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

FORM 10-K

(Mark One)

☒	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 25, 2016**
☐	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

Commission file number 001-34460

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
(Exact name of Registrant as specified in its charter)

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

4820 Eastgate Mall, Suite 200
San Diego, CA 92121
(858) 812-7300
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT

Title of Each Class	**Name of each exchange on which registered**
Common Stock, par value $0.001	The NASDAQ Global Select Market

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

The aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates as of June 26, 2016, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $182.6 million, based on the closing sale price for shares of the registrant's common stock as reported by the NASDAQ Global Select Market on such date. This disclosure excludes shares of common stock held by executive officers, directors and stockholders whose individual ownership exceeds 10% of the common stock outstanding on June 26, 2016 because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

As of February 24, 2017, 74,533,342 shares of the registrant's common stock were outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III of this annual report on Form 10-K incorporate information by reference from the registrant’s definitive proxy statement filed pursuant to Regulation 14A in connection with the registrant’s 2017 Annual Meeting of Stockholders or an amendment to this annual report on Form 10-K to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year covered by this annual report on Form 10-K.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
FORM 10-K
FOR THE FISCAL YEAR ENDED DECEMBER 25, 2016

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

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Annual Report”) contains “forward-looking statements” relating to our future financial performance, the market for our services and our expansion plans and opportunities. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” or “continue,” the negative of such terms or other comparable terminology. These forward-looking statements reflect our current beliefs, expectations and projections, are based on assumptions, and are subject to known and unknown risks and uncertainties that could cause our actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of these factors are beyond our ability to control or predict. As a result, you should not place undue reliance on forward-looking statements. The most important risk and uncertainties that could cause our actual results or achievements to differ materially from the results or achievements expressed in or implied by our forward-looking statements, include, but are not limited to those specifically addressed in Item 1A “Risk Factors” in this Annual Report, as well as those discussed elsewhere in this Annual Report. These forward-looking statements reflect our views and assumptions only as of the date such forward-looking statements are made. Except as required by law, we assume no responsibility for updating any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I.

Item 1. *Business.*

Overview

Kratos is a mid-tier government contractor at the forefront of the U.S. Department of Defense’s (the “DoD”) Third Offset Strategy. Kratos is a leading technology, intellectual property and proprietary product and solution company focused on the U.S. and its allies’ national security. Kratos’ primary focus areas are unmanned systems, satellite communications, microwave electronics, cyber security/warfare, missile defense and combat systems. We believe that our technology, intellectual property, proprietary products and designed-in positions on our customers’ platforms and systems is a competitive advantage and high barrier to entry into our markets. Our work force is primarily technically oriented and highly skilled with a significant number holding national security clearances. Our entire organization is focused on executing our strategy of becoming the leading technology and intellectual property based company in our industry.

Industry Update

Faced with significant budget pressures, in recent years the U.S. Government has implemented reductions in government spending, including reductions in appropriations for the DoD and other federal agencies, pursuant to the Budget Control Act of 2011 (“BCA”), as amended by the American Taxpayer Relief Act of 2012 and the Bipartisan Budget Act of 2013. Pursuant to the terms of the BCA, a sequestration went into effect in March 2013 resulting in a 7.8% reduction to the DoD budget for fiscal year (the period running from October 1st to September 30th, a “FY”) 2013 to $495.5 billion, excluding funding for military personnel. The DoD budget was approximately $496.0 billion in FY 2014 and remained at a similar level in FY 2015. The DoD base budget excludes funding for overseas contingency operations, such as those in Afghanistan, Iraq and Syria, which are appropriated separately and are not currently subject to the BCA.

On November 2, 2015, Barack Obama signed the Bipartisan Budget Act of 2015, formalizing the terms of a two-year budget agreement which raised the U.S. debt ceiling and lifted the sequestration spending caps by $80.0 billion. Under the budget agreement, the total federal spending increase over the BCA topline funding caps was $50.0 billion in FY 2016 and $30.0 billion in FY 2017, with the amounts divided equally between defense and domestic priorities. The overall discretionary budget was set at $1.067 trillion in FY 2016 and $1.07 trillion in FY 2017. The FY 2016 discretionary defense budget was $548.1 billion, a $25.0 billion increase over the BCA topline funding caps.

Under the Bipartisan Budget Act of 2015, the Obama Administration received $33.0 billion of the $38.0 billion national defense spending increase it sought in FY 2016. In summary the budget agreement:

- extended the BCA out to 2025;
- suspended the U.S. debt limit/ceiling until March 2017;

- increased spending caps for FY 2016 and FY 2017 by $80.0 billion, including $50.0 billion in FY 2016 and $30.0 billion in FY 2017, split evenly between defense and domestic priorities; and
- included a FY 2016 DoD base budget of $548.0 billion and a FY 2016 overseas contingency operation budget of $59.0 billion.

On December 18, 2015, Congress passed and Mr. Obama signed the Consolidated Appropriations Act of 2016, which provided funding for the U.S. Government for FY 2016, providing $1.1 trillion in discretionary funding for federal agencies through September 2016. Mr. Obama signed a continuing resolution in September 2016, which was extended in December 2016, and provides funding for the U.S. Government at FY 2016 levels through April 28, 2017.

Current Reporting Segments

The Company operates in three reportable segments. The Kratos Government Solutions ("KGS") reportable segment is comprised of an aggregation of KGS operating segments, including our microwave electronic products, satellite communications, modular systems and rocket support operating segments. The Unmanned Systems ("US") reportable segment consists of our unmanned aerial system and unmanned ground and seaborne system businesses. The Public Safety & Security ("PSS") reportable segment provides independent integrated solutions for advanced homeland security, public safety, critical infrastructure, and security and surveillance systems for government and commercial applications. We organize our business segments based primarily on the nature of the products, solutions and services offered. Transactions between segments are negotiated and accounted for under terms and conditions similar to other government and commercial contracts, and these intercompany transactions are eliminated in consolidation. For additional information regarding our reportable segments, see Note 13 of the Notes to Consolidated Financial Statements. From a customer and solutions perspective, we view our business as an integrated whole, leveraging skills and assets wherever possible.

Competitive Strengths

Kratos' primary competitive strengths are our intellectual property, proprietary products, customer relationships and the designed-in position of our technology and products into our customers' platforms and systems.

Highly specialized experience. Kratos and our work force have years of experience working on and with the U.S. and its allies' national security platforms and systems.

We believe that Kratos is one of the industry leaders in our core business areas including, unmanned systems, satellite communications, microwave products, missile systems and radars, missile defense, directed energy weapons, cyber security and warfare, and training systems.

Kratos' work force of approximately 2,900 employees have specialized national security related experience with the majority performing their duties at customer locations, secure manufacturing facilities or critical infrastructure sites.

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

- Unmanned systems
- Satellite communications and radio frequency detection
- Electronic warfare, attack, missile, and radar systems
- Intelligence, surveillance and reconnaissance
- Ballistic missile defense
- Command, control and combat systems
- Cybersecurity and information assurance
- Specialized training systems

Diverse base of key contracts with low concentration. Many of our contracts are single-award and or sole source in nature, where Kratos is the only awardee by the customer. In many cases, our ability to obtain single award, sole source contracts is due to our intellectual property, proprietary products, past performance qualifications and relative experience. We have a highly diverse base of contracts with no contract representing more than 5% of 2016 revenue. Our fixed-price contracts, the vast majority of which are production contracts, represent approximately 83% of our 2016 revenue. Our cost-plus-fee contracts and time and materials contracts represent approximately 12% and 5%, respectively, of our 2016 revenue. We believe our diverse base of key contracts and low reliance on any one contract provides us with a stable, balanced revenue stream.

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

Significant cash flow visibility driven by stable backlog. As of December 25, 2016, our total backlog (see Backlog below) was approximately $899.7 million, of which approximately $626.1 million was funded backlog. The majority of our sales are from orders issued under long-term contracts, typically three to five years in duration. Our contract backlog provides visibility into stable future revenue and cash flow over a diverse set of contracts.

Highly skilled employees and an experienced management team. We deliver our services through a skilled and primarily technically oriented workforce of approximately 2,900 employees. Our senior managers have significant experience with U.S. Government agencies, the U.S. military and U.S. Government contractors. Many of our employees hold national security clearances. Members of our management team have experience growing businesses both organically and through acquisitions. We believe that the cumulative experience and differentiated expertise of our personnel in our core focus areas, coupled with our sizable employee base, allow us to qualify for and bid on larger projects in a prime contracting role.

Our Strategy

Our strategy is to focus on our core business areas, including Unmanned Systems, Satellite Communications, Cyber Security, Microwave Electronics and Training Systems. We will continue to invest in differentiating technology and intellectual property ownership for our products and systems. We intend to be the leader in designing, developing, demonstrating and delivering to the warfighter leading technology systems very rapidly, for a low cost.

Internal Growth

We are focused on generating internal growth by capitalizing on our intellectual property, proprietary products, current contract base and customer relationships. We will make targeted discretionary investments in strategic growth areas including; unmanned systems, satellite communications, microwave electronics, cyber security and training systems, which have the highest potential for growth and in which we will retain the intellectual property rights.

Expand technology product, solution and service offerings provided to existing customers. We are focused on expanding the technology, products and solutions we provide to our current customers by leveraging our strong relationships, technical capabilities, intellectual property and past performance record and by offering a wider range of comprehensive low-cost technology rich products and solutions. In regard to areas of specialization, our product and solution offerings include manufacturing of specialized defense electronics products, integrated technology solutions for satellite communications and specialized high performance unmanned aerial aircraft, targets, Unmanned Aerial Systems ("UAS") and Unmanned Ground Systems ("UGS"). We believe our understanding of customer missions, processes, needs and requirements, and our ability to rapidly deliver low cost, technology leading products and solutions, position us well for success in the current constrained budget environment.

Capitalize on current contract base. We are pursuing new program and contract opportunities and awards as we build the business with our expanding technology base, intellectual property ownership, contract portfolio, and product, solution and service offerings. We are also aggressively pursuing several new national security priority areas, including high performance unmanned aerial systems, satellite communications command, control and signal monitoring products, microwave electronics for missiles, radars, electronic warfare and communications, cyber security solutions, specialized training systems, autonomy, artificial intelligence, robotics, directed energy systems, hypersonic systems, electromagnetic rail gun systems and next generation ballistic missile targets. We are also assessing new tactical program areas and platforms to pursue that are consistent with our core capabilities, technology and intellectual property.

Expand customer and contract base. We are focused on expanding our customer base into areas with significant growth opportunities by leveraging our technology, intellectual property, proprietary products, capabilities, industry reputation, long-term customer relationships and diverse contract base. We anticipate that this expansion will enable us both to pursue larger program opportunities, higher value work and to further diversify our revenue base across additional U.S. Government, international and commercial customers.

Improve operating margins. We believe that we have opportunities to increase our operating margins and improve profitability by capitalizing on our corporate infrastructure investments as our business grows and revenues increase. We are proactively focused on improving efficiencies, reducing costs, and concentrating our efforts on operational excellence.

Invest in strategic growth areas. Over the past several years, we have made significant investments in strategic growth areas including the unmanned tactical aircraft systems area. Specifically, we have increased internally funded research and development, capital expenditures and infrastructure investments, including executive management, bid, proposal and new business capture and pursuit expenses. We have made these investments with the intention of designing and demonstrating high performance jet powered unmanned combat aerial systems. These investments also allow us to retain the intellectual property rights and design packages for these platforms, and to ultimately secure sole source production positions in these strategic growth areas. Specifically, we have invested over $50 million in our UAS through internally funded research and development, contract design retrofit costs for new platforms under development and capital expenditures for aircraft and related equipment related to this strategic growth area.

We invested in internally funded research and development and capital expenditures to build our own UTAP-22 UAS from 2012 to 2015, and demonstrated the capabilities of the UTAP-22 in a flight demonstration in the fall of 2015. As a result, we were awarded a $12.6 million award prime contract from the Defense Innovation Unit Experimental (DIUx) for sensor integration into our UTAP-22 unmanned aerial system the following year. Under this effort, we will integrate certain sensors into our UTAP-22 and will participate in a large, complex flight exercise in 2017. Additionally, we received a $40.8 million single award, cost-share contract from the Air Force Research Laboratory (AFRL) for the Low Cost Attritable Unmanned Aerial System Demonstration (“LCASD”). Under the LCASD contract award, we will design, develop, deliver, demonstrate and test a technical baseline for a high-speed long-range, low-cost limited life-strike UAS. For our investment, we will retain hard and other assets, and important intellectual property, software, data, platform and system rights, which we believe will be critically important and valuable over the expected long-term life of this platform, including with respect to future production opportunities. We also were awarded one of four prime contract awards from the Defense Advanced Research Project Agency (DARPA) for the Gremlins program. Under the Gremlins program, DARPA envisions a swarm of approximately 20 high performance UAVs that are deployed by an inflight aircraft, and are later recovered, inflight, by an aircraft. The approximate $3.9 million Phase 1 contracts were awarded to four competing companies, with the intent to ultimately down select to one finalist company over a period of approximately 36 months.

Capitalize on corporate infrastructure investments. In recent periods, we have made significant investments in our senior management and corporate infrastructure related to cyber security threats to our Company, increased and changing regulations we are subject to, and the changing national security environment. These investments also included hiring senior executives with significant experience in the national security industry, strengthening our internal controls over financial reporting and accounting staff in support of public company reporting requirements, and expanding our backlog and bid and proposal pipeline. We expect to be allocating additional resources in our pursuit of new, larger and highly technical contract opportunities. We believe our management experience and corporate infrastructure can support a company with a much larger revenue base than ours. Accordingly, we believe that, to the extent our revenue grows, we will be able to leverage this infrastructure base and increase our operating margins.

Customers

A representative list of our customers in our KGS and US segments during 2016 included the U.S. Air Force, U.S. Army, U.S. Navy, U.S. Marines, Missile Defense Agency, Space Command, the Department of Homeland Security, the National Aeronautics and Space Administration, Foreign Military Sales (“FMS”), the U.S. Southern Command, Defense Innovation Unit Experimental, Strategic Command (STRATCOM), Special Capabilities Office (SCO), U.S. intelligence community and certain classified customers. In 2016, representative customers in the PSS segment included Metropolitan Transportation Authority of New York, Prince George’s County Public Schools, Children’s Hospital of Philadelphia, JP Morgan Chase, Alamo Colleges, City of Galveston, Texas Orthopedic Hospital, Port Authority of New York & New Jersey, Fidelity, Scripps Clinic, PNC Bank, Halliburton, AT&T, Chevron, Exxon, Calpine Power Plants, DuPont Fabros, BP America, Houston Community College, Siemens, San Francisco Municipal Transportation Agency, and New Flyer.

Revenue from the U.S. Government (which includes FMS) includes revenue from contracts for which we are the prime contractor as well as those for which we are a subcontractor and the ultimate customer is the U.S. Government. Revenues from U.S. Government agency customers in aggregate accounted for approximately 60%, 61% and 57% of total revenues in 2016, 2015, and 2014, respectively.

Revenues from foreign customers were approximately $80.1 million or 12%, $73.2 million or 11%, and $89.0 million or 12% of total revenue for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively.

Backlog

As of December 25, 2016 and December 27, 2015, our backlog was approximately $899.7 million and $913.8 million, respectively, of which $626.1 million was funded in 2016 and $528.7 million was funded in 2015. 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 the expenditure has not yet been authorized. Our total backlog does not include estimates of revenue from government wide acquisition contracts (“GWACs”) or General Services Administration (“GSA”) schedules beyond awarded or funded task orders, but our unfunded backlog does include estimates of revenue beyond awarded or funded task orders for other types of indefinite delivery or 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 that is considered to be firm, we cannot guarantee that cancellations or scope adjustments will not occur. The majority of funded backlog represents contracts with terms that would entitle us to all or a portion of our costs incurred and potential fees upon cancellation by the customer.

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.

Employees

As of December 25, 2016, we had a work force of approximately 2,900 full-time, part-time and on-call employees.

Competition

Our market is competitive and includes a number of companies in the U.S. defense and security system integration industries. Many of the companies that we compete against have significantly greater financial, technical and marketing resources and generate greater revenues than we do. Competition in the KGS and US segments include tier one, large U.S. Government contractors such as Northrop Grumman, Lockheed Martin, General Dynamics, Raytheon, BAE Systems, L3, Orbital/ATK and Boeing. While we view other government contractors as competitors, we also team with these same companies in joint proposals or in the delivery of our products, solutions and services for customers. Tier two competitors include smaller government contractors such as Mercury Computer, Qinetiq, Cobham and AAR. Intense competition and long operating cycles are key characteristics of our business within the defense industry. It is also common in the defense industry for work on major programs to be shared among a number of companies. A company competing to be a prime contractor or subcontractor on an award may, upon final award of the contract to another competitor, become a subcontractor for the final prime contractor. It is not unusual to compete for a contract award with a peer company and simultaneously perform as a supplier to or be a customer of that same competitor on other contracts, or vice versa. The nature of major defense programs, conducted under binding contracts, allows companies that perform well to benefit from a level of program continuity not frequently found in other industries. Competition in the PSS segment includes Siemens Building Technology, Johnson Controls, and Convergint Technologies, among others.

We believe that the principal competitive factors in our ability to win new business include our intellectual property, proprietary products, technology and ability to rapidly design, demonstrate and deliver systems to the warfighter at a low cost. Also important is our past performance qualifications, customer relationships, domain and technology expertise, the ability to replace contract vehicles, the ability to deliver results within budget (time and cost), reputation, accountability, staffing flexibility, and project management expertise. Additionally, our ability to deliver cost effective products, solutions and services that meet our customers' requirements is a key differentiator. The current federal procurement environment in the government services area is driven primarily by "low price, technically acceptable" contract award decisions. Accordingly, innovation and the ability for a contractor to quickly deliver a low cost, technically compliant solution or product are critical in the current competitive environment. In addition, competitor bid protests have become more prevalent in the current competitive environment, resulting in further delay of contract procurement activity.

In the U.S. defense, IT, and services markets, the U.S. Government has stressed competition and affordability in connection with its future procurement of products and services. This has led to fewer sole source awards, as well as more emphasis on cost competitiveness. In addition, the DoD has announced several initiatives to improve efficiency, refocus priorities, modify contract terms, and enhance DoD best practices including those used to procure goods and services from defense contractors. See the Industry Background section in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Industry Update section in Item 1 "Business" contained within this Annual Report. These initiatives, when implemented, together with planned reductions in defense spending levels, are likely to result in fewer new opportunities for our industry as a whole with more demanding terms. A reduced opportunity set is likely to intensify competition within the industry as companies compete for a more limited set of new programs.

Research and Development

We believe that our future success depends upon our ability to continue to develop new products and services, and enhancements to and applications for our existing products and services. Our research and development expenses were $13.9 million, $16.2 million and $18.6 million in 2016, 2015, and 2014, respectively. We intend to continue our focus on research and development as a key strategy for growth, which will focus on investments in those fields that we believe will offer the greatest opportunity for growth and profitability. Our current primary internal research and development ("IR&D") focus areas include unmanned systems, electronic warfare, satellite communications and signal monitoring.

Intellectual Property

We believe that our continued success depends in large part on our proprietary technology, the intellectual skills of our employees and the ability of our employees to continue to innovate. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements, to establish and protect our proprietary rights.

As of December 25, 2016, we held a number of U.S. and foreign patents. We do not consider our business to be materially dependent upon any individual patent. We will continue to file and pursue patent applications when and where appropriate to attempt to protect our rights in our proprietary technologies. We also encourage our employees to continue to invent and develop new technologies so as to maintain our competitiveness in the marketplace.

We own or have rights to use certain trademarks, service marks and trade names that we use in conjunction with the operation of our business. Certain of our trademarks have also been registered in selected foreign countries.

Government Regulation

We are subject to various government regulations, including various U.S. Government regulations as a contractor and subcontractor to the agencies of the U.S. Government. Among the most significant U.S. Government regulations affecting our business are:

- the Federal Acquisition Regulations and supplemental agency regulations, which comprehensively regulate the formation, administration, and performance under government contracts;
- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;
- the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under cost-based government contracts;

- the Foreign Corrupt Practices Act, which prohibits U.S. companies from providing anything of value to a foreign official to help obtain, retain or direct business, or obtain any unfair advantages;
- the False Claims Act and the False Statements Act, which, respectively, impose penalties for payments made on the basis of false facts provided to the government and impose penalties on the basis of false statements, even if they do not result in a payment; and
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

We also need special security clearances to continue working on and advancing certain of our projects with the U.S. Government. Classified programs generally will require that we comply with various Executive Orders, federal laws and regulations and customer security requirements that may include restrictions on how we develop, store, protect and share information, and may require our employees to obtain government clearances.

The nature of the work we do for the federal government may also limit the parties who may invest in or acquire us. Export laws may keep us from providing potential foreign acquirers with a review of the technical data they would be acquiring. In addition, there are special requirements for foreign parties who wish to buy or acquire control or influence over companies that control technology or produce goods in the security interests of the U.S. There may need to be a review under the Exon-Florio provisions of the Defense Production Act. Finally, the government may require a prospective foreign owner to establish intermediaries to actually run that part of the company that does classified work, and establishing a subsidiary and its separate operation may make such an acquisition less appealing to such potential acquirers.

In addition, the export from the U.S. of certain of our products may require the issuance of a license by the U.S. Department of Commerce under the Export Administration Act, as amended, and its implementing regulations as kept in force by the International Emergency Economic Powers Act of 1977, as amended. Some of our products may require the issuance of a license by the U.S. Department of State under the Arms Export Control Act and its implementing regulations, which licenses are generally harder to obtain and take longer to obtain than do Export Administration Act licenses.

Our business may require compliance with state or local laws designed to limit the uses of personal user information gathered online or require online services to establish privacy policies.

Material Availability

We procure critical material and subsystems from both domestic and global supply partners. These supply sources may be single sources for certain components and the material provided may have extended lead times. To support our continuing customer needs, we have taken steps to mitigate sourcing risks. This includes working closely with our suppliers to ensure future material and subsystem availability to support our manufacturing plans. In some cases, we have elected to stock reserve material to ensure future availability.

During fiscal year 2016, the Company paid $1.9 million to one of its suppliers, 5-D Systems, Inc. (“5-D”) for engineering services rendered to its Unmanned Systems business unit. Steve Fendley, who was promoted in January 2017 to President of our Unmanned Systems Division, is a cofounder and owns 33.3% of 5-D. Going forward, transactions with 5-D will be subject to review and approval by our Audit Committee and our board of directors consistent with the Company's policies regarding related party transactions.

Environmental

Our manufacturing operations are subject to many requirements under environmental laws. In the U.S., the U.S. Environmental Protection Agency and similar state agencies administer laws that restrict the emission of pollutants into the air, discharges of pollutants into bodies of water and disposal of pollutants in the ground. Violations of these laws can result in significant civil and criminal penalties and incarceration. The failure to obtain a permit for certain activities may be a violation of environmental law and subject the owner and operator to civil and criminal sanctions. Most environmental agencies also have the power to shut down an operation if it is operating in violation of environmental law. U.S. laws also typically allow citizens to bring private enforcement actions in some situations. Outside the U.S., the environmental laws and their enforcement vary and may be more burdensome. We have management programs and processes in place that are intended to minimize the potential for violations of these laws.

Other environmental laws, primarily in the U.S., address the contamination of land and groundwater and require the clean-up of such contamination. These laws may apply not only to the owner or operator of an on-going business, but also to the owner of land contaminated by a prior owner or operator. In addition, if a parcel is contaminated by the release of a hazardous substance, such as through its historic use as a disposal site, any person or company that has contributed to that contamination, whether or not it has a legal interest in the land, may be subject to a requirement to clean up the parcel.

Available Information

We file reports with the Securities and Exchange Commission (“SEC”). We make available on our website under “Investor Relations/Financial Information/SEC Filings,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file such materials with or furnish them to the SEC. Our website address is *www.kratosdefense.com*. You may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains our reports, proxy and information statements, and other information at www.sec.gov.

References to our website and the SEC’s website in this report are provided as a convenience and do not constitute, and should not be viewed as, incorporation by reference of the information contained on, or available through, such websites. Such information should not be considered a part of this report, unless otherwise expressly incorporated by reference in this report.

Item 1A. ***Risk Factors.***

You should carefully consider the following risk factors and all other information contained herein as well as the information included in this Annual Report and other reports and filings made with the SEC in evaluating our business and prospects. Risks and uncertainties, in addition to those we describe below, that are not presently known to us or that we currently believe are immaterial may also impair our business operations. If any of the following risks occur, our business and financial results could be harmed and the price of our common stock could decline. You should also refer to the other information contained in this Annual Report, including our Consolidated Financial Statements and the related Notes.

Risks Related to Our Business

The U.S. Government provides a significant portion of our revenue, and our business could be adversely affected by changes in the fiscal policies of the U.S. Government and governmental entities.

In fiscal 2016 , 2015 and 2014, we generated 60%, 61% and 57%, respectively, of our total revenues from contracts with the U.S. Government (including all branches of the U.S. military and FMS), either as a prime contractor or a subcontractor. We expect to continue to derive most of our revenues from work performed under U.S. Government contracts. See the Industry Update section in Item 1 “Business” contained within this Annual Report for a discussion of the current budgetary and funding constraints on U.S. Government spending and legislation enacted to reduce the U.S. federal deficit. As a result, we have experienced and expect to continue to experience reduced or delayed awards on some of our programs, with a related negative impact to our revenues, earnings and cash flows. Competitor bid protests also have become more prevalent in the current competitive environment resulting from decreased government spending, which has led to further contract award delays. In addition, any future changes to the fiscal policies of the U.S. Government and foreign governmental entities may decrease overall government funding for defense and homeland security, result in delays in the procurement of our products and services due to lack of funding, cause the U.S. Government and government agencies to reduce their purchases under existing contracts, or cause them to exercise their rights to terminate contracts at-will or to abstain from exercising options to renew contracts, any of which would have an adverse effect on our business, financial condition, results of operations and/or cash flows.

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

U.S. Government programs are subject to 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 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 obligated on a contract, we may be at risk for reimbursement of those costs unless and until additional funds are obligated to the contract. 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 annual budget process ultimately approved by Congress and the President or in separate supplemental appropriations or continuing resolutions, as applicable. Laws and plans adopted by the U.S. Government relating to, along with pressures on and uncertainty surrounding the federal budget, potential changes in priorities and defense spending levels, sequestration, the appropriations process, use of continuing resolutions (with restrictions, e.g., on new starts) and the permissible federal debt limit, could adversely affect the funding for individual programs and delay purchasing or payment decisions by our customers. In the event government funding for our significant programs becomes unavailable, or is reduced or delayed, or planned orders are reduced, our contract or subcontract under such programs may be terminated or adjusted by the U.S. Government or the prime contractor.

The budget environment, including sequestration as currently mandated, and uncertainty surrounding the appropriations processes, remain significant long-term risks. Considerable uncertainty exists regarding how future budget and program decisions will unfold, including the defense spending priorities of the new Administration and Congress, what challenges budget reductions (required by the BCA and otherwise) will present for the defense industry and whether an annual appropriations bill will be enacted for FY 2017. If an annual appropriations bill is not enacted for FY 2017 or beyond, the U.S. Government may continue to operate under a continuing resolution, restricting new contract or program starts, and we may face a government shutdown of unknown duration. It is likely budget and program decisions made in this environment would have long-term implications for our Company and the entire defense industry.

If the debt ceiling is breached, we may be required to continue to perform for some period of time on certain of our U.S. Government contracts even if the U.S. Government is unable to make timely payments. Unforeseen circumstances could cause an extended debt ceiling breach and have significant near and long-term consequences for our Company, our employees, our suppliers and the defense industry.

Long-term funding for certain programs in which we participate may be reduced, delayed or cancelled. In addition, budget cuts globally could adversely affect the viability of our subcontractors and suppliers, and our employee base. While we believe that our business is well-positioned in areas that the DoD and other customers have indicated are areas of focus for future defense spending, the long-term impact of the BCA, other defense spending cuts, the debt ceiling and the ongoing fiscal debates remain uncertain.

Significant delays or reductions in appropriations; long-term funding under a continuing resolution; an extended debt ceiling breach or government shutdown; and/or future budget and program decisions, among other items, may negatively impact our business and programs and could have a material adverse effect on our financial position, results of operations and/or cash flow.

If we fail to establish and maintain important relationships with government agencies and prime contractors, our ability to successfully maintain and develop new business may be adversely affected.

Our reputation and relationship with the U.S. Government, and in particular with the agencies of the DoD and the U.S. intelligence community, are key factors in maintaining and developing new business opportunities. In addition, we often act as a subcontractor or in “teaming” arrangements in which we and other contractors bid together on particular contracts or programs for the U.S. Government or government agencies. We expect to continue to depend on relationships with other prime contractors for a portion of our revenue for the foreseeable future. Negative press reports regarding conflicts of interest, poor contract performance, employee misconduct, information security breaches or other aspects of our business, regardless of accuracy, could harm our reputation. Additionally, as a subcontractor or team member, we often lack control over fulfillment of a contract, and poor performance on the contract could tarnish our reputation, even when we perform as required. As a result, we may be unable to successfully maintain our relationships with government agencies or prime contractors, and any failure to do so could adversely affect our ability to maintain our existing business and compete successfully for new business.

Many of our contracts contain performance obligations that require innovative design capabilities, are technologically complex, require state-of-the-art manufacturing expertise, or are dependent upon factors not wholly within our control. Failure to meet these obligations could adversely affect our profitability and future prospects. Early termination of client contracts or contract penalties could adversely affect our results of operations.

We design, develop, and manufacture technologically advanced and innovative products and services, which are applied by our customers in a variety of environments. Problems and delays in development or delivery as a result of issues with respect to design, technology, licensing and intellectual property rights, labor, inability to achieve learning curve assumptions, manufacturing materials or components could prevent us from meeting requirements. Either we or the customer may generally terminate a contract as a result of a material uncured breach by the other. If we breach a contract or fail to perform in accordance with contractual service levels, delivery schedules, performance specifications, or other contractual requirements set forth therein, the other party thereto may terminate such contract for default, and we may be required to refund money previously paid to us by the customer or to pay penalties or other damages. Even if we have not breached, we may deal with various situations from time to time that may result in the amendment or termination of a contract. These steps can result in significant current period charges and/or reductions in current or future revenue. Other factors that may affect revenue and profitability include inaccurate cost estimates, design issues, unforeseen costs and expenses not covered by insurance or indemnification from the customer, diversion of management focus in responding to unforeseen problems, and loss of follow-on work.

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

As a prime contractor, we often rely upon other companies as subcontractors to perform work we are obligated to perform for our customers. As we secure more work under certain of our contracts, we expect to require an increasing level of support from subcontractors that provide complementary and supplementary services to our offerings. We are responsible for the work performed by our subcontractors, even though in some cases we have limited involvement in that work. If one or more of our subcontractors fails to satisfactorily perform the agreed-upon services on a timely basis or violates U.S. Government contracting policies, laws or regulations, our ability to perform our obligations as a prime contractor or meet our customers' expectations may be compromised. In extreme cases, performance or other deficiencies on the part of our subcontractors could result in a customer terminating our contract for default. A termination for default could expose us to liability, including liability for the agency's costs of re-procurement, could damage our reputation and could hurt our ability to compete for future contracts.

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

Our earnings and profitability depend, in part, on subcontractor and supplier performance and product availability.

We rely on other companies to provide major components for our products. For instance, we build the airframe, electronics and flight control systems for our unmanned aerial systems. We rely on our suppliers to provide the engines and parachutes for landing the aircraft. Disruptions or performance problems caused by our subcontractors and suppliers, or a misalignment between our contractual obligations to our customers and our agreements with our subcontractors and suppliers, could have an adverse effect on our ability to meet our commitments to customers.

Our ability to perform our obligations on time could be adversely affected if one or more of our subcontractors or suppliers were unable to provide the agreed-upon products or materials or perform the agreed-upon services in a timely, compliant and cost-effective manner or otherwise to meet the requirements of the contract. Changes in economic conditions, including changes in defense budgets or credit availability, or other changes impacting a subcontractor or supplier (including changes in ownership or operations) could adversely affect the financial stability of our subcontractors and suppliers and/or their ability to perform. The inability of our suppliers to perform, or their inability to perform adequately, could also result in the need for us to transition to alternate suppliers, which could result in significant incremental cost and delay or the need for us to provide other resources to support our existing suppliers.

