and restricted stock immediately prior to closing of the Integral, Herley and HBE transactions offset by stock-based compensation expense for stock options assumed, and the tax effect of the increased interest expense and intangible amortization. The weighted average common shares also reflect the issuance of 2.5 million shares in October 2010, 4.9 million shares in February 2011 for the HBE and Herley acquisitions and 10.4 million shares in July 2011 for the Integral acquisition. These adjustments are as follows (in millions except per share data):

	For the Three Months Ended		For the Nine Months Ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Intangible Amortization	$ 8.8	$ 1.1	$ 27.5	$ 13.2
Net change in stock compensation expense	(0.8)	(0.1)	(2.6)	1.2
Net change in interest expense	1.4	(0.1)	10.4	3.9
Net change in income tax expense (benefit)	0.2	—	0.8	(0.9)
Increase in weighted average common shares outstanding for shares issued and not already included in the weighted average common shares outstanding	17.8	3.6	17.8	9.0

Table of Contents

Note 3. Goodwill and Intangible Assets

(a) Goodwill

The Company performs it annual impairment test for goodwill in accordance with ASC Topic 350, Intangibles—Goodwill and Other ("Topic 350") as of the last day of each fiscal year or when evidence of potential impairment exists. Based upon, but not limited to, the recent additions to goodwill during the reporting period, the existing short duration of the decline in market capitalization and the current operating income from continuing operations, the Company concluded that as of September 25, 2011, it was not more likely than not that events had occurred or circumstances had changed that would reduce the fair value of its goodwill in its reporting units below carrying value. However, based on the potential adverse impact on the Company's business as a result of the Budget Control Act of 2011 which establishes a joint committee of Congress responsible for identifying an additional $1.5 trillion in deficit reductions by November 23, 2011 and if at least $1.2 trillion in deficit reductions are not identified by the joint committee and passed by Congress by January 15, 2012, then under the Budget Act, very substantial automatic spending cuts split between defense and non-defense programs will be triggered beginning in 2013 over a nine-year period. Management will consider the outcome of these future events and its then current market capitalization when completing its annual impairment test during the fourth quarter.

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 KGS and PSS.

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 *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 Topic 350 prescribes the approach for determining the impairment amount, if any.

The changes in the carrying amount of goodwill for the nine months ended September 25, 2011 are as follows (in millions):

	Public Safety & Security	Government Solutions	Total
Balance as of December 26, 2010	$ 32.4	$ 194.0	$ 226.4
Retrospective adjustments to the Gichner acquisition	—	(0.2)	(0.2)
Balance as of December 26, 2010 after retrospective adjustments	32.4	193.8	226.2
Additions due to business combinations	—	321.3	321.3
Balance as of September 25, 2011	$ 32.4	$ 515.1	$ 547.5

The accumulated impairment losses as of December 26, 2010 and September 25, 2011 were $147.1 million associated with the KGS segment and $18.3 million associated with the PSS segment.

(b) Purchased Intangible Assets

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

	As of December 26, 2010			As of September 25, 2011		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets:						
Customer relationships	$ 41.5	$ (10.0)	$ 31.5	$ 74.0	$ (16.4)	$ 57.6
Contracts and backlog	24.5	(13.9)	10.6	59.5	(30.1)	29.4
Developed technology and technical know-how	22.1	(1.9)	20.2	22.1	(3.6)	18.5
Trade names	1.2	(0.6)	0.6	2.6	(0.8)	1.8
Favorable operating lease	1.8	(0.1)	1.7	1.8	(0.2)	1.6
Total	$ 91.1	$ (26.5)	$ 64.6	$ 160.0	$ (51.1)	$ 108.9

Table of Contents

In addition to the finite-life intangible assets listed in the table above, the Company has $24.5 million of indefinite-life intangible assets consisting of trade names at both December 26, 2010 and September 25, 2011.

Consolidated amortization expense related to intangible assets subject to amortization was $2.9 million and $11.9 million for the three months ended September 26, 2010 and September 25, 2011, respectively, and $6.2 million and $24.5 million for the nine months ended September 26, 2010 and September 25, 2011, respectively.

The estimated future amortization expense of purchased intangible assets with finite lives as of September 25, 2011 is as follows (in millions):

Fiscal Year	Amount
2011 (remaining three months)	$ 13.2
2012	32.3
2013	17.0
2014	15.5
2015	11.0
Thereafter	19.9
Total	$ 108.9

Note 4. Inventoried Costs

Inventoried costs are stated at the lower of cost or market. Cost is determined using the average cost or first-in, first-out method and is applied consistently within an operating entity. Inventoried costs primarily relate to work in process under fixed-price contracts using costs as the basis of the percentage-of-completion calculation under the units produced method of revenue recognition. These costs represent accumulated contract costs less the portion of such costs allocated to delivered items. Accumulated contract costs include direct production costs, factory and engineering overhead and production tooling costs. Pursuant to contract provisions of U.S. Government contracts, such customers may have title to, or a security interest in, inventories related to such contracts as a result of advances, performance-based payments, and progress payments. The Company reflects those advances and payments as an offset against the related inventory balances.

The Company regularly reviews inventory quantities on hand, future purchase commitments with its suppliers, and the estimated utility of its inventory. If the Company's review indicates a reduction in utility below carrying value, it reduces its inventory to a new cost basis.

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

	December 26, 2010	September 25, 2011
Raw materials	$ 16.5	$ 44.8
Work in process	7.9	30.7
Finished goods	1.1	7.5

Supplies and other	5.8	—
Subtotal inventoried costs	31.3	83.0
Less customer advances and progress payments	(5.4)	(3.2)
Total inventoried costs	$ 25.9	$ 79.8

Note 5. Stockholders' Equity

On February 11, 2011, the Company sold approximately 4.9 million shares of its common stock at a purchase price of $13.25 per share in an underwritten public offering. The Company received gross proceeds of approximately $64.8 million. After deducting underwriting and other offering expenses, the Company received approximately $61.1 million in net proceeds.

On July 27, 2011, pursuant to the Integral Merger Agreements, the Company issued approximately 10.4 million shares of its common stock to shareholders of Integral. See Note 2 for a complete description.

A summary of the changes in stockholders' equity is provided below (in millions):

	Nine Months Ended September 26, 2010	Nine Months Ended September 25, 2011
Stockholders' equity at beginning of period	$ 124.9	$ 169.9
Comprehensive income:		
Net income (loss)	14.1	(15.6)
Foreign currency translation	—	0.1
Total comprehensive income (loss)	14.1	(15.5)
Additional paid-in-capital from the issuance of common stock for cash	—	61.1
Additional paid-in-capital from the issuance of common stock for acquisitions	—	111.6
Stock-based compensation	1.4	2.3
Employee stock purchase plan and restricted stock units settled in cash	0.6	0.8
Exercise of stock options and warrants	1.3	1.2
Stockholders' equity at end of period	$ 142.3	$ 331.4

Table of Contents

In prior reporting periods, the Company had two classes of outstanding stock, Series B Convertible Preferred Stock and common stock. On March 8, 2011, all of the 10,000 shares of the previously issued and outstanding shares of Series B Convertible Preferred Stock were redeemed for 100,000 shares of common stock. Common stock issued by the Company for the nine months ended September 26, 2010 and September 25, 2011, was as follows (in millions):

	Nine Months Ended September 26, 2010	Nine Months Ended September 25, 2011
Shares outstanding at beginning of the period	15.8	18.6
Stock issued for employee stock purchase plan, stock options and restricted stock units exercised	0.2	0.4
Redemption of Series B Convertible Preferred Stock	—	0.1
Common stock issued for cash	—	15.3
Shares outstanding at end of the period	16.0	34.4

Note 6. Net Income (Loss) Per Common Share

The Company calculates net income (loss) per share in accordance with ASC Topic 260, *Earnings 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.

Components of basic and diluted earnings per share were as follows:

	For the Three Months Ended		For the Nine Months Ended	
(In millions, except earnings per share)	**September 26, 2010**	**September 25, 2011**	**September 26, 2010**	**September 25, 2011**
Income (loss) from continuing operations available for common shareholders(A)	$ 3.3	$ (6.9)	$ 14.0	$ (16.0)
Weighted average outstanding shares of common stock(B)	16.1	30.8	16.0	25.3
Dilutive effect of employee stock options and awards	0.2	—	0.4	—
Dilutive effect of contingently issuable shares	—	—	—	—
Common stock and common stock equivalents(C)	16.3	30.8	16.4	25.3
Earnings (loss) per share:				
Basic(A/B)	$ 0.21	$ (0.22)	$ 0.87	$ (0.63)
Diluted(A/C)	$ 0.20	$ (0.22)	$ 0.85	$ (0.63)

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

	For the Three Months Ended		For the Nine Months Ended	
(In millions)	**September 26,**	**September 25,**	**September 26,**	**September 25,**

	2010	2011	2010	2011
Shares from stock options and awards	1.3	2.8	1.2	2.0

Table of Contents

Note 7. Income Taxes

As of December 26, 2010, the Company had $12.4 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 nine months ended September 25, 2011, the Company settled its refund claim with the IRS, which will result in a refund to the Company of approximately $2.1 million, including approximately $0.5 million of interest income which was collected in the second quarter. The Company recorded an income tax benefit from continuing operations for this full amount, as this claim had been considered an uncertain tax position under *ASC Topic 740, Income Taxes*. During the nine months ended September 25, 2011, the unrecognized tax benefits were reduced by $0.3 million relating to the expiration of the statute of limitations and increased by $0.1 as a result of recording new unrecognized tax benefits. The reduction in unrecognized tax benefits was recorded as a tax benefit from discontinued operations and the increase was recorded as a tax expense related to continuing operations.

During the first quarter of 2011, the Company initially recorded the unrecognized tax benefits of Herley Industries of $1.1 million. The Company increased the unrecognized tax benefits of Herley to $1.5 million based on its updated analysis. The increase in unrecognized tax benefits was recorded as an adjustment to goodwill. Herley’s unrecognized tax benefits are related to various federal and state tax issues.

During the third quarter of 2011, the unrecognized tax benefits of Integral of $0.4 million were recorded. The increase in unrecognized tax benefits was recorded as an adjustment to goodwill. Integral’s unrecognized tax benefits are related to various federal tax issues.

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 nine months ended September 26, 2010 and September 25, 2011, respectively. As a result of the Herley acquisition, a $0.1 million liability for cumulative interest and penalties was recorded with a corresponding increase to goodwill. The Company recorded a benefit for interest and penalties related to the reversal of prior positions of $0.3 million and $0.7 million for the nine months ended September 26, 2010 and September 25, 2011, respectively. The Company believes that it is reasonably possible that as much as $0.3 million of the liabilities for uncertain tax positions will expire within 12 months of September 25, 2011 due to the expiration of various applicable statutes of limitations.

The Company is subject to taxation in the U.S., various state tax jurisdictions, and various foreign 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 (“NOL”) carryforwards. Generally, the Company’s tax years for 2002 and forward are subject to examination by various foreign tax authorities.

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

In connection with the Company’s acquisition of Integral, the Company recorded the acquired assets and liabilities at their respective fair market values. For tax purposes, the Company is required to carry over the historic tax basis of the assets and liabilities of Integral and in accordance with Topic 805, the Company established net deferred tax assets of approximately $1.1 million for U.S. and state tax purposes with a corresponding increase in the valuation allowance in the financial statement basis of the acquired assets and liabilities. Additionally, the Company recorded a net deferred tax liability of $0.5 million related to the foreign operations.

A reconciliation of 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 and nine months ended September 26, 2010 and September 25, 2011 is as follows (in millions):

	For the Three Months Ended		For the Nine Months Ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Income tax benefit at federal statutory rate	$ 0.5	$ (1.9)	$ 0.3	$ (5.2)
State and foreign taxes, net of federal tax benefit and valuation allowance	0.2	1.5	1.0	3.1
Nondeductible goodwill impairment charges	—	—	—	—
Nondeductible expenses and other	0.2	0.6	0.7	2.2
Release of valuation allowance due to Acquisitions	(1.3)	—	(13.5)	(0.1)
Impact of indefinite lived deferred tax liabilities and state law changes	—	—	—	0.3
Settlement with IRS	—	—	—	(2.1)
Increase/(Decrease) in reserves for uncertain tax positions	—	0.1	—	0.1
Increase/(Decrease) in federal valuation allowance	(0.7)	1.3	(1.0)	3.0
Total	$ (1.1)	$ 1.6	$ (12.5)	$ 1.3

Table of Contents

Federal and state income tax laws impose restrictions on the utilization of NOL and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 (“Section 382”) of the Internal Revenue Code (the “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 Internal Revenue Service ("IRS") in the month of the ownership change or the two preceding months. In March 2010, an "ownership change" occurred which will limit the utilization of the loss carryforwards. As a result, the Company's federal annual utilization of NOL carryforwards will be limited to $28.1 million for five years and $11.6 million per year thereafter. For the nine months ended September 25, 2011, there was no impact of such limitations on the income tax provision since the amount of taxable income did not exceed the annual limitation amount. In addition the recent equity offerings did not result in an "ownership change", however, future equity offerings or acquisitions that have equity as a component of the purchase price could also result in an "ownership change". If and when any other "ownership change" occurs, utilization of the NOL or other tax attributes may be further limited. As discussed elsewhere, deferred tax assets relating to the NOL and credit carryforwards are offset by a full valuation allowance. In addition, utilization of state tax loss carryforwards is dependent upon sufficient taxable income apportioned to the states.

Note 8. Discontinued Operations

On August 2, 2010, the Company divested the southeast division of its PSS segment for approximately $0.1 million cash consideration and the assumption of certain liabilities.

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

	For the Three Months Ended		For the Nine Months Ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Revenue	$ 0.3	$ —	$ 2.2	$ —
Net income (loss) before taxes	(0.1)	—	(0.7)	0.1
Provision (benefit) for income taxes	—	—	(0.8)	(0.3)
Net income (loss) after taxes	$ (0.1)	$ —	$ 0.1	$ 0.4

The benefit for income taxes for the nine months ended September 26, 2010 and September 25, 2011 was primarily due to the expiration of the statute of limitations for certain foreign tax contingencies related to the Company's discontinued wireless services business.

The following is a summary of the assets and liabilities of discontinued operations which are in other current assets, other current liabilities and other long-term liabilities in the accompanying condensed consolidated balance sheets as of December 26, 2010 and September 25, 2011 (in millions):

	December 26, 2010	September 25, 2011
Accounts receivable, net	$ 0.3	$ —
Other current assets	0.2	—
Current assets of discontinued operations	$ 0.5	$ —
Accrued expenses	$ 1.7	$ 1.4
Other current liabilities	0.4	0.3
Current liabilities of discontinued operations	$ 2.1	$ 1.7
Non-current unrecognized tax benefits	$ 0.6	$ 0.3
Other non-current liabilities	0.8	0.6
Non-current liabilities of discontinued operations	$ 1.4	$ 0.9

Note 9. Debt

(a) Issuance of 10% Senior Secured Notes due 2017

On May 19, 2010, the Company entered into an Indenture with the guarantors set forth therein and Wilmington Trust FSB ("Wilmington Trust"), as trustee and collateral agent (the "Indenture") to issue 10% Senior Secured Notes due 2017. As of September 25, 2011, the Company has issued notes of $225.0 million (the "Original Notes"), $285.0 million, and $115.0 million (the "Additional Notes" and, together with the Original Notes, the "Existing Notes") under this Indenture. These Existing Notes were used to fund acquisitions and for general corporate purposes. They are secured by a lien on substantially all of the assets of the Company and the assets of the guarantors thereunder, subject to certain exceptions and permitted liens. The holders of the Existing Notes have a first priority lien on substantially all of the Company's assets and the assets of the guarantors, except accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property) where the holders of the senior secured borrowings have a second priority lien to the $65.0 million credit facility described below.

The Company pays interest on the Existing Notes semi-annually, in arrears, on June 1 and December 1 of each year. The Existing Notes include customary covenants and events of default as well as a consolidated fixed charge ratio of 2.0:1.0 for the incurrence of additional indebtedness. Negative covenants include, among other things, limitations on additional debt, liens, negative pledges, investments, dividends, stock repurchases, asset sales and affiliate transactions. Events of default include, among other events, non-performance of covenants, breach of representations, cross-default to other material debt, bankruptcy, insolvency, material judgments and changes in control. As of September 25, 2011, the Company was in compliance with the covenants contained in the indentures related to the Existing Notes described below.

On or after June 1, 2014, the Company may redeem some or all of the Existing Notes at 105% of the aggregate principal amount of such notes through June 1, 2015, 102.5% of the aggregate principal amount of such notes through June 1, 2016 and 100% of the aggregate principal amount of such notes thereafter, plus accrued and unpaid interest to the date of redemption. Prior to June 1, 2013, the Company may redeem up to 35% of the aggregate principal amount of the Existing Notes at 110% of the aggregate principal amount of the Existing Notes, plus accrued and unpaid interest to the redemption date, with the net cash proceeds of certain equity offerings. In addition, the Company may, at its option, redeem some or all of the Existing Notes at any time prior to June 1, 2014, by paying a "make whole" premium, plus accrued and unpaid interest, if any, to the date of redemption.

Original Notes - $225 Million 10% Senior Secured Note Offering, May 2010

On May 19, 2010, the Company issued its 10% Senior Secured Notes due June 1, 2017 in the aggregate principal amount of $225.0 million in an unregistered offering pursuant to Rule 144A and Regulation S under the Securities Act and on August 11, 2010, the Company completed an exchange offer for such notes pursuant to a registration rights agreement entered into in connection with the issuance thereof. The proceeds were primarily used to finance the acquisitions of Gichner, DEI and Southside (see Note 2).

Additional Notes - $285 Million 10% Senior Secured Note Offering, March 2011

On March 25, 2011, the Stage I Issuer issued $285.0 million aggregate principal amount of the Stage I Notes pursuant to an Indenture, dated March 25, 2011, by and among the Stage I Issuer, the guarantors named therein and a party thereto, and Wilmington Trust FSB, as trustee and collateral agent (the "Stage I Indenture"). The Stage I Issuer received approximately $314.0 million in cash proceeds from the offering, which includes an approximate $20.0 million of issuance premiums and $9.0 million of accrued interest, which proceeds were used, together with cash contributions of $45.0 million from the Company, to finance the acquisition of all of the outstanding shares of common stock of Herley (see Note 2), to pay related fees and expenses and for general corporate purposes. The effective interest rate on the Additional Notes is 8.5%. In connection with the purchase and sale of the Stage I Notes, the Company entered into a registration rights agreement with the initial purchasers of the Stage I Notes. On April 4, 2011, (i) the Stage I Issuer merged with and into the Company, and the Company assumed all the assets and liabilities of the Stage I Issuer including, pursuant to a supplemental indenture to the Stage I Indenture, all the obligations of the Stage I Issuer under the Stage I Indenture, the Stage I Notes and the related collateral agreements and (ii) the Company became the issuer of the Stage I Notes under the Stage I Indenture and pledgor under such collateral agreements. On April 15, 2011, the Company redeemed all of the Stage I Notes by issuing in exchange therefore the Additional Notes in an aggregate principal amount equal to the aggregate principal amount of the Stage I Notes. On July 29, 2011, the Company completed an exchange offer for the Additional Notes pursuant to a registration rights agreement entered into in connection with the issuance thereof.

Additional Notes - $115 Million 10% Senior Secured Note Offering, July 2011

On July 27, 2011, the Company issued $115.0 million aggregate principal amount of its 10% Senior Secured Notes due 2017 pursuant to that certain indenture, dated as of May 19, 2010, among the Company, the guarantors party thereto and Wilmington Trust, as trustee and collateral agent. The Company received approximately $120.8 million in net cash proceeds from the issuance of the Notes, which includes an approximate $5.8 million of issuance premiums, which proceeds were used to finance, in part, the cash portion of the purchase price for the acquisition of Integral (see Note 2), to refinance existing indebtedness of Integral, to pay certain severance payments in connection with the acquisition of Integral and to pay related fees and expenses. The effective interest rate on the Additional Notes is 8.9%. Pursuant to the amended Registration Rights Agreement entered into as a result of the issuance of these Additional Notes, the Company filed an exchange offer registration statement on Form S-4 (File No. 333-177493) with the SEC, which was declared effective on November 1, 2011 and will use commercially reasonable efforts to consummate the exchange offer within 30 business days, or longer if required by the U.S. federal securities laws, after the date on which the exchange offer registration statement was declared effective by the SEC. In certain circumstances, the Company may be required to file a shelf registration statement to cover resales of these Additional Notes. If the Company fails to satisfy these obligations, it will pay additional interest to holders of these Additional Notes under certain circumstances.

(b) Other Indebtedness

$65 Million Credit Facility

On July 27, 2011, concurrent with the completion of the offering of the Notes, the Company entered into a credit and security agreement with KeyBank National Association, as lead arranger, sole book runner and administrative agent, and East West Bank and Bank of the West, as the lenders (the "2011 Credit Agreement"). The 2011 Credit Agreement amends and restates in its entirety the credit and security agreement, dated as of May 19, 2010, between the Company, KeyBank and the lenders named therein (as amended). The 2011 Credit Agreement establishes a five year senior secured revolving credit facility in the amount of $65.0 million (the "Amended Revolver"). The Amended Revolver is secured by a lien on substantially all of the Company's assets and the assets of the guarantors thereunder, subject to certain exceptions and permitted liens. The Amended Revolver has a first priority lien on accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property). On all other assets, the Amended Revolver has a second priority lien junior to the lien securing the Company's currently outstanding 10% Senior Secured Notes due 2017, including the Notes (collectively, the "Kratos Notes").

The Amended Revolver may be increased to $100.0 million. Any increase in the Amended Revolver is subject to the consent of the KeyBank, identification of one or more additional lenders willing to advance the increased amount of the Amended Revolver, and compliance with covenants in the Kratos Notes. The amounts of borrowings that may be made under the Amended Revolver are based on a borrowing base and are comprised of specified percentages of eligible receivables, eligible unbilled receivables and eligible inventory. If the amount of borrowings outstanding under the Amended Revolver exceeds the borrowing base then in effect, the Company is required to repay such borrowings in an amount sufficient to eliminate such excess. The Amended Revolver includes $30.0 million of availability for letters of credit and $5.0 million of availability for swing loans.

The Company may borrow funds under the Amended Revolver at a rate based either on LIBOR or a base rate established by KeyBank. Base rate borrowings bear interest at an applicable margin of 1.00% to 1.75% over the base rate (which will be the greater of the prime rate or 0.5% over the federal funds rate, with a floor of 1.0% over one month LIBOR). LIBOR rate borrowings will bear interest at an applicable margin of 3.00% to 3.75% over the LIBOR rate. The applicable margin for base rate borrowings and LIBOR borrowings will depend on the average monthly revolving credit availability. The Amended Revolver also has a commitment fee of 0.50% to 0.75%, depending on the average monthly revolving credit availability. The Company was in compliance with the financial covenants as of September 25, 2011.

During 2010, the Company refinanced its previous revolving credit facilities and, as a result, the Company recorded interest charges of approximately $3.9 million in 2010 relating to the write-off of previously deferred financing costs.

Debt Acquired in Acquisition of Herley

The Company assumed a $10.0 million ten-year term loan with a bank in Israel that Herley entered into on September 16, 2008 in connection with the acquisition of one of its wholly owned subsidiaries. The balance as of September 25, 2011 was $7.0 million and the loan is payable in quarterly installments of $0.3 million plus interest at LIBOR plus a margin of 1.5%. The loan agreement contains various financial covenants including a minimum net equity covenant as defined in the loan agreement. The Company was in compliance with the financial covenants as of September 25, 2011.

On October 19, 2001, Herley received $3.0 million in proceeds from the East Hempfield Township Industrial Development Authority Variable Rate Demand/Fixed Rate Revenue Bonds Series of 2001 (the “IDA Bonds”). The IDA Bonds were due in varying annual installments through October 1, 2021. Proceeds from the IDA Bonds were used for the construction of a 15,000 square foot expansion of Herley’s facilities in Lancaster, Pennsylvania, and for manufacturing equipment. The IDA Bonds were paid in full on May 2, 2011.

Table of Contents

Fair Value of Long-term Debt

Carrying amounts and the related estimated fair values of the Company’s long term debt financial instruments not measured at fair value on a recurring basis at December 26, 2010 and September 25, 2011 are presented in the following table.

	As of December 26, 2010			As of September 25, 2011		
$ in millions	**Principal**	**Carrying Amount**	**Fair Value**	**Principal**	**Carrying Amount**	**Fair Value**
Long-term debt	$ 225.0	$ 225.0	$ 247.2	$ 631.0	$ 654.9	$ 631.1

The fair value of the Company’s long-term debt was based upon actual trading activity (Level 1, Observable inputs—quoted prices in active markets) and it is the estimated amount the Company would have to pay to repurchase its debt, including any premium or discount attributable to the difference between the stated interest rate and market value of interest at the balance sheet date.

The net unamortized debt premium, of $23.9 million as of September 25, 2011, which is the difference between the carrying amount of $654.9 million and the principal amount of $631.0 million represented in the previous table, is being amortized to interest expense over the terms of the related debt.

Note 10. Fair Value of Financial Instruments

The following table presents the only asset or liability measured and recorded at fair value on the Company’s condensed consolidated balance sheets on a recurring basis and the level within the fair value hierarchy as of December 26, 2010 and September 25, 2011 (in millions):

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 26, 2010	$ 0.3	$ —	$ 0.3	$ —
September 25, 2011	$ —	$ —	$ —	$ —

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 percentage difference in these two rates is then multiplied by the notional 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 of similar financial instruments from a nationally recognized financial reporting service.

The carrying value of the interest rate swaps is classified as other current liabilities as of December 26, 2010. As of September 25, 2011, there were no outstanding interest rate swaps. Mark to market adjustments for the interest rate swaps are recorded in other income (expense) in the condensed consolidated statements of operations.

Carrying amounts and the related estimated fair values of the Company’s long-term debt financial instruments not measured at fair value on a recurring basis at December 26, 2010 and September 25, 2011 are presented in Note 9. 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 26, 2010 and September 25, 2011.

Note 11. Derivatives

The Company used derivative financial instruments, in particular, interest rate swaps, to reduce the Company’s exposure to certain previously outstanding variable rate debt. The primary objective of the interest rate swaps was 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 were 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 certain previously outstanding variable-rate debt.

Table of Contents

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 as effective or ineffective. Adjustments to reflect changes in fair values of derivatives that the Company considers 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. There were no interest rate swaps outstanding as of and for the period ended September 25, 2011.

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 First Credit Facility in March 2008. The effect of marking the derivative instruments to market for the nine months ended September 26, 2010 was income of $0.8 million. The fair value of the Company's derivative liabilities as of December 26, 2010 and September 25, 2011 was $0.3 million and zero, respectively, and is carried in other current liabilities in the accompanying condensed consolidated balance sheets. See Note 10 for further discussion of the fair value measurements related to the Company's derivative instruments.

Note 12. Significant Customers

Revenue from the U.S. Government, which includes foreign military sales, includes revenue from contracts for which the Company is the prime contractor as well as those for which the Company is a subcontractor and the ultimate customer is the U.S. Government. The KGS segment has substantial revenue from the U.S. Government. Sales to the U.S. Government amounted to approximately $106.5 million and $157.9 million, or 89% and 75%, of total revenue for the three months ended September 26, 2010 and September 25, 2011, respectively, and approximately $250.7 million and $374.4 million, or 87% and 74%, of total revenue for the nine months ended September 26, 2010 and September 25, 2011, respectively.

In August 2011, Congress and the Administration enacted the Budget Control Act of 2011 (the "Budget Act"). The Budget Act set a target reduction of net government spending of 1.2 trillion over the next ten years. Under the Budget Act, 50% of any failure to achieve the $1.2 trillion target reduction would automatically be applied as a reduction to discretionary appropriations for national defense programs. Any automatic reductions in national defense programs could impact our significant customers.

Note 13. Segment Information

The Company operates in two principal business segments: Kratos Government Solutions and Public Safety and Security. 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 expense, net" includes costs for certain stock-based compensation programs (including stock-based compensation costs for stock options, employee stock purchase plan and restricted stock units), the effects of items not considered part of management's evaluation of segment operating performance, merger and acquisition expenses, 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, operating income, and assets generated or held by the Company's current reporting segments for the three and nine months ended September 26, 2010 and September 25, 2011 are as follows (in millions):

	Three months ended		Nine months ended	
	September 26, 2010	September 25, 2011	September 26, 2010	September 25, 2011
Revenues:				
Kratos Government Solutions	$ 110.2	$ 178.6	$ 263.3	$ 421.3
Public Safety & Security	9.7	32.4	24.4	83.6
Total revenues	$ 119.9	$ 211.0	$ 287.7	$ 504.9
Operating income:				
Kratos Government Solutions	$ 7.1	$ 10.8	$ 17.7	$ 27.1
Public Safety & Security	0.7	3.7	0.7	6.6
Unallocated corporate expense, net	0.6	(4.5)	(1.9)	(13.6)
Total operating income	$ 8.4	$ 10.0	$ 16.5	$ 20.1

	As of December 26, 2010	As of September 25, 2011
Assets:		
Kratos Government Solutions	$ 406.5	$ 1,052.1
Public Safety & Security	97.3	102.7
Discontinued operations	0.5	—
Corporate activities	31.2	86.6
Total assets	$ 535.5	$ 1,241.4

Table of Contents

The increase in assets in the KGS segment is primarily attributable to the acquisitions of Herley and Integral. The increase in assets in corporate activities is primarily due to an increase in cash and cash equivalents from the sale of $285.0 million and $115.0 million of Additional Notes and the issuance of common stock during the nine months ended September 25, 2011 partially offset by the cash paid for the acquisitions of Herley and Integral. See Notes 2, 5 and 9.

Note 14. Commitments and Contingencies

(a) Legal Matters

For additional information regarding the Company's legal proceedings, see Item 3, "Legal Proceedings" in the Form 10-K. As of September 25, 2011, there have been no material developments in the Company's legal historical proceedings since December 26, 2010 except as described below.

Integral, which the Company acquired on July 27, 2011, was previously the subject of a Securities and Exchange Commission ("SEC") investigation and inquiry by the NASDAQ Stock Market LLC ("NASDAQ"). On July 30, 2009, the SEC and Integral each announced that a final administrative settlement had been reached concluding the SEC's investigation. Shortly after the settlement with the SEC, the NASDAQ inquiry was closed with no further action required by Integral.

In conjunction with its announcement of the administrative settlement, the SEC also disclosed that it was instituting separate civil actions against three former officers of Integral. Integral has indemnification obligations to these individuals, as well as other former directors and officers of Integral who may incur indemnifiable costs in connection with these actions, pursuant to the terms of separate indemnification agreements entered into with each of them effective as of December 4, 2002. As a result of the acquisition of Integral, the Company has assumed these indemnification obligations. The indemnification agreements each provide that, subject to certain terms and conditions, that the Company shall indemnify the individual to the fullest extent permissible by Maryland law against judgments, penalties, fines, settlements and reasonable expenses actually incurred in the event that the individual is made a party to a legal proceeding by reason of his or her present or prior service as an officer or employee of Integral, and shall also advance reasonable litigation expenses actually incurred subject to, among other conditions, receipt of a written undertaking to repay any costs or expenses advanced if it shall ultimately be determined that the individual has not met the standard of conduct required for indemnification under Maryland law. Integral has advanced legal fees and costs incurred by these individuals in connection with the SEC investigation up to the deductible limit under Integral's applicable directors and officers liability insurance policy and subsequent fees and costs have been paid directly by the insurance carrier. The Company will be obligated to advance any amounts in excess of the insurance policy limits once the fees and expenses exceed the remaining insurance policy limits.

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 effect on the Company's business, financial condition, operating results or cash flows.

(b) Warranty

Certain of the Company's products, product finishes, and services are covered by a warranty to be free from defects in material and workmanship for periods ranging from one to ten years. Optional extended warranty contracts can also be purchased with the revenue deferred and amortized over the extended warranty period. The Company accrues a warranty liability for estimated costs to provide products, parts or services to repair or replace products in satisfaction of warranty obligations. Warranty revenues related to extended warranty contracts are amortized to income, over the life of the contract, using the straight-line method. Costs under extended warranty contracts are expensed as incurred.