In connection with our U.S. Government contracts, we are required to procure certain materials, components and parts from supply sources approved by the customer. We also are facing increased and changing regulatory requirements, many of which apply to our subcontractors and suppliers. In some cases, there may be only one supplier for certain components. If a sole source supplier cannot meet our needs or is otherwise unavailable, we may be unable to find a suitable alternative.

Our procurement practices are intended to reduce the likelihood of our procurement of counterfeit, unauthorized or otherwise non-compliant parts or materials. We rely on our subcontractors and suppliers to comply with applicable laws and regulations, including regarding the parts or materials we procure from them; in some circumstances, we rely on certifications provided by our subcontractors and suppliers regarding their compliance. We also rely on our subcontractors and suppliers to effectively mitigate the risk of cyber and security threats or other disruptions with respect to the products and components they deliver to us and the information entrusted to them by us or our customers.

If we are unable to procure or experience significant delays in subcontractor or supplier deliveries of, needed materials, components, intellectual property or parts; if our subcontractors or suppliers do not comply with all applicable laws and regulations; if the certifications we receive from them are inaccurate; or if what we receive is counterfeit or otherwise improper, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

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

We operate in highly competitive markets and generally encounter intense competition to win contracts from many other firms, including mid-tier federal contractors with specialized capabilities, large defense contractors and IT services providers. Competition in our markets may increase as a result of a number of factors, such as the entrance of new or larger competitors, including those formed through alliances or consolidation, or the reduction in the overall number of government contracts. We may also face competition from prime contractors for whom we currently serve as subcontractors or teammates if those prime contractors choose to offer customer services of the type that we are currently providing. Recently, procurement award determinations have been based on lowest price, technically acceptable proposals. In addition, we may face competition from our subcontractors who, from time-to-time, seek to obtain prime contractor status on contracts for which they currently serve as a subcontractor to us.

Many of our competitors have greater financial, technical, marketing and public relations resources, larger customer bases and greater brand or name recognition than we do. Such competitors may be able to utilize their substantially greater resources and economies of scale to, among other things:

- divert sales from us by winning very large-scale government contracts, a risk that is enhanced by the recent trend in government procurement practices to bundle services into larger contracts and the recent trend of making award determinations on a lowest price, technically acceptable basis;
- divert sales from us by the award of government contracts to our competitors who may be willing to bid at substantially lower prices;
- force us to charge lower prices; or
- adversely affect our relationships with current customers, including our ability to continue to win competitively awarded engagements in which we are the incumbent.

In the event that the market for products in our US segment expands, we expect that competition will intensify as additional competitors enter the market and current competitors expand their product lines. In order to secure contracts successfully when competing with larger, well-financed companies, we may be forced to agree to contractual terms that provide for lower aggregate payments to us over the life of the contract, which could adversely affect our margins. In addition, larger diversified competitors serving as prime contractors may be able to supply underlying products and services from affiliated entities, which would prevent us from competing for subcontracting opportunities on these contracts. If we lose business to our competitors or are forced to lower our prices, our revenue and operating profits could decline.

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

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

We believe that, in order to remain competitive in the future, we will need to continue to invest significant financial resources to develop new offerings and technologies or to adapt or modify our existing offerings and technologies, including through internal research and development, acquisitions and joint ventures or other teaming arrangements. These expenditures could divert our attention and resources from other projects, and we cannot be sure that these expenditures will ultimately lead to the timely development of new offerings and technologies or identification of and expansion into new markets. Due to the design complexity of our products, we may, in the future, experience delays in completing the development and introduction of new products. Any delays could result in increased costs of development or deflect resources from other projects. In addition, there can be no assurance that the market for our products will develop or continue to expand or that we will be successful in newly identified markets as we currently anticipate. The failure of our technology to gain market acceptance could significantly reduce our revenues and harm our business. Furthermore, we cannot be sure that our competitors will not develop competing technologies that gain market acceptance in advance of our products.

Additionally, the possibility exists that our competitors might develop new technology or offerings that might cause our existing technology and offerings to become obsolete. If we fail in our new product development efforts or our products or services fail to achieve market acceptance more rapidly as compared to our competitors, our ability to procure new contracts could be negatively impacted, which could negatively impact our results of operations and financial condition.

If the UAS and UGS markets do not experience significant growth, if we cannot expand our customer base or if our products do not achieve broad acceptance, then we may not be able to achieve our anticipated level of growth.

For the fiscal year ended December 25, 2016, our US segment accounted for 11.3% of our total revenue. We cannot accurately predict the future growth rate or size of this market. Demand for our products may not increase, or may decrease, either generally or in specific markets, for particular types of products or during particular time periods. There are only a limited number of major programs under which the U.S. military, our primary customer, is currently funding the development or purchase of our UAS and UGS products. Although we are seeking to expand our US customer base to include foreign governments, domestic non-military agencies and commercial customers, we cannot assure that our efforts will be successful. The expansion of the UAS and UGS markets in general, and the market for our products in particular, depends on a number of factors, including the following:

- customer satisfaction with these types of systems as solutions;
- the cost, performance and reliability of our products and products offered by our competitors;
- customer perceptions regarding the effectiveness and value of these types of systems;
- limitations on our ability to market our US products and services outside the U.S. due to U.S. government regulations; and
- marketing efforts and publicity regarding these types of systems.

Even if UAS and UGS gain wide market acceptance in general, our specific products may not adequately address market requirements or may not gain market acceptance. If these types of systems generally, or our products specifically, do not gain wide market acceptance, then we may not be able to achieve our anticipated level of growth and our revenue and results of operations may suffer.

Loss of our GSA contracts or GWACs could impair our ability to attract new business.

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

Government contracts differ materially from standard commercial contracts, involve competitive bidding and may be subject to cancellation or delay without penalty.

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

- terminate our existing contracts;
- reduce potential future income from our existing contracts;
- modify some of the terms and conditions in our existing contracts;
- suspend or permanently prohibit us from doing business with the U.S. Government or with any specific government agency;
- impose fines and penalties;
- subject us to criminal prosecution;
- suspend work under existing multiple year contracts and related task orders if the necessary funds are not appropriated by Congress;
- decline to exercise an option to extend an existing multiple year contract; and
- claim rights in technologies and systems invented, developed or produced by us.

In addition, government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted and typically impose provisions that permit cancellation in the event that necessary funds are unavailable to the government agency. Competitive procurements impose substantial costs and managerial time and effort in order to prepare bids and proposals for contracts that may not be awarded to us. In many cases, unsuccessful bidders for government contracts are provided the opportunity to formally protest certain contract awards through various agencies, administrative and judicial channels. We have experienced an increase in competitor bid protests on contracts on which we were the successful bidder due to the competitive environment resulting from decreased government spending. In addition, we have formally protested procurement awards in which we were not the initial successful bidder, but believed that the source selection process was flawed. The protest process may substantially delay a successful bidder's contract performance, result in cancellation of the contract award entirely and distract management. We may not be awarded contracts for which we bid, and substantial delays or cancellation of purchases may follow our successful bids as a result of such protests. We believe that this environment of protracted competitive bidding processes and competitor bid protests will continue.

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

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

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

A preference for minority-owned, small and small disadvantaged businesses could impact our ability to be a prime contractor and limit our opportunity to work as a subcontractor on certain governmental procurements.

As a result of the Small Business Administration ("SBA") set-aside program, the federal government may decide to restrict certain procurements only to bidders that qualify as minority-owned, small, or small disadvantaged businesses. As a result, we would not be eligible to perform as a prime contractor on those programs and in general would be restricted to no more than 49% of the work as a subcontractor on those programs. An increase in the amount of procurements under the SBA set-aside program may impact our ability to bid on new procurements as a prime contractor, limit our opportunity to work as a subcontractor or restrict our ability to compete on incumbent work that is placed in the set-aside program.

U.S. Government in-sourcing could result in loss of business opportunities and personnel.

The U.S. Government has continued to reduce the percentage of contracted services in favor of more federal employees through an initiative called "in-sourcing." Over time, in-sourcing could have an adverse effect on our business, financial condition and results of operations. Specifically, as a result of in-sourcing government procurements for services could be fewer and smaller in the future. In addition, work we currently perform could be in-sourced by the federal government and, as a result, our revenues could be reduced. Moreover, our employees could also be hired by the government. This loss of our employees would necessitate the need to retain and train new employees. Accordingly, the effect of in-sourcing or the continuation of in-sourcing at a faster-than-expected rate, could have an adverse effect on our business, financial condition, and results of operations.

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

Many of the systems we develop, install and maintain involve managing and protecting information involved in intelligence, national security and other sensitive or classified U.S. Government functions. We face various security threats, including cybersecurity threats, to gain unauthorized access to this sensitive information. Such threats can come from external as well as internal sources. We also face 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 prevent us from being eligible for further work on sensitive or classified systems for U.S. Government customers. Further, any losses we incur from such a security breach could exceed the policy limits under our errors and omissions and product liability insurance. Any losses we incur, any damage to our reputation or any limitations on our eligibility for additional work resulting from a security breach could materially reduce our revenue and could have a material adverse effect on our business, financial condition and results of operations.

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. We have experienced cybersecurity attacks and may experience them in the future. These events could damage our reputation and lead to financial losses from remedial actions, loss of business, loss of proprietary and trade secret information or potential liability.

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

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

- lose revenue due to adverse customer reaction;
- be required to provide additional services to a customer at no charge;
- cause customers to postpone, cancel or fail to renew contracts;
- receive negative publicity, which could damage our reputation and adversely affect our ability to attract or retain customers; and
- suffer claims for substantial damages.

We cannot ensure that provisions in our customer contracts will be legally sufficient to protect us if we are sued.

In addition, our errors and omissions and product liability insurance coverage may not be adequate, may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or the insurer may disclaim coverage as to some types of future claims. The successful assertion of any large claim against us could seriously harm our business. Even if not successful, these claims may result in significant legal and other costs, be a distraction to our management and harm our reputation.

Our products are complex and could have unknown defects or errors, which may increase our costs, harm our reputation with customers, give rise to costly litigation, or divert our resources from other purposes**.**

Our products, including but not limited to unmanned vehicles, aerial targets, UAS and ballistic missile targets, are extremely complex and must operate successfully with complex products from other vendors. Despite testing, our products have contained defects and errors and may in the future contain defects or errors, or experience performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period of time. These problems could result in expensive and time-consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, diversion of our personnel's attention from our product development efforts, exposure to liability for damages, damaged customer relationships, and harm to our reputation, any of which could materially harm our results of operations. In addition, increased development and warranty costs could be substantial and could reduce our operating margins.

The existence of any defects, errors, or failures in our products or the misuse of our products could also lead to lawsuits against us, result in injury, death, or property damage, and significantly damage our reputation and support for our products in general.

Although we maintain insurance policies, we cannot provide assurance that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all. A successful liability claim could result in substantial cost to us. Even if we are fully insured as it relates to a claim, the claim could nevertheless diminish our brand and divert management's attention and resources, which could have a negative impact on our business, financial condition, and results of operations.

Due to the volatile and flammable nature of certain components of our products and equipment, fires or explosions may

disrupt our business or cause significant injuries, which could adversely affect our financial results.

The development and manufacture of certain of our products involves the handling of a variety of explosive and flammable materials as well as high power equipment. From time to time, these activities may result in incidents that could cause us to temporarily shut down or otherwise disrupt some manufacturing processes, causing production delays and resulting in liability for workplace injuries and/or fatalities. We have safety and loss prevention programs that require detailed reviews of process changes and new operations, along with routine safety audits of operations involving explosive materials, to mitigate such incidents, as well as a variety of insurance policies. However, we cannot ensure that we will not experience such incidents in the future or that any such incidents will not result in production delays or otherwise have a material adverse effect on our business and financial condition.

Our financial results may vary significantly from quarter to quarter.

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

In addition, payments due to us from our customers may be delayed due to billing cycles or as a result of failures of government budgets to gain congressional and administration approval in a timely manner. The U.S. Government's fiscal year ends September 30. If a federal budget for the next federal fiscal year has not been approved by that date in each year, our customers may have to suspend engagements that we are working on until a budget has been approved. Any such suspensions may reduce our revenue in the fourth quarter of the federal fiscal year or the first quarter of the subsequent year. The U.S. Government's fiscal year end can also trigger increased purchase requests from customers for equipment and materials. Any increased purchase requests we receive as a result of the U.S. Government's fiscal year end would serve to increase our third or fourth quarter revenue, but will generally decrease profit margins for that quarter, as these activities generally are not as profitable as our typical offerings.

Additional factors that may cause our financial results to fluctuate from quarter to quarter include those addressed elsewhere in this Item 1A "Risk Factors" and the following factors, among others:

- the terms of customer contracts that affect the timing of revenue recognition;
- variability in demand for our services and solutions;
- commencement, completion or termination of contracts during any particular quarter;
- timing of shipments and product deliveries;
- timing of award or performance incentive fee notices;
- timing of significant bid and proposal costs;
- the costs of remediating unknown defects, errors or performance problems of our product offerings;
- variable purchasing patterns under GSA contracts, GWACs, blanket purchase agreements and other indefinite delivery or indefinite quantity contracts;
- restrictions on and delays related to the export of defense articles and services;
- costs related to government inquiries;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs and joint ventures;
- strategic investments or changes in business strategy;
- changes in the extent to which we use subcontractors;
- seasonal fluctuations in our staff utilization rates;
- changes in our effective tax rate, including changes in our judgment as to the necessity of the valuation allowance recorded against our deferred tax assets; and
- the length of sales cycles.

Significant fluctuations in our operating results for a particular quarter could cause us to fall out of compliance with the financial covenants related to our debt, which if not waived, could restrict our access to capital and cause us to take extreme measures to pay down the debt, if any, under our $110.0 million Credit and Security Agreement, dated May 14, 2014 (the "Credit Agreement"), by and among the Company, the lenders from time to time party thereto, SunTrust Bank, as Agent (the "Agent"), PNC Bank, National Association, as Joint Lead Arranger and Documentation Agent, and SunTrust Robinson Humphrey, Inc., as Joint Lead Arranger and Sole Book Runner. In addition, fluctuations in our financial results could cause our stock price to decline. See the risks and uncertainties related to our ability to raise additional capital below in *"We may need additional capital to fund the growth of our business, and financing may not be available on favorable terms or at all."*

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

Although fixed-price contracts entail a greater risk of a reduced profit or financial loss on a contract compared to other types of contracts we enter into, fixed-price contracts typically provide higher profit opportunities because we may be able to benefit from cost savings and operating efficiencies. In contrast, cost-plus-fee contracts are subject to statutory limits on profit margins and generally are the least profitable of our contract types. Our U.S. Government customers typically determine what type of contract we enter into. Cost-plus-fee and fixed-price contracts in our federal business accounted for approximately 19% and 74%, respectively, of our federal business revenues for the year ended December 25, 2016. To the extent that we enter into more cost-plus-fee or less fixed-price contracts in proportion to our total contract mix in the future, our margins and operating results may suffer.

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

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

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

As of December 25, 2016, goodwill represented approximately 51% of our total assets. We periodically review the carrying values of our goodwill to determine whether such carrying values exceed the fair market value. If impairment testing indicates that the carrying value of a reporting unit exceeds its fair value, the goodwill of the reporting unit is deemed impaired. Accordingly, an impairment charge would be recognized for that reporting unit in the period identified.

The identification and measurement of impairment involves the estimation of the fair value of reporting units. Accounting for impairment contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows can be affected by changes in industry or market conditions, among other things.

Given the current market conditions and continued economic uncertainty in the U.S. defense industry, including sequestration and issues surrounding the national debt ceiling, our future revenues, profits and cash flows could be substantially lower than our current projections. Our ability to penetrate new international markets could also impact our current projections. Additional market factors could impact our projections and our ability to successfully develop new products and platforms. For example, our US reporting unit forecasts include the successful completion of certain performance criteria on new unmanned systems platforms, and acceptance of new unmanned systems platforms on a technical basis as well as from a political and government budgetary standpoint. In addition, market-based inputs to the calculations in the impairment test, such as weighted average cost of capital, and market multiples, could also be negatively impacted. Such circumstances may result in the future deterioration of the fair value of our reporting units and an impairment of our goodwill. Due to continual changes in market and general business conditions, we cannot predict whether, and to what extent, our goodwill and long-lived intangible assets may be impaired in future periods. Any resulting impairment loss could harm our profitability and financial condition.

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

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

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

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

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

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

Federal and state income tax laws impose restrictions on the utilization of net operating loss ("NOL") and tax credit carryforwards in the event that an "ownership change" occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code of 1986, as amended. We believe we underwent an ownership change in March 2010 that limited the Company's federal annual utilization of NOL carryforwards. If the entire limitation amount is not utilized in a year, the excess can be carried forward and utilized in future years. For the year ended December 25, 2016, there was no impact of such limitations on the income tax provision since the amount of taxable income did not exceed the cumulative annual limitation amount. In addition, future equity offerings or acquisitions that have equity as a component of the purchase price could also cause an "ownership change." If and when any other "ownership change" occurs, utilization of the NOL or other tax attributes may be further limited.

We expect to incur substantial research and development costs and devote significant resources to identifying and commercializing new products and services, which could significantly reduce our profitability and may never result in revenue to us.

Our future growth depends on penetrating new markets, adapting existing products to new applications, and introducing new products and services that achieve market acceptance. We plan to incur substantial research and development costs as part of our efforts to design, develop and commercialize new products and services and enhance existing products. We spent $13.9 million, or 2.1% of our revenue, in our fiscal year ended December 25, 2016 on internally funded research and development activities. We believe that there are significant investment opportunities in a number of business areas. Because we account for research and development as an operating expense, these expenditures will adversely affect our earnings in the future. Further, our research and development programs may not produce successful results, and our new products and services may not achieve market acceptance, create additional revenue or become profitable, which could materially harm our business, prospects, financial results and liquidity.

Risks Related to Our Operations

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

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

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

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

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

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

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

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

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

We believe that the success of our business and our ability to operate profitably depends on the continued contributions of the members of our senior management. We rely on our senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of our senior management team have established and maintain with U.S. Government personnel contribute to our ability to maintain strong customer relationships and to identify new business opportunities. The loss of any member of our senior management could impair our ability to identify and secure new contracts, to maintain good customer relations and to otherwise manage our business.

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

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

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

We are subject to the requirements of the National Industrial Security Program Operating Manual for our facility security clearance, which is a prerequisite to our ability to perform on classified contracts for the U.S. Government.

A facility security clearance is required for a company to perform on classified contracts for the DoD and certain other agencies of the U.S. Government. Security clearances are subject to regulations and requirements including the National Industrial Security Program Operating Manual (“NISPOM”), which specifies the requirements for the protection of classified information released or disclosed in connection with classified U.S. Government contracts.

We require certain facility and personnel security clearances to perform our classified U.S. Government related business. As such, we must comply with the requirements of the NISPOM and any other applicable U.S. Government industrial security regulations. If we were to violate the terms and requirements of the NISPOM or any other applicable U.S. Government industrial security regulations (which apply to us under the terms of classified contracts), any of our cleared facilities could lose its facility security clearance. We cannot be certain that we will be able to maintain our facility security clearances. If for some reason one or more of our facility security clearances is invalidated or terminated, we would not be able to continue to perform on classified contracts at that facility and would not be able to enter into new classified contracts, which could adversely affect our revenues. Failure to comply with the NISPOM or other security requirements may subject us to civil or criminal penalties, loss of access to classified information, loss of a U.S. Government contract, or potentially debarment as a government contractor.

We may be unable to realize any benefit from our cost reduction and restructuring efforts and our profitability may be hurt or our business otherwise might be adversely affected.

We have engaged in cost reduction and restructuring activities in the past, including the recent restructuring actions in the Modular Systems and Public Safety businesses, and we may engage in other cost reduction restructuring activities in the future. These types of cost reduction and restructuring activities are complex. If we do not successfully manage our current cost reduction and restructuring activities, or any other cost reduction and restructuring activities that we may take in the future, any expected efficiencies and benefits might be delayed or not realized, and our operations and business could be disrupted. In addition, the costs associated with implementing cost reduction and restructuring activities might exceed expectations, which could result in additional future charges.

Risks Related to Our International Operations

Revenues derived from our international business could be subject to global economic downturn and hardship.

Our international business represents 12% of our total revenue for the year ended December 25, 2016, which may be impacted by changes in foreign national priorities and government budgets and may be further impacted by global economic conditions and fluctuations in foreign currency exchange rates. Continued international economic uncertainty and reductions in consumer spending may result in reductions in our revenue. Additionally, disruptions in international credit markets may materially limit consumer credit availability and restrict credit availability of our customers. Any reduction in international sales of our solutions resulting from reductions in consumer spending or continued disruption in the availability of credit to retailers or consumers, could materially and adversely affect our business, results of operations and financial condition.

Our international business exposes us to additional risks.

Our operations outside of the U.S. are subject to risks that are inherent in conducting business under non-U.S. laws, regulations and customs, including those related to:

- foreign currency exchange rate fluctuations, potentially reducing the U.S. dollars we receive for sales denominated in foreign currency;
- the possibility that unfriendly nations or groups could boycott our solutions;
- political conditions in the markets in which we operate;
- potential increased costs associated with overlapping tax structures;
- import-export control;
- more limited protection for intellectual property rights in some countries;
- difficulties and costs associated with staffing and managing foreign operations;
- unexpected changes in regulatory requirements;
- the difficulties of compliance with a wide variety of foreign laws and regulations;
- longer accounts receivable cycles in certain foreign countries, whether due to cultural differences, exchange rate fluctuation or other factors;
- technology transfer restrictions;
- changes to our distribution networks; and
- our employees.

These risks, individually or in the aggregate, could have an adverse effect on our results of operations and financial condition. For example, we are subject to compliance with the Foreign Corrupt Practices Act and similar anti-bribery laws, which generally prohibit companies and their intermediaries from making improper payments to foreign government officials for the purpose of obtaining or retaining business. While our employees and agents are required to comply with these laws, we cannot be sure that our internal policies and procedures will always protect us from violations of these laws, despite our commitment to legal compliance and corporate ethics. The occurrence or allegation of these types of risks may adversely affect our business, performance, prospects, value, financial condition, and results of operations. In addition, our international contracts may include industrial cooperation agreements requiring specific in-country purchases, investments, manufacturing agreements or other financial obligations, known as offset obligations, and provide for penalties if we fail to meet such requirements. The impact of these factors is difficult to predict, but one or more of them could adversely affect our financial position, results of operations, or cash flows.

Violations of the International Traffic in Arms Regulations (“ITAR”) or other applicable trade compliance regulations could result in significant sanctions including fines, more onerous compliance requirements and debarments from export privileges or loss of authorizations needed to conduct aspects of our international business. A violation of ITAR or other applicable trade regulations could materially adversely affect our business, financial condition and results of operations.

Risks Related to Our Outstanding Indebtedness

We have substantial indebtedness, which could adversely affect our cash flow, financial condition and business.

As of December 25, 2016, we had approximately $432.0 million of total indebtedness outstanding, which includes $2.4 million of unamortized original issue discount and $2.9 million of unamortized debt issuance costs. As a result of this indebtedness, our interest payment obligations are significant. The degree to which we are leveraged could have adverse effects on our business, including the following:

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

Our high level of indebtedness increases the risk that we may default on our debt obligations. We may be unable to generate sufficient cash flow to pay the interest on our debt. 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, reducing internal investments in research and development efforts, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. These alternative strategies may not be affected on satisfactory terms, if at all, and they may not yield sufficient funds to make required payments on our indebtedness.

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

We and our subsidiaries may incur more debt, which may increase the risks associated with our substantial leverage, including our ability to service our indebtedness.

The agreements governing our debt permit us, under some circumstances, to incur certain additional indebtedness or obligations. 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.

Changes in our credit ratings or macroeconomic conditions may affect our liquidity, increasing borrowing costs and limiting our financing options.

Macroeconomic conditions, such as increased volatility or disruption in the credit markets, could adversely affect our ability to refinance existing debt or obtain additional financing at terms satisfactory to us, thereby affecting our resources to support operations or to fund new initiatives. In addition, if our credit ratings are lowered, borrowing costs for future long-term debt or short-term credit facilities may increase and our financing options, including our access to the unsecured credit market, could be limited. We may also be subject to restrictive covenants that would reduce our flexibility.

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

As of December 25, 2016, approximately 12% of our consolidated assets, based on book value, and 11% of our consolidated revenues for the year ended December 25, 2016, were held by foreign subsidiaries, which do not guarantee the Notes. Our ability to meet our debt service obligations with cash from foreign subsidiaries will depend upon the results of operations of these subsidiaries and may be subject to legal, contractual or other restrictions and other business considerations. In addition, dividend and interest payments to us from the foreign subsidiaries may be subject to foreign withholding taxes, which would reduce the amount of funds we receive from such foreign subsidiaries. Dividends and other distributions from our foreign subsidiaries may also be subject to fluctuations in currency exchange rates and legal and other restrictions on repatriation, which could further reduce the amount of funds we receive from such foreign subsidiaries.

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

The agreements governing our debt 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 Credit Agreement subject us, and our subsidiaries, to several financial and other restrictive covenants, including limitations on liens or indebtedness, payment of dividends, transactions with affiliates, and mergers, sales or other dispositions of our assets.

Our Credit Agreement also requires us to comply with specified financial ratios, including a borrowing base availability and minimum fixed charge coverage ratio which is required to be maintained if borrowing levels, as defined, under the Credit Agreement, occur under the line of credit. Many factors, including events beyond our control, may affect our ability to comply with these covenants and financial ratios. We cannot be sure we will meet our debt-related obligations or that lenders will waive any failure to meet those obligations. Any failure to meet those debt-related obligations could result in an event of default under our other indebtedness and the acceleration of such indebtedness.

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

Risks Related to Our Intellectual Property

We may be unable to protect our intellectual property rights.

We rely on a combination of patents, trademarks, copyrights, trade secrets and nondisclosure agreements to protect our proprietary intellectual property. Our efforts to protect our intellectual property and proprietary rights may not be sufficient. We cannot be sure that our pending patent applications will result in the issuance of patents to us, that patents issued to or licensed by us in the past or in the future will not be challenged or circumvented by competitors or that these patents will remain valid or sufficiently broad to preclude our competitors from introducing technologies similar to those covered by our patents and patent applications. In addition, our ability to enforce and protect our intellectual property rights may be limited in certain countries outside the U.S., which could make it easier for competitors to capture market position in such countries by utilizing technologies that are similar to those developed or licensed by us. Competitors also may harm our sales by designing products that mirror the capabilities of our products or technology without infringing on our intellectual property rights. If we do not obtain sufficient protection for our intellectual property, or if we are unable to effectively enforce our intellectual property rights, our competitiveness could be impaired, which would limit our growth and future revenue.

We may be harmed by intellectual property infringement claims.

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

Disclosure of trade secrets could cause harm to our business

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

Risks Related to Regulatory, Environmental and Legal Issues

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

We must comply with laws and regulations relating to the formation, administration and performance of U.S. Government contracts, which affect how we do business with our customers, prime contractors, subcontractors and vendors and may impose added costs on us. New regulations or procurement requirements (including, for example regulations regarding counterfeit and corrupt parts, supply chain diligence and cyber security) or changes to current requirements could increase our costs and risk of non-compliance. Our role as a contractor to agencies and departments of the U.S. Government results in our being routinely subject to investigations and reviews relating to compliance with various laws and regulations, including those associated with organizational conflicts of interest, procurement integrity, bid integrity and claim presentation, among others. These investigations may be conducted without our knowledge. Adverse findings in these investigations or reviews can lead to criminal, civil or administrative proceedings, and we could face civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with U.S. Government agencies. In addition, we could suffer serious harm to our reputation and competitive position if allegations of impropriety were made against us, whether or not true. If our reputation or relationship with U.S. Government agencies were impaired, or if the U.S. Government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating profit would decline.

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

U.S. Government agencies, including the Defense Contract Audit Agency (“DCAA”), routinely audit and investigate government contracts and government contractors’ administrative processes and systems. These agencies review our performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. They also review the adequacy of our compliance with government standards for our accounting and management of internal control systems, including our: control environment and overall accounting system, general IT system, budget and planning system, purchasing system, material management and accounting system, compensation system, labor system, indirect and other direct costs system, and billing system and estimating system used for pricing on government contracts. Both contractors and the U.S. Government agencies conducting these audits and reviews have come under increased scrutiny. The current audits and reviews have become more rigorous, and the standards to which contractors are being held are being more strictly interpreted, increasing the likelihood of an audit or review resulting in an adverse outcome. During the course of its current audits, the DCAA is closely examining and questioning several of our established and disclosed practices that it had previously audited and accepted, increasing the uncertainty as to the ultimate conclusion that will be reached.

A finding of significant control deficiencies in our system audits or other reviews can result in decremented billing rates to our U.S. Government customers until the control deficiencies are corrected and our corrections are accepted by Defense Contract Management Agency (“DCMA”). Government audits and reviews may conclude that our practices are not consistent with applicable laws and regulations and result in adjustments to contract costs and mandatory customer refunds. Such adjustments can be applied retroactively, which could result in significant customer refunds. Our receipt of adverse audit findings or the failure to obtain an “approved” determination of our various accounting and management internal control systems, including our changes to indirect cost and direct labor estimating systems, from the responsible U.S. Government agency could significantly and adversely affect our business, including our ability to bid on new contracts and our competitive position in the bidding process. A determination of non-compliance with applicable contracting and procurement laws, regulations and standards could also result in the U.S. Government imposing penalties and sanctions against us, including withholding of payments, suspension of payments and increased government scrutiny that could delay or adversely affect our ability to invoice and receive timely payment on contracts, perform contracts or compete for contracts with the U.S. Government.

We have submitted incurred cost claims through 2015. The actual indirect cost audits by the DCAA have been completed for our subsidiaries for fiscal 2010. Although we have recorded contract revenues subsequent to fiscal 2010 based upon costs that we believe will be approved upon final audit or review, we do not know the outcome of any ongoing or future audits or reviews and, if future adjustments exceed our estimates, our profitability would be adversely affected.

Our employees or others acting on our behalf may engage in misconduct or other improper activities, which could cause us to lose contracts.

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

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

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our operating results could be misstated, our reputation may be harmed and the trading price of our stock could be negatively affected. Our management has concluded that there are no material weaknesses in our internal controls over financial reporting as of December 25, 2016. However, although we continue to devote substantial time and resources to the documentation and testing of our controls, there can be no assurance that our controls over financial processes and reporting will be effective in the future or that material weaknesses or significant deficiencies in our internal controls will not be discovered in the future. Any failure to remediate any future material weaknesses or implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results, cause us to fail to meet our reporting obligations or result in material misstatements in our Consolidated Financial Statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

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

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

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

Regulations related to "conflict minerals" may cause us to incur additional expenses and could limit the supply and increase the cost of certain metals used in manufacturing our products.

We are subject to regulations requiring disclosures of specified minerals, known as conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured by public companies. The rule requires companies to perform due diligence, disclose and report whether or not such minerals originate from the Democratic Republic of the Congo or an adjoining country. The rule can affect sourcing at competitive prices and availability in sufficient quantities of certain minerals used in the manufacture of our products, including tantalum, tin, gold and tungsten. The number of suppliers who provide conflict-free minerals is limited. In addition, there are costs associated with complying with the disclosure requirements, such as costs related to determining the source of certain minerals used in our products, as well as costs of changes to products, processes, or sources of supply as a consequence of such verification activities. Since our supply chain is complex, we are not always able to sufficiently verify the origins of the relevant minerals used in our products through the due diligence procedures we implemented, which may harm our reputation. In addition, we may encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict-free, which could place us at a competitive disadvantage if we are unable to do so.

Litigation may distract us from operating our business, and adverse judgments or settlements could adversely affect our financial results and operations.