The Company's estimate of costs to service its warranty obligations is based upon historical experience and expectations of future conditions. To the extent that the Company experiences any changes in warranty claim activity or costs associated with servicing those claims, its warranty liability is adjusted accordingly.

Accrued product warranty and deferred warranty revenue activity is as follows (in millions):

	Nine months ended	
	September 26, 2010	September 25, 2011
Balance, at beginning of the period	$ (0.2)	$ (1.3)
Costs accrued and revenues deferred	(0.5)	(1.1)
Warranty liabilities assumed from acquisitions	(0.6)	(1.6)
Settlements made (in cash or kind) and revenues recognized	0.6	0.9
Balance, at end of period	(0.7)	(3.1)
Less: Current portion	(0.7)	(2.3)
Noncurrent accrued product warranty and deferred warranty revenue	—	(0.8)
Total warranty	$ (0.7)	$ (3.1)

Table of Contents

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; risks related to security breaches, cybersecurity attacks or other significant disruptions of our information systems; 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 ("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 (as defined below) 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 principles generally accepted in the U.S. ("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 our Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission ("SEC") on March 2, 2011 (the "Form 10-K"), including the disclosures made in Item 1A "Risk Factors" and the audited consolidated financial statements and related notes included therein, and the disclosures made in Item 1A "Risk Factors" in this Form 10-Q. All references to "us," "we," "our," the "Company" and "Kratos" refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its subsidiaries.

Overview

We are a specialized national security technology business providing mission critical products, services and solutions for U.S. national security priorities. Our core capabilities are sophisticated engineering, manufacturing and system integration offerings for national security platforms and programs. Our principal services are related to, but are not limited to: electronic attack and electronic warfare platforms, tactical missile systems, strategic deterrence systems, Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance ("C5ISR"); related cybersecurity, cyberwarfare, information assurance and situational awareness solutions; satellite communication systems and radio frequency interference detection and prevention; weapons systems lifecycle support and sustainment; military weapon range operations and technical services; missile, rocket and weapons system testing and evaluation; missile and rocket mission launch services, primarily for ballistic missile defense; public safety, critical infrastructure security and surveillance systems; modeling and simulation; unmanned aerial vehicle systems; and advanced network engineering and information technology services. We offer our customers products, solutions, services and expertise to support their mission-critical needs by leveraging our skills across our core offering areas.

Our primary end customers are U.S. Federal Government agencies, including the Department of Defense ("DoD"), classified agencies, intelligence agencies, other national security agencies and homeland security related agencies. We believe our stable client base, strong client relationships, broad array of contract vehicles, considerable employee base possessing national security clearances, extensive list of past performance qualifications, and significant management and operational capabilities position us for continued growth.

We provide products, solutions and services for a wide range of established, deployed and operating national security platforms, including, but not limited to: Aegis Ballistic Missile Defense systems, various unmanned aerial systems, certain intelligence surveillance and reconnaissance systems, M1 Abrams tanks, Bradley fighting vehicles, EA-18G, electronic warfare and electronic attack aircraft, HiMARS, Chaparral and HAWK missile systems, Kiowa AH-60 helicopters, DDG-1000 Zumwalt destroyers, attack and missile submarines, certain intelligence surveillance and reconnaissance systems and various unmanned systems.

Industry Update

In August 2011, Congress and the Administration enacted the Budget Control Act of 2011 (the "Budget Act") in order to permit an increase in the federal government's borrowing limit while reducing projected net government spending over the next 10 years. The Budget Act contains $900 billion in immediate cuts to discretionary spending for 2012-2021. It also establishes a bi-partisan congressional Joint Select Committee on Deficit Reduction, sometimes referred to as the Super Committee, which is charged with recommending legislation by November 23, 2011, that would reduce net government spending by at least $1.2 trillion over the next 10 years, in addition to the $900 billion in immediate discretionary spending reductions referenced above. In the event that the Super Committee fails to recommend legislation, Congress fails to approve that legislation by late December 2011, or the President fails to sign the legislation into law, an automatic sequestration of discretionary appropriations would be triggered, which would make up any shortfall necessary to achieve the $1.2 trillion target. Under the Budget Act, 50% of any shortfall from the $1.2 trillion target would automatically be applied as a reduction to discretionary appropriations for national security programs. Any of these reductions could have a significant impact on our business and financial results.

In October 2011, Congress passed a continuing resolution funding measure for fiscal year 2012 to finance all U.S. Government activities through November 18, 2011. Under this continuing resolution, partial-year funding at amounts consistent with appropriated levels for fiscal year 2011 are available, subject to certain restrictions, but new spending initiatives are not authorized. Our key programs continue to be supported and funded despite the continuing resolution financing mechanism. However, during periods covered by continuing resolutions (or until the regular appropriation bills are passed), we may experience delays in procurement of products and services due to lack of funding, and those delays may affect our results of operations.

This process and the spending reductions to defense programs have the potential to significantly impact our portfolio of business, which is heavily dependent upon discretionary appropriations for defense programs. Although we believe that our programs are well aligned with national defense and other priorities, shifts in domestic and international spending and tax policy, changes in security, defense and intelligence priorities, the affordability of our products and services, general economic conditions and developments, and other factors may affect the level of funding for existing or proposed programs. We cannot predict the outcome of Budget Act deliberations, actions of the Super Committee or continuing resolution or the extent to which any reductions would impact total funding and/or individual funding for programs in which we participate and the impact on our business and financial results.

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 condensed consolidated financial statements in this Form 10-Q are presented in a manner consistent with our operating structure. For additional information regarding our operating segments, see Note 13 of the notes to the condensed consolidated financial statements. From a customer and solutions perspective, we view our business as an integrated whole, leveraging skills and assets wherever possible.

Strategic Acquisitions

We intend to supplement our organic growth by identifying, acquiring and integrating businesses that meet our primary objective of providing us with enhanced capabilities to pursue a broader cross section of the DoD, Department of Homeland Security and other government markets, complement and broaden our existing client base and expand our primary service offerings. Our senior management team has significant acquisition experience. Since May 2010, we have acquired six companies, each as discussed below.

Integral Systems, Inc.

On July 27, 2011, we completed the merger (the "Integral Merger") of IRIS Merger Sub Inc., a Maryland corporation and our wholly owned subsidiary ("Integral Merger Sub"), with and into Integral Systems, Inc., a Maryland corporation ("Integral"), whereby Integral became our wholly owned subsidiary. The Integral Merger was effected pursuant to an Agreement and Plan of Merger, dated as of May 15, 2011, by and among Kratos, Integral Merger Sub, IRIS Acquisition Sub LLC, a single member Maryland limited liability company and a our direct wholly owned subsidiary, and Integral (the "Integral Merger Agreement").

Pursuant to the terms of the Integral Merger Agreement, at the effective time of the Merger (the "Effective Time"), each outstanding share of Integral common stock (other than shares of Integral common stock owned by us, Merger Sub, any of our wholly owned subsidiary or Integral stockholders, if any, who had perfected statutory dissenters' rights under Maryland law) was cancelled and converted into the right to receive (i) $5.00, in cash, without interest, and (ii) the issuance of 0.588 shares of our common stock. In addition, at the Effective Time (A) each outstanding Integral stock option with an exercise price less than $13.00 per share was, if the holder thereof had so elected in writing, cancelled in exchange for an amount in cash equal to the product of the total number of shares of Integral common stock subject to such in-the-money option, multiplied by the aggregate value of the excess, if any, of $13.00 over the exercise price per share subject to such option, less the amount of any tax withholding, (B) each outstanding Integral stock option with an exercise price equal to or greater than $13.00 per share and each Integral in-the-money option the holder of which had not made the election described in (A) above, was converted into an option to purchase our common stock, with (1) the number of shares subject to such option adjusted to equal the number of shares of Integral common stock subject to such out-of-the-money option multiplied by 0.9559, rounded up to the nearest whole share, and (2) the per share exercise price under each such option adjusted by dividing the per share exercise price under such option by 0.9559, rounded up to the nearest whole cent, and (C) each outstanding share of restricted stock granted under an Integral equity plan or otherwise, whether vested or unvested, was cancelled and converted into the right to receive $13.00, less the amount of any tax withholding.

The acquisition of Integral was completed by issuing approximately 10.4 million shares of Kratos common stock valued at $108.7 million. To fund the cash portion of the acquisition of Integral we issued $115.0 million aggregate principal amount of 10% Senior Secured Notes due 2017. We received approximately $120.8 million in gross cash proceeds from the issuance of the notes, which includes an approximate $5.8 million of issuance premiums, which proceeds were used to finance, in part, the cash portion of the purchase price for the acquisition of Integral, to refinance existing indebtedness of Integral, to pay certain severance payments in connection with the acquisition of Integral and to pay related fees and expenses.

Including the value of the common shares issued, cash paid to the stockholders of Integral, Integral debt paid at closing and the fair value of stock options not exercised of $1.0 million, the total purchase price paid for Integral was $241.0 million. In addition, we assumed change in control obligations of $2.8 million related to the transaction, the majority of which will be paid in 2011.

Integral is a global provider of products, systems and services for satellite command and control, telemetry and digital signal processing, data communications, enterprise network management and communications information assurance. Integral specializes in developing, managing and operating secure communications networks, both satellite and terrestrial, as well as systems and services to detect, characterize and geolocate sources of RF interference. Integral's customers include U.S. and foreign commercial, government, military and intelligence organizations. For almost 30 years, customers have relied on Integral to design and deliver innovative commercial-based products, solutions and services that are cost-effective and reduce delivery schedules and risk.

Herley Industries, Inc.

On March 25, 2011, pursuant to an Agreement and Plan of Merger dated as of February 7, 2011 (the "Herley Merger Agreement"), by and among us, Lanza Acquisition Co. ("Herley Acquisition Sub") and Herley Industries, Inc. ("Herley"), Herley Merger Sub acquired approximately 13.2 million shares of Herley common stock representing approximately 94% of the total outstanding shares of Herley common stock in a tender offer to purchase all of the outstanding shares of Herley common stock. On March 30, 2011, following purchases in a subsequent offering period, Herley Merger Sub was merged with and into Herley, with Herley continuing as a wholly owned subsidiary of ours. The shares of Herley common stock were purchased at a price of $19.00 per share. Accordingly, we paid approximately $245.5 million in cash consideration as of March 27, 2011 and as of April 15, 2011 had paid total aggregate cash consideration of $270.7 million in respect of the shares of Herley common stock and certain in-the-money options which were exercised upon the change in control. In addition, upon completion of the merger, all unexercised options to purchase Herley common stock were assumed by us and converted into options to purchase our common stock, entitling the holders thereof to receive 1.3495 shares of our common stock for each share of Herley common stock underlying the options (the "Herley

Options"). We assumed each Herley Option in accordance with the terms (as in effect as of the date of the Herley Merger Agreement) of the applicable Herley equity plan and the option agreement pursuant to which such Herley Option was granted. The options are exercisable for an aggregate of approximately 0.8 million shares of our common stock. All options were fully vested upon the change in control and the fair value of the options assumed was $1.9 million. The total aggregate consideration for the purchase of Herley was $272.6 million. In addition, we assumed change in control obligations of $4.0 million related to the transaction, the majority of which will be paid in 2011, and combined transaction expenses of $11.1 million.

On February 11, 2011, we completed the sale of approximately 4.9 million shares of our common stock at a purchase price of $13.25 per share in an underwritten public offering, and on March 25, 2011, Acquisition Co. Lanza Parent, our wholly owned subsidiary (the "Stage I Issuer"), issued 10% Senior Secured Notes due 2017 in the aggregate principal amount of $285.0 million (the "Stage I Notes"). The proceeds of the underwritten public offering and sale and issuance of the Stage I Notes were used to fund the acquisition of Herley. We received gross proceeds from the equity offering of approximately $64.8 million and after deducting underwriting and other offering expenses received approximately $61.1 million in net proceeds. The Stage I Notes were offered at a premium of 107%, for an effective interest rate of 8.5% and the gross proceeds were approximately $314.0 million, which includes approximately $20.0 million of issuance premium and $9.0 million of accrued interest.

Herley is a leading provider of microwave technologies for use in command and control systems, flight instrumentation, weapons sensors, radar, communication systems, and electronic warfare systems. Herley has served the defense industry for approximately 45 years by designing and manufacturing microwave devices for use in high-technology defense electronics applications.

Henry Bros. Electronics, Inc.

On December 15, 2010, we acquired Henry Bros. Electronics, Inc. ("HBE") in a cash merger for a purchase price of $56.6 million, of which $54.9 million was paid in cash and $1.7 million reflects the fair value of options to purchase common stock of HBE that were assumed by us and converted into options to purchase our common stock. Upon completion of the merger, holders of HBE common stock received $8.20 in cash for each share of HBE common stock held by them immediately prior to the closing of the merger. In addition, upon completion of the merger, all options to purchase HBE common stock (the "HBE Options") were assumed by us and converted into options to purchase our common stock, entitling the holders thereof to receive 0.7715 shares of our common stock for each share of HBE common stock underlying the HBE Options. The HBE Options will be exercisable for an aggregate of approximately 0.4 million shares of our common stock. The fair value of unvested options which are related to future service will be expensed as the service is performed over the weighted average vesting period of 2.5 years.

HBE is a leading provider of homeland security solutions, products, and system integration services, including the design, engineering and operation of command, control and surveillance systems for the protection of strategic assets and critical infrastructure in the U.S. HBE also has particular expertise in the design, engineering, deployment and operation of specialized surveillance, thermal imaging, analytics, radar, and biometrics technology based security systems. Representative HBE programs and customers include DoD agencies, nuclear power generation facilities, state government and municipality related agencies, major national airports, major harbors, railways, tunnel systems, energy centers, power plants, and related infrastructure.

HBE has been in business for over 50 years and has established relationships with manufacturing partners, industry colleagues, and customers demanding some of the most sophisticated security solutions available. HBE has a national footprint that includes offices in New York, New Jersey, Virginia, Maryland, Texas, Arizona, Colorado and California. The combination of our existing PSS businesses with one of the leading homeland security solutions and high end security system design and engineering services providers in the industry today strategically strengthens our overall capabilities and enhances its customer offerings and overall contract portfolio.

Southside Container & Trailer, LLC

On December 7, 2010, we acquired Southside Container & Trailer, LLC ("SCT") for $13.7 million of which $12.2 million in cash was paid at closing, $0.3 million was paid in March 2011, as SCT's indemnification obligations as set forth in the applicable acquisition agreement (the "SCT Agreement") were met, and approximately $1.2 million of which represents the acquisition date fair value of additional performance based consideration. Pursuant to the terms of the SCT Agreement, upon achievement of certain earnings before interest, taxes, depreciation, and amortization ("EBITDA") amounts in 2011, 2012 and 2013, we will pay the former stockholders of SCT certain additional performance-based consideration (the "SCT Contingent Consideration"). The potential undiscounted amount of all future SCT Contingent Consideration that may be payable by us under the SCT Agreement is between zero and $3.5 million.

SCT provides national security related command and control center, law enforcement, military aviation and data center products, shelters and solutions for the DoD, national security agencies and related customers. SCT also provides products and solutions for specialized war fighter and critical asymmetric warfare related missions. Founded in 2002 and headquartered in Walterboro, South Carolina, SCT designs, engineers, manufactures and delivers various products, shelters and solutions used primarily by the war fighter and first responder in fulfilling their respective national security missions. Representative end customers and program locations include the U.S. Army, Marine Corps, Special Operations Command, Space and Naval Warfare Systems Center, Fort Bragg, Fort Lewis, Fort Bliss, Fort McGregor, Fort Irwin, Fort Stewart, the Border Patrol and the National Guard. SCT is known for its superior design, engineering, construction and on schedule and on budget delivery of cost effective products and solutions that meet critical and special mission national security and asymmetric warfare requirements.

DEI Services Corporation

On August 9, 2010, we acquired DEI Services Corporation ("DEI"), in a cash merger valued at approximately $14.0 million, of which $9.0 million was paid in cash at closing and approximately $5.0 million of which represented the acquisition date fair value of additional performance-based consideration, of which $0.4 million was achieved and paid in September 2010. Pursuant to the terms of the applicable agreement and plan of merger (the "DEI Agreement"), upon achievement of certain cash receipts, revenue, EBITDA and backlog amounts in 2010, 2011 and 2012, we will be obligated to pay the former stockholders of DEI certain additional contingent consideration (the "DEI Contingent Consideration"). As of September 25, 2011, the potential undiscounted amount of all future DEI Contingent Consideration that may be payable by us under the DEI Agreement is between zero and $8.0 million. The DEI Contingent Consideration will be reduced in the event certain anticipated cash receipts are not collected within agreed upon time periods, which could decrease the future payments by approximately $6.0 million.

Founded in 1996 and headquartered in Orlando, Florida, DEI designs, manufactures and markets full-scale training simulation products. In addition to the engineering and construction of physical simulators for air and ground military vehicles, DEI provides instructional design, courseware creation, learning application programming and other supporting services. Among DEI's most successful products are training and simulation solutions for fixed-wing aircraft (including the Tiger, Harrier and Prowler aircraft), rotor-wing aircraft (including Blackhawk, Chinook and Sea Stallion helicopters) and Ground Combat Vehicles (including the M1 Abrams Main Battle Tank and M2 Bradley Fighting Vehicle).

Gichner Holdings, Inc.

On May 19, 2010, we acquired Gichner Holdings, Inc. ("Gichner") pursuant to a Stock Purchase Agreement, dated as of April 12, 2010, by and between us and the stockholders of Gichner (the "Gichner Agreement"), in a cash for stock transaction valued at approximately $133.0 million. Gichner has manufacturing and operating facilities in Dallastown and York, Pennsylvania and Charleston, South Carolina, and is a manufacturer of tactical military products, combat support facilities, subsystems, modular systems and shelters primarily for the DoD and leading defense system providers. Representative programs for which Gichner provides products and solutions include the MQ—1C Sky Warrior, Gorgon Stare, MQ—8B Fire Scout and RQ—7 Shadow Unmanned Aerial Vehicles, the Command Post Platform and Joint Light Tactical Vehicles, Combat Tactical Vehicles, DDG-1000 Modular C5 Compartments and the Persistent Threat Detection System ISR Platform.

Key Financial Statement Concepts

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 the Form 10-K.

As of September 25, 2011, we consider the following factors to be important in understanding our financial statements.

KGS' 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 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. In accounting for our long-term contracts for production of products and services provided to the federal government and to our customers under fixed price contracts, we utilize both cost-to-cost and units produced measures under the percentage-of-completion method of accounting under the provisions of *Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition*. Under the units produced measure of the percentage-of-completion method of accounting, sales are recognized as the units are accepted by the customer generally using sales values for units in accordance with the contract terms. We estimate profit as the difference between total estimated revenue and total estimated cost of a contract and recognize that profit over the life of the contract based on deliveries or as computed on the basis of the estimated final average unit costs plus profit. We classify contract revenues as product sales or service revenues depending upon the predominant attributes of the relevant underlying contracts.

Table of Contents

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.

We manage and assess the performance of our businesses based on our performance on individual contracts and programs obtained generally from government organizations with consideration given to the Critical Accounting Principles and Estimates described in the Form 10-K. Due to the Federal Acquisition Regulation rules that govern our business, most types of costs are allowable, and we do not focus on individual cost groupings (such as cost of sales or general and administrative costs) as much as we do on total contract costs, which are a key factor in determining contract operating income. As a result, in evaluating our operating performance, we look primarily at changes in sales and service revenues, and operating income, including the effects of significant changes in operating income. Changes in contract 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 in accordance with GAAP. Significant management judgments and estimates, including the estimated costs to complete the project, which determine the project's percentage completed, 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.

Comparison of Results for the Three Months Ended September 26, 2010 to the Three Months Ended September 25, 2011

Revenues. Revenues increased $91.1 million from $119.9 million for the three months ended September 26, 2010 to $211.0 million for the three months ended September 25, 2011. KGS segment revenue increased by $68.4 million. This increase was primarily due to the acquisitions of Integral, Herley, DEI, and SCT which had combined revenues of $98.2 million which was partially offset by the completion of acquired small business contracts, impact of funding and contract awards as a result of the continuing resolution earlier in 2011, weakness and increased competition in our legacy services businesses, and in-sourcing of our employees by the U.S. Government. PSS segment revenue increased by $22.7 million which was primarily due to the acquisition of HBE which had revenues of $23.5 million. Revenues by operating segment for the three months ended September 26, 2010 and September 25, 2011 are as follows (dollars in millions):

	September 26, 2010	September 25, 2011	$ change	% change
Kratos Government Solutions	$ 110.2	$ 178.6	$ 68.4	62.1%
Public Safety & Security	9.7	32.4	22.7	234.0%
Total revenues	$ 119.9	$ 211.0	$ 91.1	76.0%

Product sales increased $69.3 million from $44.1 million for the three months ended September 26, 2010 to $113.4 million for the three months ended September 25, 2011. As a percentage of total revenue, product sales were 37% for the three months ended September 26, 2010 as compared to 54% for the three months ended September 25, 2011. This increase was primarily related to the acquisitions of Integral, Herley, DEI, and SCT. Service revenues increased by $21.8 million from $75.8 million for the three months ended September 26, 2010 to $97.6 million for the three months ended September 25, 2011. The increase was primarily related to the acquisition of HBE and Integral partially offset by the reductions in service revenue in the KGS segment as discussed above.

Cost of Revenues. Cost of revenues increased from $95.5 million for the three months ended September 26, 2010 to $150.8 million for the three months ended September 25, 2011. The $55.3 million increase in cost of revenues was primarily a result of the acquisitions of Integral, Herley, HBE, DEI, and SCT which had combined cost of revenues of $62.1 million, offset by reductions in cost of revenues in our KGS segment as a result of decreased revenue discussed above.

Gross margin increased from 20.4% for the three months ended September 26, 2010 to 28.5% for the three months ended September 25, 2011. Margins on services increased for the three months ended September 26, 2010 as compared to September 25, 2011, from 20.8% to 26.4%, respectively, due primarily to the acquisitions of HBE and Integral. Margins on products increased for the three months ended September 26, 2010 as compared to September 25, 2011 from 19.5% to 30.3%, respectively, as a result of the Integral, Herley, DEI, and SCT acquisitions. Margins in the KGS segment increased from 20.6% for the three months ended September 26, 2010 to 28.3% for the three months ended September 25, 2011 primarily as a result of the higher gross margins from our Integral, Herley, and DEI acquisitions. Margins in the PSS segment decreased from 30.9% for the three months ended September 26, 2010 to 29.6% for the three months ended September 25, 2011 as a result of the mix of revenue.

Table of Contents

Selling, General and Administrative Expenses. Selling, general and administrative expenses ("SG&A") increased $26.7 million from $16.5 million for the three months ended September 26, 2010 to $43.2 million for the three months ended September 25, 2011. The increase was primarily a result of the acquisitions of Integral, Herley, DEI, SCT, and HBE. As a percentage of revenues, SG&A increased from 13.8% to 20.5%. Excluding amortization of intangibles of $2.9 million for the three months ended September 26, 2010 and amortization of intangibles of $11.9 million for the three months ended September 25, 2011, SG&A increased as a percentage of revenues from 11.3% to 14.8% for the three months ended September 26, 2010 and September 25, 2011, respectively, reflecting the SG&A of our acquisitions of Integral, Herley and HBE which have higher SG&A as a percentage of revenues and corresponding higher gross margin percentages.

Recovery of Legal Fees in Connection with Litigation. In September 2010, we reached a settlement with one of our D&O insurance carriers to cover costs related to our completed stock option and Department of Justice ("DOJ") investigations. The settlement received, net of legal expenses, was $1.4 million.

Merger and Acquisition Expenses and Other. Merger and acquisition expenses for the three months ended September 26, 2010 were $0.4 million, which were primarily related to the acquisition of DEI. Merger and acquisition expenses for the three months ended September 25, 2011 were $3.7 million, which were primarily related to our acquisition of Integral.

Research and Development Expenses. Research and development expenses increased from $0.5 million for the three months ended September 26, 2010 to $3.3 million for the three months ended September 25, 2011 primarily related to the acquisitions of Herley and Integral.

Other Expense, Net. Other expense, net increased from $6.2 million to $15.3 million for the three months ended September 26, 2010 and September 25, 2011, respectively. The increase in expense of $9.1 million is primarily related to an $8.6 million increase in interest expense as a result of the Additional Notes (as defined below) issued in March 2011 and July 2011, primarily to fund the Herley, and Integral acquisitions. We incurred other expense of $0.3 million primarily related to foreign currency transaction expenses in 2011 and had other income of $0.2 million in 2010 primarily related to the non-cash charges to mark our interest rate derivative to market.

Provision (Benefit) for Income Taxes. The benefit of $1.1 million for the three months ended September 26, 2010 was primarily related to the acquisition of DEI. In accordance with ASC Topic 805, we established deferred tax liabilities of approximately $1.3 million for the increase in the financial statement basis of the acquired assets of DEI. As a result of our ability to recognize deferred tax assets to offset these deferred tax liabilities, we released the valuation allowances against our deferred tax assets and recognized an income tax benefit of $1.3 million. This benefit was partially offset by federal AMT and current state taxes. We recorded an income tax expense of $1.6 million, or a negative 30.2% rate, on a loss of $5.3 million before income taxes for the three months ended September 25, 2011. The expense of $1.6 million was primarily related to state and foreign taxes, which cannot be offset by our net operating losses.

Income (Loss) from Discontinued Operations. Loss from discontinued operations was $0.1 million and income from discontinued operations was $0.0 million for the three months ended September 26, 2010 and September 25, 2011, respectively. Revenues generated by these businesses were approximately $0.3 million and zero for the three months ended September 26, 2010 and September 25, 2011, respectively. Loss before taxes was of $0.1 million for the three months ended September 26, 2010 and income before taxes was $0.0 million for the three months ended September 25, 2011. In August, 2010, the Company divested its southeast division of its PSS segment for approximately $0.1 million cash consideration and the assumption of certain liabilities.

Comparison of Results for the Nine Months Ended September 26, 2010 to the Nine Months Ended September 25, 2011

Revenues. Revenues increased $217.2 million from $287.7 million for the nine months ended September 26, 2010 to $504.9 million for the nine months ended September 25, 2011. The increase in revenue was primarily a result of our acquisitions. KGS segment revenue increased by $158.0 million primarily due to the acquisitions of Integral, Herley, DEI, SCT, and Gichner which had combined revenues of $204.9 million which was partially offset by the completion of acquired small business contracts, impact of funding and contract awards as a result of the continuing resolution earlier in 2011, weakness and increased competition in our legacy services businesses, and in-sourcing of our employees by the U.S. Government. PSS segment revenue increased by $59.2 million which was primarily the due to the acquisition of HBE which had revenues of $56.9 million as well as organic growth of $2.3 million in our existing PSS business as a result of increased demand for security and surveillance systems. Revenues by operating segment for the nine months ended September 26, 2010 and September 25, 2011 are as follows (dollars in millions):

	September 26, 2010	September 25, 2011	$ change	% change
Kratos Government Solutions	$ 263.3	$ 421.3	$ 158.0	60.0%
Public Safety & Security	24.4	83.6	59.2	242.6%
Total revenues	$ 287.7	$ 504.9	$ 217.2	75.5%

Product sales increased $176.0 million from $76.2 million for the nine months ended September 26, 2010 to $252.2 million for the nine months ended September 25, 2011. As a percentage of total revenue, product sales were 26% for the nine months ended September 26, 2010 as compared to 50% for the nine months ended September 25, 2011. This increase was primarily related to the acquisitions of Integral, Herley, DEI, and SCT. Service revenues increased by $41.2 million from $211.5 million for the nine months ended September 26, 2010 to $252.7 million for the nine months ended September 25, 2011. The increase was primarily related to the acquisition of Integral and HBE partially offset by the reductions in service revenue in the KGS segment as discussed above.

Table of Contents

Cost of Revenues. Cost of revenues increased from $228.2 million for the nine months ended September 26, 2010 to $371.9 million for the nine months ended September 25, 2011. The $143.7 million increase in cost of revenues was primarily a result of the acquisitions of Integral, Herley, Gichner, DEI, and SCT which had combined cost of revenues of $137.1 million.

Gross margin increased from 20.7% for the nine months ended September 26, 2010 to 26.3% for the nine months ended September 25, 2011. Margins on services increased for the nine months ended September 26, 2010 as compared to September 25, 2011, from 21.4% to 24.8%, respectively, due primarily to the acquisitions of Integral and HBE. Margins on products increased for the nine months ended September 26, 2010 as compared to September 25, 2011 from 18.8% to 27.9%, respectively, as a result of the Integral, Herley, DEI, and SCT acquisitions. Margins in the KGS segment increased from 21.2% for the nine months ended September 26, 2010 to 25.8% for the nine months ended September 25, 2011 primarily as a result of the higher gross margins from our Integral, Herley, and DEI acquisitions. Margins in the PSS segment decreased from 32.8% for the nine months ended September 26, 2010 to 28.8% for the nine months ended September 25, 2011 as a result of the mix of revenue.

Selling, General and Administrative Expenses. SG&A increased $55.1 million from $41.3 million for the nine months ended September 26, 2010 to $96.5 million for the nine months ended September 25, 2011. The increase was primarily a result of the acquisitions of Integral, Herley, HBE, DEI, and SCT. As a percentage of revenues, SG&A increased from 14.4% to 19.1%. Excluding amortization of intangibles of $6.2 million for the nine months ended September 26, 2010 and amortization of intangibles of $24.5 million for the nine months ended September 25, 2011, SG&A increased as a percentage of revenues from 12.2% to 14.3% for the nine months ended September 26, 2010 and September 25, 2011, respectively, reflecting the SG&A of our acquisitions of Integral, Herley, HBE and DEI which have higher SG&A as a percentage of revenues and corresponding higher gross margin percentages.

Merger and Acquisition Expenses. Merger and acquisition expenses increased $9.8 million from $1.5 million to $11.3 million for the nine months ended September 26, 2010 and September 25, 2011, respectively. Acquisition expenses in 2010 related primarily to our acquisitions of Gichner and DEI. Merger and acquisition expenses in 2011 are primarily related to the acquisitions of Integral and Herley.

Recovery of Legal Fees in Connection with Litigation. In September 2010, we reached a settlement with one of our D&O insurance carriers to cover costs related to our completed stock option and DOJ investigations. The settlement received, net of legal expenses, was $1.4 million.

Research and Development Expenses. Research and development expenses increased from $1.6 million for the nine months ended September 26, 2010 to $5.1 million for the nine months ended September 25, 2011 primarily related to the acquisitions of Herley and Integral.

Other Expense, Net. Other expense, net increased from $15.0 million to $34.8 million for the nine months ended September 26, 2010 and September 25, 2011, respectively. The increase in expense of $19.8 million is primarily related to an increase in interest expense as a result of the Additional Notes issued in March 2011 and July 2011, primarily to fund the Herley, and Integral acquisitions.

Provision (Benefit) for Income Taxes. We recorded an income tax benefit of $12.5 million on income of $1.5 million before income taxes for the nine months ended September 26, 2010. The benefit was primarily related to the acquisitions of Gichner and DEI. In accordance with ASC Topic 805, we established deferred tax liabilities of approximately $16.2 million and $1.3 million for the increase in the financial statement basis of the acquired assets of Gichner and DEI, respectively. As a result of our ability to offset deferred tax assets for these deferred tax liabilities, we released the valuation allowances against our deferred tax assets and recognized an income tax benefit of $13.5 million. This benefit was partially offset by current state taxes of $1.0 million.

We recorded an income tax provision of $1.3 million on a loss of $14.7 million before income taxes for the nine months ended September 25, 2011. The provision of $1.3 million was primarily related to state and foreign taxes of $3.1million, which cannot be offset by our net operating losses. This provision was partially offset by the income tax refund claim of $2.1 million that was settled with the IRS.

Income from Discontinued Operations. Income from discontinued operations improved from $0.1 million to $0.4 million for the nine months ended September 26, 2010 and September 25, 2011, respectively. Revenues generated by these businesses were approximately $2.2 million and zero for the nine months ended September 26, 2010 and September 25, 2011, respectively. For the nine months ended September 26, 2010 and September 25, 2011, we recognized a tax benefit of $0.8 million and $0.3 million, respectively, primarily related to the expiration of the statute of limitations for certain foreign tax contingencies from our discontinued wireless business. In August 2010, the Company divested its southeast division of its PSS segment for approximately $0.1 million cash consideration and the assumption of certain liabilities.

Table of Contents

Backlog

As of September 26, 2010 and September 25, 2011, our backlog was approximately $660 million and $1,034 million, respectively, of which $285 million was funded in 2010 and $548 million was funded in 2011. 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 General Services Administration 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 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 U.S. Government contracts included in backlog, whether or not funded, may be terminated at the convenience of the U.S. Government.

Liquidity and Capital Resources

As of September 25, 2011, we had cash and cash equivalents of $109.4 million compared with cash and cash equivalents of $10.8 million as of December 26, 2010. Our total debt including capital lease obligations, principal due on our Notes and other term debt, and excluding the premium of $23.9 million received on Notes issued, increased by $406.7 million, from $226.7 million on December 26, 2010 to $633.4 million on September 25, 2011. The increase in debt was the result of additional offerings of our 10% Senior Secured Notes of $285.0 million, issued at a premium of 107%, or $20.0 million in connection with the acquisition of Herley in March 2011, and $115.0 million, issued at a premium of 105%, or $5.8 million, in connection with the acquisition of Integral in July 2011. In addition, we assumed debt of $7.5 million in connection with the Herley transaction that is related to a foreign loan of which $7.0 million was outstanding as of September 25, 2011.

Our operating cash flow is used to finance trade accounts receivable, fund capital expenditures and our ongoing operations, service our debt and make strategic acquisitions. Financing trade accounts receivable is necessary because, on average, our customers do not pay us as quickly as we pay our vendors and employees for their goods and services. 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 operating activities from continuing operations from our condensed consolidated statements of cash flows is as follows (in millions):

	Nine months ended September 26, 2010	Nine months ended September 25, 2011
Net cash provided by operating activities from continuing operations	$ 24.7	$ 7.7

Cash provided by operating activities from continuing operations for the nine months ended September 26, 2010 includes $1.5 million in transaction costs paid related to the Gichner and DEI acquisitions.

Cash used in operating activities from continuing operations for the nine months ended September 25, 2011 includes $20.9 million in merger and acquisition costs paid related to our recent acquisitions. Excluding these acquisition costs paid, we generated cash flow from operating activities of $28.6 million. Our Days Sales Outstanding ("DSOs") increased from 75 days (excluding the impact of the acquisition of HBE) at December 26, 2010 to 100 days at September 25, 2011 including the Integral revenue from July which was prior to our acquisition of Integral. The increase in our DSOs is primarily the result of the timing of payments on contracts where we recognize revenue on percentage of completion and the acquisition of Integral.

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

	Nine months ended September 26, 2010	Nine months ended September 25, 2011
Investing activities:		
Cash paid for acquisitions, net of cash acquired	$ (142.3)	$ (373.8)
Decrease in restricted cash	—	3.3
Other, net	(1.4)	(5.3)
Net cash used in investing activities from continuing operations	$ (143.7)	$ (375.8)

On May 19, 2010, we purchased Gichner for $132.9 million net of cash acquired of $0.1 million. On August 9, 2010, we purchased DEI for $9.0 million, net of cash acquired of $0.0 million. In September 2010, we paid $0.4 million related to the DEI Contingent Consideration as a result of a collection milestone that was achieved.

On March 25, 2011, we completed our initial tender offer for all outstanding shares of common stock, par value $0.001 per share, of Herley. On that day, we paid $245.5 million for approximately 12.9 million shares of Herley common stock which excluded 0.3 million shares that had been tendered via a notice of guaranteed delivery. Through purchases in a subsequent offering period and a short-form merger, the Company completed its acquisition of Herley on March 30, 2011, and paid an additional $25.1 million in April 2011 for the balance of the outstanding shares of 1.2 million and the Herley Options that were exercised as a result of the change in control. In March 2011, we also paid $0.3 million to the SCT shareholders as SCT's indemnification obligations as set forth in the SCT Agreement were met.

On July 27, 2011, we completed the acquisition of Integral and paid approximately $131.4 million for the cash portion of the purchase of Integral common stock and options and to retire Integral's existing debt and capital leases.

We acquired $28.6 million in cash from Herley and Integral. During the fourth quarter of 2011, we expect to pay approximately $8.7 million in merger and acquisition expenses. See Note 2 of the notes to the condensed consolidated financial statements for a further discussion of these acquisitions.

We also had capital expenditures of $1.7 million and $5.3 million for the nine months ended September 26, 2010 and September 25, 2011, respectively. The increase in capital expenditures of $3.6 million was primarily related to the acquisitions of Herley and Integral.

Cash provided by financing activities from continuing operations is summarized as follows (in millions):

	Nine months ended September 26, 2010	Nine months ended September 25, 2011
Financing activities:		
Proceeds from the issuance of 10% Senior Secured Notes	$ 225.0	$ 427.5
Proceeds from the issuance of common stock	—	61.1
Borrowings under credit facility	61.9	—
Repayments under credit facility	(116.3)	(2.5)
Debt issuance costs	(10.6)	(20.6)
Other	0.7	1.5
Net cash provided by financing activities from continuing operations	$ 160.7	$ 467.0

During the nine months ended September 26, 2010, cash provided by financing activities was primarily related to the proceeds from the offering of the Original Notes (as defined below) in the aggregate amount of $225.0 million, which proceeds were then used to finance the acquisition of Gichner and refinance our senior secured credit facility with KeyBank and Bank of America.

Table of Contents

As described immediately below, during the nine months ended September 25, 2011, we issued common stock and additional notes to fund the acquisitions of Herley and Integral.

On February 11, 2011, we sold approximately 4.9 million shares of our common stock at a purchase price of $13.25 per share in an underwritten public offering. We received gross proceeds from the equity offering of approximately $64.8 million and after deducting underwriting and other offering expenses received approximately $61.1 million in net proceeds.

During 2011, we issued an additional $400 million in 10% Senior Secured Notes and received approximately $25.7 million of premium on these notes. We have also received $1.8 million in accrued interest that will be paid to the noteholders on December 1, 2011. On July 27, 2011 we also amended and restated our credit facility with KeyBank. We have paid debt issuance costs of approximately $20.6 million and have approximately $1.0 million in costs related to the debt that will be paid during the fourth quarter of 2011.

See "Contractual Obligations and Commitments" for a further discussion of our Notes and credit facilities.

Cash provided by (used in) discontinued operations is summarized as follows (in millions):

	Nine months ended September 26, 2010	Nine months ended September 25 2011
Net cash flows provided by (used in) discontinued operations	$ (0.3)	$ (0.1)

Contractual Obligations and Commitments

Issuance of 10% Senior Secured Notes due 2017

On May 19, 2010, we entered into an Indenture with the guarantors set forth therein and Wilmington Trust FSB, as trustee and collateral agent (the "Indenture") to issue 10% Senior Secured Notes due 2017. We have issued notes of $225.0 million (the "Original Notes") and $285.0 million (the "Additional Notes" and, together with the Original Notes, the "Existing Notes") under this Indenture, collectively referred to herein as Notes. These Existing Notes were used to fund acquisitions and for general corporate purposes. They are secured by a lien on substantially all of our assets and the assets of the guarantors thereunder, subject to certain exceptions and permitted liens. The holders of the Existing Notes have a first priority lien on substantially all of our assets and the assets of the guarantors, except accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property) where the holders of the senior secured borrowings have a second priority lien to the $35.0 million credit facility described below.

We pay interest on the Existing Notes semi-annually, in arrears, on June 1 and December 1 of each year. The Existing Notes include customary covenants and events of default as well as a consolidated fixed charge ratio of 2.0:1.0 for the incurrence of additional indebtedness. Negative covenants include, among other things, limitations on additional debt, liens, negative pledges, investments, dividends, stock repurchases, asset sales and affiliate transactions. Events of default include, among other events, non-performance of covenants, breach of representations, cross-default to other material debt, bankruptcy, insolvency, material judgments and changes in control. As of September 25, 2011, we were in compliance with the covenants contained in the indentures related to each respective Existing Notes described below.

On or after June 1, 2014, we may redeem some or all of the Existing Notes at 105% of the aggregate principal amount of such notes through June 1, 2015, 102.5% of the aggregate principal amount of such notes through June 1, 2016 and 100% of the aggregate principal amount of such notes thereafter, plus accrued and unpaid interest to the date of redemption. Prior to June 1, 2013, we may redeem up to 35% of the aggregate principal amount of the Existing Notes at 110% of the aggregate principal amount of the Existing Notes, plus accrued and unpaid interest to the redemption date, with the net cash proceeds of certain equity offerings. In addition, we may, at our option, redeem some or all of the Existing Notes at any time prior to June 1, 2014, by paying a "make whole" premium, plus accrued and unpaid interest, if any, to the date of redemption.

Original Notes - $225 Million 10% Senior Secured Note Offering, May 2010

On May 19, 2010, we issued our 10% Senior Secured Notes due June 1, 2017 in the aggregate principal amount of $225.0 million in an unregistered offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the "Securities Act") and on August 11, 2010, we completed an exchange offer for such notes pursuant to a registration rights agreement entered into in connection with the issuance thereof. The proceeds were primarily used to finance the acquisitions of Gichner, DEI and SCT.

Table of Contents

Additional Notes - $285 Million 10% Senior Secured Note Offering, March 2011

On March 25, 2011, the Stage I Issuer issued $285.0 million aggregate principal amount of the Stage I Notes pursuant to an Indenture, dated March 25, 2011, by and among the Stage I Issuer, the guarantors named therein and a party thereto, and Wilmington Trust FSB, as trustee and collateral agent (the "Stage I Indenture"). The Stage I Issuer received approximately $314.0 million in cash proceeds from the offering, which includes an approximate $20.0 million of issuance premiums and $9.0 million of accrued interest, which proceeds were used, together with our cash contributions of $45.0 million, to finance the acquisition of all of the outstanding shares of common stock of Herley, to pay related fees and expenses and for general corporate purposes. The effective interest rate on this tranche of Additional Notes is 8.5%. In connection with the purchase and sale of the Stage I Notes, we entered into a registration rights agreement with the initial purchasers of the Stage I Notes. On April 4, 2011, (i) the Stage I Issuer merged with and into Kratos, and we assumed all the assets and liabilities of the Stage I Issuer including, pursuant to a supplemental indenture to the Stage I Indenture, all the obligations of the Stage I Issuer under the Stage I Indenture, the Stage I Notes and the related Collateral Agreements and (ii) we became the issuer of the Stage I Notes under the Stage I Indenture and pledgor under such Collateral Agreements. On April 15, 2011, we redeemed all of the Stage I Notes by issuing in exchange therefore Additional Notes in an aggregate principal amount equal to the aggregate principal amount of the Stage I Notes. On July 29, 2011, we completed an exchange offer for this tranche of Additional Notes pursuant to a registration rights agreement entered into in connection with the issuance thereof.

Additional Notes - $115 Million 10% Senior Secured Note Offering, July 2011

On July 27, 2011, we issued $115.0 million aggregate principal amount of our 10% Senior Secured Notes due 2017 pursuant to that certain indenture, dated as of May 19, 2010, among Kratos, the guarantors party thereto and Wilmington Trust, as trustee and collateral agent. We received approximately $120.8 million in net cash proceeds from the issuance of the notes, which includes an approximate $5.8 million of issuance premiums, which proceeds were used to finance, in part, the cash portion of the purchase price for the acquisition of Integral, to refinance existing indebtedness of Integral, to pay certain severance payments in connection with the acquisition of Integral and to pay related fees and expenses. The effective interest rate on this tranche of Additional Notes is 8.9%. Pursuant to the amended Registration Rights Agreement entered into as a result of the issuance of these Additional Notes, we filed an exchange offer registration statement on Form S-4 (File No. 333-177493) with the SEC, which was declared effective on November 1, 2011 and we will use commercially reasonable efforts to consummate the exchange offer within 30 business days, or longer if required by the U.S. federal securities laws, after the date on which the exchange offer registration statement was declared effective by the SEC. In certain circumstances, we may be required to file a shelf registration statement to cover resales of these Additional Notes. If we fail to satisfy these obligations, we will pay additional interest to holders of these Additional Notes under certain circumstances.

Table of Contents

Other Indebtedness

$65 Million Credit Facility

On July 27, 2011, concurrent with the completion of the offering of the July Notes on July 27, 2011 we entered into an amended and restated Credit and Security Agreement (the "Amended Credit Agreement") replacing our current Credit Agreement with KeyBank as administrative agent, lead arranger and sole book runner, East West Bank and Bank of the West participating in the syndication for a five year senior secured revolving credit facility in the amount of $65.0 million (the "Amended Revolver"). The Amended Revolver has a maturity date of July 27, 2016 and is secured by a lien on substantially all of our assets and the assets of the guarantors thereunder, subject to certain exceptions and permitted liens. The Amended Revolver has a first priority lien on accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property). On all other assets, the Amended Revolver has a second priority lien junior to the lien securing the Original Notes, Additional Notes and July Notes (collectively, the "Notes").

The Amended Revolver may be increased to $100.0 million. The increases in the Amended Revolver are subject to the consent of the administrative agent, identification of one or more additional lenders willing to advance the increased amount of the Amended Revolver and compliance with covenants in the Notes. The amounts of borrowings that may be made under the Amended Revolver are based on a borrowing base and are comprised of specified percentages of eligible receivables, eligible unbilled receivables and eligible inventory. If the amount of borrowings outstanding under the Amended Revolver exceeds the borrowing base then in effect, then we are required to repay such borrowings in an amount sufficient to eliminate such excess. The Amended Revolver includes $30.0 million of availability for letters of credit and $5.0 million of availability for swingline loans.

We may borrow funds under the Amended Revolver at a base rate based either on LIBOR or a base rate established by KeyBank. Base rate borrowings bear interest at an applicable margin of 1.00% to 1.75% over the base rate (which will be the greater of the prime rate or 0.5% over the federal funds rate, with a floor of 1.0% over one month LIBOR). LIBOR rate borrowings will bear interest at an applicable margin of 3.00% to 3.75% over the

LIBOR rate. The applicable margin for base rate borrowings and LIBOR borrowings will depend on the average monthly revolving credit availability. The Amended Revolver also has a commitment fee of 0.50% to 0.75%, depending on the average monthly revolving credit availability.

Borrowings under the Amended Revolver are subject to mandatory prepayment upon the occurrence of certain events, including the issuance of certain securities, the incurrence of certain debt and the sale or other disposition of certain assets. The Amended Revolver includes customary affirmative and negative covenants and events of default, as well as a financial covenant relating to a minimum fixed charge coverage ratio of 1.25. Negative covenants include, among other limitations, limitations on additional debt, liens, negative pledges, investments, dividends, stock repurchases, asset sales and affiliate transactions. Events of default include, among other events, non-performance of covenants, breach of representations, cross-default to other material debt, bankruptcy and insolvency, material judgments and changes in control. We were in compliance with the financial covenants as of September 25, 2011.

Debt Acquired in Acquisition of Herley

We assumed a $10.0 million ten-year term loan with a bank in Israel that Herley entered into on September 16, 2008 in connection with the acquisition of one of its wholly owned subsidiaries. The balance as of September 25, 2011 was $7.2 million and the loan is payable in quarterly installments of $0.3 million plus interest at LIBOR plus a margin of 1.5%. The loan agreement contains various financial covenants including a minimum net equity covenant as defined in the loan agreement. We were in compliance with the financial covenants as of September 25, 2011.

On October 19, 2001, Herley received $3.0 million in proceeds from the East Hempfield Township Industrial Development Authority Variable Rate Demand/Fixed Rate Revenue Bonds Series of 2001 (the "IDA Bonds"). The IDA Bonds were due in varying annual installments through October 1, 2021. Proceeds from the IDA Bonds were used for the construction of a 15,000 square foot expansion of Herley's facilities in Lancaster, Pennsylvania, and for manufacturing equipment. The IDA Bonds were paid in full on May 2, 2011.

Contingent Consideration and Liabilities in Connection with Acquisitions and Divestitures

In connection with our business acquisitions, we have agreed to make additional future payments to sellers based on final purchase price adjustments and the expiration of certain indemnification obligations. Pursuant to the provisions of *FASB ASC Topic 805, Business Combinations,* such amounts are recorded at fair value on the acquisition date.

Upon completion of the Gichner transaction, we deposited $8.1 million of the purchase price into an escrow account as security for Gichner's indemnification obligations as set forth in the Gichner Agreement. In addition, the Gichner Agreement provided that the purchase price would be (i) increased on a dollar for dollar basis if the working capital on the closing date (as defined in the Gichner Agreement) exceeded $17.5 million or (ii) decreased on a dollar for dollar basis if the working capital was less than $17.1 million. We and Altus Capital Partners, Inc., the sellers' representative under the Gichner Agreement, agreed to a working capital adjustment of $0.6 million owed to us. In May 2011 we paid $7.1 million of the holdback and paid the remaining amount of the holdback owed of $0.4 million in August 2011.

The DEI Agreement provides that upon achievement of certain cash receipts, revenue, EBITDA and backlog amounts in 2010, 2011 and 2012, we shall pay the former stockholders of DEI certain additional contingent consideration. We have paid $0.4 million related to contingent consideration and the potential amount of contingent consideration that may be payable by us in the future under the DEI Agreement is between zero and $8.0 million. The contingent consideration will be reduced in the event certain anticipated cash receipts are not collected within agreed upon time periods. As of September 25, 2011, $2.6 million of these cash receipts have been collected and future payments could be reduced by approximately $6.0 million if the final cash receipt is not collected.

The SCT Agreement provides that upon achievement of certain EBITDA amounts in 2011, 2012 and 2013, we shall pay the former stockholders of SCT certain additional performance-based consideration. The potential undiscounted amount of all future contingent consideration that may be payable by us under the SCT Agreement is between zero and $3.5 million.

There were no contingent liabilities associated with the acquisition of HBE other than contingent liabilities of $0.4 million associated with HBE's acquisition of Professional Security Technologies LLC ("PST") in September, 2010. The agreement with PST provides that the former shareholders of PST receive a 5% payment for achievement of revenue amounts from certain customers for the period from June 1, 2010 through December 31, 2012.

As a result of the acquisition of Integral, we have assumed indemnification obligations related to SEC civil actions against three former officers of Integral. Integral had advanced legal fees and costs incurred by the three individuals in connection with the SEC investigation up to the deductible limit under Integral's applicable directors and officers liability insurance policy and subsequent fees and costs have been paid directly by the insurance carrier. We will be obligated to advance any amounts in excess of the insurance policy limits once the fees and expenses exceed the remaining insurance policy limits. See Item 1. Legal Proceedings for a further discussion of the indemnification obligations.

Other Liquidity Matters

At September 25, 2011, we had working capital of $237.9 million compared to $66.0 million at December 26, 2010. The increase was primarily due to the issuance of 4.9 million shares of our common stock and the issuance of the Additional Notes in the amount of $400.0 million, offset by cash paid of $248.9 million to acquire Herley and $124.6 million to acquire Integral, net of cash acquired.

We believe that our cash on hand, together with funds available under the Amended Revolver and cash expected to be generated from operating activities, will be sufficient to fund our anticipated working capital and other cash needs for at least the next 12 months.

We may also pursue business acquisitions and other transactions designed to expand our business, which we would expect to fund from borrowings under the Amended Revolver, other future indebtedness or, if appropriate, the private and/or public sale or exchange of our debt or equity securities.

As discussed in Part II, Item 1A, "Risk Factors" of the Form 10-K, our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to our control.

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. 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 nine months ended September 25, 2011, there have been no significant changes to our Critical Accounting Policies or Estimates compared to the significant accounting policies described in the Form 10-K with the following exception:

Revenue Recognition for Arrangements with Multiple Deliverables

For multi-element arrangements that include hardware products containing software essential to the hardware product's functionality, undelivered software elements that relate to the hardware product's essential software, and undelivered non-software services, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE") and (iii) best estimate of the selling price ("ESP"). VSOE generally exists only when the Company sells the deliverable separately and is the price actually charged by the Company for that deliverable. ESPs reflect the Company's best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis.

Accumulated Other Comprehensive Income (Loss)

Comprehensive income consists of (i) net income and (ii) other related gains and losses affecting stockholders' equity that, under GAAP, are excluded from net income. For the Company, other comprehensive income (loss) consists solely of unrealized foreign currency translation gains and losses.

Recent Accounting Pronouncements

New accounting pronouncements issued or effective during the nine month period ended September 25, 2011 have not had or are not expected to have a material 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, primarily related to interest rates and foreign currency exchange rates.

Exposure to market risk for changes in interest rates relates to our outstanding debt. We are exposed to interest rate risk primarily through our borrowing activities under our Amended Revolver discussed under Contractual Obligations and Commitments above. Based on our current outstanding balances, a 1% change in the LIBOR rate would not impact our financial position. 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 were contracted with investment grade counterparties to reduce exposure to nonperformance on our prior credit facilities.

Exposure to market risk for foreign currency exchange rate risk is related to receipts from customers, payments to suppliers and intercompany loans denominated in foreign currencies. We currently do not enter into foreign currency forward contracts to manage foreign currency exchange rate risk because to date exchange rate fluctuations have had minimal impact on our operating results and cash flows.

Cash and cash equivalents as of September 25, 2011 were $109.4 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 our net loss for the nine months ended September 25, 2011.

Item 4. Controls and Procedures.

Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

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

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

Based on the foregoing, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 25, 2011.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during the nine months ended September 25, 2011 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.

For additional information regarding our legal proceedings, see Item 3, "Legal Proceedings" in the Form 10-K. As of September 25, 2011, there have been no material developments in our historical legal proceedings since December 26, 2010 except as described below.

Integral, which we acquired on July 27, 2011, was previously the subject of a SEC investigation and inquiry by The NASDAQ Stock Market ("NASDAQ"). On July 30, 2009, the SEC and Integral each announced that a final administrative settlement had been reached concluding the SEC's investigation. Shortly after the settlement with the SEC, the NASDAQ inquiry was closed with no further action required by Integral.

In conjunction with its announcement of the administrative settlement, the SEC also disclosed that it was instituting separate civil actions against three former officers of Integral, Steven R. Chamberlain (now deceased), Elaine M. Brown and Gary A. Prince. The SEC seeks permanent injunctions against each defendant, as well as court orders imposing officer and director bars and civil penalties. Integral has indemnification obligations to these individuals, as well as other former directors and officers of Integral who may incur indemnifiable costs in connection with these actions, pursuant to the terms of separate indemnification agreements entered into with each of them effective as of December 4, 2002. As a result of the acquisition of Integral, we have assumed these indemnification obligations. The indemnification agreements each provide that, subject to certain terms and conditions, that we shall indemnify the individual to the fullest extent permissible by Maryland law against judgments, penalties, fines, settlements and reasonable expenses actually incurred in the event that the individual is made a party to a legal proceeding by reason of his or her present or prior service as an officer or employee of Integral, and shall also advance reasonable litigation expenses actually incurred subject to, among other conditions, receipt of a written undertaking to repay any costs or expenses advanced if it shall ultimately be determined that the individual has not met the standard of conduct required for indemnification under Maryland law. Integral has advanced legal fees and costs incurred by these individuals in connection with the SEC investigation up to the deductible limit under Integral's applicable directors and officers liability insurance policy and subsequent fees and costs have been paid directly by the insurance carrier. We will be obligated to advance any amounts in excess of the insurance policy limits once the fees and expenses exceed the remaining insurance policy limits.

From time to time, we 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 our business. We are currently not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect 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 the Form 10-K 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 the Form 10-K, except as follows:

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

The funding of U.S. Government programs is subject to an annual congressional budget authorization and appropriation processes. For many programs, Congress appropriates funds on a fiscal year basis even though the program performance period may extend over several fiscal years. Consequently, programs are often partially funded initially and additional funds are committed only as Congress makes further appropriations. If we incur costs in excess of funds committed on a contract, we are at risk for reimbursement of those costs until additional funds are appropriated. We cannot predict the extent to which total funding and/or funding for individual programs will be included, increased or reduced as part of the 2012 budget and subsequent budgets ultimately approved by Congress or in separate supplemental appropriations or continuing resolutions. In addition, although Congress has recently passed a continuing resolution to fund U.S. Government operations through November 18, 2011, it is unclear when additional short or long-term funding will be passed. The impact, severity and duration of the current U.S. economic situation and

sweeping economic plans adopted or to be adopted by the U.S. Government, along with pressures on, and uncertainty surrounding, the federal budget, could adversely affect the funding for individual programs and delay purchasing or payment decisions by our customers. In the event that government funding for any of our programs becomes unavailable, or is reduced or delayed, our contract or subcontract under such program may be terminated or adjusted by the U.S. Government, which could have a material adverse effect on our financial position, results of operations, and/or cash flows.

As discussed previously, in August 2011, Congress passed the Budget Act which, while raising the existing statutory limit on the amount of permissible federal debt, also committed the U.S. Government to significantly reducing the federal deficit over ten years. The Budget Act caps discretionary spending through 2021, reducing federal spending by approximately $900 billion relative to the fiscal year 2012 Presidential Submission and also establishes a Bi-partisan Congressional Joint Select Committee on Deficit Reduction for identifying an additional $1.5 trillion in deficit reductions by November 23, 2011. If at least $1.2 trillion in deficit reductions are not identified by the joint committee and passed by Congress by January 15, 2012, then under the Budget Act, very substantial automatic spending cuts split between defense and non-defense programs will be triggered beginning in 2013 over a nine-year period. We are unable to predict whether the required spending cuts will be identified and approved prior to the January 2012 deadline or the impact that either identified or automatic cuts would have on funding for our individual programs. In either event, long-term funding for various programs in which we participate could be reduced, delayed or cancelled. In addition, these cuts could adversely affect the viability of the suppliers and subcontractors under our programs. While we believe that our business is well-positioned in areas that the DoD has previously indicated remain areas of focus for future defense spending, the impact of the Budget Act remains uncertain and our business and industry could be materially adversely affected.

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

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

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

Risks Related to Our Indebtedness

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

In connection with the acquisition of Herley, we incurred $285.0 million of indebtedness and on July 27, 2011 in connection with the acquisition of Integral, we incurred an additional $115.0 million of indebtedness. As of September 25, 2011, we had approximately $657.3 million of total indebtedness outstanding. As a result of this increased indebtedness, our interest payment obligations have increased significantly. The degree to which we are leveraged could have adverse effects on our business, including the following:

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

Table of Contents

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

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

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

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, such as those described in the Form 10-K under the heading “Risks Related to Our Business Currently and Following the Pending Acquisition of Herley” and under the heading “Risks Related to the Combined Company if the Merger Is Completed” in the Registration Statement on Form S-4 that we filed with the SEC on June 7, 2011 (File no. 333-174745). A significant reduction in operating cash flows resulting from changes in economic conditions, increased competition or other events beyond our control could increase the need for additional or alternative sources of liquidity and could have a material adverse effect on our business, financial condition, results of operations, prospects and our ability to service our debt and other obligations. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as reducing capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. These alternative strategies may not be affected on satisfactory terms, if at all, and they may not yield sufficient funds to make required payments on the Kratos 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 the Kratos Notes, the Amended Revolver, and any other indebtedness, were to be accelerated, our assets may not be sufficient to repay in full the money owed to the lenders or to our other debt holders.

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

As of September 25, 2011, approximately 4.1% of our consolidated assets were held by foreign subsidiaries. Our ability to meet our debt service obligations (including those relating to the Notes) with cash from foreign subsidiaries will depend upon the results of operations of these subsidiaries and may be subject to legal, contractual or other restrictions and other business considerations. In addition, dividend and interest payments to us from the foreign subsidiaries may be subject to foreign withholding taxes, which would reduce the amount of funds we receive from such foreign subsidiaries. Dividends and other distributions from our foreign subsidiaries may also be subject to fluctuations in currency exchange rates and legal and other restrictions on repatriation, which could further reduce the amount of funds we receive from such foreign subsidiaries.

Table of Contents

In general, when an entity in a foreign jurisdiction repatriates cash to the U.S., the amount of such cash is treated as a dividend taxable at current U.S. tax rates. Accordingly, upon the distribution of cash to us from our foreign subsidiaries, we will be subject to U.S. income taxes. Although foreign tax credits may be available to reduce the amount of the additional tax liability, these credits may be limited and only offset the tax paid in the foreign jurisdiction, not the excess of the U.S. tax rate over the foreign tax rate. Therefore, to the extent that we must use cash generated in foreign jurisdictions to make principal or interest payments on the Kratos Notes, there may be a cost associated with repatriating the cash to the U.S.

The Indenture and the Amended Credit Agreement governing our Amended Revolver impose significant operating and financial restrictions on us and our subsidiaries that may prevent us and our subsidiaries from pursuing certain business opportunities and restrict our ability to operate our business.

The Indenture and the Amended Credit Agreement governing our Amended Revolver contain covenants that restrict our and our subsidiaries' ability to:

- incur or guarantee additional indebtedness or issue certain preferred stock;
- pay dividends or make other distributions on, or redeem or purchase, any equity interests or make other restricted payments;
- make certain acquisitions or investments;
- create or incur liens;
- transfer or sell assets;
- incur restrictions on the payments of dividends or other distributions from our restricted subsidiaries;
- enter into transactions with affiliates; and
- consummate a merger or consolidation or sell, assign, transfer, lease or otherwise dispose of all or substantially all of our assets.

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

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

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Removed and Reserved.

Item 5. Other Information.

None.

Table of Contents

Item 6. Exhibits.