Litigation that may be brought by or against us could cause us to incur significant expenditures and distract our management from the operation of our business. Furthermore, there can be no assurance that we would prevail in such litigation or resolve such litigation on terms favorable to us, which may adversely affect our financial results and operations. See Note 14 of the Notes to Consolidated Financial Statements contained within this Annual Report on Form 10-K for a further discussion of our legal proceedings.

Natural disasters or severe weather conditions could disrupt our business and result in loss of revenue or higher expenses.

Our business depends on maintaining operations at our facilities and being able to operate at our customer facilities and project locations. A serious, prolonged interruption or damage due to power outage, telecommunications outage, terrorist attack, earthquake, hurricane, fire, flood or other natural disaster, or other interruption could have a material adverse effect on our business and financial results. While we insure against certain business interruption risks, such insurance may not adequately compensate us for any losses incurred as a result of natural or other disasters.

Risks Related to Our Common Stock

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

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

The market price of our common stock may be volatile.

The price of our stock has been in the past, and will continue to be, subject to fluctuations as a result of a number of factors, including: our operating results fail to meet market or analysts' expectations; general fluctuations in the stock market; actual or anticipated fluctuations in our operating results based on reduced and/or delayed government spending or the threat thereof; fluctuations in the stock prices of companies in our industry; changes in earnings estimated by securities analysts or our ability to meet those estimates; and domestic and foreign economic conditions. Such volatility has had a significant effect on the market prices of many companies' securities for reasons unrelated to their operating performance and, in the past, has led to securities class action litigation. Securities litigation against us could result in substantial costs and a diversion of our management's attention and resources, which could have an adverse effect on our business.

Your percentage of ownership in us may be diluted in the future.

As with any publicly traded company, your percentage ownership in us may be diluted in the future because of equity issuances for acquisitions, capital market transactions or otherwise, including equity awards that we expect will be granted to our directors, officers and employees.

Certain provisions in our amended and restated certificate of incorporation and second amended and restated bylaws, as amended, and of Delaware law, may prevent or delay an acquisition of our Company, which could decrease the trading price of our common stock.

Our amended and restated certificate of incorporation, our second amended and restated bylaws, as amended, and Delaware law contain provisions that are intended to deter coercive takeover practices and inadequate takeover bids by making such practices or bids unacceptably expensive to the raider and to encourage prospective acquirers to negotiate with our board of directors rather than to attempt a hostile takeover. These provisions include, among others:

- the inability of our stockholders to call a special meeting;
- rules regarding how stockholders may present proposals or nominate directors for election at stockholder meetings;
- the right of our board to issue preferred stock without stockholder approval;
- a super-majority requirement to amend our certificate of incorporation or bylaws; and
- the ability of our directors, and not stockholders, to fill vacancies on our board of directors.

Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock.

We believe these provisions may help protect our stockholders from coercive or otherwise unfair takeover tactics by requiring potential acquirers to negotiate with our board of directors and by providing our board of directors with more time to assess any acquisition proposal. These provisions are not intended to make our Company immune from takeovers. In addition, although we believe these provisions collectively provide for an opportunity to receive higher bids by requiring potential acquirers to negotiate with our board, they would apply even if the offer may be considered beneficial by some stockholders. These provisions may also frustrate or prevent any attempts by our stockholders to replace or remove our current management team by making it more difficult for stockholders to replace members of our board, which is responsible for appointing the members of our management.

Item 1B. *Unresolved Staff Comments.*

None.

Item 2. *Properties.*

At December 25, 2016, we owned or leased approximately 1.7 million square feet of floor space at 85 separate locations, primarily in the U.S., for manufacturing, warehousing, research and development, administration and various other uses. At December 25, 2016, we leased to third parties 148,267 square feet of our leased facilities, and had vacant floor space of 23,991 square feet. We continually evaluate our current and future space capacity in relation to current and projected future staffing levels. We maintain our properties in good operating condition and believe that the productive capacity of our properties is adequate to meet current contractual requirements and those for the foreseeable future.

We have major operations at the following locations:

Kratos Government Solutions: Huntsville, AL; San Diego, CA; Colorado Springs, CO; Orlando, FL; Baltimore and Lanham, MD; Dallastown, PA; and Dahlgren, Alexandria and Chantilly, VA. Locations outside the U.S. include France, Israel, Norway, and the United Kingdom.

Unmanned Systems: San Diego and Sacramento, CA; and Fort Walton Beach, FL.

Public Safety and Security: Fullerton, CA; Newport, DE; Chicago, IL; Indianapolis, IN; Fairlawn, NJ; and Houston, TX.

Corporate and other locations: San Diego, CA.

The following is a summary of our floor space at December 25, 2016:

Square feet (in thousands)	Owned	Leased	Total
Kratos Government Solutions	449	895	1,344
Unmanned Systems	20	188	208
Public Safety and Security	—	160	160
Corporate (includes San Diego operations of KGS, US and PSS segments)	—	34	34
Total	469	1,277	1,746

See Note 5 of the Notes to Consolidated Financial Statements contained within this Annual Report on Form 10-K for information regarding commitments under leases.

Item 3. ***Legal Proceedings.***

See Note 14 of Notes to Consolidated Financial Statements contained within this Annual Report on Form 10-K for a further discussion of our legal proceedings.

Item 4. ***Mine Safety Disclosures.***

None.

PART II

Item 5. ***Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Market Information

Our common stock is listed on the NASDAQ Global Select Market and is traded under the symbol "KTOS".

The following table sets forth the high and low intraday sales prices for our common stock for the periods indicated, as reported by NASDAQ:

	High	Low
Year Ended December 25, 2016:		
Fourth Quarter	$ 8.22	$ 5.23
Third Quarter	$ 7.58	$ 3.75
Second Quarter	$ 5.58	$ 3.87
First Quarter	$ 4.70	$ 2.80
Year Ended December 27, 2015:		
Fourth Quarter	$ 5.38	$ 3.64
Third Quarter	$ 6.64	$ 3.82
Second Quarter	$ 7.12	$ 4.80
First Quarter	$ 6.02	$ 4.76

Holders of Record

On February 24, 2017, the closing sale price of our common stock as reported by the NASDAQ Global Select Market was $8.35 per share. On February 24, 2017, there were 400 shareholders of record of our common stock.

Dividend Policy

We have not declared any cash dividends since becoming a public company. We currently intend to retain any future earnings to finance the growth and development of the business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, our ability to pay dividends is restricted by both the Indenture and the Credit Agreement, each as discussed in the section entitled “Liquidity and Capital Resources” in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 4 of the Notes to Consolidated Financial Statements contained within this Annual Report. Any future determination to pay cash dividends will be at the discretion of our board of directors and will be dependent upon our future financial condition, results of operations and capital requirements, general business conditions and other relevant factors as determined by our board of directors.

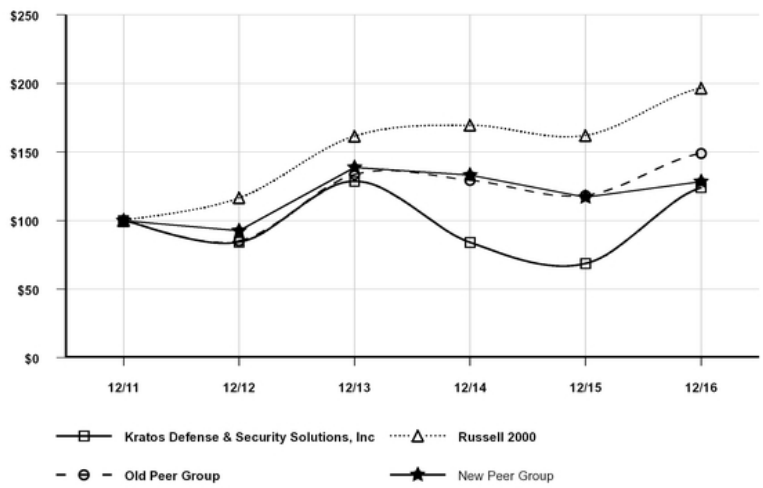
Performance Graph

The following performance graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended (the "Securities Act"), or the Exchange Act of 1934 as amended (the "Exchange Act"), except to the extent that we specifically incorporate it by reference into such filing.

The following performance graph presents a comparison of the five year cumulative stockholder return on our common stock against the cumulative total return of a broad equity market index, the Russell 2000 Stock Index, and two customized peer groups consisting of the companies listed below, for the period commencing December 25, 2011 and ending December 25, 2016. The performance graph assumes an initial investment of $100 in our common stock and in each of the Russell 2000 Stock Index and the peer groups, and further assumes that all dividends were reinvested and all returns are market-cap weighted. The historical information set forth below is not necessarily indicative of future stock price performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Kratos Defense & Security Solutions, Inc. the Russell 2000 Index,
Old Peer Group (1), and New Peer Group (2)



*$100 invested on 12/31/11 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

(1) The companies included in the Company's Old Peer Group are: AAR Corp., AeroVironment Inc., Arotech Corp., Comtech Telecommunications Corp., CPI Aerostructures Inc., Ducommun Inc., Frequency Electronics Inc., iRobot Corp., and Sparton Corp. American Science & Engineering Inc. and API Technologies Corp., each of which were included in the peer group used in preparing the Performance Graph contained in the Company's 2015 annual report on Form 10-K, have been excluded because full year standalone performance is not available for such companies through 2016.

(2) The companies included in the Company's New Peer Group are: AAR Corp., AeroVironment Inc., Arotech Corp., Comtech Telecommunications Corp., CPI Aerostructures Inc., Ducommun Inc., Frequency Electronics Inc., and Sparton Corp.

Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 6. Selected Financial Data.

The following selected consolidated financial data should be read in conjunction with our Consolidated Financial Statements and related notes thereto and with Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained within this Annual Report. Our historical results are not necessarily indicative of operating results to be expected in the future.

Amounts in millions except per share amounts

	December 25, 2016	December 27, 2015	December 28, 2014	December 29, 2013	December 30, 2012
Consolidated Statements of Operations Data:					
Revenues	$ 668.7	$ 657.1	$ 763.0	$ 844.1	$ 849.6
Gross profit	153.6	161.8	179.4	204.5	212.6
Operating income (loss)	(18.6)	(4.5)	5.3	18.2	(69.9)
Provision (benefit) for income taxes	8.1	(11.4)	3.9	1.1	(2.3)
Loss from continuing operations	(60.4)	(33.2)	(75.7)	(29.5)	(115.3)
Income (loss) from discontinued operations	(0.1)	53.0	(2.3)	(7.7)	0.9
Net income (loss)	$ (60.5)	$ 19.8	$ (78.0)	$ (37.2)	$ (114.4)
Loss from continuing operations per common share:					
Basic	$ (0.99)	$ (0.56)	$ (1.31)	$ (0.52)	$ (2.46)
Diluted	$ (0.99)	$ (0.56)	$ (1.31)	$ (0.52)	$ (2.46)
Income (loss) from discontinued operations per common share:					
Basic	$ —	$ 0.90	$ (0.04)	$ (0.13)	$ 0.02
Diluted	$ —	$ 0.90	$ (0.04)	$ (0.13)	$ 0.02
Net income (loss) per common share:					
Basic	$ (0.99)	$ 0.34	$ (1.35)	$ (0.65)	$ (2.44)
Diluted	$ (0.99)	$ 0.34	$ (1.35)	$ (0.65)	$ (2.44)
Weighted average shares:					
Basic	61.3	58.7	57.6	56.8	46.9
Diluted	61.3	58.7	57.6	56.8	46.9

	December 25, 2016	December 27, 2015	December 28, 2014	December 29, 2013	December 30, 2012
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 69.1	$ 28.5	$ 33.5	$ 54.2	$ 48.4
Working capital	176.6	148.0	147.1	174.9	172.0
Total assets	948.6	903.3	1,131.2	1,201.6	1,264.7
Short-term debt	1.0	1.0	1.1	1.3	1.5
Long-term debt	431.0	444.1	655.4	613.9	610.8
Long-term debt premium	—	—	—	14.5	18.7
Total stockholders' equity	$ 276.4	$ 254.2	$ 224.3	$ 295.8	$ 324.1

The 2012 Consolidated Statements of Operations Data and Consolidated Balance Sheet Data were impacted by the acquisition we completed in that period. We incurred acquisition-related expenses of $0.2 million for fiscal 2014, and a benefit of $2.7 million and $3.8 million related to acquisition items for fiscal 2012 and 2013 respectively. In 2012, we incurred an impairment of goodwill and intangible assets of $96.6 million. The 2014 Consolidated Statement of Operations Data includes a loss on extinguishment of debt of $39.1 million related to the refinance of the $625.0 million 10% Senior Secured Notes due in 2017 (the “10% Notes”) with the $625.0 million 7.00% Senior Secured Notes due in 2019 (the “7% Notes”). The 2015 Consolidated Financial Statements Data includes an $80.8 million gain on the disposal of discontinued operations before taxes and a loss of $3.4 million on extinguishment of debt.

The 2012 Consolidated Balance Sheet Data reflects the impact of the issuance of approximately 24.0 million common shares which were used to fund an acquisition. The 2014 Consolidated Balance Sheet Data reflects the refinancing of the $625.0 million 10% Notes with $625.0 million of 7% Notes. The net proceeds of the 7% Notes was $618.5 million after an original issue discount of $6.5 million. The Company utilized the net proceeds from the 7% Notes, a $41.0 million draw on a Credit Agreement, as well as cash from operations to extinguish the 10% Notes. The 2015 Consolidated Balance Sheet Data includes repayment of $41.0 million outstanding on the Company’s $110.0 million Credit Agreement and the repurchase of $175.0 million of the Company's Notes at par. The 2016 Consolidated Balance Sheet Data includes the Company's equity offering of 13.4 million shares of common stock, which generated net proceeds of $76.2 million and the Company's use of $14.1 million of the net proceeds from the offering to buy back and redeem approximately $14.5 million of its Notes. The 2016 Consolidated Statement of Operations Data and Consolidated Balance Sheet Data were impacted by an $18.7 million loss accrual recorded in 2016 on the LCASD cost share contract, which is expected to be incurred by the Company over the period of performance of the contract, and was incurred in order to retain the intellectual property rights for the new LCASD platform.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

In addition to historical information, the following discussion contains forward-looking statements that are subject to risks and uncertainties. Our actual results may differ substantially from those expressed in or implied by any forward-looking statements herein due to a number of factors, including but not limited to the risks and uncertainties described in this Item 7, in Item 1A “*Risk Factors*” *and elsewhere in this Annual Report. These forward-looking statements reflect our views and assumptions only as of the date such forward-looking statements are made. Except as required by law, we assume no responsibility for updating any forward-looking statements, whether as a result of new information, future events or otherwise.*

The following discussion should be read in conjunction with our audited Consolidated Financial Statements and the related notes and other financial information appearing elsewhere in this Annual Report and other reports and filings made with the SEC.

Overview

Kratos is a mid-tier government contractor at the forefront of the DoD’s Third Offset Strategy. Kratos is a leading technology, intellectual property and proprietary product and solution company focused on the U.S. and its allies’ national security. Kratos’ primary focus areas are unmanned systems, satellite communications, microwave electronics, cyber security/warfare, missile defense and combat systems. We believe that our technology, intellectual property, proprietary products and designed-in positions on our customers’ platforms and systems is a competitive advantage and high barrier to entry into our markets. Our work force is primarily technically oriented and highly skilled with a significant number holding national security clearances. Our entire organization is focused on executing our strategy of becoming the leading technology and intellectual property based company in our industry.

Our primary end customers are U.S. Government agencies, including the DoD, classified agencies, intelligence agencies, other national security agencies and homeland security related agencies. We also conduct business with local, state and foreign governments and domestic and international commercial customers. In fiscal 2016, 2015 and 2014, we generated 60%, 61% and 57%, respectively, of our total revenues from contracts with the U.S. Government (including all branches of the U.S. military), either as a prime contractor or a subcontractor. We believe our stable customer base, strong customer relationships, intellectual property, specialized and differentiated products, broad array of contract vehicles, “designed in” positions on strategic national security platforms, our targeted investments in strategic growth areas, large employee base possessing specialized skills, security clearances, specialized manufacturing facilities and equipment, extensive list of past performance qualifications, and significant management and operational capabilities position us for success.

We were incorporated in the state of New York on December 19, 1994 and began operations in March 1995. We reincorporated in the state of Delaware in 1998.

Industry Background

Faced with significant budget pressures, in recent years the U.S. Government has implemented reductions in government spending, including reductions in appropriations for the DoD and other federal agencies, pursuant to the BCA, as amended by the American Taxpayer Relief Act of 2012 and the Bipartisan Budget Act of 2013. Pursuant to the terms of the BCA, a sequestration went into effect in March 2013 resulting in a 7.8% reduction to the DoD budget for FY 2013 to $495.5 billion, excluding funding for military personnel. The DoD budget was approximately $496.0 billion in FY 2014 and remained at a similar level in FY 2015. The DoD base budget excludes funding for overseas contingency operations, such as those in Afghanistan, Iraq and Syria, which are appropriated separately and are not currently subject to the BCA.

On November 2, 2015, Barack Obama signed the Bipartisan Budget Act of 2015, formalizing the terms of a two year budget agreement which raised the U.S. debt ceiling and lifted the sequestration spending caps by $80.0 billion. Under the budget agreement, the total federal spending increase over the BCA topline funding caps was $50.0 billion in FY 2016 and $30.0 billion in FY 2017, with the amounts divided equally between defense and domestic priorities. The overall discretionary budget was set at $1.067 trillion in FY 2016 and $1.07 trillion in FY 2017. The FY 2016 discretionary defense budget was $548.1 billion, a $25.0 billion increase over the BCA topline funding caps.

Under the Bipartisan Budget Act of 2015, the Obama Administration received $33.0 billion of the $38.0 billion national defense spending increase it sought in FY 2016. In summary the budget agreement:

- extended the BCA out to 2025;
- suspended the U.S. debt limit/ceiling until March 2017;
- increased spending caps for FY 2016 and FY 2017 by $80.0 billion, including $50.0 billion in FY 2016 and $30.0 billion in FY 2017, split evenly between defense and domestic priorities; and
- included a FY 2016 DoD base budget of $548.0 billion and a FY 2016 overseas contingency operation budget of $59.0 billion.

On December 18, 2015, Congress passed and Mr. Obama signed the Consolidated Appropriations Act of 2016, which provided funding for the U.S. Government for FY 2016, providing $1.1 trillion in discretionary funding for federal agencies through September 2016. Mr. Obama signed a continuing resolution in September 2016, which was extended in December 2016, and provides funding for the U.S. Government at FY 2016 levels through April 28, 2017.

Current Reporting Segments

The Company operates in three reportable segments. The KGS reportable segment is comprised of an aggregation of KGS operating segments, including our microwave electronic products, satellite communications, modular systems and rocket support operating segments. The US reportable segment consists of our unmanned aerial system and unmanned ground and seaborne system businesses. The PSS reportable segment provides independent integrated solutions for advanced homeland security, public safety, critical infrastructure, and security and surveillance systems for government and commercial applications. We organize our business segments based primarily on the nature of the products, solutions and services offered. For additional information regarding our reportable segments, see Note 13 of the Notes to Consolidated Financial Statements. From a customer and solutions perspective, we view our business as an integrated whole, leveraging skills and assets wherever possible.

Discontinued Operations

On August 21, 2015, the Company completed the sale of the U.S. and U.K. operations of its Electronic Products Division to Ultra Electronics Holdings plc (“Ultra”), a public limited company formed under the laws of England and Wales and traded on the London Stock Exchange, and Ultra Electronics Defense Inc. (the “Buyer”), a Delaware corporation ultimately owned by Ultra (the “Transaction”). Pursuant to the terms of that certain Stock Purchase Agreement dated May 31, 2015, by and among the Company, Ultra and the Buyer, the Company sold to the Buyer all of the issued and outstanding capital stock of its wholly owned subsidiary Herley Industries, Inc. (“Herley”) and certain of Herley’s subsidiaries, including Herley-CTI, Inc., EW Simulation Technology, Ltd. and Stapor Research, Inc. (collectively, the “Herley Entities”), for $260.0 million and $5.0 million for taxes incurred as part of the Transaction, less a $2.0 million escrow to satisfy any purchase price adjustments and a working capital adjustment of approximately $8.3 million.

In November 2015, the Company and Ultra settled the working capital adjustment at $8.1 million, and the net cash position at closing, resulting in a net payment to the Company of $2.7 million. This represents the payment from escrow to the Company of $2.0 million, as well as the payment from Ultra of $0.7 million, reflecting the difference in the estimated working capital and actual working capital and the net cash position at the close of the Transaction. In December 2015, the Company submitted to Ultra for reimbursement the maximum $5.0 million for taxes incurred as part of the Transaction, which was reimbursed in January 2016. For additional information regarding discontinued operations, see Note 8 of the Notes to Consolidated Financial Statements.

Key Financial Statement Concepts

As of December 25, 2016, we consider the following factors to be important in understanding our financial statements.

KGS' and US' business with the U.S. Government and prime contractors is generally performed under fixed-price, cost reimbursable, or time and materials contracts. Cost reimbursable contracts for the U.S. 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 U.S. Government and provided to our PSS segment customers under fixed-price contracts, we utilize both cost-to-cost and units delivered measures under the percentage-of-completion method of accounting in accordance with the provisions of *Financial Accounting Standards Board* ("FASB") *Accounting Standards Codification* ("ASC") *Topic 605, Revenue Recognition*. Under the units delivered 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.

We consider the following factors when determining if collection of a receivable is reasonably assured: comprehensive collection history; results of our communications with customers; the current financial position of the customer; and the relevant economic conditions in the customer's country. If we have had no prior experience with the customer, we may review reports from various credit organizations to ensure that the customer has a history of paying its creditors in a reliable and effective manner. If the financial condition of our customers were to deteriorate and adversely affect their financial ability to make payments, additional allowances would be required. Additionally, on certain contracts whereby we perform services for a prime/general contractor, a specified percentage of the invoiced trade accounts receivable may be retained by the customer until we complete the project. We periodically review all retainages for collectability and record allowances for doubtful accounts when deemed appropriate, based on our assessment of the associated risks.

We monitor our policies and procedures with respect to our contracts on a regular basis to ensure consistent application under similar terms and conditions as well as compliance with all applicable government regulations. In addition, costs incurred and allocated to contracts with the U.S. Government are routinely audited by the DCAA.

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 our Critical Accounting Principles and Estimates discussed below. 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 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 complete, must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates.

Results of Operations

Comparison of Results for the Year Ended December 25, 2016 to the Year ended December 27, 2015

Revenues. Revenues by reportable segment for the years ended December 25, 2016 and December 27, 2015 are as follows (in millions):

	2016	2015	$ Change	% Change
Kratos Government Solutions				
Service revenues	$ 221.0	$ 209.5	$ 11.5	5.5 %
Product sales	244.8	236.6	8.2	3.5 %
Total Kratos Government Solutions	465.8	446.1	19.7	4.4 %
Public Safety & Security - service revenues	127.1	144.7	(17.6)	(12.2)%
Unmanned Systems - product sales	75.8	66.3	9.5	14.3 %
Total revenues	$ 668.7	$ 657.1	$ 11.6	1.8 %
Total service revenues	$ 348.1	$ 354.2	$ (6.1)	(1.7)%
Total product sales	320.6	302.9	17.7	5.8 %
Total revenues	$ 668.7	$ 657.1	$ 11.6	1.8 %

Revenues increased $11.6 million to $668.7 million in 2016 from $657.1 million in 2015. The increase in revenues was the result of increased revenues of $19.7 million in our KGS segment primarily resulting from increased shipments and work performed in our satellite communications business of approximately $21.1 million, our simulation and training business of approximately $6.7 million and our ballistic missile target businesses of approximately $8.6 million, offset by a reduction in shipments of our specialized ground equipment products resulting primarily from delays in contract awards of $11.8 million and other reductions primarily in our government services business, which includes our weapons reset business, of approximately $4.9 million. Increased revenues of $9.5 million in our US segment resulted from recent contract awards in unmanned combat aerial systems and unmanned aerial target systems as well as an increase in shipments of unmanned aerial target systems. Declines in our PSS segment of $17.6 million were primarily the result of our change in strategic direction in the fourth quarter of 2014 to capture higher margin work and only selectively bid on larger security integration projects that traditionally generate lower margins, coupled with the impact of approximately $4.1 million in unexpected cost growth recorded during 2016 which negatively impacted our revenues. This unexpected cost growth is primarily related to several large long-term security integration projects which are nearing completion in 2017.

Product sales increased $17.7 million to $320.6 million for the year ended December 25, 2016 from $302.9 million for the year ended December 27, 2015, primarily as a result of the increase in product shipments due to the factors discussed above in our KGS and US segments. As a percentage of total revenue, product revenues were 47.9% for the year ended December 25, 2016 as compared to 46.1% for the year ended December 27, 2015. Service revenues decreased by $6.1 million to $348.1 million for the year ended December 25, 2016 from $354.2 million for the year ended December 27, 2015. The decrease was primarily related to the change in strategic direction and the completion of larger security installation projects in our PSS segment, offset partially by increases in our KGS segment as discussed above.

As described in our “Critical Accounting Principles and Estimates” below and in the Notes to Consolidated Financial Statements contained within this Annual Report, we utilize both the cost-to-cost and units delivered measures under the percentage-of-completion method of accounting for recognizing revenue as provided for in *Topic 605*. When revenue is calculated using the percentage-of-completion method, total costs incurred to date are compared to total estimated costs to complete the contract. These estimates are reviewed monthly on a contract-by-contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. Significant management judgments and estimates, including the estimated costs to complete projects, which determine the project’s percentage of completion, 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. During the reporting periods contained herein, we did experience revenue and margin adjustments on certain projects based on the aforementioned factors, but the effect of such adjustments, both positive and negative, when evaluated in total were determined to be immaterial to our Consolidated Financial Statements.

Cost of revenues. Cost of revenues increased to $515.1 million for the year ended December 25, 2016 from $495.3 million for the year ended December 27, 2015. The $19.8 million increase in cost of revenues was primarily a result of increased revenue discussed above, as well as an $18.7 million loss accrual recorded in 2016 on the LCASD cost share contract, which is expected to be incurred by the Company over the period of performance of the contract, and was incurred in order to retain the intellectual property rights for the new LCASD platform. Cost of revenues was also impacted by approximately $4.1 million in unexpected cost growth on PSS projects recorded during 2016 which negatively impacted our revenues. This unexpected cost growth is primarily related to several large long-term security integration projects which are nearing completion in 2017.

Gross margin percentage decreased to 23.0% for the year ended December 25, 2016 compared to 24.6% for the year ended December 27, 2015. Margins on services increased to 26.5% for the year ended December 25, 2016 from 24.8% for the year ended December 27, 2015, due primarily to a more favorable mix of revenues. Margins on product sales decreased for the year ended December 25, 2016 as compared to December 27, 2015 to 19.1% from 24.5%, respectively, primarily as a result of a change in the mix of products sold. Margins in the KGS segment increased to 26.3% for the year ended December 25, 2016 from 25.4% for the year ended December 27, 2015, primarily as a result of change in the mix of products sold. Margins in the US segment decreased to (2.9)% for the year ended December 25, 2016 from 16.3% for the year ended December 27, 2015, reflecting an $18.7 million loss accrual recorded on the LCASD cost share contract, which is expected to be incurred by the Company over the period of performance of the contract, and was incurred in order to retain the intellectual property rights for the new LCASD platform. Margins in the PSS segment increased slightly to 26.1% for the year ended December 25, 2016 from 26.0% for the year ended December 27, 2015 as a result of a more favorable mix of revenues, resulting from the strategic shift in focus on smaller sized, higher margin projects and only selectively bidding on larger sized lower margin projects, the completion of certain lower margin projects, as well as the impact of cost reduction actions that were taken during the year ended December 25, 2016, offset partially by the impact of approximately $4.1 million in unexpected cost growth recorded during 2016 on several large long-term security integration projects which are nearing completion.

Selling, general and administrative expenses (SG&A). SG&A decreased $4.4 million to $146.3 million for the year ended December 25, 2016 from $150.7 million for the year ended December 27, 2015. The decrease was primarily the result of a $2.5 million reduction of amortization of intangibles in 2016, as a result of certain intangible assets being fully amortized, as well as cost reduction actions taken by the Company, offset partially by increased discretionary investments to pursue business opportunities in the unmanned tactical aircraft market. As a percentage of revenues, SG&A decreased to 21.9% for fiscal 2016 from 22.9% for fiscal 2015. Excluding amortization of intangibles of $10.5 million for the year ended December 25, 2016 and amortization of intangibles of $13.0 million for the year ended December 27, 2015, SG&A decreased as a percentage of revenues to 20.3% from 21.0% for the year ended December 25, 2016 and December 27, 2015, respectively, due primarily to the cost reduction actions the Company has taken and the increased leverage on the Company's public company infrastructure costs as revenues expand.

Internal research and development (IR&D) expenses. IR&D expenses decreased to $13.9 million for the year ended December 25, 2016 from $16.2 million for the year ended December 27, 2015. As a percentage of revenues, IR&D decreased to 2.1% of revenues for the year ended December 25, 2016 from 2.5% of revenues for the year ended December 27, 2015. IR&D expenditures are primarily related to investments we are making in conjunction with our customers and prospective customers, with the objectives of the Company's products being the new platform for or "designed in" to certain new long term program opportunities and the Company owning certain intellectual property rights for products that support these programs primarily in our unmanned systems and microwave electronic businesses as well as technology upgrades and refresh activities that are necessary for the next generation of our existing product lines primarily in our satellite communications business.

Merger and acquisition related items. Merger and acquisition related items increased to $1.9 million for the year ended December 25, 2016 from $0.1 million in the year ended December 27, 2015. The increase was primarily as a result of a $1.9 million charge related to the settlement of a contract dispute in our PSS business during the first quarter of 2016.

Unused office space and other restructuring. The expense of $10.1 million for the year ended December 25, 2016 was due to a $9.2 million charge that was recorded in the Company's modular systems business as a result of the closure of one of its manufacturing facilities, as well as, the exit from certain lower margin product business lines and employee termination costs related to personnel reduction actions taken in the first quarter of 2016. The restructuring charge recorded in our modular systems business was comprised of $4.9 million related to fixed and intangible assets, of which $1.4 million was recorded in the fourth quarter of 2016 reflecting the write-down to estimated fair value of one of its facilities, $3.0 million related to exited product lines and $1.3 million related to excess facilities. The benefit of $0.7 million for the year ended December 27, 2015 was due to a reduction in the liability for unused office space at our Columbia, Maryland facility resulting from the execution of a recent sublease arrangement, partially offset by an impairment of leasehold improvements, office furniture and equipment at that location, and employee termination costs related to personnel reduction actions taken during the year.

Other expense, net. Other expense, net decreased to $33.7 million from $40.1 million for the years ended December 25, 2016 and December 27, 2015, respectively. The decrease in expense of $6.4 million was primarily related to a $3.4 million loss on the extinguishment of the 10% Notes in the third quarter of 2015, a reduction in interest expense of $1.3 million as a result of the redemption of $175.0 million of our Notes and the repayment of $41.0 million of outstanding borrowings under our Credit Agreement in the third quarter of 2015 which both occurred as a result of our divestiture of the Herley Entities.

Provision (benefit) for income taxes from continuing operations. The provision for income taxes from continuing operations changed to an expense of $8.1 million on a loss from continuing operations before income taxes of $52.3 million for the year ended December 25, 2016 from a benefit of $11.4 million on a loss of $44.6 million from continuing operations before income taxes for the year ended December 27, 2015. The expense for the year ended December 25, 2016 was primarily comprised of a provision for foreign and state taxes increased by the change in the indefinite life deferred tax liability. The benefit for the year ended December 27, 2015 was primarily due to the intra-period allocation rules in ASC *Topic 740, Income Taxes.* Intra-period allocation rules require the Company to allocate its provision for income taxes between continuing operations and other categories of earnings, such as discontinued operations. In periods in which there is a pre-tax loss from continuing operations and pre-tax income in other categories of earnings, such as discontinued operations, the Company must allocate the tax provision to other categories of earnings. A related tax benefit is then recorded in continuing operations. See Note 7 of Notes to Consolidated Financial Statements for a further discussion of our income taxes.