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date	Exhibit	Filed-Furnished Herewith
2.1#	Agreement and Plan of Merger, dated May 15, 2011, by and among Kratos Defense & Security Solutions, Inc., Integral Systems, Inc., IRIS Merger Sub Inc., and IRIS Acquisition Sub LLC.	8-K	07/29/11	2.1	
2.2#	Agreement and Plan of Merger, dated February 7, 2011, by and among Kratos Defense & Security Solutions, Inc., Lanza Acquisition, Co. and Herley Industries, Inc. (incorporated by reference to Annex A to the Prospectus Supplement dated February 7, 2011, pursuant to the Registration Statement on Form S-3 of Kratos Defense & Security Solutions, Inc. (File No. 333-161340)).	424	02/08/11	n/a	
2.3#	Agreement and Plan of Merger, dated October 5, 2010, by and among Kratos Defense & Security Solutions, Inc., Hammer Acquisition Inc. and Henry Bros. Electronics, Inc.	8-K	10/07/10	2.1	
2.4	Amendment to the Agreement and Plan of Merger, dated November 13, 2010, by and among Kratos Defense & Security Solutions, Inc., Hammer Acquisition Inc. and Henry Bros. Electronics, Inc.	8-K	11/15/10	2.1	
2.5#	Stock Purchase Agreement, dated as of April 12, 2010, by and between Kratos Defense & Security Solutions, Inc. and the Stockholders of Gichner Holdings, Inc.	8-K	04/12/10	2.1	
3.1	Amended and Restated Certificate of Incorporation of Kratos Defense & Security Solutions, Inc.	10-Q	09/30/01	4.1	
3.2	Certificate of Ownership and Merger of Kratos Defense & Security Solutions, Inc. into Wireless Facilities, Inc.	8-K	09/12/07	3.1	
3.3	Certificate of Amendment to Amended and Restated Certificate of Incorporation of Kratos Defense & Security Solutions, Inc.	10-Q	09/27/09	3.1	
3.4	Certificate of Designations, Preferences and Rights of Series A Preferred Stock.	10-Q	09/30/01	4.2	
3.5	Certificate of Designations, Preferences and Rights of Series B Preferred Stock (included as Exhibit A to the Preferred Stock Purchase Agreement dated as of May 16, 2002 among the Company, Meritech Capital Partners II L.P., Meritech Capital Affiliates II L.P., MCB Entrepreneur Partners II L.P., Oak Investment Partners X, Limited Partnership, Oak X Affiliates Fund, Limited Partnership, Oak Investment Partners IX, L.P, Oak Affiliates Fund, L.P, Oak IX Affiliates Fund-A, L.P, and the KLS Trust dated July 14, 1999).	8-K/A	06/05/02	4.1	

Table of Contents

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Filing Date/ Period End Date	Exhibit	Filed-Furnished Herewith
3.6	Certificate of Designation of Series C Preferred Stock.	8-K	12/17/04	3.1	
3.7	Second Amended and Restated Bylaws of Kratos Defense & Security Solutions, Inc.	8-K	03/15/11	3.1	
4.1	Specimen Stock Certificate.	10-K	12/26/10	4.1	
4.2	Rights Agreement, dated as of December 16, 2004, between Kratos Defense & Security Solutions, Inc. and Wells Fargo, N.A.	8-K	12/17/04	4.1	
4.3	Indenture, dated as of May 19, 2010, by and among Kratos Defense & Security Solutions, Inc., the Guarantors set forth	8-K	05/25/10	4.1	

	therein and Wilmington Trust FSB, as Trustee and Collateral Agent (including the Form of 10% Senior Secured Notes due 2017 as an exhibit thereto).				
4.4	First Supplemental Indenture, dated as of February 7, 2011, by and among Kratos Defense & Security Solutions, Inc., the guarantors listed on Exhibit A thereto and Wilmington Trust FSB.	8-K	02/07/11	10.2	
4.5	Supplemental Indenture, dated April 1, 2011, among the guaranteeing subsidiaries named therein and Wilmington Trust FSB, as trustee, to the Indenture (as amended or supplemented), dated as of May 19, 2010, among Kratos Defense & Security Solutions, Inc., the guarantors party thereto and Wilmington Trust FSB, as trustee and collateral agent.	8-K	04/07/11	4.1	
4.6	Third Supplemental Indenture, dated April 15, 2011, by and among Kratos Defense & Security Solutions, Inc., the guaranteeing subsidiaries named therein and Wilmington Trust FSB, as trustee and collateral agent, to the Indenture, dated as of May 19, 2010 (as amended or supplemented), among Kratos Defense & Security Solutions, Inc., the guarantors party thereto and Wilmington Trust FSB, as trustee and collateral agent.	8-K	04/20/11	4.1	
4.7	Sixth Supplemental Indenture, dated July 27, 2011, by and among Kratos Defense & Security Solutions, Inc., the guaranteeing subsidiaries named therein and Wilmington Trust, National Association (as successor by merger to Wilmington Trust FSB), as trustee and collateral agent, to the Indenture, dated as of May 19, 2010 (as amended or supplemented), among Kratos Defense & Security Solutions, Inc., the guarantors party thereto and Wilmington Trust FSB, as trustee and collateral agent.	8-K	07/29/11	4.1	
4.8	Registration Rights Agreement, dated July 27, 2011, by and among Kratos Defense & Security Solutions, Inc., the guarantors named therein, Jefferies & Company, Inc., KeyBanc Capital Markets Inc., and B. Riley & Co., LLC.	8-K	07/29/11	4.2	
4.9	Form of 10% Senior Secured Note due 2017 (issuable in connection with the August 2011 exchange offer).	S-4	06/07/11	4.2	
4.10	Form of 10% Senior Secured Note due 2017 (issuable in connection with the October 2011 exchange offer).	S-4	10/25/11	4.2	

Table of Contents

		Incorporated by Reference			
Exhibit Number	**Exhibit Description**	**Form**	**Filing Date/ Period End Date**	**Exhibit**	**Filed-Furnished Herewith**
10.1	Credit and Security Agreement, dated as of May 19, 2010, as amended and restated as of July 27, 2011, among Kratos Defense & Security Solutions, Inc., the lenders named therein, and KeyBank National Association, as lead arranger, sole book runner and administrative agent.	8-K	07/29/11	10.1	
10.2	Purchase Agreement, dated July 14, 2011, by and among Kratos Defense & Security Solutions, Inc., the guarantors named therein, Jefferies & Company, Inc., KeyBanc Capital Markets Inc. and B. Riley & Co., LLC, as amended by that certain Joinder Agreement, dated July 27, 2011.				*
10.3	Second Amended and Restated Executive Employment Agreement, dated as of August 4, 2011, by and between Kratos Defense & Security Solutions, Inc. and Eric DeMarco.	10-Q	06/26/11	10.3	
10.4	Second Amended and Restated Severance and Change of Control Agreement, dated as of August 4, 2011, by and between Kratos Defense & Security Solutions, Inc. and Deanna Lund.	10-Q	06/26/11	10.4	
10.5	Second Amended and Restated Severance and Change of	10-Q	06/26/11	10.5	

	Control Agreement, dated as of August 4, 2011, by and between Kratos Defense & Security Solutions, Inc. and Laura Siegal.				
10.6	First Amendment to Amended and Restated Employment Agreement, dated as of August 4, 2011, by and between Kratos Defense Engineering Solutions, Inc. and Phil Carrai.	10-Q	06/26/11	10.6	
10.7	First Amendment to Employment Agreement, dated as of August 4, 2011, by and between Kratos Defense Engineering Solutions, Inc. and Richard Selvaggio.	10-Q	06/26/11	10.7	
10.8	Amended and Restated Severance and Change of Control Agreement, dated as of August 4, 2011, by and between Kratos Defense & Security Solutions, Inc. and Deborah S. Butera.				*
10.9	First Amendment to Employment Agreement, dated as of August 4, 2011, by and between Kratos Defense Engineering Solutions, Inc. and David Carter.				*
10.10	Employment Agreement, dated as of August 4, 2011, by and between Kratos Public Safety & Security Solutions, Inc. and Ben Goodwin.				*
10.11	Form of Indemnification Agreement by and between Kratos Defense & Security Solutions, Inc. and its directors and executive officers.	10-Q	06/26/11	10.8	
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.				*
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Eric M. DeMarco.				*
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Deanna Lund.				*
101†	Financial statements from the Quarterly Report on Form 10-Q of Kratos Defense & Security Solutions, Inc. for the nine months ended September 25, 2011, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, (iv) the Notes to the Condensed Consolidated Financial Statements.				*

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

† Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, 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, CPA
Laura L. Siegal
Vice President, Corporate Controller
(Principal Accounting Officer)

Date: November 4, 2011

Exhibit 10.2

$115,000,000

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

10% Senior Secured Notes due 2017

PURCHASE AGREEMENT

July 14, 2011

JEFFERIES & COMPANY, INC.
As Representative of the
Initial Purchasers listed in
Schedule I hereto
c/o Jefferies & Company, Inc.
520 Madison Avenue
New York, New York 10022

Ladies and Gentlemen:

KRATOS DEFENSE & SECURITY SOLUTIONS, INC., a Delaware corporation ("Kratos"), and each of the Guarantors (as hereinafter defined) hereby agree with you as follows:

1. Issuance of Notes. Subject to the terms and conditions herein contained, Kratos proposes to issue and sell to Jefferies & Company, Inc. ("Jefferies"), Keybanc Capital Markets Inc. ("Key") and B. Riley & Co., LLC ("B. Riley" and, together with Key and Jefferies, the "Initial Purchasers") an additional $115,000,000 aggregate principal amount of 10% Senior Secured Notes due 2017 (each a "Note" and, collectively, the "Notes") in each case, in an aggregate principal amount of Notes set forth opposite the name of such Initial Purchaser on Schedule I hereto. The Notes will be issued under the same indenture (as amended or supplemented through the date hereof, the "Indenture"), dated as of May 19, 2010, by and among Kratos, the Guarantors party thereto and Wilmington Trust FSB, as trustee (in such capacity, the "Trustee") and collateral agent, in such capacity, the "Collateral Agent") as Kratos' outstanding $510,000,000 aggregate principal amount 10% Senior Secured Notes due 2017 (the "Existing Notes"). The Notes will constitute the same series of securities as the Existing Notes and will be treated as a single class for all purposes under the Indenture. Capitalized terms used, but not defined herein, shall have the meanings set forth in the "Description of the Notes" section of the Final Offering Memorandum (as hereinafter defined). The proceeds from the sale of the Notes will be used, together with the issuance (the "Equity Issuance") of shares (the "Equity Consideration") of Kratos' common stock with a value of approximately $145.0 million as of May 15, 2011 and $60.7 million of borrowings under the Credit Facility (as hereinafter defined) and/or unrestricted cash on hand of Kratos, to finance the acquisition (the "Acquisition") of Integral Systems, Inc. and its subsidiaries (each, an "Integral Entity" and collectively, "Integral") by Kratos pursuant to the Agreement and Plan of Merger, dated as of May 15, 2011, among Kratos, IRIS Merger Sub Inc., a Maryland

corporation and direct wholly owned subsidiary of Kratos, IRIS Acquisition Sub LLC, a Maryland limited liability company and direct wholly owned subsidiary of Kratos, and Integral Systems, Inc. (the "Merger Agreement"), refinance certain indebtedness of Integral (the "Refinancing"), pay certain severance payments in connection with the Acquisition (the "Severance Payments") and related transactions and to pay related fees and expenses, as described under the captions "Summary—The Transactions" and "Use of Proceeds" in the Final Offering Memorandum.

The Notes will be offered and sold to the Initial Purchasers pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended, and the rules and regulations of the Securities and Exchange Commission (the "SEC") thereunder (collectively, the "Securities Act"). Upon original issuance thereof, and until such time as the same is no longer required under the applicable requirements of the Securities Act, the Notes shall bear the legends set forth in the final offering memorandum, dated the date hereof (the "Final Offering Memorandum"). Kratos has prepared a preliminary offering memorandum, dated July 14, 2011 (the "Preliminary Offering Memorandum"), (ii) a pricing term sheet, dated the date hereof, attached hereto as Schedule II, which includes pricing terms and other information with respect to the Notes (the "Pricing Supplement"), and (iii) the Final Offering Memorandum, in each case, relating to the offer and sale of the Notes (the "Offering"). All references in this Agreement to the Preliminary Offering Memorandum, the Time of Sale Document or the Final Offering Memorandum include, unless expressly stated otherwise, (i) all amendments or supplements thereto, (ii) all documents, financial statements and schedules and other information contained, incorporated by reference or deemed incorporated by reference therein (and references in this Agreement to such information being "contained," "included" or "stated" (and other references of like import) in the Preliminary Offering Memorandum, the Time of Sale Document or the Final Offering Memorandum shall be deemed to mean all such information contained, incorporated by reference or deemed incorporated by reference therein), (iii) any electronic Time of Sale Document or Final Offering Memorandum and (iv) any offering memorandum "wrapper" to be used in connection with offers to sell, solicitations of offers to buy or sales of the Notes in non-U.S. jurisdictions. The Preliminary Offering Memorandum and the Pricing Supplement are collectively referred to herein as the "Time of Sale Document."

Concurrently with the issuance of the Securities (as defined below), Kratos will enter into an amended and restated revolving credit facility that will provide for revolving commitments of at least $60.0 million thereunder and will expire no earlier than the fifth anniversary of the Closing Date (the "Credit Facility").

2. Terms of Offering. The Initial Purchasers have advised Kratos, and Kratos understands, that the Initial Purchasers will make offers to sell (the "Exempt Resales") some or all of the Notes purchased by the Initial Purchasers hereunder on the terms set forth in the Final Offering Memorandum to persons (the "Subsequent Purchasers") whom the Initial Purchasers reasonably believe (i) are "qualified institutional buyers" ("QIBs") (as defined in Rule 144A under the Securities Act), or (ii) are not "U.S. persons" (as defined in Regulation S under the Securities Act) and in compliance with the laws applicable to such persons in jurisdictions outside of the United States.

Pursuant to the Indenture, all Domestic Restricted Subsidiaries of Kratos shall fully and unconditionally guarantee, on a senior secured basis, to each holder of the Notes and the Existing Notes and the Trustee, the payment and performance of Kratos' obligations under the Indenture, the Notes and the Existing Notes (each such subsidiary being referred to herein as a "Guarantor" and each such guarantee of the Notes being referred to herein as a "Guarantee" and, together with the Notes, the "Securities," and each guarantee of the Existing Notes together with the Existing Notes, the "Existing Securities").

Pursuant to the terms of the Collateral Agreements, all of the obligations under the Existing Securities and the Indenture are secured, and all of the obligations under the Securities will be secured, by a lien and security interest in substantially all of the assets of Kratos and the Guarantors.

Holders of the Notes (including Subsequent Purchasers) will have the registration rights set forth in the registration rights agreement applicable to the Notes (the "Registration Rights Agreement") in the form attached as Exhibit A hereto, to be executed on and dated as of the Closing Date (as hereinafter defined). Pursuant to the Registration Rights Agreement, Kratos and the Guarantors will agree, among other things, to file with the SEC (a) a registration statement under the Securities Act (the "Exchange Offer Registration Statement") relating to notes to be offered in exchange for the Notes (the "Exchange Notes"), and guarantees to be offered in exchange for the Guarantees (the "Exchange Guarantees"), which shall be identical to the Notes and Guarantees, respectively, except that the Exchange Notes and Exchange Guarantees shall have been registered pursuant to the Exchange Offer Registration Statement and will not be subject to restrictions on transfer or contain additional interest provisions, (such offer to exchange being referred to as the "Exchange Offer"), and/or (b) under certain circumstances, a shelf registration statement pursuant to Rule 415 under the Securities Act (the "Shelf Registration Statement") relating to the resale by certain holders of the Notes. If required under the Registration Rights Agreement, Kratos will issue Exchange Notes to the Initial Purchasers (the "Private Exchange Notes"). If Kratos fails to satisfy its obligations under the Registration Rights Agreement, it will be required to pay additional interest to the holders of the Notes under certain circumstances to be set forth in the Registration Rights Agreement.

This Agreement, the Indenture, the Collateral Agreements, the Registration Rights Agreement, the Notes, the Guarantees, the Engagement Letter dated May 15, 2011 (the "Engagement Letter") between Kratos, Jefferies and Key, the Exchange Notes, the Exchange Guarantees and the Private Exchange Notes are collectively referred to herein as the "Documents", and the transactions contemplated hereby and thereby are collectively referred to herein as the "Transactions." Nothing in this Agreement should be read to limit or otherwise modify the terms and provisions of the Engagement Letter, provided that, in the event any terms of the Engagement Letter are inconsistent with or contradict any terms of this Agreement, this Agreement shall govern.

3. **Purchase, Sale and Delivery**. On the basis of the representations, warranties, agreements and covenants herein contained and subject to the terms and conditions herein set forth, Kratos agrees to issue and sell to the Initial Purchasers, and the Initial Purchasers agree to purchase from Kratos, the Securities at a purchase price of 102.9% of the aggregate principal amount thereof. Delivery to the Initial Purchasers of and payment for the Securities shall be

made at a closing (the "Closing") to be held at 10:00 a.m., New York City time, on July 27, 2011 (the "Closing Date") at the New York offices of White & Case LLP (or such other place as shall be reasonably acceptable to the Initial Purchasers); provided, however, that if the Closing has not taken place on the Closing Date because of a failure to satisfy one or more of the conditions specified in Section 7 hereof and this Agreement has not otherwise been terminated by the Initial Purchasers in accordance with its terms, "Closing Date" shall mean 10:00 a.m., New York City time, on the first business day following the satisfaction (or waiver) of all such conditions after notification by Kratos to the Initial Purchasers of the satisfaction (or waiver) of such conditions.

Kratos shall deliver to the Initial Purchasers one or more certificates representing the Securities in definitive form, registered in such names and denominations as the Initial Purchasers may request, against payment by the Initial Purchasers of the purchase price therefor by immediately available federal funds bank wire transfer to such bank account or accounts as Kratos shall designate to the Initial Purchasers at least two business days prior to the Closing. The certificates representing the Securities in definitive form shall be made available to the Initial Purchasers for inspection at the New York offices of White & Case LLP (or such other place as shall be reasonably acceptable to the Initial Purchasers) not later than 10:00 a.m., New York City time, one business day immediately preceding the Closing Date. Securities to be represented by one or more definitive global securities in book-entry form will be deposited on the Closing Date, by or on behalf of Kratos, with The Depository Trust Company ("DTC") or its designated custodian, and registered in the name of Cede & Co. It is understood that each Initial Purchaser has authorized Jefferies, for its account, to accept delivery of, receipt for, and make payment of the purchase price for, the Notes which it has agreed to purchase. Jefferies, individually and not as representatives of the Initial Purchasers, may (but shall not be obligated to) make payment of the purchase price for the Notes to be purchased by any Initial Purchaser whose funds have not been received by the Closing Date, but such payment shall not relieve such Initial Purchaser from its obligations hereunder.

4. **Representations and Warranties of Kratos and the Guarantors**. Each of Kratos and the Guarantors, jointly and severally, represents and warrants to, and agrees with, each of the Initial Purchasers that, as of the date hereof and as of the Closing Date:

(a) *Offering Materials Furnished to Initial Purchasers*. Kratos has delivered to the Initial Purchasers the Time of Sale Document, the Final Offering Memorandum and each Company Additional Written Communication (as hereinafter defined) in such quantities and at such places as the Initial Purchasers have reasonably requested.

(b) *Limitation on Offering Materials.* Kratos has not prepared, made, used, authorized, approved or distributed and will not, and will not cause or allow its agents or representatives to, prepare, make, use, authorize, approve or distribute any written communication that constitutes an offer to sell or a solicitation of an offer to buy the Securities, or otherwise is prepared to market the Securities, other than (i) the Time of Sale Document, (ii) the Final Offering Memorandum and (iii) any marketing materials (including any roadshow or investor presentation materials) or other written communications, in each case used in accordance with Section 5(c) hereof (each such

communication by Kratos or its agents or representatives described in this clause (iii), a "Company Additional Written Communication").

(c) *No Material Misstatement or Omission*. (i) The Time of Sale Document, as of the Applicable Time, did not include any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, (ii) the Final Offering Memorandum, as of the date thereof, did not, and at the Closing Date, will not include any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading and (iii) each such Company Additional Written Communication, when taken together with the Time of Sale Document, at the time such Company Additional Written Communication was made did not, and, at the Closing Date, will not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, except in each case that the representations and warranties set forth in this paragraph do not apply to statements or omissions made in reliance upon and in conformity with information relating to the Initial Purchasers and furnished to Kratos in writing by the Initial Purchasers expressly for use in the Time of Sale Document or the Final Offering Memorandum as set forth in Section 13. No injunction or order has been issued that either (i) asserts that any of the Transactions is subject to the registration requirements of the Securities Act or (ii) would prevent or suspend the issuance or sale of any of the Securities or the use of the Time of Sale Document or the Final Offering Memorandum in any jurisdiction. No statement of material fact included in the Final Offering Memorandum has been omitted from the Time of Sale Document, and no statement of material fact included in the Time of Sale Document has been omitted from the Final Offering Memorandum.

"Applicable Time" means 3:00 p.m., New York City time, on the date hereof or such other time as may be agreed upon in writing by Kratos and Jefferies.

(d) *Documents Incorporated by Reference.* The documents incorporated or deemed to be incorporated by reference in the Time of Sale Document and the Final Offering Memorandum, at the time they were or hereafter are filed with the SEC, complied and will comply, in all material respects with the requirements of the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC thereunder (collectively, the "Exchange Act"). There are no contracts or other documents required to be described in such incorporated documents or to be filed as exhibits to such incorporated documents which have not been described or filed as required.

(e) *Reporting Compliance.* Kratos is subject to, and is in compliance in all material respects with, the reporting requirements of Section 13 and Section 15(d), as applicable, of the Exchange Act.

(f) *Preparation of the Financial Statements.* The audited consolidated financial statements and related notes of each of Integral, Kratos, Herley Industries, Inc. and its subsidiaries ("Herley"), Gichner Holdings, Inc. and its subsidiaries ("Gichner") and Henry Bros.

Electronics Inc. and its subsidiaries ("Henry Bros.") contained in the Time of Sale Document and the Final Offering Memorandum (the "Financial Statements") present fairly in all material respects the financial position, results of operations and cash flows of each of Integral, Kratos, Herley, Gichner and Henry Bros. and their respective consolidated Subsidiaries as of the respective dates and for the respective periods to which they apply and have been prepared in accordance with generally accepted accounting principles of the United States ("GAAP"), applied on a consistent basis throughout the periods involved and the applicable requirements of Regulation S-X. The financial data set forth under the captions "Summary Historical and Pro Forma Condensed Combined Financial Data of Kratos," "Unaudited Pro Forma Condensed Combined Financial Information of Kratos" and "Selected Consolidated Financial Data of Kratos" in the Time of Sale Document and the Final Offering Memorandum with respect to Kratos and its consolidated Subsidiaries has been prepared on a basis consistent with that of the Financial Statements and present fairly in all material respects the financial position and results of operations of Kratos and its consolidated Subsidiaries as of the respective dates and for the respective periods indicated. The financial data set forth under the captions "Summary Historical and Pro Forma Condensed Combined Financial Data of Kratos," "Summary Historical Consolidated Financial Data of Integral Systems," "Unaudited Pro Forma Condensed Combined Financial Information of Kratos" and "Selected Consolidated Financial Data of Integral Systems" in the Time of Sale Document and the Final Offering Memorandum with respect to Integral has been prepared on a basis consistent with that of the Financial Statements and present fairly in all material respects the financial position and results of operations of Integral as of the respective dates and for the respective periods indicated. The financial data set forth under the captions "Summary Historical and Pro Forma Condensed Combined Financial Data of Kratos" and "Unaudited Pro Forma Condensed Combined Financial Information of Kratos" in the Time of Sale Document and the Final Offering Memorandum with respect to Herley has been prepared on a basis consistent with that of the Financial Statements and present fairly in all material respects the financial position and results of operations of Herley as of the respective dates and for the respective periods indicated. The financial data set forth under the captions "Summary Historical and Pro Forma Condensed Combined Financial Data of Kratos" and "Unaudited Pro Forma Condensed Combined Financial Information of Kratos" in the Time of Sale Document and the Final Offering Memorandum with respect to Gichner has been prepared on a basis consistent with that of the Financial Statements and present fairly in all material respects the financial position and results of operations of Gichner as of the respective dates and for the respective periods indicated. The financial data set forth under the captions "Summary Historical and Pro Forma Condensed Combined Financial Data of Kratos" and "Unaudited Pro Forma Condensed Combined Financial Information of Kratos" in the Time of Sale Document and the Final Offering Memorandum with respect to Henry Bros. has been prepared on a basis consistent with that of the Financial Statements and present fairly in all material respects the financial position and results of operations of Henry Bros. as of the respective dates and for the respective periods indicated. The unaudited pro forma financial information and related notes of Kratos and its Subsidiaries contained in the Time of Sale Document and the Final Offering Memorandum have been prepared in accordance with the applicable requirements of Regulation S-X and have been

properly presented on the bases described therein, and give effect to assumptions used in the preparation thereof are reasonable basis and in good faith and the adjustments used therein are appropriate to give effect to the transactions and circumstances referred to therein. All other financial, statistical and market and industry data and forward-looking statements (within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act) contained in the Time of Sale Document and the Final Offering Memorandum are fairly and accurately presented, are based on or derived from sources that Kratos believes to be reliable and accurate and are presented on a reasonable basis. No other financial statements or supporting schedules are required to be included in the Time of Sale Document or the Final Offering Memorandum.

(g) *Disclosure Controls and Procedures.* Kratos and its Subsidiaries maintain an effective system of "disclosure controls and procedures" (as defined in Rule 13a-15(e) of the Exchange Act) that is designed to ensure that information required to be disclosed by Kratos in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including controls and procedures designed to ensure that such information is accumulated and communicated to Kratos' management as appropriate to allow timely decisions regarding required disclosure. Kratos and its Subsidiaries have carried out evaluations of the effectiveness of their disclosure controls and procedures as required by Rule 13a-15 of the Exchange Act. The statements relating to disclosure controls and procedures made by the principal executive officers (or their equivalents) and principal financial officers (or their equivalents) of Kratos in the certifications required by the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated in connection therewith are complete and correct.

(h) *Independent Accountants of Kratos*. Grant Thornton LLP, who have certified and expressed their opinion with respect to the consolidated financial statements of Kratos and its Subsidiaries including the related notes thereto and supporting schedules contained in the Time of Sale Document and the Final Offering Memorandum, is (i) an independent registered public accounting firm with respect to Kratos and its Subsidiaries within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (ii) to the knowledge of Kratos, after due inquiry, in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (iii) to the knowledge of Kratos, after due inquiry, a registered public accounting firm as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn.

(i) *Independent Accountants of Integral*. KPMG LLP, who have certified and expressed their opinion with respect to the consolidated financial statements of Integral including the related notes thereto and supporting schedules contained in the Time of Sale Document and the Final Offering Memorandum, is, to the knowledge of Kratos, after due inquiry, (i) an independent registered public accounting firm with respect to Integral within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (ii) in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (iii) a registered public accounting firm

as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn

(j) *Independent Accountants of Herley.* (i) Grant Thornton LLP, who have certified and expressed their opinion with respect to the consolidated balance sheet of Herley as of August 1, 2010 and the related consolidated statements of operations, shareholders' equity and cash flows for the fifty-two week period then ended, and (ii) Marcum LLP, who have certified and expressed their opinion with respect to the balance sheet of Herley as of August 2, 2009 and the related consolidated statements of operations, shareholders' equity and cash flows for the fifty-two weeks ended August 2, 2009 and the fifty-three weeks ended August 3, 2008, each as contained in the Time of Sale Document and the Final Offering Memorandum, are each, to the knowledge of Kratos, after due inquiry, (x) an independent registered public accounting firm with respect to Herley within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (y) in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (z) a registered public accounting firm as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn.

(k) *Independent Accountants of General Microwave Israel Corp. and Subsidiary*. Brightman Almagor Zohar & Co, a member firm of Deloitte Touche Tohmatsu, whose opinion with respect to the consolidated financial statements of General Microwave Israel Corp. and subsidiary ("<u>General Microwave</u>") is referenced in the audit opinions of Grant Thornton LLP and Marcum LLP in connection with their respective audits of the consolidated financial statements of Herley contained in the Time of Sale Document and the Final Offering Memorandum, is, to the knowledge of Kratos, after due inquiry, (i) an independent registered public accounting firm with respect to General Microwave within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (ii) in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (iii) a registered public accounting firm as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn.

(l) *Independent Accountants of Henry Bros.* EisnerAmper LLP, who have certified and expressed their opinion with respect to the consolidated financial statements of Henry Bros. and subsidiaries including the related notes thereto and supporting schedules contained in the Time of Sale Document and the Final Offering Memorandum, is (i) an independent registered public accounting firm with respect to Henry Bros. within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (ii) to the knowledge of Kratos, after due inquiry, in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (iii) to the knowledge of Kratos, after due inquiry, a registered public accounting firm as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn.

(m) *Independent Accountants of Gichner.* Plante & Moran, PLLC, who have certified and expressed their opinion with respect to the consolidated financial statements of Gichner and subsidiaries as of December 31, 2009, 2008 and 2007 and the related consolidated financial statements for the years ended December 31, 2009 and 2008 and the period from August 22, 2007 through December 31, 2007, and the combined balance sheet of Gichner as of August 22, 2007 and the related combined financial statements for the period from January 1, 2007 through August 22, 2007, including the related notes thereto and supporting schedules contained in the Time of Sale Document and the Final Offering Memorandum, are (i) an independent registered public accounting firm with respect to Gichner within the applicable rules and regulations adopted by the SEC and as required by the Securities Act, (ii) to the knowledge of Kratos, after due inquiry, in compliance with the applicable requirements relating to the qualification of accountants Regulation S-X and (iii) to the knowledge of Kratos, after due inquiry, a registered public accounting firm as defined by the Public Company Accounting Oversight Board (United States) whose registration has not been suspended or revoked and who has not requested such registration to be withdrawn.

(n) *No Material Adverse Change*. Subsequent to the respective dates as of which information is contained in the Time of Sale Document and the Final Offering Memorandum, except as disclosed in the Time of Sale Document and the Final Offering Memorandum, (i) none of Kratos, any of its Subsidiaries, or any Integral Entity has incurred any liabilities, direct or contingent, including without limitation any losses or interference with its business from fire, explosion, flood, earthquakes, accident or other calamity, whether or not covered by insurance, or from any strike, labor dispute or court or governmental action, order or decree, that are material, individually or in the aggregate, to Kratos and its Subsidiaries, taken as a whole, or to Integral, Kratos and its Subsidiaries, taken as a whole, or has entered into any transactions not in the ordinary course of business, (ii) there has not been any material decrease in the capital stock or any material increase in any short-term or long-term indebtedness of Kratos, its Subsidiaries or Integral, or any payment of or declaration to pay any dividends or any other distribution with respect to Kratos or Integral, and (iii) there has not been any material adverse change in the properties, business, prospects, operations, earnings, assets, liabilities or condition (financial or otherwise) of Kratos, its Subsidiaries and Integral, taken as a whole (each of clauses (i), (ii) and (iii), a "Material Adverse Change"). To Kratos' knowledge, after due inquiry, there is no event that is reasonably likely to occur, which if it were to occur, would, individually or in the aggregate, have a Material Adverse Effect except as disclosed in the Time of Sale Document and the Final Offering Memorandum.

(o) *Rating Agencies.* No "nationally recognized statistical rating organization" (as defined in Rule 436(g)(2) under the Securities Act) (i) has imposed (or has informed Kratos that it is considering imposing) any condition (financial or otherwise) to retain any rating assigned to Kratos, any of its Subsidiaries or any Integral Entity or to any securities of Kratos, any of its Subsidiaries or any Integral Entity or (ii) has indicated to Kratos or Integral that it is considering (A) the downgrading, suspension, or withdrawal of, or any review (or of any potential or intended review) for a possible change in, any rating so assigned (including, without limitation, the placing of any of the foregoing ratings on credit watch with

negative or developing implications or under review with an uncertain direction) or (B) any change in the outlook for any rating of Kratos, any of its Subsidiaries or any Integral Entity or any securities of Kratos, any of its Subsidiaries or any Integral Entity.

(p) *Subsidiaries*. Each corporation, partnership or other entity in which Kratos, directly or indirectly through any of its subsidiaries, owns more than fifty percent (50%) of any class of equity securities or interests is listed on Schedule III attached hereto (the "Subsidiaries"). Each Integral Entity is listed under the heading "Integral Entities" on Schedule III attached hereto. Each Subsidiary that is a Foreign Restricted Subsidiary has an asterisk ("*") next to its name on such schedule.

(q) *Incorporation and Good Standing of Kratos, its Subsidiaries and Integral; MAE.* Each of Kratos, its Subsidiaries and each Integral Entity (i) has been duly organized or formed, as the case may be, is validly existing and, where applicable, is in good standing under the laws of its jurisdiction of organization, (ii) has all requisite power and authority to carry on its business and to own, lease and operate its properties and assets as described in the Time of Sale Document and in the Final Offering Memorandum and (iii) is duly qualified or licensed to do business and is in good standing as a foreign corporation, partnership or other entity as the case may be, authorized to do business in each jurisdiction in which the nature of such businesses or the ownership or leasing of such properties requires such qualification, except where the failure to be so qualified would not, individually or in the aggregate, have a material adverse effect on (A) the properties, business, prospects, operations, earnings, assets, liabilities or condition (financial or otherwise) of Kratos and its Subsidiaries (including, upon consummation of the Acquisition, Integral), taken as a whole, (B) the ability of Kratos, any Subsidiary or any Integral Entity to perform its obligations in all material respects under any Document, (C) the enforceability of any Collateral Agreement or the attachment, perfection or priority of any of the liens or security interests intended to be created thereby, (D) the validity or enforceability of any of the Documents, or (E) the consummation of any of the Transactions (each, a "Material Adverse Effect").

(r) *Capitalization and Other Capital Stock Matters.* All of the issued and outstanding shares of capital stock, membership interests, partnership interests or other similar equity interests, as applicable, of each of Kratos, its Subsidiaries and each Integral Entity have been duly authorized and validly issued, are fully paid and nonassessable and were not issued in violation of, and are not subject to, any preemptive or similar rights. The table under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Time of Sale Document and the Final Offering Memorandum (including the footnotes thereto) sets forth, as of the date of such table, information concerning the beneficial ownership of Kratos' common stock by (i) each stockholder known by Kratos to be the beneficial owner of 5% or more of the outstanding shares of Kratos' common stock, (ii) each of Kratos' directors, (iii) each of Kratos' executive officers, and (iv) all of Kratos' executive officers and directors as a group. All of the outstanding shares of capital stock, membership interests, partnership interests or other equity interests of each of its Subsidiaries are, and upon consummation of the Acquisition, each Integral Entity will be, owned, directly or indirectly, by Kratos, free and clear of all liens, security interests, mortgages, pledges, charges, equities, claims or restrictions on transferability or

encumbrances of any kind (collectively, "Liens), other than those Permitted Liens and those imposed by the Securities Act and the securities or "Blue Sky" laws of certain U.S. state or non-U.S. jurisdictions. Except as disclosed in the Time of Sale Document and the Final Offering Memorandum, there are no outstanding (A) options, warrants or other rights to purchase from Kratos or any of its Subsidiaries, (B) agreements, contracts, arrangements or other obligations of Kratos or any of its Subsidiaries to issue or (C) other rights to convert any obligation into or exchange any securities for, in the case of each of clauses (A) through (C), shares of capital stock of or other ownership or equity interests in Kratos or any of its Subsidiaries.

(s) *Legal Power and Authority.* Each of Kratos and the Guarantors has, and upon consummation of the Acquisition, each Integral Entity that will not be a Foreign Subsidiary of the Company will have, all necessary power and authority to execute, deliver and perform their respective obligations under the Documents to which they are or will become a party and to consummate the Transactions.

(t) *This Agreement, the Indenture and the Collateral Agreements*. This Agreement has been duly and validly authorized, executed and delivered by Kratos and the Guarantors, and, upon consummation of the Acquisition, will have been duly and validly authorized by each of the Integral Entities (other than those that will be Foreign Subsidiaries of the Company). Each of the Indenture and the Collateral Agreements, if applicable, has been duly and validly authorized by Kratos and the Guarantors and, upon consummation of the Acquisition, will have been duly and validly authorized by each of the Integral Entities (other than those that will be Foreign Subsidiaries of the Company). Each of the Indenture and the Collateral Agreements constitutes a legal, valid and binding obligation of each of Kratos and the Guarantors and, when an applicable supplement or joinder to each of the Indenture and the Collateral Agreements has been executed and delivered by such Integral Entities, each of the Indenture and the Collateral Agreements will constitute a legal, valid and binding obligation of such Integral Entities, in each case, enforceable against each of Kratos, the Guarantors and such Integral Entities in accordance with its terms, except that the enforcement thereof may be subject to (i) bankruptcy, insolvency, reorganization, receivership, moratorium, fraudulent conveyance, fraudulent transfer or other similar laws now or hereafter in effect relating to creditors' rights generally and (ii) general principles of equity (whether applied by a court of law or equity) and the discretion of the court before which any proceeding therefor may be brought. This Agreement, the Indenture and the Collateral Agreements conform in all material respects to the descriptions thereof in the Time of Sale Document and the Final Offering Memorandum. The Indenture meets the requirements for qualification under the Trust Indenture Act of 1939, as amended, and the rules and regulations of the SEC thereunder (collectively, the "TIA").

(u) *Registration Rights Agreement*. The Registration Rights Agreement has been duly and validly authorized by Kratos and the Guarantors, and, upon consummation of the Acquisition, will have been duly and validly authorized by each Integral Entity that will not be a Foreign Subsidiary of the Company. The Registration Rights Agreement, when duly executed and delivered by Kratos, the Guarantors and such Integral Entities, will constitute a valid and binding agreement of each of such parties thereto, enforceable

against each of them in accordance with its terms, except that the enforcement thereof may be subject to (A) bankruptcy, insolvency, reorganization, receivership, moratorium, fraudulent conveyance, fraudulent transfer or other similar laws now or hereafter in effect relating to creditors' rights generally, (B) general principles of equity (whether applied by a court of law or equity) and the discretion of the court before which any proceeding therefor may be brought and (C) rights to indemnity or contribution thereunder, federal and state securities laws and public policy considerations. When executed and delivered, the Registration Rights Agreement will conform in all material respects to the description thereof in the Time of Sale Document and the Final Offering Memorandum

(v) *Notes and Exchange Notes.* The Notes, Exchange Notes and Private Exchange Notes have each been duly and validly authorized by Kratos and, in the case of the Notes, when issued and delivered to and paid for by the Initial Purchasers in accordance with the terms of this Agreement and the Indenture, will have been duly executed, authenticated, issued and delivered and will constitute legal, valid and binding obligations of Kratos, entitled to the benefit of the Indenture, the Collateral Agreements and the Registration Rights Agreement, and enforceable against Kratos in accordance with their terms, except that the enforcement thereof may be subject to (i) bankruptcy, insolvency, reorganization, receivership, moratorium, fraudulent conveyance, fraudulent transfer or other similar laws now or hereafter in effect relating to creditors' rights generally and (ii) general principles of equity (whether applied by a court of law or equity) and the discretion of the court before which any proceeding therefor may be brought. When executed and delivered, the Notes, the Exchange Notes and the Private Exchange Notes will conform in all material respects to the descriptions thereof in the Time of Sale Document and the Final Offering Memorandum and will be in the form contemplated by the Indenture.

(w) *Guarantees and Exchange Guarantees.* The Guarantees and the Exchange Guarantees of the Notes have been duly and validly authorized by the Guarantors and, upon consummation of the Acquisition, will have been duly and validly authorized by each Integral Entity that will not be a Foreign Subsidiary of the Company, and, when issued and executed by the Guarantors and such Integral Entities, will have been duly executed, authenticated, issued and delivered and will constitute legal, valid and binding obligations of the Guarantors and such Integral Entities, entitled to the benefit of the Indenture, the Collateral Agreements and the Registration Rights Agreement, and enforceable against the Guarantors and such Integral Entities in accordance with their terms, except that the enforcement thereof may be subject to (i) bankruptcy, insolvency, reorganization, receivership, moratorium, fraudulent conveyance, fraudulent transfer or other similar laws now or hereafter in effect relating to creditors' rights generally and (ii) general principles of equity (whether applied by a court of law or equity) and the discretion of the court before which any proceeding therefor may be brought. When executed and delivered, the Guarantees and the Exchange Guarantees will conform in all material respects to the descriptions thereof in the Time of Sale Document and the Final Offering Memorandum.

(x) *Collateral.*

(i) With respect to any Collateral consisting of the assets of, or the equity interests issued by, any Integral Entity that becomes a Guarantor, upon:

(1) in the case of such portion of such Collateral constituting investment property represented or evidenced by certificates or other instruments, delivery to the Collateral Agent of such certificates or instruments in accordance with the Collateral Agreements, and in the case of all other investment property, the filing of financing statements or other applicable filings in the appropriate filing office, registry or other public office, together with the payment of the requisite filing or recordation fees related thereto;

(2) in the case of such portion of such Collateral constituting securities accounts, delivery to the Collateral Agent of securities account control agreements and such other agreements or instruments, in each case satisfactory in form and substance to the Collateral Agent and duly executed by the applicable securities intermediary, as may be necessary or, in the opinion of the Collateral Agent, desirable to establish and maintain control of such securities accounts from time to time;

(3) in the case of such portion of such Collateral constituting deposit accounts, delivery to the Collateral Agent of deposit account control agreements and such other agreements or instruments, in each case satisfactory in form and substance to the Collateral Agent and duly executed by the applicable depositary bank, as may be necessary or, in the opinion of the Collateral Agent, desirable to establish and maintain control of such deposit accounts from time to time;

(4) in the case of such portion of such Collateral constituting registered patents, trademarks and copyrights, the filing by the Collateral Agent of (A) initial financing statements with the appropriate filing offices, (B) any filings required with the United States Patent and Trademark Office, (C) any filings required with the United States Copyright Office and (D) the other Collateral Agreements with the appropriate filing office, registry or other public office, together with the payment of the requisite filing or recordation fees related thereto,

(5) in the case of any other such Collateral a Lien in which may be perfected by filing of an initial financing statement or other applicable document in the appropriate filing office, registry or other public office, the filing of financing statements or other applicable document in such filing office, registry or other public office, together with the payment of the requisite filing or recordation fees related thereto, and in the case of any other Collateral a Lien in which is perfected by possession or control, when the Collateral Agent obtains possession or control thereof; and

the Liens granted pursuant to the Collateral Agreements will constitute valid and enforceable perfected Liens, in each case prior and superior in right to any other Person therein (other than any Person holding a Permitted Lien).

(ii) The Liens previously granted by Kratos and the Guarantors under the Collateral Agreements will secure the Notes and all other Obligations related thereto, and it is not necessary to make any new filings or take any other action to perfect, or to maintain the perfection, of such Liens.

(iii) As of the Closing Date, there will be no currently effective financing statement, security agreement, chattel mortgage, real estate mortgage or other document filed or recorded with any filing records, registry, or other public office, that purports to cover, affect or give notice of any present or possible future Lien on any assets or property of Kratos, any Guarantor, any Subsidiary or any Integral Entity or any rights thereunder, except for Permitted Liens.

(iv) All information certified by an officer of Kratos in the Perfection Certificate to be executed on or prior to the Closing Date and delivered by such officer on behalf of Kratos is true and correct both as of the date thereof and as of the Closing Date.

(v) The representations and warranties of each of Kratos, the Guarantors and, upon the consummation of the Acquisition, each Integral Entity in the Collateral Agreements are true and correct (if such representations and warranties are not already qualified with respect to materiality) in all material respects.

(y) *Compliance with Existing Instruments.* None of Kratos, any of its Subsidiaries or any Integral Entity is (i) in violation of its certificate of incorporation, by-laws or other organizational documents (the "Charter Documents"); (ii) in violation of any U.S. or non-U.S. federal, state or local statute, law (including, without limitation, common law) or ordinance, or any judgment, decree, rule, regulation, order or injunction (collectively, "Applicable Law") of any U.S. or non-U.S. federal, state, local or other governmental or regulatory authority, governmental or regulatory agency or body, court, arbitrator or self-regulatory organization (each, a "Governmental Authority"), applicable to any of them or any of their respective properties; or (iii) in breach of or default under any bond, debenture, note, loan or other evidence of indebtedness, indenture, mortgage, deed of trust, lease or any other agreement or instrument to which any of them is a party or by which any of them or their respective properties are bound (collectively, the "Applicable Agreements"), except, (A) in the case of clauses (ii) and (iii) for such violations, breaches or defaults that would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect and (B) in the case of clause (iii), for the default under the credit agreement, dated March 5, 2010 (as amended and supplemented to the date hereof), among Integral Systems, Inc., certain of its subsidiaries, the lenders from time to time party thereto, and Bank of America, N.A., as disclosed under the caption "Information about Integral Systems" in the Time of Sale Document and the Final Offering Memorandum. There exists no condition that, with the passage of time or otherwise, would constitute (a) a violation of such Charter Documents or Applicable Laws, (b) a breach of or default or a "Debt Repayment Triggering Event" (as defined

below) under any Applicable Agreement or (c) result in the imposition of any penalty or the acceleration of any indebtedness. As used herein, a "Debt Repayment Triggering Event" means any event or condition that gives, or with the giving of notice or lapse of time would give, the holder of any note, debenture or other evidence of indebtedness (or any person acting on such holder's behalf) the right to require the repurchase, redemption or repayment of all or a portion of such indebtedness by Kratos, any of its Subsidiaries, any Integral Entity or any of their respective properties.

(z) *No Conflicts.* Neither the execution, delivery or performance of the Documents nor the consummation of any of the Transactions will conflict with, violate, constitute a breach of or a default (with the passage of time or otherwise) or a Debt Repayment Triggering Event under, or result in the imposition of a Lien on any assets of Kratos, any of its Subsidiaries and, upon consummation of the Acquisition, any Integral Entity (except for Permitted Liens or Liens pursuant to the Collateral Agreements), the imposition of any penalty or a Debt Repayment Triggering Event under or pursuant to (i) the Charter Documents, (ii) any Applicable Agreement, (iii) any Applicable Law or (iv) any order, writ, judgment, injunction, decree, determination or award binding upon or affecting Kratos, its Subsidiaries or, upon consummation of the Acquisition, any Integral Entity. After consummation of the Offering and the Transactions, no Default or Event of Default will exist.

(aa) *No Consents.* No consent, approval, authorization, order, filing or registration of or with any Governmental Authority or third party is required for execution, delivery or performance of the Documents or the consummation of the Transactions, except such (i) those that have been official or made, as the case may be, that are in full force and effect, (ii) as may be required under the securities or "Blue Sky" laws of U.S. state or non-U.S. jurisdictions or other non-U.S. laws applicable to the purchase of the Securities outside the U.S. in connection with the Transactions, (iii) those contemplated by the Registration Rights Agreement and the Collateral Agreements; (iv) the filing of articles of merger with the Maryland Secretary of State to effect the merger contemplated by the Merger Agreement and (v) the filing of a Current Report on Form 8-K with the SEC as may be required under the Securities Act and the Exchange Act, as the case may be, regarding the Documents and the Transactions.

(bb) *No Material Applicable Laws or Proceedings*. Except as disclosed in the Time of Sale Document and the Final Offering Memorandum, there is no action, claim, suit, demand, hearing, notice of violation or deficiency, or proceeding pending or, to the knowledge of Kratos or any of its Subsidiaries, after due inquiry, threatened or contemplated by Governmental Authorities or threatened by others (collectively, "Proceedings") that, would, as of the date hereof and at the Closing Date, restrain, enjoin, prevent or interfere with the consummation of the Offering or any of the Transactions or (B) would, individually or in the aggregate, have a Material Adverse Effect.

(cc) *All Necessary Permits*. Each of Kratos, its Subsidiaries and each Integral Entity possesses all licenses, permits, certificates, consents, orders, approvals and other authorizations from, and has made all declarations and filings with, all Governmental Authorities, presently required or necessary to own or lease, as the case may be, and to operate its properties and to carry on its businesses as now or proposed to be conducted as described in the Time of Sale Document and the Final Offering Memorandum ("Permits"), except where the failure to possess such Permits would not, individually or in the aggregate, have a Material Adverse Effect; each of Kratos, its Subsidiaries and each Integral Entity has fulfilled and performed all of its obligations with respect to such Permits; no event has occurred which allows, or after notice or lapse of time would allow, revocation or termination of any such Permit or has resulted, or after notice or lapse of time would result, in any other material impairment of the rights of the holder of any such Permit; and none of Kratos, any of its Subsidiaries or any Integral Entity has received or has any reason to believe it will receive any notice of any proceeding relating to revocation or modification of any such Permit, except as described in the Time of Sale Document and the Final Offering Memorandum or except where such revocation or modification would not, individually or in the aggregate, have a Material Adverse Effect.

(dd) *Title to Properties*. Each of Kratos, its Subsidiaries and each Integral Entity has good, marketable and valid title to all real property owned by it and good title to all personal property owned by it and good and valid title to all leasehold estates in real and personal property being leased by it and, as of the Closing Date, will be free and clear of all Liens other than Permitted Liens. All Applicable Agreements to which Kratos or any of its Subsidiaries is a party or by which any of them is bound are valid and enforceable against each of Kratos or such Subsidiary, as applicable, and are valid and enforceable against the other party or parties thereto and are in full force and effect with only such exceptions as would not, individually or in the aggregate, have a Material Adverse Effect.

(ee) *Tax Law Compliance*. All Tax (as hereinafter defined) returns required to be filed by Kratos, each of its Subsidiaries and each Integral Entity have been filed and all such returns are true, complete and correct in all material respects. All material Taxes that are due from Kratos, its Subsidiaries and Integral have been paid other than those (i) currently payable without penalty or interest or (ii) being contested in good faith and by appropriate proceedings and for which adequate accruals have been established in accordance with GAAP. To the knowledge of Kratos, after due inquiry, there are no actual or proposed Tax assessments against Kratos, any of its Subsidiaries or any Integral Entity that would, individually or in the aggregate, have a Material Adverse Effect. The accruals on the books and records of Kratos, its Subsidiaries and Integral in respect of any material Tax liability for any period not finally determined are adequate to meet any assessments of Tax for any such period. For purposes of this Agreement, the term "Tax" and "Taxes" shall mean all U.S. and non-U.S. federal, state, local and taxes, and other assessments of a similar nature (whether imposed directly or through withholding), including any interest, additions to tax or penalties applicable thereto.

(ff) *Intellectual Property Rights*. Each of Kratos, its Subsidiaries and Integral owns, or is licensed under, and has the right to use, all patents, patent rights, licenses, inventions, copyrights, know-how (including trade secrets and other unpatented and/or unpatentable proprietary or confidential information, systems or procedures), trademarks, service marks, domain names and trade names (collectively, "Intellectual Property") necessary for the conduct of its businesses and, as of the Closing Date, the Intellectual Property will be free and clear of all Liens, other than Permitted Liens. None of Kratos, its

Subsidiaries or any Integral Entity is a party to, or bound by, any options, licenses or agreements with respect to the intellectual property rights of any other person or entity that are necessary to be described in the Time of Sale Document or the Final Offering Memorandum to avoid a material misstatement or omission and are not described therein. No claims or notices of any potential claim have been asserted by any person challenging the use of any such Intellectual Property by Kratos, any of its Subsidiaries or any Integral Entity or questioning the validity or effectiveness of any Intellectual Property or any license or agreement related thereto, other than any claims that, if successful, would not, individually or in the aggregate, have a Material Adverse Effect. None of the intellectual property used by Kratos, any of its Subsidiaries or any Integral Entity has been obtained or is hereby used by Kratos, any of its Subsidiaries or any Integral Entity in violation of any contractual obligation binding on Kratos, any of its Subsidiaries or any Integral Entity or, to Kratos or any of its Subsidiaries' knowledge, their respective officers, directors or employees or otherwise in violation of the rights of any person.

(gg) *ERISA Matters*. Each of Kratos, its Subsidiaries, each Integral Entity and each ERISA Affiliate (as hereinafter defined) has fulfilled its obligations, if any, under the minimum funding standards of Section 302 of the United States Employee Retirement Income Security Act of 1974, as amended ("ERISA") with respect to each "pension plan" (as defined in Section 3(2) of ERISA), subject to Section 302 of ERISA, which Kratos, its Subsidiaries or any ERISA Affiliate sponsors or maintains, or with respect to which it has (or within the last three years had) any obligation to make contributions, and each such plan is in compliance in all material respects with the presently applicable provisions of ERISA and the Internal Revenue Code of 1986, as amended (the "Code"). None of Kratos, its Subsidiaries or any ERISA Affiliate has incurred any unpaid liability to the Pension Benefit Guaranty Corporation (other than for the payment of premiums in the ordinary course) or to any such plan under Title IV of ERISA. "ERISA Affiliate" means a corporation, trade or business that is, along with Kratos or any Subsidiary, a member of a controlled group of corporations or a controlled group of trades or businesses, as described in Section 414 of the Code or Section 4001 of ERISA.

(hh) *Labor Matters*. (i) Other than as disclosed in the Time of Sale Document and Final Offering Memorandum, none of Kratos, any of its Subsidiaries or any Integral Entity is party to or bound by any collective bargaining agreement with any labor organization; (ii) there is no union representation question existing with respect to the employees of Kratos, its Subsidiaries or Integral, and, to the knowledge of Kratos, after due inquiry, no union organizing activities are taking place that, could, individually or in the aggregate, have a Material Adverse Effect; (iii) to the knowledge of Kratos, after due inquiry, no union organizing or decertification efforts are underway or threatened against Kratos, its Subsidiaries or Integral; (iv) no labor strike, work stoppage, slowdown or other material labor dispute is pending against Kratos, its Subsidiaries or Integral, or, to Kratos' knowledge, after due inquiry, threatened against Kratos, its Subsidiaries or Integral; (v) there is no worker's compensation liability, experience or matter that could be reasonably expected to have a Material Adverse Effect; (vi) to the knowledge of Kratos, after due inquiry, there is no threatened or pending liability against Kratos, its Subsidiaries or Integral pursuant to the Worker Adjustment Retraining and Notification Act of 1988, as amended ("WARN"), or any similar state or local law; (vii) there is no employment-

related charge, complaint, grievance, investigation, unfair labor practice claim or inquiry of any kind, pending against Kratos, its Subsidiaries or Integral that could, individually or in the aggregate, have a Material Adverse Effect; (viii) to the knowledge of Kratos and its Subsidiaries, after due inquiry, no employee or agent of Kratos, its Subsidiaries or Integral has committed any act or omission giving rise to liability for any violation identified in subsection (vi) and (vii) above, other than such acts or omissions that would not, individually or in the aggregate, have a Material

Adverse Effect; and (ix) no term or condition of employment exists through arbitration awards, settlement agreements or side agreement that is contrary to the express terms of any applicable collective bargaining agreement.

(ii) *Compliance with Environmental Laws*. Except as disclosed in the Time of Sale Document and the Final Offering Memorandum, each of Kratos, its Subsidiaries and Integral is (i) in compliance with any and all applicable U.S. or non-U.S. federal, state and local laws and regulations relating to health and safety, or the pollution or the protection of the environment or hazardous or toxic substances of wastes, pollutants or contaminants ("Environmental Laws"), (ii) has received and is in compliance with all permits, licenses or other approvals required of them under applicable Environmental Laws to conduct its respective businesses and (iii) has not received notice of, and is not aware of, any actual or potential liability for damages to natural resources or the investigation or remediation of any disposal, release or existence of hazardous or toxic substances or wastes, pollutants or contaminants, in each case except where such non-compliance with Environmental Laws, failure to receive and comply with required permits, licenses or other approvals, or liability would not, individually or in the aggregate, have a Material Adverse Effect. Except as disclosed in the Time of Sale Document and the Final Offering Memorandum, none of Kratos, any of its Subsidiaries or any Integral Entity has been named as a "potentially responsible party" under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, or any similar U.S. or non-U.S. state or local Environmental Laws or regulation requiring Kratos, any of its Subsidiaries or any Integral Entity to investigate or remediate any pollutants or contaminants, except where such requirements would not, individually or in the aggregate, have a Material Adverse Effect, whether or not arising from transactions in the ordinary course of business. In the ordinary course of its business, Kratos and Integral periodically reviews the effects of Environmental Laws on the business, operations and properties of Kratos and its Subsidiaries and Integral, respectively, in the course of which it identifies and evaluates associated costs and liabilities (including, without limitation, any capital or operating expenditures required for clean-up, closure of properties or compliance with Environmental Laws, or any permit, license or approval, any related constraints on operating activities and any potential liabilities to third parties). On the basis of such review, Kratos and, to Kratos' knowledge, Integral have reasonably concluded that such associated costs would not have a Material Adverse Effect.

(jj) *Insurance*. Each of Kratos, its Subsidiaries and each Integral Entity is insured by insurers of recognized financial responsibility against such losses and risks and in such amounts as are prudent and customary in the businesses in which it is engaged. All policies of insurance insuring Kratos, any of its Subsidiaries or any Integral Entity or their respective

businesses, assets, employees, officers and directors are in full force and effect. Kratos, its Subsidiaries and Integral are in compliance with the terms of such policies and instruments in all material respects, and there are no claims by Kratos, any of its Subsidiaries or any Integral Entity under any such policy or instrument as to which any insurance company is denying liability or defending under a reservation of rights clause. None of Kratos, any of its Subsidiaries or any Integral Entity has been refused any insurance coverage sought or applied for, and none of Kratos, any of its Subsidiaries or any Integral Entity has any reason to believe that it will not be able to renew its existing insurance coverage as and when such coverage expires or to obtain similar coverage from similar insurers as may be necessary to continue its business at a cost that would not, individually or in the aggregate, have a Material Adverse Effect.

(kk) *Accounting System*. Each of Kratos, its Subsidiaries and each Integral Entity makes and keeps accurate books and records and maintains a system of internal accounting controls and procedures sufficient to provide reasonable assurance that (i) transactions are executed in accordance with management's general or specific authorization, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP, and to maintain asset accountability, (iii) access to assets is permitted only in accordance with management's general or specific authorization and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any material differences. Kratos' management concluded that Kratos' internal control over financial reporting was effective as of December 26, 2010, and since that date the independent auditors and board of directors of Kratos have been advised of: (i) all "material weaknesses" and "significant deficiencies" (each, as defined in Rule 12b-2 of the Exchange Act), if any, in the design or operation of Kratos' internal control over financial reporting which are reasonably likely to adversely affect Kratos' ability to record, process, summarize and report financial information and (ii) any fraud, whether or not material, that involves management or other employees who have a role in Kratos' internal control over financial reporting (whether or not remediated). Except as disclosed in the Time of Sale Document and the Final Offering Memorandum, as of the date hereof there are no material weaknesses in Kratos' internal control over financial reporting. Since the date of the most recent evaluation of Kratos' disclosure controls and procedures and internal control over financial reporting, there have been no changes in Kratos' internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Kratos' internal control over financial reporting.

(ll) *Use of Proceeds; Solvency; Going Concern*. All indebtedness represented by the Securities is being incurred for proper purposes and in good faith. On the Closing Date, after giving pro forma effect to the Offering and the use of proceeds therefrom described under the caption "Use of Proceeds" in the Time of Sale Document and Final Offering Memorandum, Kratos and each Guarantor, and, upon consummation of the Acquisition, each Integral Entity, (i) will be Solvent (as hereinafter defined), (ii) will have sufficient capital for carrying on its business and (iii) will be able to pay its debts as they mature. As used in this paragraph, the term "Solvent" means, with respect to a particular date, that on such date (i) the present fair market value (or present fair saleable value) of the assets of Kratos and each Guarantor, and, upon consummation of the Acquisition, each

Integral Entity, is not less than the total amount required to pay the liabilities of Kratos and each Guarantor on its total existing debts and liabilities (including contingent liabilities) as they become absolute and matured; (ii) Kratos and each Guarantor is, and, upon consummation of the Acquisition, each Integral Entity, is able to pay its debts and other liabilities, contingent obligations and commitments as they mature and become due in the normal course of business; (iii) assuming consummation of the issuance of the Securities as contemplated by this Agreement and the Time of Sale Document and Final Offering Memorandum, neither Kratos nor any Guarantor, and, upon consummation of the Acquisition, each Integral Entity, is incurring debts or liabilities beyond its ability to pay as such debts and liabilities mature; (iv) none of Kratos, any Guarantor or, upon consummation of the Acquisition, any Integral Entity, is engaged in any business or transaction, or proposes to engage in any business or transaction, for which its property would constitute unreasonably small capital after giving due consideration to the prevailing practice in the industry in which Kratos, any Guarantor or any Integral Entity is engaged; and (v) none of Kratos, any Guarantor or, upon consummation of the Acquisition, any Integral Entity, is otherwise insolvent under the standards set forth in Applicable Laws.

(mm) *No Price Stabilization or Manipulation.* Neither Kratos nor any of its Affiliates has and, to Kratos' knowledge, after due inquiry, no one acting on its behalf has, (i) taken, directly or indirectly, any action designed to cause or to result in, or that has constituted or which might reasonably be expected to constitute, the stabilization or manipulation of the price of any security of Kratos, whether to facilitate the sale or resale of any of the Securities or otherwise, (ii) sold, bid for, purchased, or paid anyone any compensation for soliciting purchases of, any of the Securities, or (iii) except as disclosed in the Time of Sale Document and the Final Offering Memorandum, paid or agreed to pay to any person any compensation for soliciting another to purchase any other securities of Kratos.

(nn) *No Registration Required Under the Securities Act or Qualification Under the TIA.* Without limiting any provision herein, no registration under the Securities Act and no qualification of the Indenture under the TIA is required for the offer or sale of the Securities to the Initial Purchasers as contemplated hereby or for the Exempt Resales, assuming (i) that the purchasers in the Exempt Resales are QIBs or are not "U.S. persons" (as defined under Regulation S of the Securities Act) and (ii) the accuracy of each Initial Purchaser's representations contained herein regarding the absence of general solicitation in connection with the sale of the Securities to the Initial Purchasers and in the Exempt Resales.

(oo) *No Integration.* The Securities will be, upon issuance, eligible for resale pursuant to Rule 144A under the Securities Act and no other securities of Kratos are of the same class (within the meaning of Rule 144A under the Securities Act) as the Securities and listed on a national securities exchange registered under Section 6 of the Exchange Act, or quoted in a U.S. automated inter-dealer quotation system. Except as disclosed in the Time of Sale Document and Final Offering Memorandum, no securities of Kratos of the same class as the Securities have been offered, issued or sold by Kratos or any of its Affiliates within the six-month period immediately prior to the date hereof; and Kratos does not have any intention of making, and will not make, an offer or sale of such

securities of Kratos of the same class as the Securities, for a period of six months after the date of this Agreement, except for (i) the offering of the Securities as contemplated by this Agreement or the Registration Rights Agreement and (ii) the ongoing exchange offer with respect to the $285.0 million in aggregate principal amount of Kratos' Existing Notes pursuant to the prospectus, dated June 30, 2011, filed with the SEC. As used in this paragraph, the terms "offer" and "sale" have the meanings specified in Section 2(a)(3) of the Securities Act.

(pp) *No Directed Selling Efforts.* None of Kratos, any of its Affiliates or other person acting on behalf of Kratos has, with respect to Securities sold outside the United States, offered the Securities to buyers qualifying as "U.S. persons" (as defined in Rule 902 under the Securities Act) or engaged in any directed selling efforts within the meaning of Rule 902 under the Securities Act; each of Kratos, Affiliates of Kratos and any persons acting on behalf of Kratos has complied with and will implement the "offering restrictions" within the meaning of such Rule 902; and neither Kratos nor any of its Affiliates has entered or will enter into any arrangement or agreement with respect to the distribution of the Securities, except for this Agreement; provided that no representation is made in this paragraph with respect to the actions of the Initial Purchasers.

(qq) *No Applicable Registration or Other Similar Rights.* There are no persons with registration or other similar rights to have any equity or debt securities of Kratos or any "Affiliate" registered for sale under a registration statement, except for rights (i) contained in the Registration Rights Agreement, (ii) contained in the Registration Rights Agreement, dated March 25, 2011, among, inter alios, Kratos, Acquisition Co. Lanza Parent, Jefferies and the other parties named therein or (iii) as have been duly waived.

(rr) *Margin Requirements.* None of the Transactions or the application of the proceeds of the Securities will violate or result in a violation of Section 7 of the Exchange Act (including, without limitation, Regulation T (12 C.F.R. Part 220), Regulation U (12 C.F.R. Part 221) or Regulation X (12 C.F.R. Part 224) of the Board of Governors of the Federal Reserve System).

(ss) *Investment Company Act.* Kratos has been advised of the Investment Company Act of 1940, as amended, and the rules and regulations of the SEC thereunder (collectively, the "Investment Company Act"); as of the date hereof and, after giving effect to the Offering and the use of proceeds of the Offering, none of Integral, Kratos and its Subsidiaries is or will be, individually or on a consolidated basis, an "investment company" that is required to be registered under the Investment Company Act; and following the Closing Date, each of Integral, Kratos and its Subsidiaries will conduct its business in a manner so as not to be required to register under the Investment Company Act.

(tt) *No Brokers.* Neither Kratos nor any of its Affiliates has engaged any broker, finder, commission agent or other person (other than the Initial Purchasers or their affiliates) in connection with the Offering or any of the Transactions, and neither Kratos nor any of its Affiliates is under any obligation to pay any broker's fee or commission in connection with such Transactions (other than commissions or fees to the Initial Purchasers or their affiliates).

(uu) *No Restrictions on Payments of Dividends.* As of the Closing Date, except as otherwise disclosed in the Time of Sale Document and the Final Offering Memorandum, there will be no encumbrances or restrictions on the ability of any Subsidiary of Kratos or, upon the consummation of the Acquisition, any Integral Entity (x) to pay dividends or make other distributions on the capital stock of such Subsidiary or Integral Entity, as applicable, or to pay any indebtedness to Kratos, any other Subsidiary of Kratos or any other Integral Entity, (y) to make loans or advances or pay any indebtedness to, or investments in, Kratos, any other Subsidiary or any other Integral Entity or (z) to transfer any of its property or assets to Kratos, any other Subsidiary of Kratos or any Integral Entity.

(vv) *Sarbanes-Oxley.* There is and has been no failure on the part of Kratos and its Subsidiaries or any of the officers and directors of Kratos or any of its Subsidiaries, in their capacities as such, to comply with the applicable provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated in connection therewith.