Income (loss) from discontinued operations. There was no significant activity for the year ended December 25, 2016. The loss from discontinued operations was $0.1 million for the year ended December 25, 2016, compared to income of $53.0 million for the year ended December 27, 2015, which included the gain on sale of the Herley Entities of $80.8 million which occurred on August 21, 2015. The income for the year ended December 27, 2015 also reflects interest expense allocated to discontinued operations of $9.1 million. For additional information, see Note 8 of the Notes to the Consolidated Financial Statements.

Comparison of Results for the Year Ended December 27, 2015 to the Year ended December 28, 2014

Revenues. Revenues by reportable segment for the years ended December 27, 2015 and December 28, 2014 are as follows (in millions):

	2015	2014	$ Change	% Change
Kratos Government Solutions				
Service revenues	$ 209.5	$ 207.4	$ 2.1	1.0 %
Product sales	236.6	277.7	(41.1)	(14.8)%
Total Kratos Government Solutions	446.1	485.1	(39.0)	(8.0)%
Public Safety & Security				
Service revenues	144.7	183.4	(38.7)	(21.1)%
Product sales	—	13.0	(13.0)	(100.0)%
Total Public Safety & Security	144.7	196.4	(51.7)	(26.3)%
Unmanned Systems - product sales	66.3	81.5	(15.2)	(18.7)%
Total revenue	$ 657.1	$ 763.0	$ (105.9)	
Total service revenue	$ 354.2	$ 390.8	$ (36.6)	(9.4)%
Total product sales	302.9	372.2	(69.3)	(18.6)%
Total revenue	$ 657.1	$ 763.0	$ (105.9)	(13.9)%

Revenues decreased $105.9 million to $657.1 million in 2015 from $763.0 million in 2014. The decrease in revenues was primarily attributable to our PSS business due in part to a one-time shipment of sophisticated communication equipment of $13.0 million that occurred in the second quarter of 2014, as well as due to the completion or wind-down of certain security installation projects and due to the Company's change in strategic direction in the fourth quarter of 2014 to capture higher margin work and only selectively bid on larger security integration projects that traditionally generate lower margins, resulting in aggregate reduced service revenues in the PSS segment of $38.7 million for the year ended December 27, 2015. In addition, for the year ended December 27, 2015, KGS segment revenue decreased by $39.0 million due primarily to reduced shipments of our specialized ground equipment products of $38.6 million, delays in orders and awards as a result of the challenging federal government and DoD funding environment, and continued reduction in our legacy government services business of $14.7 million, which includes reset work on legacy weapons systems, all of which adversely impacted the timing of new contract awards, bookings and our revenues, offset partially by growth in our simulation and training business and in technical government services where we support directed energy weapons and electromagnetic railgun efforts, which aggregated a net increase of $16.4 million. Revenues in our US segment decreased by $15.2 million primarily as a result of a reduction in shipments of certain of our aerial target products due to delays in the timing of follow-on and new international contract awards.

Product sales decreased $69.3 million to $302.9 million for the year ended December 27, 2015 from $372.2 million for the year ended December 28, 2014, primarily as a result of the decline in product shipments due to the factors discussed above in our KGS, PSS and US segments. As a percentage of total revenue, product revenues were 46.1% for the year ended December 27, 2015 as compared to 48.8% for the year ended December 28, 2014. Service revenues decreased by $36.6 million to $354.2 million for the year ended December 27, 2015 from $390.8 million for the year ended December 28, 2014. The decrease was primarily related to the change in strategic direction and the completion of larger security installation projects in our PSS segment as well as the continued reduction in our legacy government services business as discussed above.

As described in our “Critical Accounting Principles and Estimates” below and in the Notes to Consolidated Financial Statements contained within this Annual Report, we utilize both the cost-to-cost and units delivered measures under the percentage-of-completion method of accounting for recognizing revenue as provided for in *Topic 605*. When revenue is calculated using the percentage-of-completion method, total costs incurred to date are compared to total estimated costs to complete the contract. These estimates are reviewed monthly on a contract-by-contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. Significant management judgments and estimates, including the estimated costs to complete projects, which determine the project’s percentage of completion, 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. During the reporting periods contained herein, we did experience revenue and margin adjustments on certain projects based on the aforementioned factors, but the effect of such adjustments, both positive and negative, when evaluated in total were determined to be immaterial to our Consolidated Financial Statements.

Cost of revenues. Cost of revenues decreased to $495.3 million for the year ended December 27, 2015 from $583.6 million for the year ended December 28, 2014. The $88.3 million decrease in cost of revenues was primarily a result of decreased revenue discussed above.

Gross margin percentage increased to 24.6% for the year ended December 27, 2015 from 23.5% for the year ended December 28, 2014. Margins on services increased to 24.8% for the year ended December 27, 2015 from 22.1% for the year ended December 28, 2014, due primarily to a more favorable mix of revenues. Margins on product sales decreased for the year ended December 27, 2015 as compared to December 28, 2014 to 24.5% from 25.0%, respectively, primarily as a result of a change in the mix of products sold. Margins in the KGS segment increased to 25.4% for the year ended December 27, 2015 from 25.3% for the year ended December 28, 2014, primarily as a result of change in the mix of products sold. Margins in the US segment decreased to 16.3% for the year ended December 27, 2015 from 23.2% for the year ended December 28, 2014, primarily due to a less favorable mix of products produced and shipped and due to increased contract costs primarily reflecting retrofits required to conform to required design configuration changes identified in recent successful demonstration test flights recorded on certain international aerial target projects in the year ended December 27, 2015. Margins in the PSS segment increased to 26.0% for the year ended December 27, 2015 from 19.3% for the year ended December 28, 2014 as a result of a more favorable mix of revenues, resulting from the strategic shift in focus on smaller sized, higher margin projects and only selectively bidding on larger sized lower margin projects, the completion of certain lower margin projects, as well as the impact of cost reduction actions that were taken during the year ended December 27, 2015.

Selling, general and administrative expenses (SG&A). SG&A decreased $2.9 million to $150.7 million for the year ended December 27, 2015 from $153.6 million for the year ended December 28, 2014. The decrease was primarily the result of a $6.1 million reduction of amortization of intangibles in 2015, as a result of certain intangible assets being fully amortized, as well as cost reduction actions taken by the Company, offset partially by increased discretionary investments to pursue business opportunities in the unmanned tactical aircraft market. As a percentage of revenues, SG&A increased to 22.9% for fiscal 2015 from 20.1% for fiscal 2014. Excluding amortization of intangibles of $13.0 million for the year ended December 27, 2015 and amortization of intangibles of $19.1 million for the year ended December 28, 2014, SG&A increased as a percentage of revenues to 21.0% from 17.6% for the year ended December 27, 2015 and December 28, 2014, respectively, due primarily to the decline in revenues discussed previously, as well as the impact of the public company corporate SG&A costs which are not allocable to the Herley Entities which have been classified as discontinued operations. In addition, due to contract award delays specifically in our unmanned and modular systems businesses, the reduced volumes have resulted in increased unabsorbed overhead costs.

Internal research and development (IR&D) expenses. IR&D expenses decreased to $16.2 million for the year ended December 27, 2015 from $18.6 million for the year ended December 28, 2014. As a percentage of revenues, IR&D increased to 2.5% of revenues for the year ended December 27, 2015 from 2.4% of revenues for the year ended December 28, 2014. IR&D expenditures are primarily related to investments we are making in conjunction with our customers and prospective customers, with the objectives of the Company's products being the new platform for or "designed in" to certain new long term program opportunities and the Company owning certain intellectual property rights for products that support these programs primarily in our unmanned systems and microwave electronic businesses as well as technology upgrades and refresh activities that are necessary for the next generation of our existing product lines primarily in our satellite communications business.

Unused office space and other restructuring. The benefit of $0.7 million for the year ended December 27, 2015 was due to a reduction of the liability for unused office space at our Columbia, Maryland facility resulting from the execution of a recent sublease arrangement, partially offset by an impairment of leasehold improvements and office furniture and equipment at that location, and employee termination costs related to personnel reduction actions taken during the year. The expense of $1.7 million for the year ended December 28, 2014 was primarily due to an estimated excess facility accrual of office space at our Sacramento, California administrative facilities, and employee termination costs related to personnel reduction actions taken during the year.

Other expense, net. Other expense, net decreased to $40.1 million from $77.1 million for the years ended December 27, 2015 and December 28, 2014, respectively. The decrease in expense of $37.0 million was primarily related to $39.1 million loss on the extinguishment of the 10% Notes in the second quarter of 2014 and a reduction in interest expense as a result of the refinancing of our 10% Notes with our 7% Notes.

Provision (benefit) for income taxes. The provision for income taxes changed to a benefit of $11.4 million on a loss before income taxes of $44.6 million for the year ended December 27, 2015 from a provision of $3.9 million on a loss of $71.8 million from continuing operations before income taxes for the year ended December 28, 2014. The benefit for the year ended December 27, 2015 was primarily due to the intra-period allocation rules in ASC *Topic 740, Income Taxes.* Intra-period allocation rules require the Company to allocate its provision for income taxes between continuing operations and other categories of earnings, such as discontinued operations. In periods in which there is a pre-tax loss from continuing operations and pre-tax income in other categories of earnings, such as discontinued operations, the Company must allocate the tax provision to other categories of earnings. A related tax benefit is then recorded in continuing operations. See Note 7 of Notes to Consolidated Financial Statements for a further discussion of our income taxes. The provision for the year ended December 28, 2014 was primarily comprised of a provision for foreign and state taxes increased by the change in the indefinite life deferred tax liability.

Income (loss) from discontinued operations. Revenue from discontinued operations decreased to $59.7 million from $108.9 million for the year ended December 27, 2015 and December 28, 2014, respectively. The reduction is primarily due to the sale of the Herley Entities which occurred on August 21, 2015, and therefore reflects the operating performance through the date of sale compared to a full year's operating results for the comparable prior year. The income from discontinued operations was $53.0 million for the year ended December 27, 2015 which includes the gain on sale of the Herley Entities of $80.8 million and the net loss from discontinued operations was $2.3 million for the year ended December 27, 2014. The loss and income for the two years also reflects interest expense allocated to discontinued operations of $9.1 million and $15.0 million for the year ended December 27, 2015 and December 28, 2014, respectively.

Liquidity and Capital Resources

As of December 25, 2016, we had cash and cash equivalents of $69.1 million compared with cash and cash equivalents of $28.5 million as of December 27, 2015, which includes $5.2 million and $10.8 million, respectively, of cash and cash equivalents held by our foreign subsidiaries. We are not presently aware of any restrictions on the repatriation of these funds, however, they are essentially considered permanently invested in these foreign subsidiaries. If these funds were needed to fund our operations or satisfy obligations in the U.S. they could be repatriated, and their repatriation into the U.S. may cause us to incur additional U.S. income taxes or foreign withholding taxes. Any additional taxes could be offset, in part or in whole, by foreign tax credits. The amount of such taxes and application of tax credits would be dependent on the income tax laws and other circumstances at the time these amounts are repatriated. Based on these variables, it is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated. We do not currently intend to repatriate these earnings.

On November 23, 2016, we sold approximately 13.4 million shares of our common stock at a purchase price of $6.00 per share in an underwritten public offering. We received gross proceeds of approximately $80.5 million. After deducting underwriting fees and other offering expenses, we received approximately $76.2 million in net proceeds. We used $14.1 million of the net proceeds from this transaction to buy back and redeem approximately $14.5 million of our Notes, and we used $5.1 million to fund a strategic initial investment in a satellite signal monitoring, signal intelligence and location identification technology and product line to enhance our existing satellite communications business offering. The remainder of the funds are expected to be used for general corporate purposes, including funding expected growth and strategic investments in our high performance unmanned aerial vehicle business area and other new programs under contract.

Our total debt, including capital lease obligations, principal due on the Notes, other term debt, the discount of $2.4 million on the Notes issued, and debt issuance costs of $2.9 million, decreased by $13.1 million to $432.0 million as of December 25, 2016 from $445.1 million as of December 27, 2015. The decrease in debt was due to the buy back and redemption of approximately $14.5 million of Notes which occurred in the quarter ended December 25, 2016.

We use our operating cash flow to finance trade accounts receivable, fund necessary increases in inventory, fund capital expenditures, our IR&D investments, and our ongoing operations, service our debt and make strategic acquisitions. Financing trade accounts receivable is necessary because, on average, our customers do not pay us as quickly as we pay our vendors and employees for their goods and services since a number of our receivables are contractually billable and due to us only when certain contractual milestones are achieved. Our days sales outstanding on our receivables can be impacted and can fluctuate due to contractual billing milestones under which we are unable to bill and collect certain amounts until the milestones have been satisfied. Financing increases in inventory balances is necessary to fulfill shipment requirements to meet delivery schedules of our customers. Cash from continuing operations is primarily derived from our customer contracts in progress and associated changes in working capital components.

A summary of our net cash provided by (used in) operating activities from continuing operations from our Consolidated Statements of Cash Flows is as follows (in millions):

	Year Ended		
	December 25, 2016	December 27, 2015	December 28, 2014
Net cash provided by (used in) operating activities from continuing operations	$ (12.4)	$ (29.7)	$ 2.5

Our cash provided by (used in) operating activities was impacted by interest expense we paid related to our senior secured notes. We paid $32.4 million, $43.8 million, and $57.1 million in interest expense in 2016, 2015, and 2014, respectively. Cash used in operating activities in 2016 and 2015 was also negatively impacted by reduced operating income which reflected discretionary investments we have made in internally funded research and development of $13.9 million in 2016, $16.2 million in 2015 and $18.6 million in 2014, contract development costs on new platforms in our US segment, and increased SG&A expenditures primarily related to business capture pursuits in the tactical unmanned aircraft systems initiatives, as well as changes in working capital accounts.

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

	Year Ended		
	December 25, 2016	December 27, 2015	December 28, 2014
Investing activities:			
Cash paid for acquisitions, net of cash acquired	$ (5.1)	$ —	$ (2.6)
Proceeds from sale of assets	0.1	0.9	—
Change in restricted cash	0.3	4.7	(0.4)
Capital expenditures	(9.2)	(11.3)	(11.6)
Net cash used in investing activities from continuing operations	$ (13.9)	$ (5.7)	$ (14.6)

Net cash used in investing activities was primarily driven by capital expenditures in 2016, 2015, and 2014, which reflects investments we made for certain machinery, test equipment, demonstration units and company owned aircraft in our unmanned aerial systems business, and to a lesser degree, investments we made in our microwave electronic products business, and our satellite communications business. In addition, we used $5.1 million during the fourth quarter of 2016 to fund a strategic initial investment in a satellite signal monitoring, signal intelligence and location identification technology and product line to enhance our existing satellite communications business offering. An initial purchase price holdback of $0.9 million to provide security for potential indemnification obligations, less any indemnification claims, will be payable in July 2018, in cash or shares of common stock, at our option. In addition, an earn-out of $2.0 million, payable in cash or shares of common stock, at our option, will be payable in July 2018. As of December 25, 2016, the earn-out criteria had been achieved.

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

	Year Ended		
	December 25, 2016	December 27, 2015	December 28, 2014
Financing activities:			
Proceeds from the issuance of long-term debt	$ —	$ —	$ 618.5
Extinguishment of long-term debt	(14.1)	(175.0)	(661.5)
Proceeds from the issuance of common stock	76.2	—	—
Cash paid for contingent acquisition consideration	—	(1.1)	—
Borrowings under credit facility	—	—	41.0
Repayment under credit facility	(1.0)	(42.0)	(1.0)
Debt issuance costs	—	—	(10.0)
Proceeds from the exercise of restricted stock units, employee stock options, and employee stock purchase plan	2.0	3.4	3.3
Net cash provided by (used in) financing activities from continuing operations	$ 63.1	$ (214.7)	$ (9.7)

Net cash flows provided by financing activities for the year ended December 25, 2016 included $76.2 million in net proceeds from the equity offering we completed in the fourth quarter of 2016, $14.1 million of which was used to buy back and redeem approximately $14.5 million of our Notes. Net cash flows used in financing activities from continuing operations for the year ended December 27, 2015 was primarily due to the repurchase of $175.0 million of our Notes and the repayment of $41.0 million outstanding on our Credit Agreement.

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

	Year Ended		
	December 25, 2016	December 27, 2015	December 28, 2014
Net operating cash flows provided by discontinued operations	$ 0.1	$ 2.8	$ 4.1
Net investing cash flows provided by (used in) discontinued operations	4.0	242.5	(2.6)

The operating cash flow provided by discontinued operations for the years ended December 27, 2015 and December 28, 2014 is substantially related to Herley Industries, Inc. and certain of Herley's subsidiaries. The investing cash flow provided by discontinued operations for the year ended December 25, 2016 reflects the reimbursement of taxes from the Buyer of the Herley Entities received in 2016. The investing cash flow provided by discontinued operations for the year ended December 27, 2015 reflects cash provided of $243.2 million which is related to the sale of the Herley Entities, net of related transaction expenses.

7.00% Senior Secured Notes due 2019

In May 2014, we refinanced our $625.0 million in outstanding principal amount 10% Notes with $625.0 million of newly issued 7% Notes. The net proceeds from the issuance of the 7% Notes was $618.5 million after an original issue discount of $6.5 million. We incurred debt issuance costs of $8.8 million associated with the new 7% Notes. We utilized the net proceeds from the

7% Notes, a $41.0 million draw on our Credit Agreement discussed below, as well as cash from operations to extinguish the 10% Notes. The total reacquisition price of the 10% Notes was $661.5 million, including a $31.2 million early termination fee, the write-off of $15.5 million of unamortized issue costs, $12.9 million of unamortized premium, along with $5.3 million of additional interest while in escrow, which resulted in a loss on extinguishment of $39.1 million.

We completed the offering of the 7% Notes in a private placement conducted pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the “Act”). On October 16, 2014, we exchanged the outstanding 7% Notes for an equal amount of new 7.00% Senior Secured Notes due in 2019 (the “Notes”) that had been registered under the Act. The terms of the Notes issued in the exchange offer were identical in all material respects to the terms of the 7% Notes, except the Notes issued in the exchange offer had been registered under the Act.

The Notes are governed by the Indenture, dated May 14, 2014 (the “Indenture”), among the Company, all of the Company’s 100% owned domestic subsidiaries (the “Subsidiary Guarantors”) and Wilmington Trust, National Association, as Trustee and Collateral Agent. A Subsidiary Guarantor can be released from its guarantee if (a) all of the capital stock issued by such Subsidiary Guarantor or all or substantially all of the assets of such Subsidiary Guarantor are sold or otherwise disposed of; (b) we designate such Subsidiary Guarantor as an Unrestricted Subsidiary; (c) we exercise our legal defeasance option or our covenant defeasance option; or (d) upon satisfaction and discharge of the Indenture or payment in full in cash of the principal of, premium, if any, accrued and unpaid interest.

The holders of the Notes have a first priority lien on substantially all of our assets and the assets of the Subsidiary Guarantors, except with respect to accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property), on which the holders of the Notes have a second priority lien to the $110.0 million Credit Agreement.

We pay interest on the Notes semi-annually, in arrears, on May 15 and November 15 of each year. The Notes include customary covenants and events of default as well as a consolidated fixed charge ratio of 2.0:1 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 December 25, 2016, we were in compliance with the covenants contained in the Indenture governing the Notes.

We may redeem some or all of the Notes at 105.25% of the aggregate principal amount of such Notes through May 15, 2017, 102.625% of the aggregate principal amount of such Notes if redeemed on or after May 16, 2017 but on or before May 15, 2018 and 100% of the aggregate principal amount of such Notes if redeemed on or after May 16, 2018, plus accrued and unpaid interest to the date of redemption.

The terms of the Indenture require that the net cash proceeds from asset dispositions be either utilized to (i) repay or prepay amounts outstanding under the Credit Agreement unless such amounts are reinvested in similar collateral, (ii) make an investment in assets that replace the collateral of the Notes or (iii) a combination of both (i) and (ii). To the extent there are any remaining net proceeds from the asset disposition after application of (i) and (ii), such amounts are required to be utilized to repurchase Notes at par after 360 days following the asset disposition.

Following the sale of the U.S. and U.K. Electronic Products Division (see Note 8 of the Notes to Consolidated Financial Statements), on September 22, 2015, we repurchased $175.0 million of the Notes at par, in accordance with the Indenture and on August 21, 2015 paid down the $41.0 million outstanding on the $110.0 million Credit Agreement. The total reacquisition price of the Notes was $178.4 million including the write off of $1.8 million of unamortized issue costs, $1.4 million of unamortized discount, along with $0.2 million of legal fees, which resulted in a loss on extinguishment of $3.4 million.

The Company reinvested all net proceeds remaining after the repurchase of the $175.0 million of Notes in replacement collateral under the Indenture within 360 days following the asset disposition.

During the quarter ended December 25, 2016, the Company repurchased and extinguished $14.5 million of the Notes outstanding which resulted in a gain of $0.4 million offset by $0.1 million of unamortized issuance cost and $0.1 million of unamortized discount resulting in a net gain of $0.2 million.

As of December 25, 2016, there were $435.5 million in Notes outstanding.

Other Indebtedness

$110.0 Million Credit Agreement

On May 14, 2014, we replaced the credit facility with KeyBank National Association and entered into the Credit Agreement. The Credit Agreement established a five-year senior secured revolving credit facility in the maximum amount of $110.0 million (subject to a potential increase of the maximum principal amount to $135.0 million, subject to the Agent's and applicable lenders' approval as described therein), consisting of a subline for letters of credit in the amount not to exceed $50.0 million, as well as a swingline loan in an aggregate principal amount at any time outstanding not to exceed $10.0 million. The Credit Agreement 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 Credit Agreement 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 Credit Agreement has a second priority lien junior to the lien securing the Notes.

The Credit Agreement contains certain covenants, which include, but are not limited to, restrictions on indebtedness, liens, and investments, and limits on other various payments, as well as a financial covenant relating to a minimum fixed charge coverage ratio of 1.15:1 (as modified per the Third Amendment and the Fourth Amendment, as defined and discussed below). Events of default under the terms of the Credit Agreement include, but are not limited to: failure of the Company to pay any principal of any loans in full when due and payable; failure of the Company to pay any interest on any loan or any fee or other amount payable under the Credit Agreement within three business days after the date when due and payable; failure of the Company or any of its subsidiaries to comply with certain covenants and agreements, subject to applicable grace periods and/or notice requirements; any representation, warranty or statement made in or pursuant to the Credit Agreement or any related writing or any other material information furnished by the Company or any of its subsidiaries to the Agent or the lenders proving to be false or erroneous; and the occurrence of an event or condition having or reasonably likely to have a material adverse effect, which includes a material adverse effect on the business, operations, condition (financial or otherwise) or prospects of the Company or the ability of the Company to repay its obligations. Where an event of default arises from certain bankruptcy events, the commitments will automatically and immediately terminate and the principal of, and interest then outstanding on, all of the loans will become immediately due and payable. Subject to certain notice requirements and other conditions, upon the occurrence of an event of default, including the occurrence of a condition having or reasonably likely to have a material adverse effect, commitments may be terminated and the principal of, and interest then outstanding on, all of the loans may become immediately due and payable. As of December 25, 2016, no event of default had occurred and the Company believes that events or conditions having a material adverse effect, giving rise to an acceleration of any amounts outstanding under the Credit Agreement, have not occurred and the likelihood of such events or conditions occurring is remote.

Borrowings under the Credit Agreement may take the form of a base rate revolving loan, Eurodollar revolving loan or swingline loan. Base rate revolving loans and swingline loans will bear interest at a rate per annum equal to the sum of the applicable margin from time to time in effect plus the highest of (i) the Agent's prime lending rate, as in effect at such time, (ii) the federal funds rate, as in effect at such time, plus 0.50% per annum, and (iii) the adjusted London Interbank Offered Rate ("LIBOR") determined at such time for an interest period of one month, plus 1.00% per annum. Eurodollar revolving loans will bear interest at a rate per annum equal to the sum of the applicable margin from time to time in effect plus the adjusted LIBOR rate. The applicable margin varies between 1.50% - 2.00% for base rate revolving loans and swingline loans and 2.50% - 3.00% for Eurodollar loans, and is based on several factors including our then-existing borrowing base and the lender's total commitment amount and revolving credit exposure. The calculation of our borrowing base takes into account several items relating to us and our subsidiaries, including amounts due and owing under billed and unbilled accounts receivables, then-held eligible raw materials inventory, work-in-process inventory, and applicable reserves.

On May 31, 2015, we entered into a third amendment (the "Third Amendment") to the Credit Agreement. Under the terms of the Third Amendment, the definitions of certain terms of the Credit Agreement were modified, the disposition of the Herley Entities was approved by the lenders, a minimum $175.0 million repurchase of the Notes by the Company was required, and the payment in full of the outstanding balance of the Credit Agreement was required. Additionally, the measurement of the fixed charge coverage ratio of 1.15:1 was modified as follows: (i) the fixed charge coverage ratio will not be measured as of the end of any quarterly reporting period ending on or about June 30, 2015, or as of the end of any quarterly reporting period ending after June 30, 2015, if on such date (a) there are no outstanding revolving loans or swingline loans and (b) the aggregate amount outstanding under letters of credit is less than or equal to $17.0 million, and (ii) as to any subsequent quarterly reporting period ending after June 30, 2015, and not covered by (i) above, a fixed charge coverage ratio of at least 1.05:1 must be maintained if the percentage of (a) outstanding revolving loans plus the sum of the outstanding swingline loans and outstanding letters of credit that are in excess of $17.0 million, to (b) the revolving credit commitment, minus the Herley Disposition Proceeds Reinvestment Reserve, as defined below, is greater than 0.00% but less than 15.00% or a fixed charge coverage ratio of at least 1.10:1 must be maintained if the aforementioned percentage is equal to or greater than 15.00% but less than 25.00%. In all other instances, a fixed charge coverage ratio of 1.15:1 must be maintained. For purposes of computing the fixed charge coverage ratio, the associated reduction in consolidated interest expense in connection with the repurchase of Notes with proceeds from the sale of the Herley Entities shall be deemed to have occurred on the first day of the most recently completed four quarterly reporting periods prior to the sale.

The terms of the Third Amendment also included the establishment of a reserve (the “Herley Disposition Proceeds Reinvestment Reserve”) that reduced the maximum $110.0 million total borrowing base on the Credit Agreement. With the sale of the Herley Entities, a $50.8 million reserve was established based upon the collateral carrying value under the Credit Agreement of the Herley Entities disposed. The reserve and therefore the maximum borrowing base were adjusted monthly for the subsequent cumulative reinvestment in similar collateral assets over a period not to have exceeded 360 days from the date of sale of the Herley Entities. As of September 25, 2016, there was no reserve on the maximum borrowings, resulting from a cumulative reinvestment in similar collateral assets since the sale of the Herley Entities in excess of the $50.8 million reserve established at the date of the sale of the Herley Entities. We made investments in assets that replaced the collateral, which reinstated the maximum facility to the full $110.0 million as of the end of the first quarter of 2016.

On August 19, 2015, we entered into a fourth amendment (the “Fourth Amendment”) to the Credit Agreement. Among other things, the Fourth Amendment provides for a modification of the Third Amendment as it relates to when the minimum fixed charge coverage ratio will be measured based upon outstanding borrowings. Outstanding borrowings for purposes of computing the applicable minimum fixed charge coverage ratio exclude any letter of credit exposure outstanding of $17.0 million plus the amount of letters of credit outstanding for the divested Herley Entities for which a cash deposit was placed in escrow by the Buyer to cover the amount of such outstanding letters of credit, should the letters of credit be pulled.

As of December 25, 2016, there were no borrowings outstanding on the Credit Agreement and $11.1 million was outstanding on letters of credit, resulting in net borrowing base availability of $56.0 million. We were in compliance with the financial covenants as of December 25, 2016.

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 December 25, 2016 was $1.8 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 covenants including a minimum net equity covenant as defined in the loan agreement. We were in compliance with the financial covenants of the loan agreement as of December 25, 2016.

Off Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined in Regulation S-K, Item 303(a)(4)(ii).

Contractual Obligations and Commitments

The following table summarizes our contractual obligations and other commitments at December 25, 2016, and the effect such obligations could have on our liquidity and cash flow in future periods (in millions):

	Payments due/forecast by Period				
	Total	**2017**	**2018 - 2019**	**2020 - 2021**	**2022 and After**
Debt, net of interest(1)	$ 437.3	$ 1.0	$ 436.3	$ —	$ —
Estimated interest on debt(2)	76.3	30.6	45.7	—	—
Purchase orders(3)	139.7	117.4	22.3	—	—
Operating leases(4)	67.5	19.0	31.1	15.3	2.1
Unrecognized tax benefits, including interest and penalties(5)	—	—	—	—	—
Total commitments and recorded liabilities	$ 720.8	$ 168.0	$ 535.4	$ 15.3	$ 2.1

(1) The Notes in the aggregate outstanding principal amount of $435.5 million are due May 15, 2019. See Note 4 in the Notes to Consolidated Financial Statements contained within this Annual Report for further details.

(2) Includes interest payments based on current interest rates for variable rate debt and the Notes. See Note 4 in the Notes to Consolidated Financial Statements contained within in this Annual Report for further details.

(3) Purchase orders include commitments in which a written purchase order has been issued to a vendor, but the goods have not been received or services have not been performed.

(4) We have entered into or acquired various non-cancelable operating lease agreements that expire on various dates through 2025. The amounts include $4.0 million in excess facility costs and exclude expected sublease income. See Note 5 in the Notes to Consolidated Financial Statements contained within this Annual Report for further details.

(5) Our Consolidated Balance Sheet at December 25, 2016 included a $5.8 million noncurrent liability for uncertain tax positions and a $3.7 million guarantor liability, all of which may result in cash payments. The future payments related to uncertain tax positions have not been presented in the table above due to the uncertainty of the amounts and timing of cash settlements with the taxing authorities.

As of December 25, 2016, we have $11.1 million of standby letters of credit outstanding. Our letters of credit are primarily related to milestone payments received from foreign customers for which the customer has not yet received the product. Additional information regarding our financial commitments at December 25, 2016 is provided in the Notes to Consolidated Financial Statements contained in this Annual Report, specifically Note 14.

Other Liquidity Matters

We intend to fund our cash requirements with cash flows from operating activities, proceeds from our recent equity offering and borrowings under the Credit Agreement. We believe these sources should be sufficient to meet our cash needs for at least the next 12 months. As discussed in Item 1A “Risk Factors” contained within this Annual Report, our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to our control. If the conditions in our industry deteriorate or our customers cancel or postpone projects or if we are unable to sufficiently increase our revenues or further reduce our expenses, we may experience, in the future, a significant long-term negative impact to our financial results and cash flows from operations. In such a situation, we could fall out of compliance with our financial and other covenants which, if not waived, could limit our liquidity and capital resources.

Critical Accounting Principles and Estimates

We have identified the following critical accounting policies that affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements. The preparation of our Consolidated Financial Statements in conformity with GAAP requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, stockholders’ equity, revenues and expenses, and related disclosures of contingent assets and liabilities. On a periodic basis, as deemed necessary, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, valuation of inventory including the reserves for excess and obsolete inventory, valuation of long-lived assets including identifiable intangibles and goodwill, accounting for income taxes including the related valuation allowance, warranties, contingencies and litigation, contingent acquisition consideration, stock-based compensation, and losses on unused office space. We explain these accounting policies in the Notes to Consolidated Financial Statements contained within this Annual Report and at relevant sections in this discussion and analysis. These estimates are based on the information that is currently available and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions and such differences may be material.

Revenue recognition. We generate our revenue from three different types of contractual arrangements: cost-plus-fee contracts, time-and-materials contracts, and fixed-price contracts. Revenue on cost-plus-fee contracts is recognized to the extent of allowable costs incurred plus an estimate of the applicable fees earned. We consider fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract. We recognize the relevant portion of the expected fee to be awarded by the customer at the time such fee can be reasonably estimated, based on factors such as our prior award experience and communications with the customer regarding performance, including any interim performance evaluations rendered by the customer. Revenue on time-and-materials contracts is recognized to the extent of billable rates times hours delivered for services provided, to the extent of material cost for products delivered to customers, and to the extent of expenses incurred on behalf of the customers.