(ww) *Foreign Corrupt Practices Act.* None of Kratos, any of its Subsidiaries or any Integral Entity or any director, officer, employee or, to the knowledge of Kratos or any of its Subsidiaries, any agent or other person acting on behalf of Kratos, any of its Subsidiaries or any Integral Entity has, in the course of its actions for, or on behalf of, Kratos, any of its Subsidiaries or any Integral Entity (i) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity; (ii) made any direct or indirect unlawful payment to any domestic government official, "foreign official" (as defined in the U.S. Foreign Corrupt Practices Act of 1977, as amended, and the rules and regulations thereunder (collectively, the "FCPA") or employee from corporate funds; (iii) violated or is in violation of any provision of the FCPA or any applicable non-U.S. anti-bribery statute or regulation; or (iv) made any unlawful bribe, rebate, payoff, influence payment, kickback or other unlawful payment to any domestic government official, such foreign official or employee.

(xx) *Money Laundering.* The operations of Kratos, its Subsidiaries and Integral are and have been conducted at all times in compliance with applicable financial recordkeeping and reporting requirements of the Currency and Foreign Transactions Reporting Act of 1970, as amended, the money laundering statutes of all applicable jurisdictions, the rules and regulations thereunder and any related or similar rules, regulations or guidelines issued, administered or enforced by any governmental agency (collectively, the "Money Laundering Laws"), and no action, suit or proceeding by or before any court or governmental agency, authority or body or any arbitrator involving Kratos, any of its Subsidiaries or any Integral Entity with respect to the Money Laundering Laws is pending or, to Kratos' knowledge, after due inquiry, threatened.

(yy) *OFAC.* None of Kratos, any of its Subsidiaries or, to Kratos' knowledge, after due inquiry, any Integral Entity or any director, officer, agent, employee or Affiliate of Kratos or any of its Subsidiaries or other person acting on their behalf is currently subject to any U.S. sanctions administered by the Office of Foreign Assets Control of the U.S. Treasury Department ("OFAC"); and Kratos will not directly or indirectly use the proceeds of the Offering, or lend, contribute or otherwise make available such proceeds to any

subsidiary, joint venture partner or other person or entity, for the purpose of financing the activities of any person currently subject to any U.S. sanctions administered by OFAC.

(zz) *Stamp Taxes.* There are no stamp or other issuance or transfer taxes or duties or other similar fees or charges required to be paid in connection with the execution and delivery of this Agreement or the issuance or sale of the Securities.

(aaa) *Indebtedness to be Refinanced.* Set forth on Schedule IV hereto is a list of all Indebtedness that is to be paid in full using the proceeds of the Offering and terminated, retired or redeemed, as applicable, on the Closing Date. Set forth on Schedule IV opposite the description of each such Indebtedness is the aggregate principal amount of Indebtedness outstanding thereunder.

(bbb) *Financial Services and Market Act.* Kratos has not taken or omitted to take any action and will not take any action or omit to take any action (such as issuing any press release or making any other public announcement referring to the Offering without an appropriate stabilization legend) which may result in the loss by the Initial Purchasers of the ability to rely on any stabilization safe harbour provided by the Financial Services Authority of the United Kingdom under the Financial Services and Markets Act 2000 (the "FSMA"); provided, however, that an appropriate stabilization legend was not in the Preliminary Offering Memorandum or the Pricing Term Sheet. Kratos has been informed of the guidance relating to stabilization provided by the Financial Services Authority of the United Kingdom, in particular the guidance contained in Section MAR 2 of the Financial Services Handbook.

(ccc) *Merger Agreement.* The Merger Agreement has been duly authorized, executed and delivered by Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC and Integral Systems, Inc., and constitutes a valid and legally binding agreement of Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC and Integral Systems, Inc. enforceable in accordance with its terms, except that the enforcement thereof may be subject to (i) bankruptcy, insolvency, reorganization, receivership, moratorium, fraudulent conveyance, fraudulent transfer or other similar laws now or hereafter in effect relating to creditors' rights generally and (ii) general principles of equity (whether applied by a court of law or equity) and the discretion of the court before which any proceeding therefor may be brought. Compliance by Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC and Integral Systems, Inc. with their respective obligations under the Merger Agreement does not conflict with or constitute a breach of, or default under, or result in the creation or imposition of any lien, charge or encumbrance upon any property or assets of Kratos or any of its Subsidiaries pursuant to, any contract, indenture, mortgage, loan agreement, note, lease or other instrument to which Kratos is a party or by which they may be bound or to which any of the property or assets of Kratos or any of its Subsidiaries is subject, except for any such conflict, breach, default, creation or imposition that would not have a Material Adverse Effect, nor will such action result in any violation of the provisions of the charter or bylaws of Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC or Integral Systems, Inc., or any law, administrative regulation or administrative or court order or decree. No consent, approval, authorization or order of any court or governmental authority or agency is required for the

consummation by Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC or Integral Systems, Inc. of the transactions contemplated by the Merger Agreement, except such as has been obtained or is contemplated by the Merger Agreement. Statements included or incorporated by reference in the Time of Sale Document and the Offering Memorandum relating to the Merger Agreement and the transactions contemplated thereby are correct in all material respects. None of Kratos, IRIS Merger Sub Inc., IRIS Acquisition Sub LLC or Integral Systems, Inc. is in default under the Merger Agreement. The representations and warranties contained in the Merger Agreement relating to Kratos, IRIS Merger Sub Inc. and IRIS Acquisition Sub LLC are true and correct in all material respects, other than those representations and warranties relating to Kratos that are already qualified by materiality, which are true and correct. To the knowledge of Kratos, the representations and warranties contained in the Merger Agreement relating to Integral Systems, Inc. are true and correct in all material respects, other than those representations and warranties relating to Integral Systems, Inc. that are already qualified by materiality, which are true and correct.

(ddd) *Certificates*. Each certificate signed by any officer of Kratos or any of its Subsidiaries, delivered to the Initial Purchasers shall be deemed a representation and warranty by Kratos or any such Subsidiary (and not individually by such officer) to the Initial Purchasers with respect to the matters covered thereby.

(eee) *CFO Certification*. The Chief Financial Officer of Kratos or members of her staff who are responsible for the the financial accounting matters of Kratos and the Guarantors have carried out procedures designed to provide reasonable assurance as to the accuracy of the data included in the attached Appendix 1, which is included in the Time of Sale Document and the Final Offering Memorandum. To the best of Kratos' knowledge and belief, such data is true and correct in all material respects.

5. **Covenants of Kratos and the Guarantors**. Each of Kratos and the Guarantors, jointly and severally, agrees:

(a) *Securities Law Compliance*. To (i) advise the Initial Purchasers promptly after obtaining knowledge (and, if requested by the Initial Purchasers, confirm such advice in writing) of (A) the issuance by any U.S. or non-U.S. federal or state securities commission of any stop order suspending the qualification or exemption from qualification of any of the Securities for offer or sale in any jurisdiction, or the initiation of any proceeding for such purpose by any U.S. or non-U.S. federal or state securities commission or other regulatory authority, or (B) the happening of any event that makes any statement of a material fact made in the Time of Sale Document, any Company Additional Written Communication or the Final Offering Memorandum, untrue or that requires the making of any additions to or changes in the Time of Sale Document, any Company Additional Written Communication, or the Final Offering Memorandum, to make the statements therein, in the light of the circumstances under which they were made, not misleading, (ii) use its reasonable best efforts to prevent the issuance of any stop order or order suspending the qualification or exemption from qualification of any of the Securities under any securities or "Blue Sky" laws of U.S. state or non-U.S. jurisdictions and (iii) if, at any time, any U.S. or non-U.S. federal or state securities commission or other

regulatory authority shall issue an order suspending the qualification or exemption from qualification of any of the Securities under any such laws, use its reasonable best efforts to obtain the withdrawal or lifting of such order at the earliest possible time.

(b) *Offering Documents*. To (i) furnish the Initial Purchasers, without charge, as many copies of the Time of Sale Document and the Final Offering Memorandum, and any amendments or supplements thereto, as the Initial Purchasers may reasonably request, and (ii) promptly prepare, upon the Initial Purchasers' reasonable request, any amendment or supplement to the Time of Sale Document or Final Offering Memorandum that the Initial Purchasers, upon advice of legal counsel, determines may be necessary in connection with Exempt Resales (and Kratos and the Guarantors hereby consent to the use of the Time of Sale Document and the Final Offering Memorandum, and any amendments and supplements thereto, by the Initial Purchasers in connection with Exempt Resales).

(c) *Consent to Amendments and Supplements*. Not to amend or supplement the Time of Sale Document or the Final Offering Memorandum prior to the Closing Date, or at any time prior to the completion of the resale by the Initial Purchasers of all the Securities purchased by the Initial Purchasers, unless the Initial Purchasers shall previously have been advised thereof and shall have provided its written consent thereto. Before making, preparing, using, authorizing, approving or referring to any Company Additional Written Communications, Kratos will furnish to the Initial Purchasers and counsel for the Initial Purchasers a copy of such written communication for review and will not make, prepare, use, authorize, approve or refer to any such written communication to which the Initial Purchasers reasonably objects. Kratos and the Guarantors consent to the use by the Initial Purchasers of a Company Additional Written Communication that contains (A) information describing the preliminary terms of the Securities or their offering or (B) information that describes the final terms of the Securities or their offering and that is included in or is subsequently included in the Final Offering Memorandum, including by means of the Pricing Supplement.

(d) *Preparation of Amendments and Supplements to Offering Documents*. So long as the Initial Purchasers shall hold any of the Securities, (i) if any event shall occur as a result of which, in the reasonable judgment of Kratos or the Initial Purchasers, it becomes necessary or advisable to amend or supplement the Time of Sale Document or the Final Offering Memorandum to correct any untrue statement of a material fact or omission to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, or if it is necessary to amend or supplement the Time of Sale Document or the Final Offering Memorandum to comply with any Applicable Law, to prepare, at the expense of Kratos, an appropriate amendment or supplement to the Time of Sale Document and the Final Offering Memorandum (in form and substance reasonably satisfactory to the Initial Purchasers) so that (A) as so amended or supplemented, the Time of Sale Document and the Final Offering Memorandum will not include an untrue statement of material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, and (B) the Time of Sale Document and the Final Offering Memorandum will comply with Applicable Law and (ii) if in the

reasonable judgment of Kratos it becomes necessary or advisable to amend or supplement the Time of Sale Document or the Final Offering Memorandum so that the Time of Sale Document and the Final Offering Memorandum will contain all of the information specified in, and meet the requirements of, Rule 144A(d)(4) of the Securities Act, to prepare an appropriate amendment or supplement to the Time of Sale Document or the Final Offering Memorandum (in form and substance reasonably satisfactory to the Initial Purchasers) so that the Time of Sale Document or the Final Offering Memorandum, as so amended or supplemented, will contain the information specified in, and meet the requirements of, such Rule.

(e) *"Blue Sky" Law Compliance*. To cooperate with the Initial Purchasers and the Initial Purchasers' counsel in connection with the qualification of the Securities under the securities or "Blue Sky" laws of U.S. state or non-U.S. jurisdictions as the Initial Purchasers may request and continue such qualification in effect so long as reasonably required for Exempt Resales. Kratos will advise the Initial Purchasers promptly of the suspension of any such exemption relating to the Securities for offering, sale or trading in any jurisdiction or any initiation or threat of any proceeding for any such purpose, and in the event of the issuance of any order suspending such exemption, Kratos shall use its best efforts to obtain the withdrawal thereof at the earliest possible moment.

(f) *Payment of Expenses*. Whether or not any of the Offering or the Transactions are consummated or this Agreement is terminated, to pay (i) all costs, expenses, fees and taxes incident to and in connection with: (A) the preparation, printing and distribution of the Time of Sale Document and the Final Offering Memorandum and all amendments and supplements thereto (including, without limitation, financial statements and exhibits), and all other agreements, memoranda, correspondence and other documents prepared and delivered in connection herewith, (B) the negotiation, printing, processing and distribution (including, without limitation, word processing and duplication costs) and delivery of, each of the Documents, (C) the preparation, issuance and delivery of the Securities, (D) the qualification of the Securities for offer and sale under the securities or "Blue Sky" laws of U.S. state or non-U.S. jurisdictions (including, without limitation, the reasonable fees and disbursements of the Initial Purchasers' counsel relating to such registration or qualification), (E) furnishing such copies of the Time of Sale Document and the Final Offering Memorandum, and all amendments and supplements thereto, as may reasonably be requested for use by the Initial Purchasers and (F) the performance of the obligations of Kratos and the Guarantors under the Registration Rights Agreement, including but not limited to the Exchange Offer, the Exchange Offer Registration Statement and any Shelf Registration Statement, (ii) all fees and expenses of the counsel, accountants and any other experts or advisors retained by Kratos or the Guarantors, (iii) all fees and expenses (including fees and expenses of counsel) of Kratos or the Guarantors in connection with approval of the Securities by DTC for "book-entry" transfer, (iv) all fees charged by rating agencies in connection with the rating of the Securities, (v) all fees and expenses (including reasonable fees and expenses of counsel) of the Trustee and all collateral agents, (vi) all costs and expenses in connection with the creation and perfection of the security interest to be created and perfected pursuant to the Collateral Agreements (including without limitation, filing and recording fees, search fees, taxes and costs of title policies) and (vii) all out-of-pocket expenses (including (i) up

to $200,000 of fees, disbursements and other expenses of White & Case LLP, which limitation is an aggregate cap for all such fees, disbursements and other expenses of White & Case LLP and (ii) the fees and expenses of any other independent experts retained by Jefferies) reasonably incurred by the Initial Purchasers and their designated affiliates, travel and lodging expenses, chartering of airplanes, roadshow or investor presentation expenses, word processing charges, the costs of printing or producing any investor presentation materials, messenger and duplicating service expenses, facsimile expenses and other customary expenditures.

(g) *Use of Proceeds*. To use the proceeds of the Offering in the manner described in the Time of Sale Document and the Final Offering Memorandum under the caption "Use of Proceeds."

(h) *Transaction Documents*. To do and perform all things required to be done and performed under the Documents prior to and after the Closing Date.

(i) *Integration*. Not to, and to ensure that no Affiliate of Kratos will, sell, offer for sale or solicit offers to buy or otherwise negotiate in respect of any "security" (as defined in the Securities Act) that would be integrated with the sale of the Securities in a manner that would require the registration under the Securities Act of the sale to the Initial Purchasers or to the Subsequent Purchasers of the Securities.

(j) *Stabilization or Manipulation*. Not to take, directly or indirectly, any action designed to or that might be reasonably expected to cause or result in stabilization or manipulation of the price of the Securities or any other reference security, whether to facilitate the sale or resale of the Securities or otherwise.

(k) *DTC*. To comply with the representation letter of Kratos to DTC relating to the approval of the Securities by DTC for "book-entry" transfer.

(l) *Rule 144(A) Information*. For so long as any of the Securities remain outstanding, during any period in which Kratos is not subject to Section 13 or 15(d) of the Exchange Act, to make available, upon request, to any owner of the Securities in connection with any sale thereof and any prospective Subsequent Purchasers of such Securities from such owner, the information required by Rule 144A(d)(4) under the Securities Act.

(m) *Furnish Trustee and Noteholder Reports*. For so long as any of the Securities remain outstanding, to furnish to the Initial Purchasers copies of all reports and other communications (financial or otherwise) furnished by Kratos to the Trustee or to the holders of the Securities and, as soon as available, copies of any reports or financial statements furnished to or filed by Kratos with the SEC or any national securities exchange on which any class of securities of Kratos may be listed.

(n) *Additional Offering Materials*. Except in connection with the Exchange Offer or the filing of the Shelf Registration Statement, not to, and not to authorize or permit any person acting on its behalf to, (i) distribute any offering material in connection with the offer and sale of the Securities other than the Time of Sale Document and the Final Offering Memorandum and any amendments and supplements to the Preliminary

Offering Memorandum or the Final Offering Memorandum prepared in compliance with this Agreement, (ii) solicit any offer to buy or offer to sell the Securities by means of any form of general solicitation or general advertising (including, without limitation, as such terms are used in Regulation D under the Securities Act) or in any manner involving a public offering within the meaning of Section 4(2) of the Securities Act, or (iii) engage in any directed selling efforts within the meaning of Regulation S, and all such persons will comply with the offering restrictions requirement of Regulation S.

(o) *Sale of Restricted Securities*. During the one year period after the Closing Date (or such shorter period as may be provided for in Rule 144 under the Securities Act, as the same may be in effect from time to time), to not, and to not permit any current or future Subsidiaries of either Kratos or any other Affiliates controlled by Kratos to, resell any of the Securities which constitute "restricted securities" under Rule 144 that have been reacquired by Kratos, any current or future Subsidiaries or any other Affiliates controlled by Kratos, except pursuant to an effective registration statement under the Securities Act.

(p) *Stamp Taxes*. To pay all stamp or other issuance or transfer taxes or duties other similar fees or charges which may be imposed by any governmental or regulatory authority in connection with the execution and delivery of this Agreement or the issuance or sale of the Securities.

(q) *Security Interests.* To complete on or prior to the Closing Date all filings and other similar actions required in connection with the perfection of security interests as and to the extent contemplated by the Collateral Agreements.

(r) *Good Standings.* To deliver to the Initial Purchasers on the date hereof satisfactory evidence of the good standing of Kratos and its Subsidiaries in their respective jurisdictions of organization and the good standing of Kratos and its Subsidiaries in such other jurisdictions as the Initial Purchasers may reasonably request and, on the Closing Date, "bring down" evidence of the same, in each case in writing or any standard form of telecommunication, from the appropriate governmental authorities of such jurisdictions.

(s) *Investment Company.* Each of Kratos and its Subsidiaries will conduct its business in a manner so as to not be required to register under the Investment Company Act.

(t) *Integral as Guarantor.* Kratos shall cause IRIS Merger Sub Inc. and IRIS Acquisition Sub LLC to consummate the Acquisition in accordance with the Merger Agreement. Concurrently with the consummation of the Acquisition, Kratos shall cause each Integral Entity that will not be a Foreign

Subsidiary of the Company to (a) become a party to each of this Agreement and the Registration Rights Agreement as a Guarantor by executing and delivering a joinder agreement in the form of Exhibit B hereto to the Initial Purchasers and (ii) become a Guarantor under the Indenture.

6. **Representations and Warranties of the Initial Purchasers.** Each Initial Purchaser, severally and not jointly, represents and warrants to Kratos that:

(a) *Initial Purchaser Status, Resale Terms*. It is a QIB and it will offer the Securities for resale only upon the terms and conditions set forth in this Agreement and in the Time of Sale Document and the Final Offering Memorandum.

(b) *Sale of Restricted Exchange Securities*. It will solicit offers to buy the Securities only from, and will offer and sell the Securities only to, persons reasonably believed by the Initial Purchaser (A) to be QIBs or (B) to not be "U.S. persons" (as defined under Regulation S under the Securities Act) and in compliance with laws applicable to such persons in jurisdictions outside of the United States; provided, however, that in purchasing such Securities, such persons are deemed to have represented and agreed as provided under the caption "Notice to Investors" contained in the Time of Sale Document and the Final Offering Memorandum.

(c) *General Solicitation*. No form of general solicitation or general advertising in violation of the Securities Act has been or will be used nor will any offers in any manner involving a public offering within the meaning of Section 4(2) of the Securities Act or, with respect to Securities to be sold in reliance on Regulation S, by means of any directed selling efforts be made by such Initial Purchaser or any of its representatives in connection with the offer and sale of any of the Securities.

7. **Conditions**. The obligations of the Initial Purchasers to purchase the Securities under this Agreement are subject to the performance by each of Kratos and the Guarantors of their respective covenants and obligations hereunder and the satisfaction of each of the following conditions:

(a) *Representations, Warranties and Agreements*. All the representations and warranties of Kratos and the Guarantors contained in this Agreement and in each of the other Documents shall be true and correct as of the date hereof and at the Closing Date. On or prior to the Closing Date, Kratos and each other party to the Documents (other than the Initial Purchasers) shall have performed or complied with all of the agreements and satisfied all conditions on their respective parts to be performed, complied with or satisfied pursuant to the Documents (other than conditions to be satisfied by such other parties, which the failure to so satisfy would not, individually or in the aggregate, have a Material Adverse Effect). It is understood and agreed that, for purposes of this Agreement, in the event that the Initial Purchasers determine that a Material Adverse Effect or a Material Adverse Change has occurred and Kratos or a Guarantor seeks to dispute such determination, Kratos or such Guarantor shall bear the burden of proof to demonstrate by clear and convincing evidence that a Material Adverse Effect or a Material Adverse Change, as applicable, has not occurred.

(b) *Closing Deliverables.* The Initial Purchasers shall have received on the Closing Date:

(i) *Officers' Certificate.* Certificates dated the Closing Date, signed by (1) the Chief Executive Officer and (2) the principal financial or accounting officer of Kratos

and the Guarantors, on behalf of Kratos and the Guarantors, to the effect that (a) the representations and warranties set forth in Section 4 hereof, in each of the Documents and the Perfection Certificate are true and correct in all material respects with the same force and effect as though expressly made at and as of the Closing Date, (b) Kratos and the Guarantors have performed and complied with all agreements and satisfied all conditions in all material respects on its part to be performed or satisfied at or prior to the Closing Date, (c) at the Closing Date, since the date hereof or since the date of the most recent financial statements in the Time of Sale Document and the Final Offering Memorandum (exclusive of any amendment or supplement thereto after the date hereof), no event or events have occurred, no information has become known nor does any condition exist that, individually or in the aggregate, would have a Material Adverse Effect, (d) since the date of the most recent financial statements in the Time of Sale Document and the Final Offering Memorandum (exclusive of any amendment or supplement thereto after the date hereof), other than as described in the Time of Sale Document and the Final Offering Memorandum or contemplated hereby, neither Kratos, the Guarantors nor any other Subsidiary has incurred any liabilities or obligations, direct or contingent, not in the ordinary course of business, that are material to Kratos and its Subsidiaries, taken as a whole, or entered into any transactions not in the ordinary course of business that are material to the business, condition (financial or otherwise) or results of operations or prospects of Kratos and its Subsidiaries, taken as a whole, and there has not been any change in the capital stock or long-term indebtedness of Kratos, the Guarantors or any other Subsidiary of Kratos that is material to the business, condition (financial or otherwise) or results of operations or prospects of Kratos and its Subsidiaries, taken as a whole, and (e) the sale of the Securities has not been enjoined (temporarily or permanently).

(ii) *Secretary's Certificate.* A certificate, dated the Closing Date, executed by the Secretary of Kratos and each Guarantor, certifying such matters as the Initial Purchasers may reasonably request.

(iii) *Good Standing Certificates.* A certificate evidencing qualification by such entity as a foreign corporation in good standing issued by the Secretaries of State (or comparable office) of each of the jurisdictions in which each of Kratos and its Subsidiaries operates as of a date within five days prior to the Closing Date.

(iv) *Solvency Certificate.* A certificate of solvency, dated the Closing Date, executed by the chief financial officer of Kratos in the form of Exhibit C attached hereto.

(v) *Company Counsel Opinion.* The opinion of Paul, Hastings, Janofsky & Walker LLP, counsel to Kratos and the Guarantors, dated the Closing Date, in the form of Exhibit D attached hereto.

(vi) *Opinion of Sheppard Mullin Richter & Hampton LLP*. The opinion of Sheppard Mullin Richter & Hampton LLP, counsel to Kratos and the Guarantors, regarding

security interests and collateral matters, dated the Closing Date, in the form of Exhibit E attached hereto.

(vii) *Local Counsel Opinions.* Each of the local counsel to Kratos and the Guarantors listed on Schedule V hereto or otherwise agreed upon by the Initial Purchasers shall have furnished to the Initial Purchasers, at the request of Kratos, its written opinion, addressed to the Initial Purchasers and dated the Closing Date, in form and substance reasonably satisfactory to the Initial Purchasers.

(viii) *Initial Purchaser Counsel Opinion.* An opinion, dated the Closing Date, of White & Case LLP, counsel to the Initial Purchasers, in form satisfactory to the Initial Purchasers covering such matters as are customarily covered in such opinions.

(ix) *Comfort Letters.* The Initial Purchasers shall have received from each of Grant Thornton LLP, the registered public or certified public accountants of each of Kratos and Herley, from KPMG, LLP, the registered public or certified public accountants of Integral, from Marcum LLP, the registered public or certified public accountants of Herley Industries, Inc. for the years ended August 3, 2008 and August 2, 2009, from EisnerAmper LLP, the registered public or certified public accountants of Henry Bros. and from Brightman Almagor Zohar & Co., a member firm of Deloitte Touche Tohmatsu, the registered public or certified public accountants of General Microwave, (A) a customary initial comfort letter delivered according to Statement of Auditing Standards No. 72 (or any successor bulletin) or Statement of Auditing Standards No. 100 (or any successor bulletin), as applicable, dated the date hereof, in form and substance reasonably satisfactory to the Initial Purchasers and their counsel, with respect to the financial statements and certain financial information contained in the Time of Sale Document and the Final Offering Memorandum, and (B) a customary "bring-down" comfort letter, dated the Closing Date, in form and substance reasonably satisfactory to the Initial Purchasers and their counsel, which includes, among other things, a reaffirmation of the statements made in the initial letter furnished pursuant to clause (A) with respect to such financial statements and financial information contained in the Time of Sale Document and the Final Offering Memorandum.

(c) *Executed Documents.* The Initial Purchasers shall have received fully executed originals of each Document (each of which shall be in full force and effect on terms reasonably satisfactory to the Initial Purchasers), and each opinion, certificate, letter and other document to be delivered in connection with the Offering or any other Transaction.

(d) *Collateral.*

(A) The Collateral Agent shall have received on the Closing Date the following, in the form and substance reasonably satisfactory to the Initial Purchasers, but only to the extent not previously delivered:

(i) appropriately completed copies of Uniform Commercial Code financing statements naming Kratos and each Guarantor as a debtor and the

Collateral Agent as the secured party, or other similar instruments or documents to be filed under the Uniform Commercial Code of all jurisdictions as may be necessary or, in the reasonable opinion of the Collateral Agent and its counsel, desirable to perfect the security interests of the Collateral Agent pursuant to the Collateral Agreements;

(ii) appropriately completed copies of Uniform Commercial Code Form UCC- 3 termination statements, if any, necessary to release all Liens (other than Permitted Liens) of any person in any collateral described in any Collateral Agreement previously granted by any person;

(iii) certified copies of Uniform Commercial Code Requests for Information or Copies (Form UCC 11), or a similar search report certified by a party acceptable to the Collateral Agent, dated a date reasonably near to the Closing Date, listing all effective financing statements which name Kratos or any Guarantor (under its present name and any previous names) as the debtor, together with copies of such financing statements (none of which shall cover any collateral described in any Collateral Agreement, other than such financing statements that evidence Permitted Liens);

(iv) such other approvals, opinions, or documents as the Collateral Agent may reasonably request in form and substance reasonably satisfactory to the Collateral Agent;

(B) The Collateral Agent and its counsel shall be satisfied that (a) the Lien granted to the Collateral Agent, for the benefit of the Secured Parties in the collateral described above is of the priority described in the Time of Sale Document and the Final Offering Memorandum and (b) no Lien exists on any of the collateral described above, other than the Lien created in favor of the Collateral Agent, for the benefit of the Secured Parties pursuant to a Collateral Agreement in each case subject to the Permitted Liens;

(C) All Uniform Commercial Code financing statements or other similar financing statements and Uniform Commercial Code Form UCC-3 termination statements required pursuant to clause (d)(A)(i) and (d)(A)(ii) above (collectively, the "UCC Statements") shall have been delivered to CT Corporation System or another similar filing service company acceptable to the Collateral Agent (the "Filing Agent"). The Filing Agent shall have acknowledged in a writing that is reasonably satisfactory to the Collateral Agent and its counsel (i) the Filing Agent's receipt of all UCC Statements, (ii) that the UCC Statements have either been submitted for filing in the appropriate filing offices or will be submitted for filing in the appropriate offices within ten days following the Closing Date and (iii) that the Filing Agent will notify the Collateral Agent and its counsel of the results of such submissions within 30 days following the Closing Date.

(e) *Refinancing.* The Initial Purchasers shall have received substantially contemporaneously with the Closing Date a copy of an executed payoff letter from each of the institutions listed on Schedule IV attached hereto. Immediately following such payoffs, the only

indebtedness of Integral outstanding shall be existing capitalized leases in an amount not exceeding $8.0 million.

(f) *Merger*. The closing conditions to the consummation of the Acquisition shall have been satisfied pursuant to the terms of the Merger Agreement (with no provision thereof having been waived, amended, supplemented or otherwise modified in a manner which could reasonably be expected to be materially adverse to the rights or interests of Kratos or any holder of the Notes without the consent from the holders of at least a majority in aggregate principal amount thereof).

(g) *Acquiror Shares*. In connection with the payment of the Merger Consideration (as defined in the Merger Agreement), Kratos shall have duly authorized and issued Parent Shares (as defined in the Merger Agreement) in an amount sufficient to satisfy all of Kratos' obligations under the Merger Agreement with respect to the conversion of the Company Shares (as defined in the Merger Agreement) into Parent Shares in accordance with the Merger Agreement as part of the Merger Consideration.

(h) *Credit Facility*. The amendment and restatement of the credit agreement governing the Credit Facility shall have been executed and delivered by all parties thereto and the Initial Purchasers shall have received a copy of such fully executed amended and restated credit agreement.

(i) *Sufficient Consideration*. The gross proceeds from the issuance of the Notes shall, together with the Equity Consideration, the existing unrestricted cash balances of Kratos, and if applicable, the proceeds of any revolving loans made under the Credit Agreement, be sufficient to pay the purchase price for the Acquisition, the Refinancing and the Severance Payments and all related fees, commissions and expenses related to the Transactions, the Acquisition, the Refinancing, the Equity Issuance and the Severance Payments.

(j) *Minimum Liquidity*. Immediately following consummation of the issuance of the Notes, the Acquisition, the Refinancing, the Equity Issuance, the Severance Payments and the payment of all related fees, commissions and expenses in connection therewith, the sum of (x) the aggregate amount of revolving loans that shall be available to be drawn under a the Credit Agreement and (y) the aggregate amount of unrestricted cash on hand of the Kratos and its Restricted Subsidiaries (as defined in the Indenture) shall not be less than $35.0 million.

(k) *Additional Parties.* Each Integral Entity that will not be a Foreign Subsidiary of the Company shall have executed the joinder agreement to this Agreement and delivered copies of each such executed documents to the Initial Purchasers.

(l) *No Material Adverse Change*. Subsequent to the respective dates as of which information is given in the Time of Sale Document (exclusive of any amendment or supplement thereto), there shall not have been any Material Adverse Change that could, in the sole judgment of Jefferies be expected to (i) make it impracticable or inadvisable to proceed with the offering, sale or delivery of the Securities on the terms and in the

manner contemplated by this Agreement, the Time of Sale Document and the Final Offering Memorandum, or (ii) materially impair the investment quality of any of the Securities.

(m) *No Hostilities.* Any outbreak or escalation of hostilities or other national or international calamity or crisis, including acts of terrorism, or material adverse change or disruption in economic conditions in, or in the financial markets of, the United States (it being understood that any such change or disruption shall be relative to such conditions and markets as in effect on the date hereof), if the effect of such outbreak, escalation, calamity, crisis, act or material adverse change in the economic conditions in, or in the financial markets of, the United States could be reasonably expected to make it, in the sole judgment of Jefferies, impracticable or inadvisable to market or proceed with the offering or delivery of the Securities on the terms and in the manner contemplated in the Time of Sale Document and the Final Offering Memorandum or to enforce contracts for the sale of any of the Securities.

(n) *No Suspension in Trading; Banking Moratorium.* (i) Trading in Kratos' common stock shall have been suspended by the SEC or the NASDAQ Global Market or a suspension or limitation of trading generally in securities on the New York Stock Exchange, the American Stock Exchange or the NASDAQ Global Market or any setting of limitations on prices for securities occurs on any such exchange or market or (ii) the declaration of a banking moratorium by any Governmental Authority has occurred or the taking of any action by any Governmental Authority after the date hereof in respect of its monetary or fiscal affairs that, in the case of clause (i) or (ii) of this paragraph, in the sole judgment of Jefferies could reasonably be expected to have a material adverse effect on the financial markets in the United States or elsewhere.

(o) *Corporate Proceedings*. All corporate proceedings and other legal matters incident to the authorization, form and validity of the Documents and the Transactions and all other legal matters relating of the offering, issuance and sale of the Securities and the Transactions shall be reasonably satisfactory in all material respects to counsel to the Initial Purchasers; and Kratos shall have furnished to such counsel all documents and information that they may reasonably request to enable them to pass upon such matters.

(p) *No Material Applicable Laws or Proceedings.* (i) No Applicable Law shall have been enacted, adopted or issued and (ii) no stop order suspending the qualification or exemption from qualification of any of the Securities in any jurisdiction shall have been issued and no proceeding for that purpose shall have been commenced or, to Kratos' knowledge, after due inquiry, be pending or contemplated as of the Closing Date that, would, as of the date hereof and at the Closing Date, restrain, enjoin, prevent or interfere with the consummation of the Offering or any of the Transactions or would, individually or in the aggregate, have a Material Adverse Effect.

8. Indemnification and Contribution.

(a) *Indemnification by Kratos and the Guarantors.* Kratos and each of the Guarantors jointly and severally agree to indemnify and hold harmless each Initial Purchaser, its affiliates, directors, officers and employees, and each person, if any, who controls such Initial Purchaser within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, against any losses, claims, damages or liabilities of any kind to which such Initial Purchaser, affiliate, director, officer, employee or such controlling person may become subject under the Securities Act, the Exchange Act or other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the written consent of Kratos, insofar as any such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon:

(i) any untrue statement or alleged untrue statement of a material fact contained in the Time of Sale Document, any Company Additional Written Communication or the Final Offering Memorandum, or any amendment or supplement thereto; or

(ii) the omission or alleged omission to state, in the Time of Sale Document, any Company Additional Written Communication or the Final Offering Memorandum, or any amendment or supplement thereto, a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading;

and, subject to the provisions hereof, will reimburse, as incurred, such Initial Purchaser and its affiliates, directors, officers, employees and each such controlling persons for any legal or other expenses incurred by such person in connection with investigating, defending against, settling, compromising, paying or appearing as a third-party witness in connection with any such loss, claim, damage, liability, expense or action in respect thereof; provided, however, Kratos and the Guarantors will not be liable in any such case to the extent (but only to the extent) that a court of competent jurisdiction shall have determined by a final, unappealable judgment that such loss, claim, damage, liability or expense resulted solely from any untrue statement or alleged untrue statement or omission or alleged omission made in the Time of Sale Document, any Company Additional Written Communication or the Final Offering Memorandum or any amendment or supplement thereto in reliance upon and in conformity with written information concerning the Initial Purchasers furnished to Kratos by the Initial Purchasers specifically for use therein, it being understood and agreed that the only such information furnished by the Initial Purchasers to Kratos consists of the information set forth in Section 13. The indemnity agreement set forth in this Section shall be in addition to any liability that Kratos and the Guarantors may otherwise have to the indemnified parties.

(b) *Indemnification by the Initial Purchasers*. Each Initial Purchaser agrees severally and not jointly to indemnify and hold harmless each of Kratos, each of the Guarantors and their respective directors, officers and each person, if any, who controls Kratos within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act against any losses, claims, damages, liabilities or expenses to which Kratos, such Guarantors or any such director, officer or controlling person may become subject under the Securities Act, the Exchange Act or otherwise, insofar as a court of competent jurisdiction shall have determined by a final, unappealable judgment that such losses, claims, damages,

liabilities or expenses (or actions in respect thereof) have resulted solely from (i) any untrue statement or alleged untrue statement of any material fact contained in the Time of Sale Document or the Final Offering Memorandum or any amendment or supplement thereto or (ii) the omission or the alleged omission to state therein a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, in each case to the extent (but only to the extent) that such untrue statement or alleged untrue statement or omission or alleged omission was made in reliance upon and in conformity with written information concerning the Initial Purchasers furnished to Kratos by the Initial Purchasers specifically for use therein as set forth in Section 13; and, subject to the limitation set forth immediately preceding this clause, will reimburse, as incurred, any legal or other expenses incurred by Kratos, each of the Guarantors or any such director, officer or controlling person in connection with any such loss, claim, damage, liability, expense or action in respect thereof. The indemnity agreement set forth in this Section shall be in addition to any liability that the Initial Purchasers may otherwise have to the indemnified parties.

(c) *Notifications and Other Indemnification Procedures*. As promptly as reasonably practicable after receipt by an indemnified party under this Section of notice of the commencement of any action for which such indemnified party is entitled to indemnification under this Section, such indemnified party will, if a claim in respect thereof is to be made against the indemnifying party under this Section, notify the indemnifying party of the commencement thereof in writing; but the omission to so notify the indemnifying party (i) will not relieve such indemnifying party from any liability under Section 8(a) or (b) above unless and only to the extent it is materially prejudiced as a proximate result thereof and (ii) will not, in any event, relieve the indemnifying party from any obligations to any indemnified party other than the indemnification obligation provided in Section 8(a) and (b) above. In case any such action is brought against any indemnified party, and it notifies the indemnifying party of the commencement thereof, the indemnifying party will be entitled to participate therein and, to the extent that it may elect, jointly with any other indemnifying party similarly notified by written notice delivered to the indemnified party promptly after receiving the aforesaid notice from such indemnified party, to assume the defense thereof, with counsel reasonably satisfactory to such indemnified party; provided, however, that if (i) the use of counsel chosen by the indemnifying party to represent the indemnified party would present such counsel with a conflict of interest, (ii) the defendants in any such action include both the indemnified party and the indemnifying party, and the indemnified party shall have concluded that a conflict may arise between the positions of the indemnifying party and the indemnified party in conducting the defense of any such action or that there may be one or more legal defenses available to it and/or other indemnified parties that are different from or additional to those available to the indemnifying party, or (iii) the indemnifying party shall not have employed counsel reasonably satisfactory to the indemnified party to represent the indemnified party within a reasonable time after receipt by the indemnifying party of notice of the institution of such action, then, in each such case, the indemnifying party shall not have the right to direct the defense of such action on behalf of such indemnified party or parties and such indemnified party or parties shall have the right to select separate counsel to defend such action on behalf of such indemnified party or parties at the expense of the indemnifying party. After notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof and approval by such indemnified party of counsel appointed to defend such action, the indemnifying party will not be liable to such indemnified party under this Section for any legal or other expenses, other than reasonable costs of investigation, subsequently incurred by such indemnified party in connection with the defense thereof, unless (i) the indemnified party shall have employed separate counsel in accordance with the proviso to the immediately preceding sentence (it being understood, however, that in connection with such action the indemnifying party shall not be liable for the fees and expenses of more than one separate counsel (in addition to local counsel) in any one action or separate but substantially similar actions in the same jurisdiction arising out of the same general allegations or circumstances, designated by the Initial Purchasers in the case of Section 8(a) or Kratos in the case of Section 8(b), representing the indemnified parties under such Section 8(a) or (b), as the case may be, who are parties to such action or actions), (ii) the indemnifying party has authorized in writing the employment of counsel for the indemnified party at the expense of the indemnifying party or (iii) the indemnifying party shall not have employed counsel satisfactory to the indemnified party to represent the indemnified party within a reasonable time after notice of commencement of the action, in each of which cases the fees and expenses of counsel shall be at the expense of the indemnifying party and shall be paid as they are incurred. After such notice from the indemnifying party to such indemnified party, the indemnifying party will not be liable for the costs and expenses of any settlement of such action effected by such indemnified party without the prior written consent of the indemnifying party (which consent shall not be unreasonably withheld), unless such indemnified party waived in writing its rights under this Section, in which case the indemnified party may effect such a settlement without such consent.

(d) *Settlements*. No indemnifying party shall be liable under this Section for any settlement of any claim or action (or threatened claim or action) effected without its written consent, which shall not be unreasonably withheld, but if a claim or action settled with its written consent, or if there be a final judgment for the plaintiff with respect to any such claim or action, each indemnifying party jointly and severally agrees, subject to the exceptions and limitations set forth above, to indemnify and hold harmless each indemnified party from and against any and all losses, claims, damages or liabilities (and legal and other expenses as set forth above) incurred by reason of such settlement or judgment. No indemnifying party shall, without the prior written consent of the indemnified party (which consent shall not be unreasonably withheld), effect any settlement or compromise of any pending or threatened proceeding in respect of which the indemnified party is or could have been a party, or indemnity could have been sought hereunder by the indemnified party, unless such settlement (A) includes an unconditional written release of the indemnified party, in form and substance satisfactory to the indemnified party, from all liability on claims that are the subject matter of such proceeding and (B) does not include any statement as to an admission of fault, culpability or failure to act by or on behalf of the indemnified party.

(e) *Contribution*. In circumstances in which the indemnity agreements provided for in this Section is unavailable to, or insufficient to hold harmless, an indemnified party in respect of any losses, claims, damages, liabilities or expenses (or actions in respect thereof), each

indemnifying party, in order to provide for just and equitable contributions, shall contribute to the amount paid or payable by such indemnified party as a result of such losses, claims, damages, liabilities or expenses (or actions in respect thereof) in such proportion as is appropriate to reflect (i) the relative benefits received by the indemnifying party or parties, on the one hand, and the indemnified party, on the other hand, from the Offering or (ii) if the allocation provided by the foregoing clause (i) is not permitted by applicable law, not only such relative benefits but also the relative fault of the indemnifying party or parties, on the one hand, and the indemnified party, on the other hand, in connection with the statements or omissions or alleged statements or omissions that resulted in such losses, claims, damages or liabilities (or actions in respect thereof). The relative benefits received by Kratos and the Guarantors, on the one hand, and the Initial Purchasers, on the other hand, shall be deemed to be in the same proportion as the total proceeds from the Offering (before deducting expenses) received by Kratos bear to the total discounts and commissions received by the Initial Purchasers. The relative fault of the parties shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by Kratos and the Guarantors, on the one hand, or the Initial Purchasers pursuant to Section 8(b) above, on the other hand, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission or alleged statement or omissions, and any other equitable considerations appropriate in the circumstances.

(f) *Equitable Consideration.* Kratos, the Guarantors and the Initial Purchasers agree that it would not be equitable if the amount of such contribution determined pursuant to Section 8(e) were determined by pro rata or per capita allocation or by any other method of allocation that does not take into account the equitable considerations referred to in Section 8(e). Notwithstanding any other provision of this Section, the Initial Purchasers shall not be obligated to make contributions hereunder that in the aggregate exceed the total discounts, commissions and other compensation received by such Initial Purchasers under this Agreement, less the aggregate amount of any damages that such Initial Purchasers have otherwise been required to pay by reason of the untrue or alleged untrue statements or the omissions or alleged omissions to state a material fact. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. The Initial Purchasers' obligation to contribute hereunder shall be several in proportion to their respective purchase obligations hereunder and not joint. For purposes of Section 8(e), each director, officer and employee of each Initial Purchaser, and each person, if any, who controls such Initial Purchaser within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, shall have the same rights to contribution as the Initial Purchasers, and each director, officer and employee of Kratos and the Guarantors, and each person, if any, who controls Kratos or any of the Guarantors within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, shall have the same rights to contribution as Kratos and the Guarantors.

9. **Termination**. Jefferies may terminate this Agreement at any time prior to the Closing Date by written notice to Kratos if any of the events described in Sections 7(l) (No

Material Adverse Change), 7(m) (No Hostilities) or 7(n) (No Suspension in Trading; Banking Moratorium) shall have occurred or if the Initial Purchasers shall decline to purchase the Securities for any reason permitted by this Agreement. Kratos may terminate this Agreement on or before the Closing Date by written notice to Jefferies if Kratos becomes aware that the transactions contemplated by the Merger Agreement will not be consummated on or prior to the Closing Date (other than as a result of any action or inaction by Kratos or any of its Subsidiaries). Any termination pursuant to this Section shall be without liability on the part of (a) Kratos or the Guarantors to the Initial Purchasers, except that Kratos and the Guarantors shall be obligated to reimburse the expenses of the Initial Purchasers pursuant to Section 5(f) hereof; provided, however that if Kratos terminates this Agreement pursuant to the immediately preceding sentence then no such reimbursement obligation shall exist hereunder (but Kratos acknowledges and agrees that to the extent such expenses are reimbursable under the Debt Financing Letters (as defined in the Commitment Letter), such expenses shall continue to be reimbursable thereunder in accordance with the terms thereof) or (b) the Initial Purchasers to Kratos or the Guarantors, except, in the case of each of clauses (a) and (b), that the provisions of Sections 9 and 10 hereof shall at all times be effective and shall survive such termination.

10. **Survival.** The representations and warranties, covenants, indemnities and contribution and expense reimbursement provisions and other agreements of Kratos and the Guarantors set forth in or made pursuant to this Agreement shall remain operative and in full force and effect, and will survive, regardless of (i) any investigation, or statement as to the results thereof, made by or on behalf of the Initial Purchasers, (ii) the acceptance of the Securities, and payment for them hereunder, and (iii) any termination of this Agreement.

11. **Defaulting Initial Purchaser.** If, on the Closing Date, any one of the Initial Purchasers shall fail or refuse to purchase Securities that it or they have agreed to purchase hereunder on such date, and the aggregate principal amount of Securities which such defaulting Initial Purchaser agreed but failed or refused to purchase is not more than one tenth of the aggregate principal amount of Securities to be purchased on such date, the other Initial Purchasers shall be obligated severally in the proportions that the principal amount of Securities set forth opposite their respective names in Schedule I hereto bears to the aggregate principal amount of Securities set forth opposite the names of all such non-defaulting Initial Purchasers to purchase the Securities which such defaulting Initial Purchaser agreed but failed or refused to purchase on such date. If, on the Closing Date any Initial Purchaser shall fail or refuse to purchase Securities which it or they have agreed to purchase hereunder on such date and the aggregate principal amount of Securities with respect to which such default occurs is more than one tenth of the aggregate principal amount of Securities to be purchased on such date, and arrangements satisfactory to the non-defaulting Initial Purchasers and Kratos for the purchase of such Securities are not made within 36 hours after such default, this Agreement shall terminate without liability on the part of the non-defaulting Initial Purchasers or of Kratos or any Guarantor. Any action taken under this Section shall not relieve any defaulting Initial Purchaser from liability in respect of any default of such Initial Purchaser under this Agreement.

12. **No Fiduciary Relationship.** Kratos and the Guarantors hereby acknowledge that each Initial Purchaser is acting solely as initial purchaser in connection with the purchase and sale of the Securities. Kratos and the Guarantors further acknowledge that each Initial Purchaser is acting pursuant to a contractual relationship created solely by this Agreement entered into on

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an arm's length basis, and in no event do the parties intend that the Initial Purchasers act or be responsible as a fiduciary to either Kratos, the Guarantors or their respective management, stockholders or creditors or any other person in connection with any activity that the Initial Purchasers may undertake or have undertaken in furtherance of the purchase and sale of the Securities, either before or after the date hereof. The Initial Purchasers hereby expressly disclaim any fiduciary or similar obligations to either Kratos or the Guarantors, either in connection with the transactions contemplated by this Agreement or any matters leading up to such transactions, and Kratos and the Guarantors hereby confirm their understanding and agreement to that effect. Kratos, the Guarantors and the Initial Purchasers agree that they are each responsible for making their own independent judgments with respect to any such transactions and that any opinions or views expressed by the Initial Purchasers to Kratos and the Guarantors regarding such transactions, including, but not limited to, any opinions or views with respect to the price or market for the Securities, do not constitute advice or recommendations to Kratos and the Guarantors. Kratos and the Guarantors hereby waive and release, to the fullest permitted by law, any claims that either of Kratos or the Guarantors may have against the Initial Purchasers with respect to any breach or alleged breach of any fiduciary or similar duty to Kratos or the Guarantors in connection with the transactions contemplated by this Agreement or any matters leading up to such transactions.

13. **Information Supplied by Initial Purchasers.** Each of Kratos and the Guarantors hereby acknowledges that, for purposes of Section 4(c) and Section 8, the only information that the Initial Purchasers have furnished to Kratos specifically for use in the Preliminary Offering Memorandum or the Final Offering Memorandum are the statements set forth in (a) the first sentence of the sixth paragraph and (b) the first sentence of the eighth paragraph under the caption "Plan of Distribution" in the Preliminary Offering Memorandum and the Final Offering Memorandum.

14. **Miscellaneous.**

(a) *Notices*. Notices given pursuant to any provision of this Agreement shall be addressed as follows: (i) if to Kratos, to:

Kratos Defense & Security Solutions, Inc.
4820 Eastgate Mall
San Diego, CA 92121
Tel: (858) 812-7300
Fax: (858) 812-7301
Attention: Deanna Lund

with a copy to:

Paul, Hastings, Janofsky & Walker LLP
4747 Executive Drive, 12th Floor
San Diego, CA 92121
Tel: (858) 458-3000
Fax: (858) 458-3005
Attention: Deyan Spiridonov

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and (ii) if to the Initial Purchasers, to:

Jefferies & Company, Inc.
520 Madison Avenue
New York, NY 10022
Attention: General Counsel

KeyBanc Capital Markets Inc.
127 Public Square
Cleveland, Ohio 44114-1306
Attention: General Counsel

and

B. Riley & Co., LLC
11100 Santa Monica Blvd. Suite 800
Los Angeles, CA 90025
Attention: General Counsel

(or in any case to such other address as the person to be notified may have requested in writing).

(b) *Beneficiaries.* This Agreement has been and is made solely for the benefit of and shall be binding upon Kratos, the Guarantors, the Initial Purchasers and to the extent provided in Section 8 hereof, the controlling persons, affiliates, officers, directors, partners, employees, representatives and agents referred to in Section 8 hereof and their respective heirs, executors, administrators, successors and assigns, all as and to the extent provided in this Agreement, and no other person shall acquire or have any right under or by virtue of this Agreement. The term "successors and assigns" shall not include a purchaser of any of the Securities from the Initial Purchasers merely because of such purchase. Notwithstanding the foregoing, it is expressly understood and agreed that each purchaser who purchases Securities from the Initial Purchasers is intended to be a beneficiary of the covenants of Kratos and the Guarantors contained in the Registration Rights Agreement to the same extent as if the Securities were sold and those covenants were made directly to such purchaser by Kratos and the Guarantors, and each such purchaser shall have the right to take action against Kratos and the Guarantors to enforce, and obtain damages for any breach of, those covenants.

(c) *Governing Law; Jurisdiction; Waiver of Jury Trial; Venue.* This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York. Each of Kratos and the Guarantors hereby expressly and irrevocably (i) submits to the non-exclusive jurisdiction of the federal and state courts sitting in the Borough of Manhattan in the City of New York in any suit or proceeding arising out of or relating to this Agreement or the Transactions, and (ii) waives (a) its right to a trial by jury in any legal action or proceeding relating to this Agreement, the Transactions or any course of conduct, course of dealing, statements (whether verbal or written) or actions of the Initial

Purchasers and for any counterclaim related to any of the foregoing and (b) any obligation which it may have or hereafter may have to the laying of venue of any such litigation brought in any such court referred to above and any claim that any such litigation has been brought in an inconvenient forum.

(d) *Entire Agreement; Counterparts.* This Agreement, together with the Engagement Letter, constitutes the entire agreement of the parties to this Agreement and supersedes all prior written or oral and all contemporaneous oral agreements, understandings and negotiations with respect to the subject matter hereof. This Agreement may be executed in two or more counterparts, each one of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument.

Notwithstanding the foregoing or anything else contained in this Agreement (other than the last sentence of this paragraph) to the contrary, nothing contained in this Agreement shall be deemed to (except as otherwise provided in this paragraph) amend, modify or impair or otherwise affect the rights and obligations (including in the case of the Commitment Parties (as such term is defined in the Commitment Letter as herein defined), the Commitments (as such term is defined in the Commitment Letter)) of any of the parties under the Commitment Letter dated May 15, 2011 among Kratos, on the one hand, and Jefferies Group, Inc. and Key Capital Corporation, on the other hand (the "Commitment Letter") or any other Debt Financing Letter (as defined therein), in any manner whatsoever. In the event (A) (i) any of the conditions set forth in Section 7 of this Agreement are not satisfied or waived by the Initial Purchasers on July 27, 2011 or (ii) the Initial Purchasers would have the right to terminate this Agreement in accordance with Section 9 of this Agreement but (B) the Commitment Parties would not have the right to terminate their Commitments under the Commitment Letter and the conditions to the obligations of the Commitment Parties to purchase Notes (as defined therein) under Section 3 of the Commitment Letter have been satisfied by such date, then (1) unless otherwise waived in writing by B. Riley (which waiver may be given or withheld by B. Riley in its sole and absolute discretion), all rights and obligations of B. Riley hereunder shall be deemed to be terminated and the principal amounts set forth opposite the names of Jefferies, Key and B. Riley on Schedule I hereto shall be deemed to be equal to $66^{2}/_{3}\%$, $33^{1}/_{3}\%$ and 0%, respectively, of such aggregate principal amount of Notes that would yield $85,000,000 of gross proceeds upon the issuance thereof, in each case, as of the date hereof, *ab initio*, and (2) each of Jefferies and Key agrees (and, if B. Riley provides such written waiver, B. Riley agrees solely in the case of clause (y) below) that (x) it shall, severally and not jointly, (i) honor the obligation of it or its affiliate that is a Commitment Party under the Commitment Letter to purchase Notes or (ii) cause such affiliate to enter into a joinder and amendment to this Agreement such that such affiliate shall become a party hereto and purchase Notes, in each case, yielding gross proceeds equal to its or such affiliate's Commitment unless it or such affiliate agrees to purchase Notes in excess of its or such affiliate's Commitment (which agreement to purchase Notes in excess of such applicable Commitment may be given or withheld by it or such affiliate in its or such affiliate's sole and absolute discretion) and (y) this Agreement shall be amended in a manner consistent with the terms set forth under the caption "Purchase Agreement" in Exhibit A to the Commitment Letter to modify the representations and warranties, conditions and termination rights as provided for under such caption (and

each of Jefferies, Key and Kratos (and, if B. Riley provides such written waiver, B. Riley) agree to negotiate such amendment in good faith); provided, that in no event shall the failure to agree upon such joinder and amendment be an excuse for the Commitment Parties to fail to fund the Commitments on July 27, 2011 provided that Kratos has in fact satisfied the conditions set forth in Section 3 of the Commitment Letter (including those set forth in Exhibit B to the Commitment Letter (after giving effect to the waivers set forth in the proviso to the immediately succeeding sentence)); it being acknowledged that the Commitment Parties shall have the right to exercise their market flex rights under Section 2 of the Fee Letter (as defined in the Commitment Letter). Each of Jefferies, Key and Kratos acknowledge and agree that the conditions set forth in paragraphs

(i) 5 (provided that the condition set forth in Section 7(e) hereof has been satisfied), (ii) 6, (iii) 13, (iv) 14 (subject to Kratos' continued compliance with Section 5(d) hereof) and (v) 15 (to the extent that such paragraph 15 relates to the delivery of a comfort letter and a "bring down" comfort letter from Plante & Moran, PLLC) of Exhibit B to the Commitment Letter are waived as of the date of this Agreement; provided that, in the case of clauses (ii), (iii), (iv) and (v) above, such limited waiver is effective only until 5:00 p.m. EDT on July 27, 2011, at which time such limited waiver with respect to such clauses will expire and such conditions will be reinstated and in full force and effect (it being acknowledged and agreed that after such date, 9 consecutive business days of the 10 consecutive business day period referred to in the last sentence of such paragraph 14 shall remain available for further marketing of the Notes). Notwithstanding anything contained in this Agreement to the contrary, if (i) the Notes are purchased hereunder on the Closing Date or (ii) (A) by no later than 1:00 p.m. EDT on July 27, 2011, all of the conditions in the Merger Agreement to Kratos' obligation to consummate the Acquisition have been satisfied or waived and (B) Jefferies, Key and their respective affiliates, as applicable, are ready and willing to purchase all of the Notes and Kratos refuses to issue the Notes by such time, then, in the case of each of clauses (i) and (ii), all of the Commitments shall be terminated.

(e) *Headings*. The headings in this Agreement are for convenience of reference only and shall not limit or otherwise affect the meaning hereof.

(f) *Separability*. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction to be invalid, illegal, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions set forth herein shall remain in full force and effect and shall in no way be affected, impaired or invalidated, and the parties hereto shall use their reasonable best efforts to find and employ an alternative means to achieve the same or substantially the same result as that contemplated by such term, provision, covenant or restriction. It is hereby stipulated and declared to be the intention of the parties that they would have executed the remaining terms, provisions, covenants and restrictions without including any of such that may be hereafter declared invalid, illegal, void or unenforceable.

(g) *Amendment*. This Agreement may be amended, modified or supplemented, and waivers or consents to departures from the provisions hereof may be given, provided that the same are in writing and signed by all of the signatories hereto.

(h) *Agreement Among Initial Purchasers.* Any action by the Initial Purchasers hereunder may be taken by Jefferies on behalf of the Initial Purchasers, and any such action taken by Jefferies shall be binding upon each of the Initial Purchasers.

(i) *Representations and Warranties Regarding Integral*. Notwithstanding anything to the contrary in this Agreement, each representation and warranty (except to the extent such representation and warranty is already modified with a knowledge qualifier) made or to be made with respect to Integral shall be deemed to have been made or will be made to the knowledge, after due inquiry, of Kratos to the extent such representation and warranty is applicable to Integral.

[Remainder of this page intentionally left blank.]

Please confirm that the foregoing correctly sets forth the agreement between Kratos, the Guarantors and the Initial Purchasers.

Very truly yours,

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

AI METRIX, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

AIRORLITE COMMUNICATIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

CHARLESTON MARINE CONTAINERS INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

DALLASTOWN REALTY I, LLC

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Gichner Holdings, Inc., sole member of Dallastown Realty I, LLC

DALLASTOWN REALTY II, LLC

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Dallastown Realty I, LLC, sole member of Dallastown Realty II, LLC

DEFENSE SYSTEMS, INCORPORATED

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

DEI SERVICES CORPORATION

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

DIGITAL FUSION SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

DIGITAL FUSION, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

DIVERSIFIED SECURITY SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

DTI ASSOCIATES, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

GENERAL MICROWAVE CORPORATION
(DBA HERLEY NEW YORK)

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

GENERAL MICROWAVE ISRAEL CORPORATION

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

GICHNER HOLDINGS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

GICHNER SYSTEMS INTERNATIONAL, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

GICHNER SYSTEMS GROUP, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

HAVERSTICK CONSULTING, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and
Chief Financial Officer

HAVERSTICK GOVERNMENT SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

HENRY BROS. ELECTRONICS, INC.,
a Delaware corporation

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HENRY BROS. ELECTRONICS, INC.,
a Colorado corporation

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HENRY BROS. ELECTRONICS, INC.,
a Virginia corporation

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HENRY BROS. ELECTRONICS, INC.,
a New Jersey corporation

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HENRY BROS. ELECTRONICS, INC.,
a California corporation

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

HENRY BROS. ELECTRONICS, LLC,

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Henry Bros. Electronics, Inc., sole member of Henry Bros. Electronics, LLC

HERLEY INDUSTRIES, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HERLEY-CTI, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HERLEY-RSS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

HGS HOLDINGS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

IRIS ACQUISITION SUB LLC

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Kratos Defense & Security Solutions, Inc., sole

member of Iris Acquisition Sub LLC

IRIS MERGER SUB INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

JMA ASSOCIATES, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS DEFENSE ENGINEERING SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS PUBLIC SAFETY & SECURITY SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS MID-ATLANTIC, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS SOUTHEAST, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS SOUTHWEST L.P.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Kratos Texas, Inc., General Partner of Kratos Southwest L.P.

KRATOS TEXAS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

MADISON RESEARCH CORPORATION

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

MICRO SYSTEMS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

MSI ACQUISITION CORP.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

NATIONAL SAFE OF CALIFORNIA, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

POLEXIS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

REALITY BASED IT SERVICES, LTD.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

ROCKET SUPPORT SERVICES, LLC

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of HGS Holdings, Inc., sole managing member of Rocket Support Services LLC

SHADOW I, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

SHADOW II, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

SHADOW III, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

SCT ACQUISITION, LLC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of Charlestown Marine Containers Inc., sole member of SCT Acquisition, LLC

SCT REAL ESTATE, LLC

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer of SCT Acquisition, LLC, sole member of SCT Real Estate, LLC

STAPOR RESEARCH, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

SUMMIT RESEARCH CORPORATION

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

KRATOS TECHNOLOGY & TRAINING SOLUTIONS, INC.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

WFI NMC CORP.

By: /s/ Deanna H. Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Financial Officer

Purchase Agreement

Accepted and Agreed to:

JEFFERIES & COMPANY, INC.

By: /s/ Kevin Lockhart
Name: Kevin Lockhart
Title: Managing Director

Purchase Agreement

KEYBANC CAPITAL MARKETS INC.

By: /s/ Eric Peiffer
Name: Eric Peiffer
Title:

Purchase Agreement

B. RILEY & CO., LLC

By: /s/ Bryant Riley
Name: Bryant Riley
Title: Chairman

JOINDER AGREEMENT

July 27, 2011

Pursuant to Sections 5(t) and 7(i) of the purchase agreement dated July 14, 2011, among Kratos Defense & Security Solutions, Inc., a Delaware corporation (the "Company"), each of the Guarantors (as defined therein) and the Initial Purchasers (as defined therein) (the "Purchase Agreement"), such sections being an inducement to the Initial Purchasers to execute the Purchase Agreement, the undersigned (the "Additional Guarantor") hereby agrees to be bound by the terms of the Purchase Agreement as though the Additional Guarantor had entered into the Purchase Agreement as of July 14, 2011. For the avoidance of doubt, such obligations shall include, but not be limited to, (a) the making to the Initial Purchasers on the Closing Date all of the representations and warranties of Kratos and the Guarantors contained in the Purchase Agreement with the same force and effect as if made by Kratos and the Guarantors on and as of the date of the Purchase Agreement and the Closing Date, (b) the assumption of the obligations of the Guarantors to perform and comply with all of the agreements contained in the Purchase Agreement, and (c) the obligations enumerated in Section 8(a) of the Purchase Agreement.

This joinder agreement shall be governed by, and construed in accordance with, the laws of the State of New York.

This joinder agreement may be executed in one or more counterparts and, if executed in more than one counterpart, the executed counterparts shall each be deemed to be an original but all such counterparts shall together constitute one and the same instrument.

INTEGRAL SYSTEMS, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

AVTEC SYSTEMS, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

CVG, INCORPORATED

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

LUMISTAR, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

LVDM, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

NEWPOINT TECHNOLOGIES, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

REAL TIME LOGIC, INC.

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

SAT CORPORATION

By: /s/ Deanna Lund
Name: Deanna H. Lund
Title: Executive Vice President and Chief Executive Officer

AMENDED AND RESTATED SEVERANCE AND CHANGE OF CONTROL AGREEMENT

This AMENDED AND RESTATED SEVERANCE AND CHANGE OF CONTROL AGREEMENT ("Agreement") is effective as of August 4, 2011 by and between Kratos Defense & Security Solutions, Inc., (the "Company" or "Kratos") and Deborah S. Butera ("Butera"), as approved by the Company's Board Compensation Committee.

A. Butera and the Company entered into a Severance and Change of Control Agreement dated August 2, 2010 (the "Original Agreement") to give Butera certain protection if she is terminated from employment without Cause, or if there is a Change of Control of the Company, as defined and more particularly set forth below.

B. As consideration for Butera's agreement to continue her duties and responsibilities, the Company desires to amend and restate the Original Agreement to make certain changes to comply with Section 409A of the Code and to give Butera additional protection in the event of a Change of Control of the Company.

Therefore, in consideration of the promises and the mutual covenants contained below, and for other good and valuable consideration, the receipt of which is hereby acknowledged, the parties agree as follows:

1. *Position.* Butera is presently employed as Senior Vice President, General Counsel and Secretary/Registered In-House Counsel of the Company. The Company shall not change Butera's job duties and responsibilities after the Change of Control (as that term is defined in section 4(a) below), if, when considered in their totality as a whole, such a change results in the nature of Butera's job duties being substantially different than the nature of the job duties Butera performed immediately prior to the Change of Control.