We have three basic categories of fixed-price contracts: fixed unit price, fixed-price level of effort, and fixed-price completion. Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. Revenues on fixed-price service contracts are recorded as work is performed in accordance with *Topic 605*. *Topic 605* generally requires revenue to be deferred until all of the following have occurred: (1) there is a contract in place, (2) delivery has occurred or services have been provided, (3) the price is fixed or determinable, and (4) collectability is reasonably assured. Revenues on fixed-price contracts that require delivery of specific items may be recorded based on a price per unit as units are delivered. Revenue for fixed-price contracts in which we are paid a specific amount to provide services for a stated period of time is recognized ratably over the service period.

A portion of our fixed-price completion contracts are within the scope of *Topic 605*. For these contracts, revenue is recognized using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. Estimates of costs to complete include material, direct labor, overhead, and allowable indirect expenses for our government contracts. These cost estimates are reviewed and, if necessary, revised monthly on a contract-by-contract basis. If, as a result of this review, we determine that a loss on a contract is probable, then the full amount of estimated loss is charged to operations in the period it is determined that it is probable a loss will be realized from the full performance of the contract.

In accounting for our long-term contracts for production of products provided to the U.S. Government, we utilize both cost-to-cost and units delivered measures under the percentage-of-completion method of accounting under the provisions of *Topic 605*. Under the units delivered 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 units delivered 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. Significant management judgments and estimates, including but not limited to the estimated costs to complete projects, must be made and used in connection with the revenue recognized in any accounting period. A cancellation, schedule delay, or modification of a fixed-price contract that is accounted for using the percentage-of-completion method may adversely affect our gross margins for the period in which the contract is modified or canceled. Under certain circumstances, a cancellation or negative modification could result in us having to reverse revenue that we recognized in a prior period, thus significantly reducing the amount of revenues we recognize for the period in which the adjustment is made. Correspondingly, a positive modification may positively affect our gross margins. In addition, a schedule delay or modifications can result in an increase in estimated cost to complete the project, which would also result in an impact to our gross margin. Material differences may result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates.

It is our policy to review any arrangement containing software or software deliverables and services against the criteria contained in FASB ASC *Topic 985*, *Software* (“*Topic 985*”) and related technical practice aids. Under the provisions of *Topic 985*, we review the contract value of software deliverables and services and determine allocations of the contract value based on Vendor Specific Objective Evidence (“VSOE”). All software arrangements requiring significant production, modification, or customization of the software are accounted for in conformity with *Topic 605*.

Our contracts may include the provision of more than one of our services (“multiple element arrangements”). In these situations, we apply the guidance of *Topic 605*. Accordingly, for applicable arrangements, revenue recognition includes the proper identification of separate units of accounting and the allocation of revenue across all elements based on relative fair values, with proper consideration given to the guidance provided by other authoritative literature.

For multiple element arrangements that include hardware products containing software essential to the hardware products’ functionality and undelivered non-software services, we allocate revenue to all deliverables based on their relative selling prices. In such circumstances, we use a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) VSOE, (ii) third-party evidence of selling price (“TPE”), and (iii) best estimate of the selling price (“ESP”).

VSOE generally exists only when we sell the deliverable separately and is the price actually charged by us for that deliverable. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain significant differentiation such that comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor products’ selling prices are on a stand-alone basis. Therefore, we typically are not able to obtain TPE of selling price. ESP reflects our best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis. We determine ESP for a product or service by considering multiple factors including, but not limited to major product groupings, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The determination of ESP is made through consultation with our management, taking into consideration our marketing strategy.

We account 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 we cannot objectively determine the fair value of any undelivered element included in such multiple element arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. Under certain of our contractual arrangements, we may also recognize revenue for out-of-pocket expenses in accordance with *Topic 605.* Depending on the contractual arrangement, these expenses may be reimbursed with or without a fee.

Under certain of our contracts, we provide supplier procurement services and materials for our customers. We record revenue on these arrangements on a gross or net basis in accordance with *Topic 605*. Depending on the specific circumstances of the arrangement we consider the following criteria, among others, for recording revenue on a gross or net basis:

(1) whether we act as a principal in the transaction;

(2) whether we take title to the products;

(3) whether we assume risks and rewards of ownership, such as risk of loss for collection, delivery or returns;

(4) whether we serve as an agent or broker, with compensation on a commission or fee basis; and

(5) whether we assume the credit risk for the amount billed to the customer subsequent to delivery.

For our federal contracts, we follow U.S. Government procurement and accounting standards in assessing the allowability and the allocability of costs to contracts. Due to the significance of the judgments and estimation processes, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. We closely monitor compliance with, and the consistent application of, our critical accounting policies related to contract accounting. Business operations personnel conduct periodic contract status and performance reviews. When adjustments in estimated contract revenues or costs are required, any significant changes from prior estimates are included in earnings in the current period. Also, regular and recurring evaluations of contract cost, scheduling and technical matters are performed by management personnel who are independent from the business operations personnel performing work under the contract. Costs incurred and allocated to contracts with the U.S. Government are scrutinized for compliance with regulatory standards by our personnel, and are subject to audit by the DCAA.

From time to time, we may proceed with work based on customer direction prior to the completion and signing of formal contract documents. We have a formal review process for approving any such work. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. We base our estimates on previous experiences with the customer, communications with the customer regarding funding status, and our knowledge of available funding for the contract or program.

Allowance for doubtful accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the potential inability of certain customers to make required future payments on amounts due to us. Management determines the adequacy of this allowance by periodically evaluating the aging and past due nature of individual customer accounts receivable balances and considering the customer’s current financial situation as well as the existing industry economic conditions and other relevant factors that would be useful towards assessing the risk of collectability. If the future financial condition of our customers were to deteriorate, resulting in their inability to make specific required payments, additions to the allowance for doubtful accounts may be required. In addition, if the financial condition of our customers improves and collections of amounts outstanding commence or are reasonably assured, then we may reverse previously established allowances for doubtful accounts. Changes to estimates of contract value are recorded as adjustments to revenue and not as a component of the allowance for doubtful accounts. We write off accounts receivable when they become uncollectible and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Long-lived and Intangible Assets. We account for long-lived assets in accordance with the provisions of FASB ASC *Topic 360 Property, Plant, and Equipment* (“*Topic 360*”)*. Topic 360* addresses financial accounting and reporting for the impairment or disposal of long-lived assets and requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparing the carrying amount of an asset to the expected future net cash flows generated by the asset. If it is determined that the asset may not be recoverable and if the carrying amount of an asset exceeds its estimated fair value, an impairment charge is recognized to the extent of the difference. *Topic 360* requires companies to separately report discontinued operations, including components of an entity that either have been disposed of (by sale, abandonment or in a distribution to owners) or classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

In accordance with *Topic 360*, we assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could individually or in combination trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- our market capitalization relative to net book value.

If we determined that the carrying value of intangibles and long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we would record an impairment equal to the excess of the carrying amount of the asset over its estimated fair value.

Goodwill and Purchased Intangibles. The purchase price of an acquired business is allocated to the underlying tangible and intangible assets acquired and liabilities assumed based upon their respective fair market values, with the excess recorded as goodwill. Such fair market value assessments require judgments and estimates that can be affected by contract performance and other factors over time, which may cause final amounts to differ materially from original estimates.

We have established certain accruals in connection with indemnities and other contingencies from our acquisitions. These accruals and subsequent adjustments have been recorded during the purchase price allocation period for acquisitions. The accruals were determined based upon the terms of the purchase or sales agreements and, in most cases, involve a significant degree of judgment. Management has recorded these accruals in accordance with its interpretation of the terms of the purchase or sale agreements, known facts, and an estimation of probable future events based on management's experience. Any changes to recorded estimates will be recognized through earnings.

We perform our impairment test for goodwill in accordance with *Topic 350*. We assess 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. We determine our reporting units by first identifying our 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. We aggregate components within an operating segment that have similar economic characteristics.

KGS has four operating segments: Defense Rocket Support Services ("DRSS"), Microwave Electronics Division ("ME"), Technical and Training Solutions ("TTS"), and Modular Systems ("MS") that provide technology based defense solutions, involving products and services, primarily for mission critical U.S. National Security priorities, with the primary focus relating to the nation's Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance requirements. The PSS operating segment provides integrated solutions for advanced homeland security, public safety, critical infrastructure security, and security and surveillance systems for government, industrial and commercial customers. The US reportable segment provides unmanned aerial systems and unmanned ground and seaborne systems. The Company has identified its reporting units to be the DRSS, ME, TTS, and MS operating segments, within its KGS reportable segment, the US reportable segment, and the PSS reportable segment to be tested for potential impairment in its fiscal year 2016 annual test.

We also perform impairment tests for goodwill whenever evidence of potential impairment exists. When it is determined that impairment has occurred, a charge to operations is recorded. In order to test for potential impairment, we estimate the fair value of each of our reporting units based on a comparison and weighting of the income approach, specifically the discounted cash flow ("DCF") method and the market approach, which estimates the fair value of our reporting units based upon comparable market prices and recent transactions and also validates the reasonableness of the implied multiples from the income approach. We reconcile the fair value of our reporting units to our market capitalization on the last business day of fiscal October and assume a control premium.

In testing for impairment of our goodwill, we make assumptions about the amount and timing of future expected cash flows, terminal growth rates, appropriate discount rates, market multiples, and the control premium a controlling shareholder could be expected to pay:

- The timing of future cash flows within our DCF analysis is based on our most recent forecasts and other estimates. Our historical growth rates and operating results are not indicative of our projected growth rates and operating results as a consequence of our acquisitions and divestitures.
- The terminal growth rate is used to calculate the value of cash flows beyond the last projected period in our DCF analysis and reflects our best estimates for stable, perpetual growth of our reporting units.
- We use estimates of market participant weighted average cost of capital (“WACC”) as a basis for determining the discount rates to apply to our reporting units’ future expected cash flows. The significant assumptions within our WACC are: (a) equity risk premium, (b) beta, (c) size premium adjustments, (d) cost of debt and (e) capital structure assumptions. In addition, we use a company specific risk adjustment which is a subjective adjustment that, by its very nature does not include market related data, but instead examines the prospects of the reporting unit relative to the broader industry to determine if there are specific factors which may make it more “risky” relative to the industry.
- Recent historical market multiples are used to estimate future market pricing.
- We use an estimated control premium in reconciling the aggregate value of our reporting units to our market capitalization. As discussed in *Topic 350*, control premiums may effectively cause a company’s aggregate fair value of its reporting unit(s) to exceed its current market capitalization due to the ability of a controlling shareholder to benefit from synergies and other intangible assets that arise from such control. As a result, the measurement of fair value of an entity with a collection of assets and liabilities that operate together to produce cash flows is different from the fair value measurement of that entity’s individual securities, hence, the reason a control premium is paid.

We review intangible assets subject to amortization for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Impairment losses, where identified, are determined as the excess of the carrying value over the estimated fair value of the long-lived asset. We assess the recoverability of the carrying value of assets held for use based on a review of projected undiscounted cash flows.

The goodwill of the PSS, US, and KGS reportable segments are $35.6 million, $97.3 million and $352.5 million, respectively, at December 25, 2016.

In determining the fair value of our reporting units, there are key assumptions related to our future operating performance and revenue growth. If the actual operating performance and financial results are not consistent with our assumptions an impairment in our $485.4 million goodwill and $32.6 million long-lived intangibles could occur in future periods. In particular, the US reporting unit fair value includes assumptions that the development of the high performance Unmanned Combat Aerial System (“UCAS”) product is successful and we are awarded future contracts for the UCAS product and other new tactical unmanned aircraft systems. Additionally, the US reporting unit fair value assumes that the U.S. Navy will exercise options under the existing current contract and we will commence low rate initial production for the Sub-Sonic Aerial Target. For certain of our reporting units, the fair value includes assumptions of the entry to new international markets for which we have not yet penetrated. Additional risks for goodwill across all reporting units include, but are not limited to, the risks discussed in Item 1A “Risk Factors” contained within this Annual Report and:

- a decline in our stock price and resulting market capitalization, if we determine the decline is sustained and is indicative of a reduction in the fair value below the carrying value of our reporting units;
- a decrease in available government funding, including budgetary constraints affecting U.S. Government spending generally, or specific departments or agencies;
- changes in U.S. Government programs or requirements, including the increased use of small business providers;
- our failure to reach our internal forecasts could impact our ability to achieve our forecasted levels of cash flows and reduce the estimated discounted value of our reporting units;
- volatility in equity and debt markets resulting in higher discount rates; and
- market and political factors that could impact the success of new products, especially related to new unmanned systems platforms.

It is not possible at this time to determine if an impairment charge would result from these factors, or, if it does, whether such charge would be material. We will continue to monitor our goodwill for potential impairment indicators.

Accounting for income taxes and tax contingencies. FASB ASC *Topic 740 Income Taxes* (“*Topic 740*”) provides the accounting treatment for uncertainty in income taxes recognized in an enterprise’s financial statements. *Topic 740* prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. *Topic 740* also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As part of the process of preparing our Consolidated Financial Statements, we are required to estimate our provision for income taxes in each of the tax jurisdictions in which we conduct business. This process involves estimating our actual current tax expense in conjunction with the evaluation and measurement of temporary differences resulting from differing treatment of certain items for tax and accounting purposes. These temporary differences result in the establishment of deferred tax assets and liabilities, which are recorded on a net basis and included in our Consolidated Balance Sheets. We then assess on a periodic basis the probability that our net deferred tax assets will be recovered and therefore realized from future taxable income and to the extent we believe that recovery is not more likely than not, a valuation allowance is established to address such risk resulting in an additional related provision for income taxes during the period.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, tax contingencies, unrecognized tax benefits, and any required valuation allowance, including taking into consideration the probability of the tax contingencies being incurred. Management assesses this probability based upon information provided to us by our tax advisers, our legal advisers and similar tax cases. If at a later time our assessment of the probability of these tax contingencies changes, our accrual for such tax uncertainties may increase or decrease.

We have a valuation allowance at December 25, 2016 due to management’s overall assessment of risks and uncertainties related to our future ability to realize and, hence, utilize certain deferred tax assets, primarily consisting of net operating losses, carry forward temporary differences and future tax deductions resulting from certain types of stock option exercises, before they expire.

The 2016 effective tax rate at December 25, 2016 for annual and interim reporting periods could be impacted if uncertain tax positions that are not recognized at December 25, 2016 are settled at an amount which differs from our estimate. Finally, during 2016 and thereafter, if we are impacted by a change in the valuation allowance as of December 25, 2016 resulting from a change in judgment regarding the realizability of deferred tax assets beyond December 25, 2016, such effect will be recognized in the interim period in which the change occurs.

Contingencies and litigation. We are currently involved in certain legal proceedings. We estimate a range of liability related to pending litigation where the amount and range of loss can be estimated. We record our estimate of a loss when the loss is considered probable and reasonably estimable. Where a liability is probable and there is a range of estimated loss and no amount in the range is more likely than any other number in the range, we record the minimum estimated liability related to the claim in accordance with FASB ASC *Topic 450 Contingencies.* As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates. Revisions in our estimates of potential liability could materially impact our results of operations. See Item 3 “Legal Proceedings” contained within this Annual Report for additional information.

Stock-based Compensation. We account for stock-based compensation arrangements in accordance with the provisions of FASB ASC *Topic 718, Compensation-Stock Compensation* (“*Topic 718*”), which requires the measurement and recognition of compensation expense for all stock-based payment awards to employees and directors based on estimated fair values.

The valuation provisions of *Topic 718* apply to new awards and to awards that are outstanding on the effective date and subsequently modified or canceled. We use the Black-Scholes option pricing model and a lattice options pricing model for market condition options to estimate the fair value of our stock options at the grant date. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. The lattice options pricing model breaks down the time to expiration into potentially a very large number of time intervals, or steps which makes it possible to check at every point in an option’s life for the possibility of early exercise. Our employee stock options are generally subject to vesting restrictions and are generally not transferable.

Valuing options requires highly subjective assumptions including the expected stock price volatility over the term of the award, the expected life of an option and the number of awards ultimately expected to vest. Changes in these assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by an employee. We used historical data to estimate the expected forfeiture rate, intrinsic and historical data to estimate the expected price volatility, and a weighted-average expected life formula to estimate the expected option life. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option.

Estimates of stock-based compensation expenses are significant to our Consolidated Financial Statements, but these expenses are based on option valuation models and will never result in the payment of cash by us. For this reason, and because we do not view stock-based compensation to be significant as related to our operational performance, we exclude estimated stock-based compensation expense when evaluating the business performance of our operating segments.

Recent Accounting Pronouncements

See Note 1 of the Notes to Consolidated Financial Statements contained within this Annual Report on Form 10-K for a discussion of recent accounting pronouncements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate and Foreign Currency Risks

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 the Credit Agreement discussed under **"**Liquidity and Capital Resources" above. Based on our current outstanding balances, a 1% change in the LIBOR rate would not materially 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 interest rate risk 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. Accordingly, a strengthening of the U.S. dollar ("USD") will negatively impact revenues and gross margins expressed in consolidated USD terms. We currently enter into limited foreign currency forward contracts to manage foreign currency exchange rate risk because exchange rate fluctuations have had, and we expect will have, minimal impact on our operating results and cash flows.

Cash and cash equivalents as of December 25, 2016 were $69.1 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 year ended December 25, 2016.

Commodity Price Risk Management

We purchase commodities for use in our manufacturing processes. We typically purchase these commodities at market prices, and as a result are affected by market price fluctuations. We have decided not to hedge these exposures as they are deemed immaterial.

Item 8. ***Financial Statements and Supplementary Data.***

Our Consolidated Financial Statements and supplementary data required by this item are set forth at the pages indicated in Item 15(a) (1) and 15(a) (2), respectively.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under 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) and 15d-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 Annual 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 December 25, 2016.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that internal controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in the 2013 *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the results of our evaluation, our management concluded that our internal control over financial reporting was effective at the reasonable assurance level as of December 25, 2016.

Our internal control over financial reporting has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report appearing below, which expresses an unqualified opinion on the effectiveness of our internal control over financial reporting as of December 25, 2016.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial accounting and reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the fourth quarter of the fiscal year ended December 25, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. *Other Information.*

None.

PART III

Item 10. *Directors, Executive Officers and Corporate Governance.*

The information required by this item is incorporated by reference to our definitive proxy statement filed in connection with our 2017 Annual Meeting of Stockholders or an amendment to this Annual Report to be filed with the SEC within 120 days after the close of our fiscal year ended December 25, 2016.

Item 11. *Executive Compensation.*

The information required by this item is incorporated by reference to our definitive proxy statement filed in connection with our 2017 Annual Meeting of Stockholders or an amendment to this Annual Report to be filed with the SEC within 120 days after the close of our fiscal year ended December 25, 2016.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.***

The information required by this item is incorporated by reference to our definitive proxy statement filed in connection with our 2017 Annual Meeting of Stockholders or an amendment to this Annual Report to be filed with the SEC within 120 days after the close of our fiscal year ended December 25, 2016.

Item 13. ***Certain Relationships and Related Transactions, and Director Independence.***

The information required by this item is incorporated by reference to our definitive proxy statement filed in connection with our 2017 Annual Meeting of Stockholders or an amendment to this Annual Report to be filed with the SEC within 120 days after the close of our fiscal year ended December 25, 2016.

Item 14. ***Principal Accountant Fees and Services.***

The information required by this item is incorporated by reference to our definitive proxy statement filed in connection with our 2017 Annual Meeting of Stockholders or an amendment to this Annual Report to be filed with the SEC within 120 days after the close of our fiscal year ended December 25, 2016.

PART IV

Item 15. ***Exhibits and Financial Statements Schedules.***

(a)(1) Financial Statements

The Consolidated Financial Statements of Kratos Defense & Security Solutions, Inc. and Report of Deloitte & Touche LLP, Independent Registered Public Accounting Firm, are included in a separate section of this Annual Report beginning on page F-1.

(a)(2) Financial Statement Schedules

All schedules have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or the notes thereto.

(a) (3). Exhibits.

		Incorporated by Reference			
Exhibit Number	**Exhibit Description**	**Form**	**Filing Date (File No.)**	**Exhibit**	**Filed-Furnished Herewith**
2.1+*	Stock Purchase Agreement, dated May 31, 2015, by and among Kratos Defense & Security Solutions, Inc., Herley Industries, Inc., Ultra Electronics Holdings plc and Ultra Electronics Defense Inc.	10-Q	08/06/2015 (001-34460)	2.4	
3.1	Amended and Restated Certificate of Incorporation of Kratos Defense & Security Solutions, Inc., as amended.				*
3.2	Second Amended and Restated Bylaws of Kratos Defense & Security Solutions, Inc., as amended.				*
4.1	Specimen Stock Certificate.				*

4.2	Indenture, dated as of May 14, 2014, among Kratos Defense & Security Solutions, Inc., as Issuer, the Guarantors as named therein and party thereto, and Wilmington Trust, National Association, as Trustee and Collateral Agent (including the Form of 7.00% Senior Secured Notes due 2019).	8-K	05/15/2014 (001-34460)	4.1
4.3	Registration Rights Agreement, dated as of May 14, 2014, among Kratos Defense & Security Solutions, Inc., as Issuer, and SunTrust Robinson Humphrey, Inc., as Representative of the Initial Purchasers.	8-K	05/15/2014 (001-34460)	10.1
10.1#	Form of Indemnification Agreement by and between Kratos Defense & Security Solutions, Inc. and its directors and executive officers.	10-Q	08/04/2011 (001-34460)	10.8
10.2#	Amended and Restated 1999 Employee Stock Purchase Plan.	S-8	09/13/2013 (333-191156)	99.1
10.3#	2000 Nonstatutory Stock Option Plan.	10-Q	11/14/2000 (000-27231)	10.2
10.4#	Form of Stock Option Agreement and Form of Stock Option Grant Notice used in connection with the 2000 Nonstatutory Stock Option Plan.	10-Q	11/14/2000 (000-27231)	10.3
10.5#	2005 Equity Incentive Plan.	S-8	08/01/2005 (333-127060)	99.2
10.6#	Form of Stock Option Agreement pursuant to the 2005 Equity Incentive Plan.	S-8	08/01/2005 (333-127060)	99.1
10.7#	Form of Restricted Stock Unit Agreement and Form of Notice of Grant of Restricted Stock Units under the 2005 Equity Incentive Plan.	8-K	01/17/2007 (000-27231)	99.3
10.8#	Herley Industries, Inc. 1997 Stock Option Plan.	S-8	04/08/2011 (333-173383)	4.11
10.9#	Herley Industries, Inc. 2000 Stock Option Plan.	S-8	04/08/2011 (333-173383)	4.13
10.10#	Herley Industries, Inc. 2003 Stock Option Plan.	S-8	04/08/2011 (333-173383)	4.14
10.11#	Herley Industries, Inc. Amended and Restated 2006 New Employee Stock Option Plan.	S-8	04/08/2011 (333-173383)	4.15
10.12#	2011 Equity Incentive Plan.	DEF 14A	04/15/2011 (001-34460)	n/a
10.13#	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Unit Award Agreement pursuant to the 2011 Equity Incentive Plan.	8-K	11/18/2011 (001-34460)	10.2
10.14#	2014 Equity Incentive Plan.	DEF 14A	04/11/2014 (001-34460)	n/a
10.15#	Form of Restricted Stock Unit Grant & Notice and Form of Restricted Stock Unit Award Agreement pursuant to the 2014 Equity Incentive Plan.	10-Q	11/07/2014 (001-34460)	10.1
10.16#	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	08/04/2011 (001-34460)	10.3

10.17#	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	08/04/2011 (001-34460)	10.4
10.18	Sublease Agreement, dated as of December 17, 2009, by and between Amylin Pharmaceuticals, Inc., as Sublessor, and Kratos Defense & Security Solutions, Inc., as Sublessee.	10-K	03/11/2010 (001-34460)	10.26
10.19#	Herley Industries, Inc. Amended and Restated 2010 Stock Plan, and the related Form of Notice of Grant of Restricted Stock Units and Restricted Stock Unit Award Agreement.	S-8	03/08/2012 (333-179977)	4.10
10.20#	Amended and Restated Integral Systems, Inc. 2008 Stock Incentive Plan, and the related Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units and Restricted Stock Unit Award Agreement.	S-8	03/08/2012 (333-179977)	4.11
10.21	Standstill Agreement, dated May 14, 2012, between Kratos Defense & Security Solutions, Inc., Bandel Carano, Oak Investment Partners IX, L.P., Oak IX Affiliates Fund, L.P., Oak IX Affiliates Fund-A, L.P., Oak X Affiliates Fund, L.P., Oak Investment Partners X, L.P., and Oak Investment Partners XIII, L.P.	8-K	05/15/2012 (001-34460)	10.1
10.22#	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Unit Award Agreement, entered into between Kratos Defense & Security Solutions, Inc. and certain employees of Composite Engineering, Inc.	S-8	07/27/2012 (333-182910)	4.12
10.23#	Employment Agreement, effective January 1, 2015, by and between Kratos Defense & Security Solutions, Inc. and Richard Poirier.	8-K	03/12/2015 (001-34460)	10.1
10.24#	Bonus Agreement, dated June 1, 2015, by and between Kratos Defense & Security Solutions, Inc. and Richard Poirier.	8-K	06/02/2015 (001-34460)	10.1
10.25	Credit and Security Agreement, dated as of May 14, 2014, among Kratos Defense & Security Solutions, Inc., as Borrower, the Lenders named therein, SunTrust Bank, as Agent, PNC Bank, National Association, as Joint Lead Arranger and Documentation Agent, and SunTrust Robinson Humphrey, Inc., as Joint Lead Arranger and Sole Book Runner.	8-K	05/15/2014 (001-34460)	10.2
10.26	Third Amendment to Credit and Security Agreement, dated May 31, 2015, among Kratos Defense & Security Solutions, Inc., as Borrower, each of the Credit Parties and Required Lenders party thereto and SunTrust Bank as Agent.	10-Q	08/06/2015 (001-34460)	10.1
10.27	Fourth Amendment to Credit and Security Agreement, dated August 20, 2015, among Kratos Defense & Security Solutions, Inc., as Borrower, each of the Credit Parties and Required Lenders party thereto and SunTrust Bank as Agent.	8-K	08/24/2015 (001-34460)	10.1

10.28#	Employment Agreement, effective August 5, 2016, by and between Kratos Defense & Security Solutions, Inc. and Gerald Beaman	8-K	08/05/2016 (001-34460)	10.1	
10.29#	Employment Agreement, effective January 1, 2017, by and between Kratos Defense & Security Solutions, Inc. and Phil Carrai.	8-K	12/05/2016 (001-34460)	10.1	
21.1	List of Subsidiaries.				*
23.1	Consent of Independent Registered Public Accounting Firm.				*
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 Annual Report on Form 10-K of Kratos Defense & Security Solutions, Inc. for the year ended December 25, 2016, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations and Comprehensive Loss, (iii) the Consolidated Statements of Cash Flows, (iv) the Notes to the 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.

* Certain portions have been omitted pursuant to a confidential treatment request. Omitted information has been filed separately with the SEC.

Management contract or compensatory plan or arrangement.

(b) Exhibits

See Item 15(a)(3) above.

(c) Financial Statement Schedules

See Item 15(a)(2) above.

Item 16. ***Form 10-K Summary.***

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: February 27, 2017

Kratos Defense & Security Solutions, Inc.

	/s/ Eric M. DeMarco
By:	Eric M. DeMarco *President and Chief Executive Officer (Principal Executive Officer)*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Eric M. DeMarco Eric M. DeMarco	President, Chief Executive Officer and Director (Principal Executive Officer)	February 27, 2017
/s/ Deanna H. Lund Deanna H. Lund	Executive Vice President, Chief Financial Officer (Principal Financial Officer)	February 27, 2017
/s/ Maria Cervantes de Burgreen Maria Cervantes de Burgreen	Vice President and Corporate Controller (Principal Accounting Officer)	February 27, 2017
/s/ Scott Anderson Scott Anderson	Director	February 27, 2017
/s/ Bandel Carano Bandel Carano	Director	February 27, 2017
/s/ William Hoglund William Hoglund	Director	February 27, 2017
/s/ Scot Jarvis Scot Jarvis	Director	February 27, 2017
/s/ Jane E. Judd Jane E. Judd	Director	February 27, 2017
/s/ Sam Liberatore Sam Liberatore	Director	February 27, 2017
/s/ Amy Zegart Amy Zegart	Director	February 27, 2017

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Kratos Defense & Security Solutions, Inc.
San Diego, California

We have audited the accompanying consolidated balance sheets of Kratos Defense & Security Solutions, Inc. and subsidiaries (the “Company”) as of December 25, 2016 and December 27, 2015, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the three fiscal years in the period ended December 25, 2016. We also have audited the Company's internal control over financial reporting as of December 25, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 25, 2016 and December 27, 2015, and the results of their operations and their cash flows for each of the three fiscal years in the period ended December 25, 2016, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 25, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ DELOITTE & TOUCHE LLP

San Diego, California
February 27, 2017

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONSOLIDATED BALANCE SHEETS
December 25, 2016 and December 27, 2015
(in millions, except par value and number of shares)

	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$ 69.1	$ 28.5
Restricted cash	0.5	0.7
Accounts receivable, net	229.4	206.8
Inventoried costs	55.4	55.6
Income taxes receivable	4.6	4.6
Prepaid expenses	8.9	10.6
Other current assets	5.2	13.6
Total current assets	373.1	320.4
Property, plant and equipment, net	49.8	56.2
Goodwill	485.4	483.4
Intangible assets, net	32.6	36.5
Other assets	7.7	6.8
Total assets	$ 948.6	$ 903.3
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 52.7	$ 48.3
Accrued expenses	50.0	33.1
Accrued compensation	39.1	36.8
Accrued interest	3.6	3.9
Billings in excess of costs and earnings on uncompleted contracts	41.8	42.3
Other current liabilities	6.7	5.1
Current portion of long-term debt	1.0	1.0
Current liabilities of discontinued operations	1.6	1.9
Total current liabilities	196.5	172.4
Long-term debt principal, net of current portion	431.0	444.1
Deferred income tax liability	17.3	10.5
Other long-term liabilities	23.7	18.0
Long-term liabilities of discontinued operations	3.7	4.1
Total liabilities	672.2	649.1
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 authorized, 0 shares outstanding at December 25, 2016 and December 27, 2015	—	—
Common stock, $0.001 par value, 195,000,000 shares authorized; 73,945,533 and 59,139,651 shares issued and outstanding at December 25, 2016 and December 27, 2015, respectively	—	—
Additional paid-in capital	956.2	873.2
Accumulated other comprehensive loss	(1.7)	(1.4)
Accumulated deficit	(678.1)	(617.6)
Total stockholders' equity	276.4	254.2
Total liabilities and stockholders' equity	$ 948.6	$ 903.3

The accompanying notes are an integral part of these Consolidated Financial Statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
Years ended December 25, 2016, December 27, 2015, and December 28, 2014,
(in millions, except per share amounts)

	2016	2015	2014
Service revenues	$ 348.1	$ 354.2	$ 390.8
Product sales	320.6	302.9	372.2
Total revenues	668.7	657.1	763.0
Cost of service revenues	255.8	266.5	304.6
Cost of product sales	259.3	228.8	279.0
Total costs	515.1	495.3	583.6
Gross profit	153.6	161.8	179.4
Selling, general and administrative expenses	146.3	150.7	153.6
Merger and acquisition related items	1.9	0.1	0.2
Research and development expenses	13.9	16.2	18.6
Unused office space and other restructuring	10.1	(0.7)	1.7
Operating income (loss) from continuing operations	(18.6)	(4.5)	5.3
Other income (expense):			
Interest expense, net	(34.7)	(36.0)	(39.2)
Gain (loss) on extinguishment of debt	0.2	(3.4)	(39.1)
Other income (expense), net	0.8	(0.7)	1.2
Total other expense, net	(33.7)	(40.1)	(77.1)
Loss from continuing operations before income taxes	(52.3)	(44.6)	(71.8)
Provision (benefit) for income taxes from continuing operations	8.1	(11.4)	3.9
Loss from continuing operations	(60.4)	(33.2)	(75.7)
Discontinued operations (Note 8)			
Income (loss) from operations of discontinued component (including gain on disposal of $80.8 million for the year ended December 27, 2015)	(0.1)	75.5	(1.1)
Income tax expense	—	22.5	1.2
Income (loss) from discontinued operations	(0.1)	53.0	(2.3)
Net income (loss)	$ (60.5)	$ 19.8	$ (78.0)
Basic income and loss per common share:			
Loss from continuing operations	$ (0.99)	$ (0.56)	$ (1.31)
Income (loss) from discontinued operations	—	0.90	(0.04)
Net income (loss) per common share	$ (0.99)	$ 0.34	$ (1.35)
Diluted income and loss per common share:			
Loss from continuing operations	$ (0.99)	$ (0.56)	$ (1.31)
Income (loss) from discontinued operations	—	0.90	(0.04)
Net income (loss) per common share	$ (0.99)	$ 0.34	$ (1.35)
Weighted average common shares outstanding:			
Basic	61.3	58.7	57.6
Diluted	61.3	58.7	57.6
Comprehensive Income (Loss)			
Net income (loss) from above	$ (60.5)	$ 19.8	$ (78.0)
Other comprehensive income (loss):			
Change in cumulative translation adjustment	(0.5)	0.1	(0.4)
Postretirement benefit reserve adjustment net of tax expense	0.2	0.2	(0.5)
Other comprehensive income (loss), net of tax	(0.3)	0.3	(0.9)
Comprehensive income (loss)	$ (60.8)	$ 20.1	$ (78.9)

The accompanying notes are an integral part of these Consolidated Financial Statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 25, 2016, December 27, 2015, and December 28, 2014
(in millions)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amounts				
Balance, December 29, 2013	57.0	$ —	$ 856.0	$ (0.8)	$ (559.4)	$ 295.8
Stock-based compensation	—	—	3.8	—	—	3.8
Issuance of common stock for employee stock purchase plan, options and warrants	0.7	—	3.9	—	—	3.9
Restricted stock issued and related taxes	0.1	—	(0.3)	—	—	(0.3)
Net loss	—	—	—	—	(78.0)	(78.0)
Other comprehensive loss, net of tax	—	—	—	(0.9)	—	(0.9)
Balance, December 28, 2014	57.8	—	863.4	(1.7)	(637.4)	224.3
Stock-based compensation	—	—	6.4	—	—	6.4
Issuance of common stock for employee stock purchase plan, options and warrants	0.9	—	4.0	—	—	4.0
Restricted stock issued and related taxes	0.4	—	(0.6)	—	—	(0.6)
Net income	—	—	—	—	19.8	19.8
Other comprehensive income, net of tax	—	—	—	0.3	—	0.3
Balance, December 27, 2015	59.1	—	873.2	(1.4)	(617.6)	254.2
Stock-based compensation	—	—	5.1	—	—	5.1
Issuance of common stock for cash	13.4	—	75.8	—	—	75.8
Issuance of common stock for employee stock purchase plan, options and warrants	0.8	—	2.6	—	—	2.6
Restricted stock issued and related taxes	0.6	—	(0.5)	—	—	(0.5)
Net loss	—	—	—	—	(60.5)	(60.5)
Other comprehensive loss, net of tax	—	—	—	(0.3)	—	(0.3)
Balance, December 25, 2016	73.9	$ —	$ 956.2	$ (1.7)	$ (678.1)	$ 276.4

The accompanying notes are an integral part of these Consolidated Financial Statements.

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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 25, 2016, December 27, 2015, and December 28, 2014
(in millions)

	2016	2015	2014
Operating activities:			
Net income (loss)	$ (60.5)	$ 19.8	$ (78.0)
Income (loss) from discontinued operations	(0.1)	53.0	(2.3)
Loss from continuing operations	(60.4)	(33.2)	(75.7)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities from continuing operations:			
Depreciation and amortization	22.8	25.5	32.4
Deferred income taxes	4.7	0.9	1.8
Stock-based compensation	5.1	6.1	3.6
Loss (gain) on extinguishment of debt	(0.2)	3.4	39.1
Non-cash income tax benefit	—	(18.7)	—
Amortization of deferred financing costs	1.5	1.9	3.2
Amortization of premium and discount on Senior Secured Notes	0.9	1.1	(0.9)
Provision for doubtful accounts	0.3	0.4	1.5
Litigation related charges	1.7	—	—
Provision for non-cash restructuring charges	9.1	—	—
Change in accrual for excess facilities	—	(2.3)	0.2
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable	(24.7)	10.3	14.8
Inventoried costs	(2.7)	(8.2)	2.7
Prepaid expenses	1.8	(3.5)	2.7
Other assets	3.2	(3.2)	1.3
Accounts payable	2.9	2.9	(11.6)
Accrued expenses	16.5	0.6	(9.8)
Accrued compensation	2.3	(4.4)	1.0
Accrued interest	(0.3)	1.5	0.4
Billings in excess of costs and earnings on uncompleted contracts	(0.4)	(7.3)	(0.9)
Income tax receivable and payable	1.2	(3.1)	0.4
Other liabilities	2.3	(0.4)	(3.7)
Net cash provided by (used in) operating activities from continuing operations	(12.4)	(29.7)	2.5
Investing activities:			
Cash paid for acquisitions, net of cash acquired	(5.1)	—	(2.6)
Proceeds from sale of assets	0.1	0.9	—
Change in restricted cash	0.3	4.7	(0.4)
Capital expenditures	(9.2)	(11.3)	(11.6)
Net cash used in investing activities from continuing operations	(13.9)	(5.7)	(14.6)
Financing activities:			
Proceeds from the issuance of long-term debt, net of issuance costs	—	—	618.5
Extinguishment of long-term debt	(14.1)	(175.0)	(661.5)
Proceeds from the issuance of common stock	76.2	—	—
Borrowing under credit facility	—	—	41.0
Repayments under credit facility	(1.0)	(42.0)	(1.0)
Cash paid for contingent acquisition consideration	—	(1.1)	—
Debt issuance costs	—	—	(10.0)
Proceeds from exercise of restricted stock units, employee stock options, and employee stock purchase plan	2.0	3.4	3.3
Net cash provided by (used in) financing activities from continuing operations	63.1	(214.7)	(9.7)
Net cash flows of continuing operations	36.8	(250.1)	(21.8)
Net operating cash flows of discontinued operations	0.1	2.8	4.1
Net investing cash flows of discontinued operations	4.0	242.5	(2.6)
Effect of exchange rate changes on cash and cash equivalents	(0.3)	(0.2)	(0.4)
Net increase (decrease) in cash and cash equivalents	40.6	(5.0)	(20.7)
Cash and cash equivalents at beginning of year	28.5	33.5	54.2
Cash and cash equivalents at end of year	$ 69.1	$ 28.5	$ 33.5
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$ 32.4	$ 43.8	$ 57.1
Net cash paid during the year for income taxes	$ —	$ 8.8	$ 1.2
Non-cash financing and investing activities:			
Capital expenditures included in accounts payable and accrued expenses	$ 2.1	$ —	$ —
Liability for contingent consideration and goodwill related to acquisition	$ 5.1	$ —	$ —

The accompanying notes are an integral part of these Consolidated Financial Statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

(a) Description of Business

Kratos is a mid-tier government contractor at the forefront of the U.S. Department of Defense's (the "DoD") Third Offset Strategy. Kratos is a leading technology, intellectual property and proprietary product and solution company focused on the U.S. and its allies' national security. Kratos' primary focus areas are unmanned systems, satellite communications, microwave electronics, cyber security/warfare, missile defense and combat systems. We believe that our technology, intellectual property, proprietary products and designed-in positions on our customers' platforms and systems is a competitive advantage and high barrier to entry to our markets. Our work force is primarily technically oriented, highly skilled with a significant number holding national security clearances. Our entire organization is focused on executing our strategy of becoming the leading technology and intellectual property based company in our industry.

The Company conducts most of its business with the U.S. Government (which includes foreign military sales) and performs work as the prime contractor, subcontractor, or preferred supplier. The Company also conducts business with local, state, and foreign governments and domestic and international commercial customers.

The Company operates in three reportable segments. The Kratos Government Solutions ("KGS") reportable segment is comprised of an aggregation of operating segments, including its microwave electronic products, satellite communications, modular systems and rocket support operating segments. The Unmanned Systems ("US") reportable segment consists of its unmanned aerial system and unmanned ground and seaborne system businesses. The Public Safety & Security ("PSS") reportable segment consists of its businesses that provide independent integrated solutions for advanced homeland security, public safety, critical infrastructure, and security and surveillance systems for government and commercial applications. The Company organizes its business segments based primarily on the nature of the products, solutions and services offered. Transactions between segments are negotiated and accounted for under terms and conditions similar to other government and commercial contracts, and these intercompany transactions are eliminated in consolidation. For additional information regarding the Company's operating segments, see Note 13 of these Notes to Consolidated Financial Statements.

(b) Principles of Consolidation and Basis of Presentation

The Consolidated Financial Statements include the accounts of Kratos and its 100% owned subsidiaries, for which all intercompany transactions have been eliminated in consolidation.

As discussed in "Discontinued Operations" in Note 8 of these Notes to Consolidated Financial Statements, these consolidated financial statements have been recast for 2015 and prior periods presented to reflect the disposition of the Company's 100% owned subsidiary Herley Industries, Inc. ("Herley") and certain of Herley's subsidiaries, including Herley-CTI, Inc., EW Simulation Technology, Ltd. and Stapor Research, Inc. (collectively, the "Herley Entities") as discontinued operations.

(c) Fiscal Year

The Company has a 52/53 week fiscal year ending on the last Sunday of the calendar year, with interim fiscal periods ending on the last Sunday of each calendar quarter. There were 52 calendar weeks in the fiscal years ended on December 25, 2016, December 27, 2015 and December 28, 2014.

(d) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include revenue recognition, allowance for doubtful accounts, warranties, inventory valuation, valuation of long-lived assets including identifiable intangibles and goodwill, accounting for income taxes including the related valuation allowance on the deferred tax asset and uncertain tax positions, contingencies and litigation, contingent acquisition consideration, stock-based compensation, and losses on unused office space. In the future, the Company may realize actual results that differ from the current reported estimates and if the estimates that the Company has used change in the future, such changes could have a material impact on the Company's consolidated financial position, results of operations and cash flows.

(e) Revenue Recognition

The Company generates its revenue from three different types of contractual arrangements: cost-plus-fee contracts, time-and-materials contracts, and fixed-price contracts. Revenue on cost-plus-fee contracts is recognized to the extent of allowable costs incurred plus an estimate of the applicable fees earned. The Company considers fees under cost-plus-fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract and recognizes the relevant portion of the expected fee to be awarded by the customer at the time such fee can be reasonably estimated, based on factors such as its prior award experience and communications with the customer regarding performance, including any interim performance evaluations rendered by the customer. Revenue on time-and-materials contracts is recognized to the extent of billable rates times hours delivered for services provided, to the extent of material cost for products delivered to customers, and to the extent of expenses incurred on behalf of the customers.

The Company has three basic categories of fixed-price contracts: fixed unit price, fixed-price-level of effort, and fixed-price-completion. Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. Revenues on fixed-price service contracts are recorded as work is performed in accordance with *Accounting Standards Codification* ("ASC") *Topic 605, Revenue Recognition* ("*Topic 605*"), specifically *Topic 605-10-S99*, which generally requires revenue to be deferred until all of the following have occurred: (1) there is a contract in place; (2) delivery has occurred or services have been provided; (3) the price is fixed or determinable; and (4) collectability is reasonably assured. Revenues on fixed-price contracts that require delivery of specific items may be recorded based on a price per unit as units are delivered. Revenue for fixed-price contracts in which the Company is paid a specific amount to provide services for a stated period of time is recognized ratably over the service period.

On a portion of the fixed price-completion contracts, revenue is recognized in accordance with *Topic 605* using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. Estimates of costs to complete include material, direct labor, overhead, and allowable indirect expenses for government contracts. These cost estimates are reviewed and, if necessary, revised on a contract-by-contract basis. If, as a result of this review, management determines that a loss on a contract is probable, then the full amount of estimated loss is charged to operations in the period. As of December 25, 2016 and December 27, 2015, accrued expenses included the accrual for losses on contracts of $17.7 million and $3.5 million, respectively.

In certain instances, when the Company's customers have requested that it commence work prior to receipt of the contract award and funding and it has incurred costs related to that specific anticipated contract, and the Company believes recoverability of the costs is probable, it may defer those costs incurred until the associated contract has been awarded and funded by the customer.

In accounting for the Company's long-term contracts for production of products provided to the U.S. Government, the Company utilizes both cost-to-cost and units delivered measures under the percentage-of-completion method of accounting under the provisions of *Topic 605*. Under the units delivered 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. The Company estimates profit as the difference between total estimated revenue and total estimated cost of a contract and recognizes that profit over the life of the contract based on units delivered or as computed on the basis of the estimated final average unit costs plus profit. The Company classifies contract revenues as product sales or service revenues depending upon the predominant attributes of the relevant underlying contracts.

Significant management judgments and estimates, including but not limited to the estimated costs to complete projects, must be made and used in connection with the revenue recognized in any accounting period. A cancellation, schedule delay, or modification of a fixed-price contract which is accounted for using the percentage-of-completion method may adversely affect the Company's gross margins for the period in which the contract is modified or canceled. Under certain circumstances, a cancellation or negative modification could result in the Company having to reverse revenue that was recognized in a prior period, thus significantly reducing the amount of revenues recognized for the period in which the adjustment is made. Correspondingly, a positive modification may positively affect gross margins. In addition, a schedule delay or modifications can result in an increase in estimated cost to complete the project, which would also result in an impact to gross margins. Changes in contract estimates are reviewed 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. Material differences may result in the amount and timing of the Company's revenue for any period if management made different judgments or utilized different estimates.

It is the Company's policy to review any arrangement containing software or software deliverables and services against the criteria contained in ASC *Topic 985, Software* ("*Topic 985*"). Under the provisions of *Topic 985*, the Company reviews the contract value of software deliverables and services and determines allocations of the contract value based on vendor-specific objective evidence ("VSOE") of fair value for each of the software elements. All software arrangements requiring significant production, modification, or customization of the software are accounted for in conformity with *Topic 605*.

The Company's contracts may include the provision of more than one of its services ("multiple element arrangements"). In these situations, the Company applies the guidance of *Topic 605*. Accordingly, for applicable arrangements, revenue recognition includes the proper identification of separate units of accounting and the allocation of revenue across all elements based on relative fair values.

For multiple element arrangements that include hardware products containing software essential to the hardware products' functionality, 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) 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. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company's offerings contain significant differentiation such that comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis. Therefore, the Company typically is unable to obtain TPE of selling price. 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 determines ESP for a product or service by considering multiple factors including, but not limited to major product groupings, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The determination of ESP is made through consultation with management, taking into consideration the Company's marketing strategy.

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. Under certain of the Company's contractual arrangements, the Company may also recognize revenue for out-of-pocket expenses in accordance with *Topic 605*. Depending on the contractual arrangement, these expenses may be reimbursed with or without a fee.

Under certain of its contracts, the Company provides supplier procurement services and materials for its customers. The Company records revenue on these arrangements on a gross or net basis in accordance with *Topic 605*, depending on the specific circumstances of the arrangement. The Company considers the following criteria, among others, for recording revenue on a gross or net basis:

(1) whether the Company acts as a principal in the transaction;
(2) whether the Company takes title to the products;
(3) whether the Company assumes risks and rewards of ownership, such as risk of loss for collection, delivery or returns;
(4) whether the Company serves as an agent or broker, with compensation on a commission or fee basis; and,

(5) whether the Company assumes the credit risk for the amount billed to the customer subsequent to delivery.

For federal contracts, the Company follows U.S. Government procurement and accounting standards in assessing the allowability and the allocability of costs to contracts. Due to the significance of the judgments and estimation processes, it is likely that materially different amounts could be recorded if different assumptions were used or if the underlying circumstances were to change. The Company closely monitors the consistent application of its critical accounting policies and compliance with contract accounting. Business operations personnel conduct periodic contract status and performance reviews. When adjustments in estimated contract revenues or costs are required, any significant changes from prior estimates are included in earnings in the current period. Also, regular and recurring evaluations of contract cost, scheduling and technical matters are performed by management personnel who are independent from the business operations personnel performing work under the contract. Costs incurred and allocated to contracts with the U.S. Government are scrutinized for compliance with regulatory standards by the Company's personnel, and are subject to audit by the Defense Contract Audit Agency.

From time to time, the Company may proceed with work based on customer direction prior to the completion and signing of formal contract documents. The Company has a formal review process for approving any such work. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. The Company bases its estimates on previous experiences with the customer, communications with the customer regarding funding status, and its knowledge of available funding for the contract or program. As of December 25, 2016 and December 27, 2015, approximately $2.0 million and $1.7 million, respectively, of the Company's unbilled accounts receivable balance were under an authorization to proceed or work order from its customers where a formal purchase order had not yet been received.

Costs incurred for shipping and handling are included in cost of product sales at the time the related revenue is recognized. Amounts billed to a customer for shipping and handling are reported as revenue.

(f) 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 methods and the applicable method is applied consistently within an operating entity. Inventoried costs primarily relate to work under fixed-price contracts using the units-of-delivery method of percentage-of-completion accounting. 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.

(g) Research and Development

Costs incurred in research and development activities are expensed as incurred in accordance with *Financial Accounting Standards Board* ("FASB") ASC *Topic 730, Research and Development.*

(h) Income Taxes

The Company records deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company maintains a valuation allowance on the deferred tax assets for which it is more likely than not that the Company will not realize the benefits of these tax assets in future tax periods. The valuation allowance is based on estimates of future taxable income by tax jurisdiction in which the Company operates, the number of years over which the deferred tax assets will be recoverable, and scheduled reversals of deferred tax liabilities.

In accordance with the recognition standards established by ASC *Topic 740*, *Income Taxes* ("*Topic 740*"), the Company makes a comprehensive review of its portfolio of uncertain tax positions regularly. In this regard, an uncertain tax position represents the Company's expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return or claim, which has not been reflected in measuring income tax expense for financial reporting purposes. Until these positions are sustained by the taxing authorities, the Company has not recognized the tax benefits resulting from such positions and reports the tax effects as a liability for uncertain tax positions in its Consolidated Balance Sheets.

(i) Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC *Topic 718, Compensation-Stock Compensation* ("*Topic 718*"). All of the Company's stock-based compensation plans are considered equity plans under *Topic 718*, and compensation expense recognized is net of estimated forfeitures over the vesting period. The Company issues stock options and stock awards under its existing plans. The fair value of stock options is estimated on the date of grant using a Black-Scholes option-pricing model or a trinomial lattice options pricing model and is expensed on a straight-line basis over the remaining vesting period of the options, which is generally six or less years. The fair value of stock awards is determined based on the closing market price of the Company's common stock on the grant date and is adjusted at each reporting date based on the amount of shares ultimately expected to vest. Compensation expense for stock awards is expensed over the vesting period, usually five to ten years. Compensation expense for stock issued under the Company's employee stock purchase plan is estimated at the beginning date of the offering period using a Black-Scholes option-pricing model and is expensed on a straight-line basis over the period of the offering, which is generally six months.

For the years ended December 25, 2016, December 27, 2015 and December 28, 2014, there were no incremental tax benefits from stock options exercised in the periods. The following table shows the amounts recognized in the Consolidated Financial Statements for 2016, 2015 and 2014 for stock-based compensation expense related to stock options, stock awards and to stock offered under the Company's employee stock purchase plan (in millions, except per share amounts).

	2016	2015	2014
Selling, general and administrative expenses	$ 5.1	$ 6.1	$ 3.6
Total cost of employee stock-based compensation included in operating income (loss) from continuing operations	5.1	6.1	3.6
Impact on net income (loss) per common share:			
Basic and diluted	$ (0.08)	$ (0.10)	$ (0.06)

(j) Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments, which results in bad debt expense. Management periodically determines the adequacy of this allowance by evaluating the comprehensive risk profiles of all individual customer receivable balances including, but not limited to, the customer's financial condition, credit agency reports, financial statements and overall current economic conditions. Additionally, on certain contracts whereby the Company performs services for a prime/general contractor, a specified percentage of the invoiced trade accounts receivable may be retained by the customer until the project is completed. The Company periodically reviews all retainages for collectability and records allowances for doubtful accounts when deemed appropriate, based on its assessment of the associated credit risks. Changes to estimates of contract value are recorded as adjustments to revenue and not as a component of the allowance for doubtful accounts. Individual accounts receivable are written off to the allowance for doubtful accounts when the Company becomes aware of a specific customer's inability to meet its financial obligation, and all collection efforts are exhausted.

The following table outlines the balance of the Company's Allowance for Doubtful Accounts for 2016, 2015 and 2014. The table identifies the additional provisions each year as well as the write-offs that utilized the allowance (in millions).

Allowance for Doubtful Accounts	Balance at Beginning of Year		Provisions		Write-offs/Recoveries		Balance at End of Year	
Year ended December 28, 2014	$	2.2	$	1.5	$	(1.8)	$	1.9
Year ended December 27, 2015	$	1.9	$	0.4	$	(0.5)	$	1.8
Year ended December 25, 2016	$	1.8	$	0.3	$	(0.4)	$	1.7

(k) Cash and Cash Equivalents

The Company's cash equivalents consist of its highly liquid investments with an original maturity of three months or less when purchased by the Company.

The Company has restricted cash accounts of approximately $0.5 million at December 25, 2016 and $0.7 million at December 27, 2015. As of December 25, 2016 and December 27, 2015, restricted cash consists primarily of a deposit securing foreign letters of credit related to payment and performance bonds on international contracts.

(l) Property and Equipment, Net

Property and equipment, net owned by the Company is depreciated over the estimated useful lives of individual assets. Equipment acquired under capital leases are amortized over the shorter of the lease term or the estimated useful life of the asset. Improvements, which significantly improve and extend the useful life of an asset, are capitalized and depreciated over the shorter of the lease period or the estimated useful life. Expenditures for maintenance and repairs are charged to operations as incurred.

Assets are depreciated predominately using the straight-line method, with the following lives:

	Years
Buildings and improvements	15 – 39
Machinery and equipment	3 – 10
Computer equipment and software	1 – 10
Vehicles, furniture, and office equipment	5
Leasehold improvements	Shorter of useful life or length of lease

The Company classifies assets and liabilities as held for sale ("disposal group") when management, having the authority to approve the action, commits to a plan to sell the disposal group, the sale is probable within one year, and the disposal group is available for immediate sale in its present condition. The Company also considers whether an active program to locate a buyer has been initiated, whether the disposal group is marketed actively for sale at a price that is reasonable in relation to its current fair value, and whether actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or the plan will be withdrawn.

At the time of classifying assets as held for sale and at the end of each reporting period, the Company compares the carrying value of these assets to estimates of fair value to assess for impairment. We compare the carrying value to estimates of fair value utilizing the assistance of third-party broker opinions of value to assist in our fair value estimates.

In the third quarter of 2016, the Company's management, following the closure of its manufacturing facility in South Carolina, committed to a plan to sell the Walterboro building facility reported within the KGS segment. At that time, the building facility had a carrying value of $1.9 million and was classified as held for sale. In the fourth quarter of 2016, after not receiving any viable offers to purchase the building facility, the Company decided to reclassify the building facility from held for sale to held for use. In accordance with ASC *Topic 360-10, Property, Plant and Equipment - Disposal of Long-Lived Assets*, utilizing the assistance of a third-party broker to assist in the estimating of fair value, the remeasured fair value of the building was determined to be $500,000. The impairment loss of $1.4 million was recorded at that time and is reflected in unused office space and other restructuring in the Consolidated Statements of Operations and Comprehensive Income (Loss) for the year ended December 25, 2016.

(m) Leases

The Company uses its incremental borrowing rate in the assessment of lease classification as capital or operating and defines the initial lease term to include renewal options determined to be reasonably assured. The Company conducts operations primarily under operating leases.

Most lease agreements for real property contain incentives for tenant improvements, rent holidays, or rent escalation clauses. For incentives for tenant improvements, the Company capitalizes the leasehold improvements which are depreciated over the shorter of the lease term or their estimated useful life and records a deferred rent liability which is amortized over the term of the lease as a reduction to rent expense. For rent holidays and rent escalation clauses during the lease term, the Company records minimum rental expenses on a straight-line basis over the term of the lease. For purposes of recognizing lease incentives, the Company uses the date of initial possession as the commencement date, which is generally when the Company is given the right of access to the space and begins to make improvements in preparation for intended use.

(n) Goodwill and Other Intangible Assets, Net

In accordance with the provisions of ASC *Topic 350, Intangibles-Goodwill and Other* ("*Topic 350*"), the Company performs impairment tests for goodwill and indefinite lived intangibles as of the last day of its fiscal October, or when evidence of potential impairment exists. When it is determined that impairment has occurred, a charge to operations is recorded. Goodwill and other purchased intangible asset balances are included in the identifiable assets of the operating segment to which they have been assigned. Any goodwill impairment, as well as the amortization of other purchased intangible assets, is charged against the respective segments' operating income.

In accordance with *Topic 350*, the Company classifies intangible assets into three categories: (1) intangible assets with finite lives subject to amortization, (2) intangible assets with indefinite lives not subject to amortization, and (3) goodwill. The Company tests intangible assets with finite lives for impairment if conditions exist that indicate the carrying value may not be recoverable. Such conditions may include an economic downturn in a geographic market or a change in the assessment of future operations. The Company records an impairment charge when the carrying value of the finite lived intangible asset is not recoverable by the cash flows generated from the use of the asset.

The Company determines the useful lives of identifiable intangible assets after considering the specific facts and circumstances related to each intangible asset. Factors considered when determining useful lives include the contractual term of any agreement, the history of the asset, the Company's long-term strategy for the use of the asset, any laws or other local regulations which could impact the useful life of the asset, and other economic factors, including competition and specific market conditions. Intangible assets that are deemed to have finite lives are amortized, generally on a straight-line basis, over their useful lives, ranging from one to 15 years.

(o) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC *Topic 360, Property, Plant, and Equipment*, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future net cash flows (undiscounted and without interest) expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(p) Fair Value of Financial Instruments

ASC *Topic 825, Financial Instruments*, requires that fair values be disclosed for the Company's financial instruments. The carrying amounts of cash equivalents, accounts receivable, accounts payable, accrued expenses, billings in excess of costs and earnings on uncompleted contracts, and income taxes payable, approximate fair value due to the short-term nature of these instruments. The fair value of the Company's long-term debt is based upon actual trading activity. The fair value of capital lease obligations is estimated based on quoted market prices for the same or similar obligations with the same remaining maturities.

(q) 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 U.S. 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 of these Notes to Consolidated Financial Statements for a discussion of the Company's significant customers.

(r) Debt Issuance Costs

Fees paid to obtain debt financing and revolving credit facilities or amendments under such debt financing and revolving credit facilities are treated as debt issuance costs and are capitalized and amortized over the expected term of the related debt or revolving credit facility and are shown as a financing activity in the Consolidated Statements of Cash Flows. Issuance costs related to debt are presented in the Consolidated Balance Sheet as a direct deduction from the carrying amount of the associated debt liability. Issuance costs related to a revolving credit facility are included in other assets in the Consolidated Balance Sheet.

(s) Interest Expense, Net

Interest expense, net in the Consolidated Statements of Operations and Comprehensive Income (Loss) is summarized in the following table (in millions):

	2016	2015	2014
Interest expense incurred primarily on the Company's Senior Secured Notes	$ (34.7)	$ (36.0)	$ (39.4)
Miscellaneous interest income	—	—	0.2
Interest expense, net	$ (34.7)	$ (36.0)	$ (39.2)

(t) Foreign Currency

For operations outside the U.S. that prepare financial statements in currencies other than the U.S. dollar, results of operations and cash flows are translated at average exchange rates during the period, and assets and liabilities are generally translated at end-of-period exchange rates. Translation adjustments are included as a separate component of accumulated other comprehensive loss in the Consolidated Statements of Stockholders' Equity.

The Company transacts with foreign customers in currencies other than the U.S. dollar. It experiences realized and unrealized foreign currency gains or losses on foreign denominated receivables. In addition, certain intercompany transactions give rise to realized and unrealized foreign currency gains or losses. Also, any other transactions between the Company or its subsidiaries and a third-party, denominated in a currency different from the functional currency, are foreign currency transactions.

The aggregate foreign currency transaction gain (loss) included in determining net loss for the years ended December 25, 2016, December 27, 2015, and December 28, 2014 was approximately $0.4 million, $(0.8) million, and $0.0 million, respectively, which is included in other income (expense), net on the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss).

(u) Recent Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2016-16 ("ASU 2016-16"), *Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory.* ASU 2016-16 requires that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset is sold to an outside party. ASU 2016-16 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods. Early adoption is permitted as of the beginning of an annual reporting period (as of the first interim period if an entity issues interim financial statements). ASU 2016-16 requires adoption on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company does not believe that the adoption of this guidance will have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15 ("ASU 2016-15"), *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.* The objective of ASU 2016-15 is to reduce existing diversity in practice by addressing eight specific cash flow issues related to how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. If early adopted, an entity must adopt all of the amendments in the same period. The Company is currently evaluating the impact of the adoption of ASU 2016-15 on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09 ("ASU 2016-09"), *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.* ASU 2016-09 simplifies several aspects of the accounting for employee share-based payments, including accounting for income taxes, forfeitures, statutory tax withholding requirements, and classification on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016. Early adoption is permitted. The Company early adopted this standard in the quarter ended December 25, 2016, which did not have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 ("ASU 2016-02"), *Leases*. ASU 2016-02 requires that lessees recognize assets and liabilities for the rights and obligations underlying leases with a lease term of more than one year. The amendments in this ASU are effective for annual periods ending after December 15, 2018. Early adoption is permitted. The standard must be applied using a modified retrospective approach. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In January 2015, the FASB issued ASU 2015-01 ("ASU 2015-01"), *Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.* ASU 2015-01 eliminates from GAAP the concept of extraordinary items. Subtopic 225-20, *Income Statement - Extraordinary and Unusual Items*, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Company adopted this standard in the quarter ended March 27, 2016, which did not have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 ("ASU 2014-09"), *Revenue from Contracts with Customers*. ASU 2014-09 establishes a broad principle that would require an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this principle, an entity identifies the contract with a customer, identifies the separate performance obligations in the contract, determines the transaction price, allocates the transaction price to the separate performance obligations and recognizes revenue when each separate performance obligation is satisfied. ASU 2014-09 was further updated in March, April, May, and December 2016 to provide clarification on a number of specific issues as well as requiring additional disclosures. ASU 2014-09 may be applied either retrospectively or through the use of a modified-retrospective method. The full retrospective method requires companies to recast each prior reporting period presented as if the new guidance had always existed. Under the modified retrospective method, companies would recognize the cumulative effect of initially applying the standard as an adjustment to opening retained earnings at the date of initial application. On July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017. The Company plans to adopt the new revenue standard effective January 1, 2018.

While the Company has not yet completed its evaluation of the impact of the new standard upon adoption, based upon an assessment of material active contracts, the Company does not expect the impact on the results of operations or cash flows in the periods after adoption to be material. Under ASU 2014-09, revenue is recognized as control transfers to the customer. As such, revenue for the Company's contracts will generally be recognized over time using the cost-to-cost method, which is consistent with the revenue recognition model currently in use for the majority of contracts. For those contracts where revenue is currently recognized as units are delivered, in most cases the accounting for those contracts will change under ASU 2014-09 such that revenue will be recognized as costs are incurred. This change will generally result in an acceleration of revenue as compared with the current revenue recognition method for those contracts. The Company expects to adopt the new standard using the modified retrospective method.

Note 2. Goodwill and Other Intangible Assets

(a) Goodwill

The Company performs its annual impairment test for goodwill in accordance with *Topic 350* as of the last day of its fiscal October or when evidence of potential impairment exists.