2. *Vesting Upon Change of Control*. Upon the occurrence of a Change of Control, the vesting of 100% of all stock options, stock appreciation rights, restricted stock units and any other equity awards granted to Butera under the Company's equity incentive plans that as of the date of such Change of Control remain unvested shall accelerate, to the extent permissible by law, notwithstanding and in addition to any existing vesting provisions set forth in the applicable equity award agreement and/or the Company equity incentive plan.

3. *Severance Payments*.

(a) If Butera (x) is terminated without Cause (as defined in section 4(c) below) or (y) terminates as a result of a Change in Control (as defined by section 4(a) below) followed by a Triggering Event (as defined in section 4(b) below), then Butera will be entitled to receive in satisfaction of all obligations (other than as provided in section 2 above) that the Company may have to Butera: (i) in the case of clause (x) hereof, severance compensation equal to nine (9) months of her base salary then in effect; or in the case of clause (y) hereof, severance compensation equal to twelve (12) months of her base salary plus her maximum potential bonus amount for twelve (12) months; in either case, less applicable taxes and withholding paid on the 60th day following Butera's termination of employment; and, in the case of either clause (x) or (y), if needed by Butera, (ii) her then-current health insurance coverage, at the then current employee cost, during the nine (9) month period following a termination in

the case of clause (x) or during the twelve (12) month period following a resignation in the case of clause (y). Such benefits will be provided for the applicable period following the date of Butera's termination. In addition in the event that Butera is terminated without Cause, the vesting of 100% of all stock options, stock appreciation rights, restricted stock units and any other equity awards granted to Butera under the Company's equity incentive plans that as of the date of such termination remain unvested shall accelerate, to the extent permissible by law, notwithstanding and in addition to any existing vesting provisions set forth in the applicable equity award agreement and/or the Company equity incentive plan. The receipt of the foregoing severance compensation, health insurance coverage and acceleration of vesting pursuant to this section 3 will be subject to Butera signing and not revoking a release of claims agreement in a form reasonably acceptable to the Company, and such release becoming effective within forty-five (45) days of Butera's termination and not thereafter being revoked. To the extent that any of the health insurance coverage benefits provided in this section 3(a) would result in unintended tax consequences under Code Section 105(h) or its analog in the Patient Protection and Affordable Care Act of 2010, Company shall in lieu of providing such benefits provide Butera with a lump sum payment equal to nine (9) months of COBRA continuation coverage on the 55th day following Butera's termination of employment.

(b) For the sake of clarity, no severance benefit that is paid on account of Butera's termination of employment will be paid unless and until Butera incurs a "separation from service" under the default rules of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"). Notwithstanding any other provision of this Agreement to the contrary, if Butera is a "specified employee" within the meaning of Section 409A of the Code and the related guidance ("Section 409A") at the time of Butera's separation from service, then only that portion of the severance and benefits set forth in section 3(a) above, together with any other severance payments or benefits, that may be considered deferred compensation under Section 409A, which (when considered together) do not exceed the Section 409A Limit (as defined below) and which qualify as separation pay under Treasury Regulation Section 1.409A-1(b)(9)(iii), may be paid within the first six (6) months following Butera's separation from service in accordance with section 3(a) above or (for payments or benefits not provided under this Agreement) with the payment schedule applicable to each such other payment or benefit. Otherwise, the portion of the severance and benefits provided under this Agreement, together with any other severance payments or benefits that may be considered deferred compensation under Section 409A, that would otherwise be payable within the six (6) month period following Butera's separation from service will accrue during such six (6) month period and will be paid in a lump sum on the date six (6) months and one (1) day following the date of Butera's separation from service (or the next business day if such date is not a business day). All remaining severance payments and benefits will be payable in accordance with the payment schedule applicable to such payments or benefits. For purposes of this Agreement, "Section 409A Limit" means the lesser of two (2) times: (i) the sum of Butera's annualized compensation based upon the annual rate of pay for services provided to the Company for the taxable year of Butera preceding the taxable year of Butera's separation from service from the Company as determined under Treasury Regulation Section 1.409A-1(b)(9)(iii)(A)(1) and any related Internal Revenue Service guidance; or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year in which such separation from service occurs.

(c) Additional Election Upon Certain Changes of Control. If Kratos enters into a definitive agreement ("Definitive Agreement") that would result in a Change of Control as defined herein, Butera shall have the following options in connection with the consummation of the Change of

Control, but only to the extent that the Definitive Agreement so provides: (a) to the extent that Kratos is the surviving entity in the Change of Control, Butera may elect to retain, immediately after the consummation of the Change of Control, ownership of Kratos equity with a fair market value immediately after the consummation of the Change of Control that is equal to no less than 50% of the fair market value of her equity interests in Kratos (including stock options and restricted stock) immediately prior to the consummation of the Change of Control, or (b) in the event that Kratos is not the surviving entity in a Change of Control, Butera may elect to require that no less than 50% of her equity interests in Kratos (including stock options and restricted stock) be converted into the same form of equity interest (i.e., common stock, stock options, restricted stock, etc.) of the surviving entity or its parent such that the fair market value of her ownership in the surviving entity immediately following the Change of Control is no less than the fair market value of her converted ownership interest in Kratos immediately prior to the consummation of the Change of Control. A Definitive Agreement may contain other or no options and Kratos shall have no obligation to ensure that a Definitive Agreement provides for any of the foregoing options and shall not be responsible for ensuring any particular tax treatment. Kratos' compliance with the foregoing shall be determined without regard to the tax effect of the transaction resulting in a Change of Control.

4. *Definition of Change of Control and Triggering Event.*

(a) A Change of Control means the occurrence of one of the following after the date of this Agreement:

(i) Acquisition of Controlling Interest. Any person (other than persons who are employed by Kratos or its affiliates at any time more than one year before a transaction) ("Buyer") becomes the "beneficial owner" within the meaning of Rule 13d-3 of the Securities Exchange Act of 1934, as amended, directly or indirectly, of Kratos securities representing 50% or more of the combined voting power of Kratos' then-outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

(ii) Change in Board Control. During any consecutive one-year period commencing after the date of this Agreement, individuals who constituted Kratos' Board of Directors ("Board") at the beginning of such period or their approved replacements, as defined in the next sentence ("Beginning Board") cease for any reason to constitute a majority of the Board. An individual is an "approved replacement" Board member if the Board members then in office who are Beginning Board members approved his or her election (or nomination for election) by majority votes, but in either case excluding any Board member whose initial assumption of office occurred as a result of an actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board, but only to the extent that such acquisition constitutes a "change in the effective control" of Kratos within the meaning of Treasury Regulation Section 1.409A-3(i)(5)(vi).

(iii) Merger. Kratos consummates a merger or consolidation of Kratos with any other corporation unless: (a) the voting securities of Kratos outstanding immediately before the merger or consolidation would continue to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least 50% of the combined voting power of the voting securities of Kratos or such surviving entity outstanding immediately after such merger or consolidation; and (b) no Buyer becomes the "beneficial owner," directly or indirectly, of Kratos

securities representing 50% or more of the combined voting power of Kratos' then outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

(iv) Sale of Assets. Any Buyer acquires all, or substantially all, of Kratos' assets, but only to the extent that such acquisition results in a "change in the ownership of a substantial portion" of Kratos' assets within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(vii).

(b) A "Triggering Event" means (i) Butera's termination from employment by the Company without Cause; (ii) a material change in the nature of Butera's role or job responsibilities so that Butera's duties and responsibilities after the Change of Control, when considered in their totality as a whole, are substantially diminished in nature from the job duties Butera performed immediately prior to the Change of Control; (ii) the relocation of Butera's principal place of work to a location of more than thirty (30) miles from the location Butera was assigned to immediately prior to the Change of Control and more than 30 miles farther from Butera's principal residence immediately prior to the Change of Control and such relocation results in Butera's one-way commute to work increasing by more than thirty (30) miles based on Butera's principal place of residence immediately before such relocation was announced ; or (iii) the Company materially breaches this Agreement; *provided, however,* in the case of a Triggering Event described in clause (i), (ii) or (iii) hereof, such condition shall not exist unless Butera provides written notice to the Company within ninety (90) days of its initial existence and the Company does not cure such condition within thirty (30) days from the date it receives such notice from Butera. In addition, no Triggering Event will be deemed to have occurred unless Butera separates from service within twelve (12) months from the date such Triggering Event initially.

(c) "Cause" means (i) acts or omissions constituting gross negligence, recklessness or willful misconduct on the part of Butera with respect to Butera's obligations or otherwise relating to the business of the Company; (ii) Butera's material breach of this Agreement or the Company's standard form of confidentiality agreement; (iii) Butera's conviction or entry of a plea of *nolo contendere* for fraud, misappropriation or embezzlement, or any felony or crime of moral turpitude; (iv) Butera's failure to perform her duties and responsibilities as General Counsel to the reasonable satisfaction of the Board after being provided with notice thereof and thirty (30) days opportunity to remedy such failure; and (v) Butera's willful neglect of duties or performance. Notwithstanding the foregoing, a termination under subsection (v) shall not constitute a termination for "Cause" unless the Company has first given Butera written notice of the offending conduct (such notice shall include a description of remedial actions that the Company reasonably deems appropriate to cure such offending conduct) and a thirty (30) day opportunity to cure such offending conduct. In the event the Company terminates Butera's employment under subsection (v), the Company agrees to participate in binding arbitration, if requested by Butera, to determine whether the cause for termination was willful neglect of duties or poor performance as opposed to some other reason that does not constitute Cause under this Agreement.

5. *General Provisions.* Nothing in this Agreement is intended to change the at-will nature of Butera's employment with the Company. This Agreement and Butera's offer letter and the Proprietary Information and Innovations Agreement signed by Butera, constitute the entire agreement between Butera and the Company with respect to Butera's employment with the Company. No amendment or modification of the terms or conditions of this Agreement shall be valid unless in writing and signed by the parties.

6. *Compliance with Section 409A of the Code*. This Agreement is intended to comply with Section 409A of the Code (or any regulations or rulings thereunder), and shall be construed and interpreted in accordance with such intent. Notwithstanding anything to the contrary in this Agreement, the Company, in the exercise of its sole discretion and without the consent of Butera, may amend or modify this Agreement in any manner in order to meet the requirements of Section 409A as amplified by any Internal Revenue Service or U.S. Treasury Department guidance. Any provision of this Agreement that would cause the payment of any benefit to fail to satisfy Section 409A shall have no force and effect until amended to comply with Code Section 409A (which amendment shall be retroactive to the extent permitted by the Code or any regulations or rulings thereunder). Butera is encouraged to consult a tax adviser regarding the potential impact of Section 409A.

7. Parachute Payment Excise Tax.

(a) In the event that any payment or benefit (within the meaning of Section 280G(b)(2) of the Code) to Butera for Butera's benefit, paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise in connection with, or arising out of, Butera's employment with the Company or a Change of Control (a "Payment" or "Payments"), would be subject to the excise tax imposed by Code Section 4999, or any interest or penalties are incurred by Butera with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then Butera will be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by Butera of all taxes (including any interest or penalties (other than interest and penalties imposed by reason of Butera's failure to file timely a tax return or pay taxes shown due on Butera's return) imposed with respect to such taxes and the Excise Tax), including any Excise Tax imposed upon the Gross-Up Payment, Butera retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(b) An initial determination as to whether a Gross-Up Payment is required pursuant to this Agreement and the amount of such Gross-Up Payment shall be made by the Company. The Company shall provide its determination (the "Determination"), together with detailed supporting calculations and documentation, to Butera within fifteen (15) days of the date of Butera's termination, if applicable, or such other time as requested by Butera (provided Butera reasonably believes that any of the Payments may be subject to the Excise Tax). If requested by Butera, the Company shall furnish Butera, at the Company's expense, with an opinion reasonably acceptable to Butera from the Company's accounting firm (or an accounting firm of equivalent stature reasonably acceptable to Butera) that there is a reasonable basis for the Determination. Any Gross-Up Payment determined pursuant to this section 7 shall be paid by the Company to Butera within five (5) days of receipt of the Determination.

(c) As a result of the uncertainty in the application of Sections 4999 and 280G of the Code, it is possible that a Gross-Up Payment (or a portion thereof) will be paid which should not have been paid (an "Excess Payment") or a Gross-Up Payment (or a portion thereof) which should have been paid will not have been paid (an "Underpayment").

(d) An Underpayment shall be deemed to have occurred (A) upon notice (formal or informal) to Butera from any governmental taxing authority that Butera's tax liability (whether in respect of Butera's current taxable year or in respect of any prior taxable year) may be increased by reason of the imposition of the Excise Tax on a Payment or Payments with respect to which the Company has failed to make a sufficient Gross-Up Payment, (B) upon a determination by a court, or (C)

by reason of determination by the Company (which shall include the position taken by the Company, together with its consolidated group, on its federal income tax return). If an Underpayment occurs, Butera shall promptly notify the Company and the Company shall promptly, but in any event at least five (5) days prior to the date on which the applicable government taxing authority has requested payment, pay to Butera an additional Gross-Up Payment equal to the amount of the Underpayment plus any interest and penalties (other than interest and penalties imposed by reason of Butera's failure to file timely a tax return or pay taxes shown due on Butera's return) imposed on the Underpayment.

(e) An Excess Payment shall be deemed to have occurred upon a Final Determination (as hereinafter defined) that the Excise Tax shall not be imposed upon a Payment or Payments (or portion thereof) with respect to which Butera had previously received a Gross-Up Payment. A "Final Determination" shall be deemed to have occurred when Butera has received from the applicable government taxing authority a refund of taxes or other reduction in Butera's tax liability by reason of the Excise Payment and upon either (A) the date a determination is made by, or an agreement is entered into with, the applicable governmental taxing authority which finally and conclusively binds Butera and such taxing authority, or in the event that a claim is brought before a court of competent jurisdiction, the date upon which a final determination has been made by such court and either all appeals have been taken and finally resolved or the time for all appeals has expired or (B) the statute of limitations with respect o Butera's applicable tax return has expired. If an Excess Payment is determined to have been made, the amount of the Excess Payment shall be repaid by Butera to the Company unless, and only to the extent that, the repayment would either reduce the amount on which Butera is subject to tax under Code Section 4999 or generate a refund of tax imposed under Code Section 4999.

(f) Notwithstanding anything contained in this Agreement to the contrary, in the event that, according to the Determination, an Excise Tax will be imposed on any Payment or Payments, the Company shall pay to the applicable government taxing authorities, as Excise Tax withholding, the amount of the Excise Tax that the Company has actually withheld from the Payment or Payments.

	Deborah S. Butera
Dated: August 4, 2011	/s/ Deborah S. Butera
	Kratos Defense & Security Solutions, Inc.
Dated: August 4, 2011	/s/ Eric DeMarco By: Eric DeMarco, President and CEO

FIRST AMENDMENT TO EMPLOYMENT AGREEMENT

THIS FIRST AMENDMENT TO EMPLOYMENT AGREEMENT ("**First Amendment**") is entered into by and between Kratos Defense Engineering Solutions, Inc., a Delaware corporation formerly known as Kratos Government Solutions, Inc. (the "**Company**") and David Carter, an individual ("**Executive**"), effective as of August 4, 2011 ("**Effective Date**"). For purposes of this Agreement, the defined term "Company" is intended to include DTI Associates, Inc. ("**DTI**"). Certain terms used in this Agreement denoted by initial capital letters are defined in Section 17.

RECITALS

A. Executive is an officer of the Company and in such capacities has obtained extensive and valuable knowledge and confidential information concerning the Company's and its Defense Engineering Services Division's ("**DES**") business and confidential customer relationships.

B. Executive and the Company entered into an Employment Agreement made effective as of July 22, 2010 (the **"Original Agreement"**).

C. As consideration for Executive's agreement to continue his duties and responsibilities as described herein, Executive and the Company desire to amend the Original Agreement to afford Executive additional protection in the event of a change in control of the Company, as set forth more particularly herein.

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

AMENDMENT

1. **Effect of First Amendment**. This First Amendment supplements, but does not replace, the Original Agreement. The Original Agreement shall remain in full force and effect, except as modified specifically herein. Certain terms used in this First Amendment denoted by capital letters are defined in Section 17 of the Original Agreement, except as such defined terms are modified herein.

2. **Amended Terms.** Section 17.3 of the Original Agreement is hereby amended by deleting Section 17.3 in its entirety and replacing it with the following:

17.3 Change of Control. "**Change of Control**" means the occurrence of one of the following after the date of this Agreement, with respect to the Company's parent company, Kratos Defense & Security Solutions, Inc. ("**Kratos**"):

17.3.1 Acquisition of Controlling Interest. Any person (other than persons who are employed by Kratos or its affiliates at any time more than one year before a transaction) ("**Buyer**") becomes the "beneficial owner" within the meaning of Rule 13d-3 of the Securities Exchange Act of 1934, as amended, directly or indirectly, of Kratos

securities representing 50% or more of the combined voting power of Kratos' then-outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

17.3.2 Change in Board Control. During any consecutive one-year period commencing after the date of this Agreement, individuals who constituted Kratos' Board of Directors ("**Board"**) at the beginning of such period or their approved replacements, as defined in the next sentence ("**Beginning Board**") cease for any reason to constitute a majority of the Board. An individual is an "approved replacement" Board member if the Board members then in office who are Beginning Board members approved his or her election (or nomination for election) by majority votes, but in either case excluding any Board member whose initial assumption of office occurred as a result of an actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board, but only to the extent that such acquisition constitutes a "change in the effective control" of Kratos within the meaning of Treasury Regulation Section 1.409A-3(i)(5)(vi).

17.3.3 Merger. Kratos consummates a merger or consolidation of Kratos with any other corporation unless: (a) the voting securities of Kratos outstanding immediately before the merger or consolidation would continue to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least 50% of the combined voting power of the voting securities of Kratos or such surviving entity outstanding immediately after such merger or consolidation; and (b) no Buyer becomes the "beneficial owner," directly or indirectly, of Kratos securities representing 50% or more of the combined voting power of Kratos' then outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

17.3.4 Sale of Assets. Any Buyer acquires all, or substantially all, of Kratos' assets, but only to the extent that such acquisition results in a "change in the ownership of a substantial portion" of Kratos' assets within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(vii).

3. **Certain Elections upon Certain Changes of Control**. Section 18 is hereby added to the Original Agreement as follows:

Additional Election Upon Certain Changes of Control. If Kratos enters into a definitive agreement ("**Definitive Agreement**") that would result in a Change of Control as defined herein, Executive shall have the following options in connection with the consummation of the Change of Control, but only to the extent that the Definitive Agreement so provides: (a) to the extent that Kratos is the surviving entity in the Change of Control, Executive may elect to retain, immediately after the consummation of the Change of Control, ownership of Kratos equity with a fair market value immediately after the consummation of the Change of Control that is equal to no less than 50% of the fair market value of his equity interests in Kratos (including stock options and restricted stock) immediately prior to the consummation of the Change of Control, or (b) in the event that Kratos is not the surviving entity in a Change of Control, Executive may elect to require that no less than 50% of his equity interests in Kratos (including stock options and restricted stock) be converted into the same form of equity interest (i.e., common stock, stock options, restricted stock, etc.) of the surviving entity or its parent such that the fair market value of his ownership in the surviving entity immediately following the Change of Control is no less than the fair market value of his converted ownership interest in Kratos immediately prior to the consummation of the Change of Control. A Definitive Agreement may contain other or no options and Kratos shall have no obligation to ensure that a Definitive Agreement provides for any of the foregoing options and shall not be responsible for ensuring any particular tax treatment. Kratos' compliance with the foregoing shall be determined without regard to the tax effect of the transaction resulting in a Change of Control.

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

THE COMPANY: **Kratos Defense Engineering Solutions, Inc.**	**EXECUTIVE:**
By: /s/ Eric DeMarco Name: Eric DeMarco Title: President and CEO	/s/ David Carter David Carter Title: Division President, DES Date: August 4, 2011
Address for Notice:	Address for Notice:

4820 Eastgate Mall
San Diego, CA 92121
Attn: President and CEO
Law Department

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT ("**Agreement**") is entered into by and between Kratos Public Safety & Security Solutions, Inc., a Delaware corporation (the "**Company**") and Ben Goodwin, an individual ("**Executive**"), effective as of August 4, 2011 ("**Effective Date**"). Certain terms used in this Agreement denoted by initial capital letters are defined in Section 16.

RECITALS

A. Executive is an officer of the Company and in such capacities has obtained extensive and valuable knowledge and confidential information concerning the Company's and its Public Safety and Security Services Division's ("**PSS**") business and confidential customer relationships.

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

AGREEMENT

1. **Employment**. The Company shall employ Executive as Division President of PSS (the "**Position**"), and Executive accepts such employment and agrees to perform services for the Company, for the period and upon the other terms and conditions set forth in this Agreement.

2. **Term.** The term of Executive's employment hereunder shall be for a period commencing on the Effective Date (the **"Term**") and ending on December 31, 2013, subject to earlier termination as hereinafter specified. Upon expiration of the Term, this Agreement may be renewed upon agreement of the parties for an additional term of one (1) year.

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

4. **Compensation**.

4.1 **Base Salary**. As compensation for all services to be rendered by Executive under this Agreement, the Company shall pay to Executive a base annual salary of Two Hundred Thirty-Five Thousand Dollars ($235,000.00) (the "**Base Salary**"), which shall be

paid on a regular basis in accordance with the Company's customary payroll procedures and policies. Executive will be eligible for annual increases to the Base Salary in accordance with the Company's then current compensation policies.

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

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

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

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

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

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

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

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

6. **Compensation upon Termination**. Executive shall be entitled to the following payments, if any, upon the termination of his employment by the Company.

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

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

6.3 **Without Cause**. In the event Executive is terminated by the Without Cause pursuant to Section 11.3, the Company shall pay to Executive (i) any Base Salary accrued through the date of termination, (ii) any accrued but unused paid time off; and (iii) continued payment of the Base Salary for twelve (12) months (the "**Severance Period**"). Subsection (iii) of this Section 6.3 shall be referred to as a "**Severance Payment**". Except as otherwise provided herein, the Severance Payment shall be paid to Executive on a regular basis in accordance with the company's regular payroll procedures and policies as in effect immediately prior to such termination.

6.4 **Upon Change of Control**. In the event Executive is terminated Upon a Change of Control of the Company pursuant to Section 11.4, the Company shall pay to Executive: (i) any Base Salary accrued through the date of termination, (ii) any accrued but unused paid time off; and (iii) continued payment of the Base Salary for a period of twelve (12) months. Subsection (iii) of this Section 6.4 shall be referred to as a "**Severance Payment**". Except as otherwise provided herein, the Severance Payment shall be paid to Executive on a regular basis in accordance with the company's regular payroll procedures and policies as in effect immediately prior to such termination.

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

Section 409A. For the sake of clarity, no severance benefit that is paid on account of Goodwin's termination of employment will be paid unless and until Goodwin incurs a "separation from service" under the default rules of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"). Notwithstanding any other provision of this Agreement whatsoever, the Company, in its sole discretion, shall have the right to provide for the application and effects of Section 409A of the Code (relating to deferred compensation arrangements) and

any related administrative guidance issued by the Internal Revenue Service. Notwithstanding any inconsistent provision of this Agreement, if Executive is a "specified employee" within the meaning of Section 409A of the Code at the time of Executive's termination, then only that portion of the Severance Payment, together with any other severance payments or benefits that, in each case, may otherwise be considered deferred compensation under Code Section 409A, which (a) do not exceed the Section 409A Limit (as defined below), and (b) which qualify as separation pay under Treasury Regulation Section 1. 409A-1(b)(9)(iii), may be paid within the first six (6) months following Executive's termination in accordance with -1(b)(9) this Section 6 or (for payments or benefits not provided under this Agreement) with the payment schedule applicable to each such other payment or benefit. Otherwise, the portion of the Severance Payment, together with any other severance payments or benefits that, in each case, may be considered deferred compensation under Section 409A, that would otherwise be payable within the six (6) month period following Executive's termination will accrue during that six (6) month period and will be paid in a lump sum on the date six (6) months and one (1) day following the date of Executive's termination (or the next business day if such date is not a business day), provided Executive has complied with the requirements for such payment. For purposes of this Agreement, "**Section 409A Limit**" means the lesser of two (2) times: (i) Executive's "annualized compensation" as determined under Treasury Regulation Section 1.409A-1(b)(9)(iii)(A)(1), or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year of the termination, or such successor limit as may apply. Notwithstanding anything to the contrary, no actions taken pursuant to this section shall reduce the total amount of payments and benefits owed to Executive and to be paid to Executive under this Agreement.

7. **Proprietary Matter; Ownership**.

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

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

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

9. **Noninterference With Business**. Executive understands and agrees that Company's employees and customers and any information regarding Company employees and/or customers is confidential and constitutes trade secrets. Accordingly, Executive agrees that during his employment and thereafter, Executive will not, either directly or indirectly, separately or in association with others: (a) use Company trade secret or confidential information to interfere with, impair, disrupt or damage Company's relationship with any of its customers or customer prospects by soliciting or encouraging others to solicit any of them for the purpose of diverting or taking away business from Company; or (b) directly or indirectly, separately or in association with others, interfere with, impair, disrupt or damage Company's business by soliciting, encouraging or attempting to hire any of Company's employees or causing others to solicit or encourage any of Company's employees to discontinue their employment with Company; provided, however, that Executive's obligations under clause (b) shall terminated at the end of the Restricted Period.

10. **Non-Disparagement**. Executive expressly agrees that during his employment by the Company and following the termination of such employment for any reason, he will make no statement and take no actions of any kind, verbal or written, that directly or indirectly disparages the Company or the Related Parties, injures their general reputation or interferes with the Company's operations.

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

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

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

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

11.4 **Termination Upon Change of Control**. Termination **"Upon Change of Control"** shall mean the Company's, or its legal successor's, termination of Executive's employment Without Cause and within six months after a Change of Control, as defined in Section 17.3.

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

13. **Assignment**. This Agreement shall not be assignable, in whole or in part, by either party without the written consent of the other party. However, the Company may, without the consent of Executive, assign its rights and obligations under this Agreement to any corporation, firm or other business entity (i) owned or controlled by the Company or to any entity which is or may own or control the Company, or (ii) with which the Company may merge into or consolidate, or (iii) to which the Company may sell or transfer all or substantially all of its assets or to which fifty percent (50%) or more of the equity investment and of the voting control is owned, directly or indirectly, by, or is under the common ownership with, the Company.

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

14. **Injunctive Relief**. Executive agrees that it would be difficult to compensate the Company fully for damages for any violation of the provisions of this Agreement, including, without limitation, the provisions of Sections 7, 9, 10 and 12. Accordingly, Executive specifically agrees that the Company shall

be entitled to temporary and permanent injunctive relief to enforce the provisions of this Agreement. This provision with respect to injunctive relief shall not, however, diminish the right of the Company to claim and recover damages in addition to injunctive relief.

15. **Miscellaneous**.

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

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

15.3 **Taxes**. The Company may withhold from any benefits payable under this Agreement all federal, state, city or other taxes as shall be required pursuant to any law or governmental regulation or ruling.

15.4 **Successors**. The terms of this Agreement and all rights of Executive hereunder shall inure to the benefit of, and be enforceable by, Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

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

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

15.7 **Severability**. To the extent any provision of this Agreement shall be considered by a court or arbitrator to be invalid or unenforceable, the provision shall be considered deleted herefrom and the remainder of such provision and of this Agreement shall be unaffected and shall continue in full force and effect.

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

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

specifying next day delivery, with written verification of receipt. All communications shall be sent to the Company and Executive at their respective addresses as set forth on the signature page hereof or at such other address as the Company or Executive may designate by ten (10) days advance written notice to the other party.

15.10 If Kratos enters into a definitive agreement ("**Definitive Agreement**") that would result in a Change of Control as defined herein, Executive shall have the following options in connection with the consummation of the Change of Control, but only to the extent that the Definitive Agreement so provides: (a) to the extent that Kratos is the surviving entity in the Change of Control, Executive may elect to retain, immediately after the consummation of the Change of Control, ownership of Kratos equity with a fair market value immediately after the consummation of the Change of Control that is equal to no less than 50% of the fair market value of his equity interests in Kratos (including stock options and restricted stock) immediately prior to the consummation of the Change of Control, or (b) in the event that Kratos is not the surviving entity in a Change of Control, Executive may elect to require that no less than 50% of his equity interests in Kratos (including stock options and restricted stock) be converted into the same form of equity interest (i.e., common stock, stock options, restricted stock, etc.) of the surviving entity or its parent such that the fair market value of his ownership in the surviving entity immediately following the Change of Control is no less than the fair market value of his converted ownership interest in Kratos immediately prior to the consummation of the Change of Control. A Definitive Agreement may contain other or no options and Kratos shall have no obligation to ensure that a Definitive Agreement provides for any of the foregoing options and shall not be responsible for ensuring any particular tax treatment. Kratos' compliance with the foregoing shall be determined without regard to the tax effect of the transaction resulting in a Change of Control..

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

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

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

16.3 **Change of Control**. "**Change of Control**" means, with respect to the Company's parent company, Kratos Defense & Security Solutions, Inc. ("**Kratos**"), the occurrence of one of the following after the date of this Agreement:

16.3.1 Acquisition of Controlling Interest. Any person (other than persons who are employed by the Company or its affiliates at any time more than one year before a transaction) ("**Buyer**") becomes the "beneficial owner" within the meaning of Rule 13d-3 of the Securities Exchange Act of 1934, as amended, directly or indirectly, of Kratos securities representing 50% or more of the combined voting power of Kratos' then-outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

16.3.2 Change in Board Control. During any consecutive one-year period commencing after the date of this Agreement, individuals who constituted Kratos' Board of Directors ("**Board**") at the beginning of such period or their approved replacements, as defined in the next sentence ("**Beginning Board**") cease for any reason to constitute a majority of the Board. An individual is an "approved replacement" Board member if the Board members then in office who are Beginning Board members approved his or her election (or nomination for election) by majority votes, but in either case excluding any Board member whose initial assumption of office occurred as a result of an actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board, but only to the extent that such acquisition constitutes a "change in the effective control" of Kratos within the meaning of Treasury Regulation Section 1.409A-3(i)(5)(vi).

16.3.3 Merger. Kratos consummates a merger or consolidation of Kratos with any other corporation unless: (a) the voting securities of Kratos outstanding immediately before the merger or consolidation would continue to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least 50% of the combined voting power of the voting securities of Kratos or such surviving entity outstanding immediately after such merger or consolidation; and (b) no Buyer becomes the "beneficial owner," directly or indirectly, of Kratos securities representing 50% or more of the combined voting power of Kratos' then outstanding securities, but only to the extent that such ownership constitutes a "change in the ownership" of Kratos within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(v).

16.3.4 Sale of Assets. Any Buyer acquires all, or substantially all, of Kratos' assets, but only to the extent that such acquisition results in a "change in the ownership of a substantial portion" of Kratos' assets within the meaning of U.S. Treasury Regulation Section 1.409A-3(i)(5)(vii).

16.4 **Misconduct**. "Misconduct" means:

16.4.1 Commission of a felony or an act of fraud, embezzlement or other act of gross misconduct against the Company in the performance of duties hereunder.

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

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

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

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

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

16.6 **Restricted Period.** The Restricted Period is (a) the Severance Period resulting from Executive's termination due to Change of Control or termination without Cause; or (b) a period of one (1) year after Executive's resignation or termination due to Misconduct or Cause.

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

THE COMPANY: **Kratos Government Solutions, Inc.**	**EXECUTIVE:**
By: /s/ Eric DeMarco Name: Eric DeMarco Title: President and CEO	/s/ Ben Goodwin Ben Goodwin Title: Division President, PSS Date: August 4, 2011
Address for Notice:	Address for Notice:

4820 Eastgate Mall
San Diego, CA 92121
Attn: President and CEO

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 (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2011

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-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 4, 2011

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

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

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 September 25, 2011 (the "Report"), I, Eric M. DeMarco, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 4, 2011

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ ERIC M. DEMARCO
Eric M. DeMarco
Chief Executive Officer, President
(Principal Executive Officer)

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 September 25, 2011 (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: November 4, 2011

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

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