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

In determining the fair value for the reporting units, there are key assumptions relating to future operating performance and revenue growth. If the actual operating performance and financial results are not consistent with our assumptions, an impairment in our $485.4 million goodwill and $32.6 million long-lived intangible assets could occur in future periods. Market factors that could impact our ability to successfully develop new products include the successful completion of certain unmanned system platforms, and the successful acceptance of new unmanned system platforms, including from a political and budgetary standpoint. For example, the US reporting unit fair value includes assumptions that the development of the high performance Unmanned Combat Aerial System ("UCAS") product is successful and we are awarded future contracts for the UCAS product and other new tactical aerial systems. Additionally, the US reporting unit fair value assumes that we will receive follow on orders for the Sub-Sonic Aerial Target, which is currently under contract with the U.S. Navy.

The KGS reportable segment has four operating segments: Defense Rocket Support Services ("DRSS"), Microwave Electronics ("ME"), Technical and Training Solutions ("TTS"), and Modular Systems ("MS"). All of the KGS operating segments provide technology based defense solutions, involving products and services, primarily for mission critical U.S. National Security priorities, with the primary focus relating to the nation's Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance requirements. The PSS reportable business segment provides integrated solutions for advanced homeland security, public safety, critical infrastructure security, and security and surveillance systems for government, industrial and commercial customers. The US reportable segment consists of our unmanned aerial system and unmanned ground and seaborne system businesses.

Concurrent with the sale on August 21, 2015 of the U.S. and U.K. operations of its Electronic Products Division to Ultra Electronics Holdings plc (see Note 8) the Company changed the name of its Electronic Products Division to the Microwave Electronics Division ("ME"). In the second quarter of 2015, as a result of the pending disposition of the Herley Entities, the Company performed a valuation analysis to apportion the carrying value of the goodwill of its EP reportable unit to the retained ME products business and the Herley Entities which were subsequently sold. As a result, the KGS reportable segment is comprised of an aggregation of Kratos' Government Solutions operating segments, including our microwave products, satellite communications, modular systems and rocket support operating segments. The Company identified its reporting units to be the DRSS, ME, TTS, MS, US and PSS operating segments, which were tested for potential impairment in the fiscal year 2016 annual test.

In order to test for potential impairment, the Company estimates the fair value of each of its reporting units based on a comparison and weighting of the income approach, specifically the discounted cash flow method and the market approach, which estimates the fair value of the Company's reporting units based upon comparable market prices and recent transactions and also validates the reasonableness of the implied multiples from the income approach. The Company reconciles the fair value of its reporting units to its market capitalization based upon the last business day of fiscal October and assumes a control premium. The Company uses this methodology to determine the fair value of its reporting units for comparison to their corresponding book values because there are no observable inputs available, a Level 3 measurement (See Note 9 of these Notes to Consolidated Financial Statements). If the book value exceeds the estimated fair value for a reporting unit a potential impairment is indicated, and *Topic 350* prescribes the approach for determining the impairment amount, if any.

The Company concluded that its goodwill was not impaired at the annual test at October 31, 2016 and the interim assessment at December 25, 2016.

The carrying amounts of goodwill as of December 25, 2016 and December 27, 2015 by reportable segment are as follows (in millions):

	As of December 25, 2016			
	PSS	**US**	**KGS**	**Total**
Gross value	$ 53.9	$ 111.1	$ 567.8	$ 732.8
Less accumulated impairment	18.3	13.8	215.3	247.4
Net	$ 35.6	$ 97.3	$ 352.5	$ 485.4

	As of December 27, 2015			
	PSS	**US**	**KGS**	**Total**
Gross value	$ 53.9	$ 111.1	$ 565.8	$ 730.8
Less accumulated impairment	18.3	13.8	215.3	247.4
Net	$ 35.6	$ 97.3	$ 350.5	$ 483.4

The $2.0 million increase in goodwill is related to a strategic initial investment in a satellite signal monitoring, signal intelligence and location identification technology and product line to enhance our existing satellite communications business offering completed in November, 2016.

(b) Purchased Intangible Assets

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

	As of December 25, 2016			As of December 27, 2015		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets:						
Customer relationships	$ 53.7	$ (44.9)	$ 8.8	$ 83.7	$ (67.1)	$ 16.6
Contracts and backlog	30.8	(23.7)	7.1	71.3	(69.4)	1.9
Developed technology and technical know-how	25.2	(15.7)	9.5	23.1	(13.3)	9.8
Trade names	1.4	(1.1)	0.3	5.3	(4.9)	0.4
Favorable operating lease	—	—	—	1.8	(0.9)	0.9
Total finite-lived intangible assets	111.1	(85.4)	25.7	185.2	(155.6)	29.6
Indefinite-lived trade names	6.9	—	6.9	6.9	—	6.9
Total intangible assets	$ 118.0	$ (85.4)	$ 32.6	$ 192.1	$ (155.6)	$ 36.5

The aggregate amortization expense for finite-lived intangible assets was $10.5 million, $13.0 million and $19.1 million, for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively. The Company records all amortization expense in selling, general and administrative expenses in the Consolidated Statements of Operations and Comprehensive Income (Loss).

The estimated future amortization expense of acquired intangible assets with finite lives as of December 25, 2016 is as follows (in millions):

Fiscal Year	Amount
2017	$ 10.5
2018	5.9
2019	5.1
2020	3.1
2021	1.1
Total	$ 25.7

Note 3. Balance Sheet Details

The detail of certain assets in the Consolidated Balance Sheets consists of the following (in millions).

Cash and cash equivalents

The Company’s cash equivalents consist of overnight cash sweep accounts that are invested on a daily basis. Cash and cash equivalents at December 25, 2016 and December 27, 2015 were $69.1 million and $28.5 million, respectively and approximated their fair value.

Accounts receivable, net (in millions)

Receivables including amounts due under long-term contracts are summarized as follows:

	December 25, 2016	December 27, 2015
Billed, current	$ 102.8	$ 96.6
Unbilled, current	128.3	112.0
Total current accounts receivable	231.1	208.6
Allowance for doubtful accounts	(1.7)	(1.8)
Total accounts receivable, net	$ 229.4	$ 206.8

Unbilled receivables represent the balance of recoverable costs and accrued profit, composed principally of revenue recognized on contracts for which billings have not been presented to the customer because the amounts were earned but not contractually billable as of the balance sheet date. Retainages receivable were $6.2 million as of December 25, 2016 and $6.4 million as of December 27, 2015 and are included in accounts receivable, net in the Consolidated Balance Sheets.

Substantially all accounts receivable at December 25, 2016, are expected to be collected in 2017. The Company does not believe it has significant exposure to credit risk, as accounts receivable and the related unbilled amounts are primarily from contracts where the end customer is the U.S. Government.

U.S. Government contract receivables where the Company is the prime contractor included in accounts receivable, net (in millions)

	December 25, 2016	December 27, 2015
Billed	$ 15.6	$ 13.5
Unbilled	39.3	31.0
Total U.S. Government contract receivables	$ 54.9	$ 44.5

Inventoried costs, net of progress payments (in millions)

	December 25, 2016	December 27, 2015
Raw materials	$ 31.9	$ 32.9
Work in process	22.1	19.2
Finished goods	1.4	2.6
Supplies and other	1.8	1.6
Subtotal inventoried costs	57.2	56.3
Less customer advances and progress payments	(1.8)	(0.7)
Total inventoried costs	$ 55.4	$ 55.6

Property and equipment, net (in millions)

	December 25, 2016	December 27, 2015
Land and buildings	$ 12.2	$ 13.3
Computer equipment and software	26.9	27.0
Machinery and equipment	47.2	47.4
Furniture and office equipment	5.3	5.8
Leasehold improvements	9.9	10.9
Construction in progress	6.1	5.7
Property and equipment	107.6	110.1
Accumulated depreciation and amortization	(57.8)	(53.9)
Total property and equipment, net	$ 49.8	$ 56.2

Depreciation expense was $12.3 million, $12.5 million and $13.3 million for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively.

Note 4. Debt

(a) Issuance of 7.00% Senior Secured Notes due 2019

In May 2014, the Company refinanced its $625.0 million 10% Senior Secured Notes due in 2017 (the "10% Notes") with $625.0 million of newly issued 7.00% Senior Secured Notes due in 2019 (the "7% Notes"). The net proceeds of the 7% Notes was $618.5 million after an original issue discount of $6.5 million. The Company incurred debt issuance costs of $8.8 million associated with the new 7% Notes. The Company utilized the net proceeds from the 7% Notes, a $41.0 million draw on the Credit Agreement discussed below, as well as cash from operations to extinguish the 10% Notes. The total reacquisition price of the 10% Notes was $661.5 million including a $31.2 million early termination fee, the write-off of $15.5 million of unamortized issue costs, $12.9 million of unamortized premium, along with $5.3 million of additional interest while in escrow, which resulted in a loss on extinguishment of $39.1 million.

The Company completed the offering of the 7% Notes in a private placement conducted pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the "Act"). On October 16, 2014, the Company exchanged the outstanding 7% Notes for an equal amount of new 7.00% Senior Secured Notes due in 2019 (the "Notes") that had been registered under the Act. The terms of the Notes issued in the exchange offer were identical in all material respects to the terms of the 7% Notes, except the Notes issued in the exchange offer had been registered under the Act.

The Notes are governed by an Indenture dated May 14, 2014 (the "Indenture") among the Company, certain of the Company's subsidiaries (the "Subsidiary Guarantors") and Wilmington Trust, National Association, as Trustee and Collateral Agent. A Guarantor can be released from its Guarantee if (a) all of the capital stock issued by such Guarantor or all or substantially all of the assets of such Guarantor are sold or otherwise disposed of; (b) the Company designates such Guarantor as an Unrestricted Subsidiary; (c) if the Company exercises its legal defeasance option or its covenant defeasance option; or (d) upon satisfaction and discharge of the Indenture or payment in full in cash of the principal or, premium, if any, accrued and unpaid interest.

The holders of the Notes have a first priority lien on substantially all of the Company's assets and the assets of the Subsidiary Guarantors, except with respect to accounts receivable, inventory, deposit accounts, securities accounts, cash, securities and general intangibles (other than intellectual property), on which the holders of the Notes have a second priority lien to the $110.0 million Credit Agreement.

The Company pays interest on the Notes semi-annually, in arrears, on May 15 and November 15 of each year. The Notes include customary covenants and events of default as well as a consolidated fixed charge ratio of 2.0:1 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 December 25, 2016, the Company was in compliance with the covenants contained in the Indenture governing the Notes.

The Company may redeem some or all of the Notes at 105.25% of the aggregate principal amount of such Notes through May 15, 2017, 102.625% of the aggregate principal amount of such Notes if redeemed on or after May 16, 2017 but on or before May 15, 2018 and 100% of the aggregate principal amount of such Notes if redeemed on or after May 16, 2018, plus accrued and unpaid interest to the date of redemption.

The terms of the Indenture require that the net cash proceeds from asset dispositions be either utilized to (i) repay or prepay amounts outstanding under the Indenture and Credit Agreement unless such amounts are reinvested in similar collateral, (ii) make an investment in assets that replace the collateral of the Notes or (iii) a combination of both (i) and (ii). To the extent there are any remaining net proceeds from the asset disposition after application of (i) and (ii), such amounts are required to be utilized to repurchase Notes at par after 360 days following the asset disposition.

Following the sale of the Herley Entities (see Note 8 - Discontinued Operations), the Company, on August 21, 2015, paid down the $41.0 million outstanding on the $110.0 million Credit Agreement and on September 22, 2015, repurchased $175.0 million of the Notes at par, in accordance with the Indenture. In connection with the $175.0 million repurchase of Notes, the Company wrote off $1.8 million of unamortized issue costs, $1.4 million of unamortized discount, and incurred $0.2 million of legal fees, which resulted in a loss on extinguishment of debt of $3.4 million.

The Company reinvested all net proceeds remaining after the repurchase of the $175.0 million of Notes in replacement collateral under the Indenture within the 360 days following the asset disposition.

During the quarter ended December 25, 2016, the Company repurchased and extinguished $14.5 million of the outstanding Notes, which resulted in a gain of $0.4 million offset by $0.1 million of unamortized issuance cost and $0.1 million of unamortized discount resulting in a net gain of $0.2 million.

As of December 25, 2016 and December 27, 2015, there were $435.5 million and $450.0 million, respectively, in Notes outstanding.

(b) Other Indebtedness

$110.0 Million Credit Facility

On May 14, 2014, the Company replaced its credit facility with KeyBank National Association and entered into the Credit Agreement. The Credit Agreement established a five-year senior secured revolving credit facility in the maximum amount of $110.0 million (subject to a potential increase of the maximum principal amount to $135.0 million, subject to the Agent’s and applicable lenders’ approval as described therein), consisting of a subline for letters of credit in an amount not to exceed $50.0 million, as well as a swingline loan in an aggregate principal amount at any time outstanding not to exceed $10.0 million. The Credit Agreement is secured by a lien on substantially all of the Company’s assets and the assets of the Subsidiary Guarantors thereunder, subject to certain exceptions and permitted liens. The Credit Agreement 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 Credit Agreement has a second priority lien junior to the lien securing the Notes.

The Credit Agreement contains certain covenants, which include, but are not limited to, restrictions on indebtedness, liens, and investments, and limits on other various payments, as well as a financial covenant relating to a minimum fixed charge coverage ratio of 1.15:1 (as modified per the Third Amendment and the Fourth Amendment, as defined and discussed below). Events of default under the terms of the Credit Agreement include, but are not limited to: failure of the Company to pay any principal of any loans in full when due and payable; failure of the Company to pay any interest on any loan or any fee or other amount payable under the Credit Agreement within three business days after the date when due and payable; failure of the Company or any of its subsidiaries to comply with certain covenants and agreements, subject to applicable grace periods and/or notice requirements; any representation, warranty or statement made in or pursuant to the Credit Agreement or any related writing or any other material information furnished by the Company or any of its subsidiaries to the Agent or the lenders proving to be false or erroneous; and the occurrence of an event or condition having or reasonably likely to have a material adverse effect, which includes a material adverse effect on the business, operations, condition (financial or otherwise) or prospects of the Company or the ability of the Company to repay its obligations. Where an event of default arises from certain bankruptcy events, the commitments will automatically and immediately terminate and the principal of, and interest then outstanding on, all of the loans will become immediately due and payable. Subject to certain notice requirements and other conditions, upon the occurrence of an event of default, including the occurrence of a condition having or reasonably likely to have a material adverse effect, commitments may be terminated and the principal of, and interest then outstanding on, all of the loans may become immediately due and payable. As of December 25, 2016, no event of default had occurred and the Company believes that events or conditions having a material adverse effect, giving rise to an acceleration of any amounts outstanding under the Credit Agreement, have not occurred and the likelihood of such events or conditions occurring is remote.

Borrowings under the revolving Credit Agreement may take the form of a base rate revolving loan, Eurodollar revolving loan or swingline loan. Base rate revolving loans and swingline loans will bear interest at a rate per annum equal to the sum of the applicable margin from time to time in effect plus the highest of (i) the Agent's prime lending rate, as in effect at such time, (ii) the federal funds rate, as in effect at such time, plus 0.50% per annum, and (iii) the adjusted London Interbank Offered Rate ("LIBOR") rate determined at such time for an interest period of one month, plus 1.00% per annum. Eurodollar revolving loans will bear interest at a rate per annum equal to the sum of the applicable margin from time to time in effect plus the adjusted LIBOR rate. The applicable margin varies between 1.50% - 2.00% for base rate revolving loans and swingline loans and 2.50% - 3.00% for Eurodollar loans, and is based on several factors including the Company's then-existing borrowing base and the Lender's total commitment amount and revolving credit exposure. The calculation of the Company's borrowing base takes into account several items relating to the Company and its subsidiaries, including amounts due and owing under billed and unbilled accounts receivables, then-held eligible raw materials inventory, work-in-process inventory, and applicable reserves.

On May 31, 2015, the Company entered into a third amendment (the "Third Amendment") to the Credit Agreement. Under the terms of the Third Amendment, the definitions of certain terms of the Credit Agreement were modified, the disposition of the Herley Entities was approved by the lenders, a minimum $175.0 million repurchase of the Notes by the Company was required and the payment in full of the outstanding balance of the Credit Agreement was required upon consummation of the sale of the Herley Entities. Additionally, the measurement of the fixed charge coverage ratio of 1.15:1 was modified as follows: (i) the fixed charge coverage ratio will not be measured as of the end of any quarterly reporting period ending after June 30, 2015, if on such date (a) there are no outstanding revolving loans or swingline loans and (b) the aggregate amount outstanding under letters of credit is less than or equal to $17.0 million, and (ii) as to any subsequent quarterly reporting period ending after June 30, 2015, and not covered by (i) above, a fixed charge coverage ratio of at least 1.05:1 must be maintained if the percentage of (a) outstanding revolving loans plus the sum of the outstanding swingline loans and outstanding letters of credit that are in excess of $17.0 million, to (b) the revolving credit commitment, minus the Herley Disposition Proceeds Reinvestment Reserve, as defined below, is greater than 0.00% but less than 15.00% or a fixed charge coverage ratio of at least 1.10:1 must be maintained if the aforementioned percentage is equal to or greater than 15.00% but less than 25.00%. In all other instances, a fixed charge coverage ratio of at least 1.15:1 must be maintained. For purposes of computing the fixed charge coverage ratio, the associated reduction in consolidated interest expense in connection with the repurchase of Notes with proceeds from the sale of the Herley Entities shall be deemed to have occurred on the first day of the most recently completed four quarterly reporting periods prior to the sale.

The terms of the Third Amendment also included the establishment of a reserve (the "Herley Disposition Proceeds Reinvestment Reserve") that reduced the maximum $110.0 million total borrowing base on the Credit Agreement. With the sale of the Herley Entities, a $50.8 million reserve was established based upon the collateral carrying value under the Credit Agreement of the Herley Entities disposed. The reserve and therefore the maximum borrowing base were adjusted monthly for the subsequent cumulative reinvestment in similar collateral assets over a period not to have exceeded 360 days from the date of sale of the Herley Entities. As of December 25, 2016, there was no reserve on the maximum borrowings, resulting from a cumulative reinvestment in similar collateral assets since the sale of the Herley Entities in excess of the $50.8 million reserve established at the date of the sale of the Herley Entities. The Company made investments in assets that replaced the collateral, which reinstated the maximum facility to the full $110.0 million.

On August 19, 2015, the Company entered into a fourth amendment (the "Fourth Amendment") to the Credit Agreement. Among other things, the Fourth Amendment provides for a modification of the Third Amendment as it relates to when the minimum fixed charge coverage ratio will be measured based upon the Company's outstanding borrowings. Outstanding borrowings for purposes of computing the applicable minimum fixed charge coverage ratio exclude any letter of credit exposure outstanding of $17.0 million plus the amount of letters of credit outstanding for the divested Herley Entities for which a cash deposit was placed in escrow by the Buyer to cover the amount of such outstanding letters of credit, should the letters of credit be pulled.

As of December 25, 2016, there were no borrowings outstanding on the Credit Agreement; there was $11.1 million outstanding on letters of credit, resulting in net borrowing base availability of $56.0 million. The Company was in compliance with the financial covenants of the Credit Agreement and its amendments as of December 25, 2016.

Debt Acquired in Acquisition

The Company has a 10-year term loan with a bank in Israel entered into on September 16, 2008 in connection with the acquisition of one of its wholly owned subsidiaries. The balance as of December 25, 2016 and December 27, 2015 was $1.8 million and $2.7 million, respectively. 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 covenants, including a minimum net equity covenant as defined in the loan agreement. The Company was in compliance with all covenants as of December 25, 2016.

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 25, 2016 and December 27, 2015 are presented in the following table:

	As of December 25, 2016			As of December 27, 2015		
$ in millions	**Principal**	**Carrying Amount**	**Fair Value**	**Principal**	**Carrying Amount**	**Fair Value**
Long-term debt	$ 437.3	$ 432.0	$ 423.6	$ 452.7	$ 445.1	$ 315.2

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

As of December 25, 2016, the difference between the carrying amount of $432.0 million and the principal amount of $437.3 million presented in the previous table, is the net unamortized original issue discount of $2.4 million and the unamortized debt issuance costs of $2.9 million, which are being accreted to interest expense over the term of the related debt. As of December 27, 2015, the difference between the carrying amount of $445.1 million and the principal amount of $452.7 million presented in the above table is the net unamortized original issue discount of $3.3 million and the unamortized debt issuance costs of $4.3 million, which are being accreted to interest expense over the term of the related debt.

Future maturities of long-term debt are $1.0 million in 2017, $0.8 million in 2018, and $435.5 million in 2019.

Note 5. Lease Commitments

The Company leases certain facilities and equipment under operating and capital leases having terms expiring at various dates through 2025.

Future minimum lease payments under capital and operating leases as of December 25, 2016, which does not include $11.2 million in sublease income on the Company's operating leases, are as follows (in millions):

Year	**Operating Leases**
2017	$ 19.0
2018	16.6
2019	14.5
2020	9.6
2021	5.7
Thereafter	2.1
Total future minimum lease payments	$ 67.5

There was no amortization expense related to capital leases for the years ended December 25, 2016 and December 27, 2015, and $0.2 million for the year ended December 28, 2014.

Gross rent expense under operating leases for the years ended December 25, 2016, December 27, 2015, and December 28, 2014 was $21.6 million, $23.1 million, and $24.6 million, respectively. Total sublease income for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, totaling $3.3 million, $3.3 million, and $3.3 million, respectively, has been netted against rent expense.

The Company's accrual for excess facilities was $4.0 million and $5.5 million, as of December 25, 2016 and December 27, 2015, respectively. The Company estimates that the remaining accrual will be paid through 2020.

The accrual for excess facilities is as follows (in millions):

	Excess Facilities
Balance as of December 28, 2014	$ 11.3
Adjustment of excess facility accrual	(4.3)
Cash payments	(1.5)
Balance as of December 27, 2015	5.5
Adjustments of excess facility accruals	—
Cash payments	(1.5)
Balance as of December 25, 2016	$ 4.0

The adjustment in 2015 reflects the impact of a new sublease arrangement that the Company entered into for our Columbia, Maryland facility.

The lease on certain office facilities includes scheduled base rent increases over the term of the lease. The total amount of the base rent payments is being charged to expense on the straight-line method over the term of the lease. In addition to the base rent payment, the Company pays a monthly allocation of the building's operating expenses. The Company has recorded deferred rent, included in accrued expenses and other long-term liabilities in the Consolidated Balance Sheets, of $3.9 million, $4.6 million, and $5.2 million at December 25, 2016, December 27, 2015 and December 28, 2014, respectively, to reflect the excess of rent expense over cash payments since inception of the respective leases.

Note 6. Net Loss Per Common Share

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

The following shares were excluded from the calculation of diluted loss per share because their inclusion would have been anti-dilutive (in millions):

	December 25, 2016	December 27, 2015	December 28, 2014
Shares from stock options and awards	1.4	1.9	0.9

Note 7. Income Taxes

The components of income (loss) from continuing operations before income taxes for the years ended December 25, 2016, December 27, 2015, and December 28, 2014 are comprised of the following (in millions):

	2016	2015	2014
Domestic	$ (61.8)	$ (54.2)	$ (78.8)
Foreign	9.5	9.6	7.0
Total	$ (52.3)	$ (44.6)	$ (71.8)

The provision (benefit) for income taxes from continuing operations for the years ended December 25, 2016, December 27, 2015, and December 28, 2014 are comprised of the following (in millions):

	2016	2015	2014
Federal income taxes:			
Current	$ (0.5)	$ (15.7)	$ —
Deferred	4.0	1.4	2.9
Total Federal	3.5	(14.3)	2.9
State and local income taxes			
Current	2.3	0.8	1.6
Deferred	0.7	—	(1.7)
Total State and local	3.0	0.8	(0.1)
Foreign income taxes:			
Current	1.5	1.2	0.7
Deferred	0.1	0.9	0.4
Total Foreign	1.6	2.1	1.1
Total	$ 8.1	$ (11.4)	$ 3.9

A reconciliation of the total income tax provision (benefit) to the amount computed by applying the statutory federal income tax rate of 35% to the loss from continuing operations before income taxes for the years ended December 25, 2016, December 27, 2015 and December 28, 2014 is as follows (in millions):

	2016	2015	2014
Income tax (benefit) at federal statutory rate	$ (18.3)	$ (15.6)	$ (25.1)
State taxes, net of federal tax benefit and valuation allowance	0.2	(0.2)	0.8
Difference in tax rates between U.S. and foreign	0.1	(0.7)	(1.4)
Increase in federal valuation allowance	19.1	—	26.0
Nondeductible expense	0.7	0.8	1.5
Increase in reserve for uncertain tax positions	2.2	0.9	0.9
Changes to indefinite life items and separate state deferred taxes	4.1	3.4	1.2
Total	$ 8.1	$ (11.4)	$ 3.9

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities as of December 25, 2016 and December 27, 2015 are as follows (in millions):

	2016	2015
Deferred tax assets:		
Allowance for doubtful accounts	$ 0.4	$ 0.5
Sundry accruals	2.2	2.2
Vacation accrual	4.7	4.5
Stock-based compensation	5.2	5.1
Payroll related accruals	2.9	3.6
Lease accruals	4.5	5.1
Investments	2.0	2.0
Net operating loss carryforwards	124.8	98.4
Tax credit carryforwards	9.4	9.2
Deferred revenue	2.5	3.1
Reserves and other	11.9	7.0
	170.5	140.7
Valuation allowance	(133.1)	(102.1)
Total deferred tax assets, net of valuation allowance	37.4	38.6
Deferred tax liabilities:		
Unearned revenue	(43.0)	(39.1)
Other intangibles	(7.0)	(3.2)
Property and equipment, principally due to differences in depreciation	(2.0)	(4.5)
Other	(2.7)	(2.3)
Total deferred tax liabilities	(54.7)	(49.1)
Net deferred tax asset (liability)	$ (17.3)	$ (10.5)

In assessing the Company’s ability to realize deferred tax assets, management considers, on a periodic basis, whether it is more likely than not that some portion or all of 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 and certain foreign and separate state deferred tax assets. Management will continue to evaluate the necessity to maintain a valuation allowance against the Company’s net deferred tax assets. During fiscal 2016, the Company recorded a net increase in its federal valuation allowance of $29.6 million.

At December 25, 2016, the Company had federal tax loss carryforwards of $340.8 million and various state tax loss carryforwards of $243.5 million. The federal tax loss carryforwards will begin to expire in 2020 and state tax loss carryforwards will begin to expire in 2017 in certain states.

Federal and state income tax laws impose restrictions on the utilization of net operating loss (“NOL”) and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code of 1986, as amended (“Section 382”). In general, an ownership change occurs when shareholders owning 5% or more of a “loss corporation” (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation’s value at the time of the ownership change by the greater of the long-term tax-exempt rate determined by the Internal Revenue Service in the month of the ownership change or the two preceding months. This base limitation is subject to adjustments, including an increase for built-in gains recognized in the five year period after the ownership change. In March 2010, an “ownership change” occurred that will limit the utilization of NOL carryforwards. In July 2011, another “ownership change” occurred. The March 2010 ownership change limitation is more restrictive. In prior years the Company acquired corporations with NOL carryforwards at the date of acquisition (“Acquired NOLs”). The Acquired NOLs are subject to separate limitations that may further restrict the use of Acquired NOLs. As a result, the Company’s federal annual utilization of NOL carryforwards were limited to at least $27.0 million a year for the five years succeeding the March 2010 ownership change and at least $11.6 million for each year thereafter subject to separate limitations for Acquired NOLs. If the entire limitation amount is not utilized in a year, the excess can be carried forward and utilized in future years. For the year ended December 25, 2016, 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, future equity offerings or acquisitions that have equity as a component of the purchase price could also cause an “ownership change.” If and when any other “ownership change” occurs, utilization of the 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.

The Company has not provided deferred U.S. income taxes or foreign withholding taxes of approximately $22.2 million on temporary differences relating to the outside basis in its investment in foreign subsidiaries which are essentially permanent in duration. It is the Company’s intention to permanently reinvest undistributed earnings of its foreign subsidiaries. As of December 25, 2016 the Company has $5.2 million of cash and cash equivalents available for distribution.

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 later are subject to examination by the U.S. and state tax authorities due to the existence of NOL carryforwards. Generally, the Company’s tax years for 2002 and later are subject to examination by various foreign tax authorities.

The following table summarizes the activity related to the Company’s unrecognized tax benefits (in millions):

Balance as of December 29, 2013	$	15.8
Increases related to current year tax positions		0.8
Expiration of applicable statutes of limitations		(0.2)
Balance as of December 28, 2014		16.4
Increases related to prior periods (acquired entities)		0.4
Increases related to current year tax positions		0.9
Decreases related to disposition		(0.5)
Balance as of December 27, 2015		17.2
Increases related to prior periods		1.4
Increases related to current year tax positions		0.2
Expiration of applicable statutes of limitations		(0.2)
Balance as of December 25, 2016	$	18.6

Included in the balance of unrecognized tax benefits at December 25, 2016, are $18.6 million of tax benefits that, if recognized, would affect the effective tax rate. Included in this amount is $14.8 million that would become a deferred tax asset if the tax benefit were recognized. As such, this benefit may be impacted by a corresponding valuation allowance depending upon the Company’s consolidated financial position at the time the benefits are recognized.

The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. For the years ended December 25, 2016, December 27, 2015 and December 28, 2014, the Company recorded $0.9 million, $0.2 million, and $0.2 million, respectively, in interest or penalties. These amounts are netted by a benefit for interest and penalties related to the reversal of prior positions as noted above of $0.0 million, $0.1 million, and $0.1 million for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively. As of December 25, 2016, December 27, 2015, and December 28, 2014, the Company had recorded total interest and penalties of $1.9 million, $1.0 million, and $0.8 million, respectively.

The Company believes that it is reasonably possible that as much as $1.1 million of the liabilities for uncertain tax positions will expire within 12 months of December 25, 2016 due to the expiration of various applicable statues of limitations.

Note 8. Discontinued Operations

On August 21, 2015, the Company completed the sale of the U.S. and U.K. operations of its Electronic Products Division to Ultra Electronics Holdings plc (“Ultra”), a public limited company formed under the laws of England and Wales and traded on the London Stock Exchange, and Ultra Electronics Defense Inc. (the “Buyer”), a Delaware corporation ultimately owned by Ultra, (the “Transaction”). Pursuant to the terms of that certain Stock Purchase Agreement, dated May 31, 2015, by and among the Company, Ultra and the Buyer (the “Purchase Agreement”), the Company sold to the Buyer all of the issued and outstanding capital stock of its wholly owned subsidiary Herley Industries, Inc. (“Herley”) and certain of Herley’s subsidiaries, including Herley-CTI, Inc., EW Simulation Technology, Ltd. and Stapor Research, Inc. (collectively, the "Herley Entities"), for $260.0 million in cash plus $5.0 million for taxes incurred as part of the Transaction, less a $2.0 million escrow to satisfy any purchase price adjustments, and an estimated working capital adjustment of $8.3 million. The Purchase Agreement also contains certain non-compete and indemnification provisions. Under the Purchase Agreement, the Company entered into an agreement to indemnify the Buyer for any pre-acquisition tax liabilities. The Company also agreed to indemnify Ultra for pre-existing environmental conditions for a period of five years from the closing date and with a maximum indemnification payment of $34.0 million. The Company does not believe payments will be required under the indemnification provision, and the assessment of the fair value is immaterial. Under the terms of the Purchase Agreement, a joint 338(h)(10) election has been made for income tax purposes, providing a "step up" in tax basis to Ultra. The Company incurred approximately $11.5 million in transaction-related costs. The gain on sale of $80.8 million is subject to changes in the indemnification obligations. In accordance with *ASC 360-10-45-9, Property, Plant, and Equipment (Topic 360) and ASC 205-20-45-3 Presentation of Financial Statements (Topic 205)*, the Herley Entities were classified as discontinued operations in the accompanying consolidated financial statements for all periods presented.

Immediately prior to the closing of the Transaction, the outstanding shares of the capital stock of (i) General Microwave Corporation, a New York corporation, and its direct and indirect wholly owned subsidiaries General Microwave Israel Corporation, a Delaware corporation, General Microwave Israel (1987) Ltd., an Israeli company, and Herley GMI Eyal Ltd., an Israeli company, (ii) MSI Acquisition Corp., a Delaware corporation and its wholly owned subsidiary Micro Systems, Inc., a Florida corporation, and (iii) Herley-RSS, Inc., a Delaware corporation, were distributed as a dividend by Herley to the Company and will continue their current operations as wholly owned subsidiaries of the Company.

In November 2015, the Company and Ultra settled the working capital adjustment at $8.1 million, and the net cash position at closing, resulting in a net payment to the Company of $2.7 million. This represents the payment from escrow to the Company of $2.0 million, as well as the payment from Ultra of $0.7 million, reflecting the difference in the estimated working capital and actual working capital and the net cash position at the close of the Transaction. In December 2015, the Company submitted to Ultra for reimbursement the maximum $5.0 million for taxes incurred as part of the Transaction, which was reimbursed in January 2016.

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

	Year ended December 25, 2016	Year ended December 27, 2015	Year ended December 28, 2014
Revenue	$ —	$ 59.7	$ 108.9
Cost of sales	—	40.6	70.1
Selling, general and administrative expenses	0.1	15.2	24.1
Interest expense, net	—	9.1	15.1
Other net expense items that are not major	—	0.1	0.7
Loss from discontinued operations before income taxes	(0.1)	(5.3)	(1.1)
Gain on disposal of discontinued operations before income taxes	—	80.8	—
Total gain (loss) of discontinued operations before income taxes	(0.1)	75.5	(1.1)
Income tax expense	—	22.5	1.2
Income (loss) from discontinued operations	$ (0.1)	$ 53.0	$ (2.3)

The results for the year ended December 27, 2015 are through the date of disposal of August 21, 2015.

There was no depreciation and amortization expense included in selling, general and administrative expenses for the year ended December 25, 2016, but there was $4.2 million, and $6.7 million of depreciation and amortization expense included in selling, general and administrative expenses for the years ended December 27, 2015, and December 28, 2014, respectively.

Interest expense is included based on an allocation consistent with the redemption of $175.0 million of the Notes and the repayment of $41.0 million in outstanding borrowings on the Credit Agreement that was repaid upon the completion of the sale of the Herley Entities in accordance with the terms and conditions of the Indenture and the Credit Agreement. Refer to Note 4 of these Notes to Consolidated Financial Statements for further discussion.

Intra-period tax allocation rules require the Company to allocate its provision for income taxes between continuing operations and other categories of earnings, such as discontinued operations. In periods in which there is a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of earnings, such as discontinued operations, the Company must allocate the tax provision to the other categories of earnings. A related tax benefit is then recorded in continuing operations. Due to the intra-period allocation rules, the Company recorded income tax expense of $22.5 million, and $1.2 million in discontinued operations for the years ended December 27, 2015, and December 28, 2014, respectively. There was no income tax recorded in discontinued operations for the year ended December 25, 2016.

The following is a summary of the assets and liabilities of discontinued operations in the accompanying Consolidated Balance Sheets as of December 25, 2016 and December 27, 2015 (in millions):

	December 25, 2016	December 27, 2015
Accrued compensation	$ 0.6	$ 0.9
Other current liabilities	1.0	1.0
Current liabilities of discontinued operations	$ 1.6	$ 1.9
Other long-term liabilities of discontinued operations	$ 3.7	$ 4.1

Note 9. Fair Value Measurement

The Company adopted FASB ASC *Topic 820*, *Fair Value Measurement (“Topic 820”)* with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. Non-recurring nonfinancial assets and nonfinancial liabilities for which it has not applied the provisions of *Topic 820* include those measured at fair value in goodwill impairment testing, indefinite lived intangible assets measured at fair value for impairment testing, asset retirement obligations initially measured at fair value, and those assets and liabilities initially measured at fair value in a business combination.

Topic 820 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company’s own assumptions used to measure assets and liabilities at fair value. A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Note 10. Stockholders’ Equity

(a) Common Stock

On November 23, 2016, the Company sold approximately 13.4 million shares of its common stock at a purchase price of $6.00 per share in an underwritten public offering. The Company received gross proceeds of approximately $80.5 million. After deducting underwriting fees and other offering expenses, the Company received approximately $76.2 million in net proceeds. The Company used $14.1 million of the net proceeds from this transaction to redeem approximately $14.5 million of its Notes. The remainder of the funds will be used for general corporate purposes, including funding expected growth and strategic investments in the Company's high performance unmanned aerial vehicle business area and other new programs under contract.

(b) Stock Option Plans and Restricted Stock Unit Plans

In March 2014 the Company's board of directors (the “Board”) approved the 2014 Equity Incentive Plan (the “2014 Plan”). The 2014 Plan is the successor to the Kratos Defense & Security Solutions, Inc. 2011 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. Amended and Restated 2005 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. 2000 Nonstatutory Stock Option Plan, the Kratos Defense & Security Solutions, Inc. 1999 Equity Incentive Plan, the Amended and Restated Integral Systems, Inc. 2008 Stock Incentive Plan, the Amended and Restated Herley Industries, Inc. 2010 Stock Plan, the Herley Industries, Inc. 2003 Stock Option Plan, the Henry Bros. Electronics, Inc. 2007 Stock Option Plan, the Henry Bros. Electronics, Inc. 2006 Stock Option Plan, the Amended and Restated 2005 Digital Fusion, Inc. Equity Incentive Plan, the 2000 Digital Fusion, Inc. Stock Option Plan, the 1999 Digital Fusion, Inc. Stock Option Plan, and the 1998 Digital Fusion, Inc. Stock Option Plan (collectively, the “Prior Plans”).

The 2014 Plan became effective May 14, 2014 and no additional stock awards will be granted under the Prior Plans as of April 1, 2014. All outstanding stock awards granted subject to the terms of the Prior Plans will continue to be subject to the terms and conditions as set forth in the agreements evidencing such stock awards and the terms of the respective Prior Plans. Any shares subject to outstanding stock awards granted under the Prior Plans or granted outside of a Prior Plan that, at any time after March 27, 2014, (i) expire or terminate for any reason prior to exercise or settlement; (ii) are forfeited, canceled or otherwise returned to the Company because of the failure to meet a contingency or condition required to vest such shares; or (iii) are reacquired, withheld (or not issued) to satisfy a tax withholding obligation in connection with an award or to satisfy the purchase price or exercise price of a stock award (collectively, the “Returning Shares”) will immediately be added to the share reserve of the 2014 Plan and become available for issuance pursuant to stock awards granted under the 2014 Plan.

As of March 27, 2014, there were 2,306,256 shares remaining available for issuance under the Prior Plans. The total number of awards outstanding under all of the Prior Plans and outside of any Prior Plan was 5,511,322 as of March 27, 2014. The 2014 Plan decreased the number of shares remaining available for issuance under its equity compensation plans from 2,306,256 to 1,550,000, although, per the 2014 Plan, up to 5,511,322 shares subject to outstanding awards under the Prior Plans and non-plan grants could potentially become Returning Shares available for issuance under the 2014 Plan.

The Board may grant equity-based awards to selected employees, directors and consultants of the Company pursuant to its 2014 Plan. As of December 25, 2016, there are 2,392,842 shares reserved for issuance for future grant under the 2014 Plan. The Board may amend or terminate the 2014 Plan at any time. Certain amendments, including an increase in the share reserve, require stockholder approval. Generally, options and restricted stock units outstanding vest over periods not exceeding ten years. When the Company grants stock options, they are granted with a per share exercise price not less than the fair market value of the Company’s common stock on the date of grant, and generally would be exercisable for up to ten years from the grant date.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model or a trinomial lattice options pricing model with the weighted average assumptions (annualized percentages) included in the following table. Awards with graded vesting are recognized using the straight-line method with the following assumptions:

	2016	2015	2014
Stock Options			
Expected life	10.0	10.0	10.0
Risk-free interest rate(1)	1.8% - 2.4%	2.1% - 2.3%	2.4% - 2.7%
Volatility(2)	55.2% - 55.8%	54.4% - 54.7%	54.5% - 56.1%
Forfeiture rate(3)	5.0%	5.0%	2.5% - 15.2%
Dividend yield(4)	—%	—%	—%

(1) The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant with a term equal to the expected term of the options.
(2) In 2016, 2015, and 2014, the Company estimated implied volatility based upon trailing volatility.
(3) Forfeitures are estimated at the time of grant based upon historical information. Forfeitures will be revised, if necessary, in subsequent periods if actual forfeitures differ from estimates.
(4) The Company has no history or expectation of paying dividends on its common stock.

A summary of the status of the Company's stock option plan as of December 25, 2016 and changes in options outstanding under the plan for the year ended December 25, 2016 is as follows:

	Number of Shares Under Option	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
	(000's)			(000's)
Options outstanding at December 27, 2015	1,077	$ 9.14	5.5	$ —
Granted	11	$ 5.13		
Exercised	—	$ —		
Forfeited or expired	(125)	$ 17.14		
Options outstanding at December 25, 2016	963	$ 8.05	5.2	1,924.1
Options exercisable at December 25, 2016	357	$ 13.27	3.8	$ 348.3

As of December 25, 2016, there was $0.4 million of total unrecognized stock-based compensation expense related to nonvested options which is expected to be recognized over a remaining weighted-average vesting period of 1.4 years. Upon exercise of an option, the Company issues new shares of common stock.

During the years ended December 25, 2016, December 27, 2015, and December 28, 2014 the following values relate to the grants and exercises under the Company's option plans:

	2016	2015	2014
Weighted average grant date fair value of options granted	$ 3.36	$ 3.31	$ 4.40
Total intrinsic value of options exercised (in thousands)	$ —	$ —	$ 171.0

The following table summarizes the Company's Restricted Stock Unit activity:

	Restricted Stock Units (000's)	Weighted-Average Grant Date Fair Value
Nonvested balance at December 27, 2015	2,409	$ 7.37
Grants	785	$ 4.22
Vested	(731)	$ 6.46
Forfeitures	(46)	$ 5.38
Vested but not released	(171)	$ 4.79
Nonvested balance at December 25, 2016	2,246	$ 6.81

As of December 25, 2016, there was $5.6 million of total unrecognized stock-based compensation expense related to nonvested restricted stock units which is expected to be recognized over a remaining weighted-average vesting period of 3.1 years. The fair value of RSU awards that vested in 2016, 2015, and 2014 was $4.7 million, $3.6 million, and $1.4 million, respectively.

(c) Amended and Restated Employee Stock Purchase Plan

In August 1999, the Board approved the 1999 Employee Stock Purchase Plan (as amended from time to time, the "Purchase Plan"). A total of 5.2 million shares of Common Stock have been authorized for issuance under the Purchase Plan. The Purchase Plan qualifies as an employee stock purchase plan within the meaning of Section 423 of the Internal Revenue Service Code. Unless otherwise determined by the Compensation Committee of the Board, all employees are eligible to participate in the Purchase Plan so long as they are employed by the Company (or a subsidiary designated by the Board) for at least 20 hours per week and were customarily employed by the Company (or a subsidiary designated by the Board) for at least 5 months per calendar year.

Employees who actively participate in the Purchase Plan are eligible to have up to 15% of their earnings for each purchase period withheld pursuant to the Purchase Plan. The amount that is withheld is used at various purchase dates within the offering period to purchase shares of Common Stock. The price paid for Common Stock at each such purchase date is equal to the lower of 85% of the fair market value of the Common Stock at the commencement date of that offering period or 85% of the fair market value of the Common Stock on the relevant purchase date. Employees are also able to end their participation in the offering at any time during the offering period, and participation ends automatically upon termination of employment. From the Purchase Plan's inception through December 25, 2016, the cumulative number of shares of Common Stock that have been issued under the Purchase Plan is 4.1 million and approximately 1.1 million shares are available for future issuance. During fiscal 2016, approximately 760,000 shares were issued under the plan at an average price of $3.47.

The fair value of Kratos' Purchase Plan shares for 2016 was estimated using the Black-Scholes option pricing model. The assumptions and resulting fair values of options granted for 2016, 2015 and 2014 were as follows:

	Offering Periods January 1 to December 31 2016	**Offering Periods January 1 to December 31, 2015**	**Offering Periods January 1 to December 31, 2014**
Expected term (in years)(1)	0.5	0.5	0.5
Risk-free interest rate(2)	.36% - .49%	0.11% - 0.12%	0.07% - 0.10%
Expected volatility(3)	53.00% - 55.55%	39.63% - 40.91%	40.14% - 40.23%
Expected dividend yield(4)	—%	—%	—%
Weighted average grant-date fair value per share	$1.23	$1.43	$2.09

(1) The expected term is equivalent to the offering period.
(2)The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant with a term equal to the expected term.
(3) The Company estimated implied volatility based upon trailing volatility.
(4) The Company has no history or expectation of paying dividends on its common stock.

As of December 25, 2016, there was no material unrecognized compensation expense related to the Purchase Plan.

Note 11. Retirement Plans

The Company provides eligible employees the opportunity to participate in defined-contribution savings plans (commonly known as 401(k) plans), which permit contributions on a before-tax basis. Generally, salaried employees and certain hourly employees are eligible to participate in the plans. Under most plans, the employee may contribute to various investment alternatives. In certain plans, the Company matches a portion of the employees' contributions. The Company's matching contributions to these defined-contribution savings plans totaled $4.3 million in 2016, $4.9 million in 2015, and $4.9 million in 2014.

Note 12. Significant Customers

Revenue from the U.S. Government (which includes Foreign Military Sales) includes revenue from contracts for which Kratos is the prime contractor as well as those for which the Company is a subcontractor and the ultimate customer is the U.S. Government. The KGS and US segments have substantial revenue from the U.S. Government. Sales to the U.S. Government amounted to approximately $398.3 million, $402.9 million, and $437.4 million or 60%, 61%, and 57%, of total revenue for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively.

Note 13. Segment Information

The KGS reportable segment is comprised of an aggregation of KGS operating segments, including defense and rocket support services, our microwave electronic products and satellite communications, technical and training solutions, and modular systems operating segments. The US reportable segment consists of our unmanned aerial, ground, seaborne and command, control and communications system business. The KGS and US segments provide products, solutions and services for mission critical national security programs. KGS and US customers primarily include national security related agencies, the DoD, intelligence agencies and classified agencies, and to a lesser degree, international government agencies and domestic and international commercial customers. The PSS segment designs, engineers, deploys, operates, integrates into command and control infrastructure, maintains and operates security and surveillance solutions for homeland security, public safety, critical infrastructure, government and commercial customers. PSS customers include those in the critical infrastructure, power generation, power transport, nuclear energy, financial, IT, healthcare, education, transportation and petro-chemical industries, as well as certain government and military customers.

The Company organizes its reportable segments based on the nature of the products, solutions and services offered. Transactions between segments are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts. In the following table total operating income (loss) from continuing operations of the reportable 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 segments, and other miscellaneous corporate activities.

As discussed in “Discontinued Operations” in Note 8 of these Notes to Consolidated Financial Statements, the Company began reporting the Herley Entities as discontinued operations effective in the second quarter of fiscal 2015. Prior to the decision to sell the Herley Entities, the Company reported their financial results in the KGS reportable segment. Accordingly, segment results have been recast for 2015 and prior periods presented to reflect the disposition of the Herley Entities as discontinued operations.

As certain overhead type costs previously allocated to the Herley Entities are not allocable to discontinued operations, prior period corporate costs have been reallocated amongst the continuing reportable segments.

Revenues, operating income (loss) and assets disclosed below provided by the Company’s reportable segments for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, are as follows (in millions):

	2016	2015	2014
Revenues:			
Kratos Government Solutions			
Service revenues	$ 221.0	$ 209.5	$ 207.4
Product sales	244.8	236.6	277.7
Total Kratos Government Solutions	465.8	446.1	485.1
Public Safety & Security			
Service revenues	127.1	144.7	183.4
Product sales	—	—	13.0
Total Public Safety & Security	127.1	144.7	196.4
Unmanned Systems			
Service revenues	—	—	—
Product sales	75.8	66.3	81.5
Total Unmanned Systems	75.8	66.3	81.5
Total revenues	$ 668.7	$ 657.1	$ 763.0
Depreciation and amortization:			
Kratos Government Solutions	$ 14.9	$ 18.2	$ 23.1
Public Safety & Security	0.5	0.6	2.0
Unmanned Systems	7.4	6.7	7.3
Total depreciation and amortization	$ 22.8	$ 25.5	$ 32.4
Operating income (loss) from continuing operations:			
Kratos Government Solutions	$ 17.3	$ 16.1	$ 24.4
Public Safety & Security	(3.0)	2.6	(4.9)
Unmanned Systems	(27.7)	(16.2)	(9.8)
Corporate activities	(5.2)	(7.0)	(4.4)
Total operating income (loss) from continuing operations	$ (18.6)	$ (4.5)	$ 5.3

Revenues from foreign customers were approximately $80.1 million or 12%, $73.2 million or 11% and $89.0 million or 12% of total revenue for the years ended December 25, 2016, December 27, 2015, and December 28, 2014, respectively.

Included in the 2016 operating losses for the US reportable segment is an $18.7 million loss accrual recorded on the Air Force Research Laboratory ("AFRL") Low-Cost Attritable Strike UAS Demonstration ("LCASD") cost share contract awarded in July 2016. Included in the 2015 and 2014 operating losses for the US reportable segment are increased costs of $5.7 million, and $3.1 million respectively, primarily related to certain retrofits necessary to address product design changes as well as due to a contract conversion adjustment on certain of the Company's aerial platforms.

Included in the 2016 operating losses for the PSS reportable segment is a $1.9 million charge related to the settlement of a contract dispute and $4.1 million in unexpected cost growth on several large long-term security integration projects which are nearing completion.

Included in the 2016 operating income for the KGS reportable segment is a $9.2 million charge that was recorded in the Company's modular systems business as a result of the closure of one of its manufacturing facilities, and the exit from certain lower margin product business lines.

Reportable segment assets are as follows (in millions):

	December 25, 2016	December 27, 2015	December 28, 2014
Assets:			
Kratos Government Solutions	$ 609.8	$ 606.8	$ 618.9
Unmanned Systems	172.1	162.0	166.1
Public Safety & Security	92.0	96.8	100.2
Discontinued operations	—	—	190.8
Corporate activities	74.7	37.7	55.2
Total assets	$ 948.6	$ 903.3	$ 1,131.2

Assets of foreign subsidiaries in the KGS segment were $113.7 million, $106.2 million and $115.5 million as of December 25, 2016, December 27, 2015 and December 28, 2014,respectively.

Note 14. Commitments and Contingencies

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

Legal and Regulatory Matters.

U.S. Government Cost Claims

The Company's contracts with the DoD are subject to audit by the Defense Contract Audit Agency ("DCAA"). As a result of these audits, from time to time the Company is advised of claims concerning potential disallowed, overstated or disputed costs. For example, during the course of recent audits of the Company's contracts, the DCAA is closely examining and questioning certain of the established and disclosed practices that it had previously audited and accepted. Costs incurred and allocated to contracts with the U.S. Government are regularly scrutinized for compliance with regulatory standards by the Company's personnel. On July 28, 2015, the Company received a determination letter from Defense Contract Management Agency ("DCMA") regarding what DCMA believed were certain unallowable costs for one of the Company's subsidiaries with respect to fiscal year 2007. In April 2016, the Company reached agreement with the DCAA to settle matters related to unallowable costs for this subsidiary for fiscal years 2007 and 2008 for approximately $0.2 million. For those Company subsidiaries and fiscal years which have not yet been audited by the DCAA or for those audits which are in process which have not been completed by the DCAA, the Company cannot reasonably estimate the range of loss, if any, that may result from audits and reviews in which it is currently involved given the inherent difficulty in predicting regulatory action, fines and penalties, if any, and the various remedies and levels of judicial review available to the Company in the event of an adverse finding. As a result, the Company has not recorded any liability related to these matters.

Other Litigation Matters

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

Note 15. Quarterly Financial Data (Unaudited)

The following financial information reflects all normal and recurring adjustments that are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for the years ended December 25, 2016 and December 27, 2015, is as follows (in millions, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal year 2016				
Revenues	$ 153.0	$ 168.2	$ 165.4	$ 182.1
Gross profit	35.9	45.2	25.9	46.6
Operating income (loss) from continuing operations	(10.2)	—	(13.0)	4.6
Provision for income taxes	3.6	1.8	1.9	0.8
Loss from continuing operations	(22.2)	(10.3)	(23.5)	(4.4)
Income (loss) from discontinued operations	—	(0.1)	(0.1)	0.1
Net loss	$ (22.2)	$ (10.4)	$ (23.6)	$ (4.3)
Basic loss per common share:				
Loss from continuing operations	$ (0.37)	$ (0.17)	$ (0.39)	$ (0.07)
Loss from discontinued operations	$ —	$ —	$ —	$ —
Net loss per common share	$ (0.37)	$ (0.17)	$ (0.39)	$ (0.07)
Diluted loss per common share:				
Loss from continuing operations	$ (0.37)	$ (0.17)	$ (0.39)	$ (0.07)
Loss from discontinued operations	$ —	$ —	$ —	$ —
Net loss per common share	$ (0.37)	$ (0.17)	$ (0.39)	$ (0.07)

In the first, second, third, and fourth quarters of 2016, the Company recorded restructuring charges of $3.0 million, $4.7 million, $0.1 million, and $1.4 million, respectively, related to the closure of one of its facilities for its modular systems business and exit from certain lower margin product lines. In the third quarter of 2016, the Company recorded an $18.7 million loss accrual recorded on the AFRL LCASD cost share contract awarded in July 2016.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal year 2015				
Revenues	$ 157.1	$ 160.8	$ 161.7	$ 177.5
Gross profit	38.3	40.9	40.4	42.2
Operating income (loss) from continuing operations	(3.9)	(3.7)	1.6	1.5
Provision (benefit) for income taxes	1.9	2.3	(15.3)	(0.3)
Income (loss) from continuing operations	(14.5)	(16.0)	4.3	(7.0)
Income (loss) from discontinued operations	(1.7)	0.9	50.8	3.0
Net income(loss)	$ (16.2)	$ (15.1)	$ 55.1	$ (4.0)
Basic income (loss) per common share:				
Income (loss) from continuing operations	(0.25)	(0.27)	0.07	(0.12)
Income (loss) from discontinued operations	(0.03)	0.02	0.86	0.05
Net income (loss) per common share	(0.28)	(0.25)	0.93	(0.07)
Diluted income (loss) per common share:				
Income (loss) from continuing operations	$ (0.25)	$ (0.27)	$ 0.07	$ (0.12)
Income (loss) from discontinued operations	$ (0.03)	$ 0.02	$ 0.85	$ 0.05
Net income (loss) per common share	$ (0.28)	$ (0.25)	$ 0.92	$ (0.07)

In the third quarter of 2015, the Company completed the sale of the U.S. and U.K. operations of its Electronic Products Division, which resulted in income from discontinued operations of $50.8 million. The tax benefit for the third quarter reflects the intra-period tax allocation rules under which a tax benefit is provided in continuing operations to offset a tax provision recorded in discontinued operations related to the sale.

Note 16. Condensed Consolidating Financial Statements

The Company has $435.5 million in outstanding Notes. See Note 4 of these Notes to Consolidated Financial Statements. The Notes are guaranteed by the Subsidiary Guarantors and are collateralized by the assets of all of the Company’s 100% owned subsidiaries. The Notes are fully and unconditionally guaranteed on a joint and several basis by each guarantor subsidiary and the Company. There are no contractual restrictions limiting cash transfers from guarantor subsidiaries by dividends, loans or advances to the Company. The Notes are not guaranteed by the Company’s foreign subsidiaries (the “Non-Guarantor Subsidiaries”).

The following tables present condensed consolidating financial statements for the parent company, the Subsidiary Guarantors and the Non-Guarantor Subsidiaries, respectively, for 2016, 2015, and 2014. The consolidating financial information below follows the same accounting policies as described in the Consolidated Financial Statements, except for the use of the equity method of accounting to reflect ownership interests in wholly-owned subsidiaries, which are eliminated upon consolidation.

Condensed Consolidating Balance Sheet
December 25, 2016
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Assets					
Current Assets:					
Cash and cash equivalents	$ 67.2	$ (3.3)	$ 5.2	$ —	$ 69.1
Accounts receivable, net	—	197.9	31.5	—	229.4
Amounts due from affiliated companies	204.6	—	—	(204.6)	—
Inventoried costs	—	37.2	18.2	—	55.4
Other current assets	6.3	11.6	1.3	—	19.2
Total current assets	278.1	243.4	56.2	(204.6)	373.1
Property, plant and equipment, net	1.6	41.7	6.5	—	49.8
Goodwill	—	442.5	42.9	—	485.4
Intangible assets, net	—	24.5	8.1	—	32.6
Investment in subsidiaries	458.0	67.5	—	(525.5)	—
Other assets	0.4	7.3	—	—	7.7
Total assets	$ 738.1	$ 826.9	$ 113.7	$ (730.1)	$ 948.6
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	$ 4.5	$ 43.7	$ 4.5	$ —	$ 52.7
Accrued expenses	5.6	44.5	3.5	—	53.6
Accrued compensation	4.0	31.2	3.9	—	39.1
Billings in excess of costs and earnings on uncompleted contracts	—	38.9	2.9	—	41.8
Amounts due to affiliated companies	—	174.6	30.0	(204.6)	—
Other current liabilities	1.4	4.1	2.2	—	7.7
Current liabilities of discontinued operations	1.5	—	0.1	—	1.6
Total current liabilities	17.0	337.0	47.1	(204.6)	196.5
Long-term debt, net of current portion	430.2	—	0.8	—	431.0
Other long-term liabilities	10.8	19.9	10.3	—	41.0
Non-current liabilities of discontinued operations	3.7	—	—	—	3.7
Total liabilities	461.7	356.9	58.2	(204.6)	672.2
Total stockholders' equity	276.4	470.0	55.5	(525.5)	276.4
Total liabilities and stockholders' equity	$ 738.1	$ 826.9	$ 113.7	$ (730.1)	$ 948.6

Condensed Consolidating Balance Sheet
December 27, 2015
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Assets					
Current Assets:					
Cash and cash equivalents	$ 22.5	$ (4.8)	$ 10.8	$ —	$ 28.5
Accounts receivable, net	—	179.0	27.8	—	206.8
Amounts due from affiliated companies	207.8	—	—	(207.8)	—
Inventoried costs	—	36.9	18.7	—	55.6
Other current assets	16.4	11.7	1.4	—	29.5
Total current assets	246.7	222.8	58.7	(207.8)	320.4
Property, plant and equipment, net	2.0	47.5	6.7	—	56.2
Goodwill	—	442.6	40.8	—	483.4
Intangible assets, net	—	36.5	—	—	36.5
Investment in subsidiaries	477.8	60.3	—	(538.1)	—
Other assets	0.7	6.1	—	—	6.8
Total assets	$ 727.2	$ 815.8	$ 106.2	$ (745.9)	$ 903.3
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable	$ 4.3	$ 36.5	$ 7.5	$ —	$ 48.3
Accrued expenses	4.7	29.3	3.0	—	37.0
Accrued compensation	4.1	29.2	3.5	—	36.8
Billings in excess of costs and earnings on uncompleted contracts	—	37.1	5.2	—	42.3
Amounts due to affiliated companies	—	175.7	32.1	(207.8)	—
Other current liabilities	4.3	0.2	1.6	—	6.1
Current liabilities of discontinued operations	1.8	—	0.1	—	1.9
Total current liabilities	19.2	308.0	53.0	(207.8)	172.4
Long-term debt, net of current portion	442.4	—	1.7	—	444.1
Other long-term liabilities	7.3	18.0	3.2	—	28.5
Non-current liabilities of discontinued operations	4.1	—	—	—	4.1
Total liabilities	473.0	326.0	57.9	(207.8)	649.1
Total stockholders' equity	254.2	489.8	48.3	(538.1)	254.2
Total liabilities and stockholders' equity	$ 727.2	$ 815.8	$ 106.2	$ (745.9)	$ 903.3

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Year Ended December 25, 2016
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Service revenues	$ —	$ 330.9	$ 17.2	$ —	$ 348.1
Product sales	—	273.8	54.6	(7.8)	320.6
Total revenues	—	604.7	71.8	(7.8)	668.7
Cost of service revenues	—	244.0	11.8	—	255.8
Cost of product sales	—	225.0	42.1	(7.8)	259.3
Total costs	—	469.0	53.9	(7.8)	515.1
Gross profit	—	135.7	17.9	—	153.6
Selling, general and administrative expenses	6.3	142.3	9.7	—	158.3
Research and development expenses	—	13.5	0.4	—	13.9
Operating income (loss) from continuing operations	(6.3)	(20.1)	7.8	—	(18.6)
Other income (expense):					
Interest expense, net	(34.6)	(0.1)	—	—	(34.7)
Loss on extinguishment of debt	0.2	—	—	—	0.2
Other income (expense), net	—	0.2	0.6	—	0.8
Total other income (expense), net	(34.4)	0.1	0.6	—	(33.7)
Income (loss) from continuing operations before income taxes	(40.7)	(20.0)	8.4	—	(52.3)
Provision (benefit) for income taxes from continuing operations	(0.1)	7.0	1.2	—	8.1
Income (loss) from continuing operations	(40.6)	(27.0)	7.2	—	(60.4)
Income (loss) from discontinued operations	(0.1)	—	—	—	(0.1)
Equity in net income (loss) of subsidiaries	(19.8)	7.2	—	12.6	—
Net income (loss)	$ (60.5)	$ (19.8)	$ 7.2	$ 12.6	$ (60.5)
Comprehensive income (loss)	$ (60.8)	$ (19.8)	$ 6.9	$ 12.9	$ (60.8)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Year Ended December 27, 2015
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Service revenues	$ —	$ 339.0	$ 15.2	$ —	$ 354.2
Product sales	—	262.3	56.3	(15.7)	302.9
Total revenues	—	601.3	71.5	(15.7)	657.1
Cost of service revenues	—	255.5	11.0	—	266.5
Cost of product sales	—	203.1	41.4	(15.7)	228.8
Total costs	—	458.6	52.4	(15.7)	495.3
Gross profit	—	142.7	19.1	—	161.8
Selling, general and administrative expenses	10.1	130.8	9.2	—	150.1
Research and development expenses	—	15.7	0.5	—	16.2
Operating income (loss) from continuing operations	(10.1)	(3.8)	9.4	—	(4.5)
Other income (expense):					
Interest expense, net	(35.8)	(0.1)	(0.1)	—	(36.0)
Loss on extinguishment of debt	(3.4)	—	—	—	(3.4)
Other income (expense), net	—	(3.3)	2.6	—	(0.7)
Total other income (expense), net	(39.2)	(3.4)	2.5	—	(40.1)
Income (loss) from continuing operations before income taxes	(49.3)	(7.2)	11.9	—	(44.6)
Provision (benefit) for income taxes from continuing operations	(17.8)	4.4	2.0	—	(11.4)
Income (loss) from continuing operations	(31.5)	(11.6)	9.9	—	(33.2)
Income (loss) from discontinued operations	71.8	(21.1)	2.3	—	53.0
Equity in net income (loss) of subsidiaries	(20.5)	12.2	—	8.3	—
Net income (loss)	$ 19.8	$ (20.5)	$ 12.2	$ 8.3	$ 19.8
Comprehensive income (loss)	$ 20.1	$ (20.5)	$ 12.3	$ 8.2	$ 20.1

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)
Year Ended December 28, 2014
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Service revenues	$ —	$ 380.8	$ 10.0	$ —	$ 390.8
Product sales	—	326.1	54.6	(8.5)	372.2
Total revenues	—	706.9	64.6	(8.5)	763.0
Cost of service revenues	—	297.0	7.6	—	304.6
Cost of product sales	—	247.9	39.6	(8.5)	279.0
Total costs	—	544.9	47.2	(8.5)	583.6
Gross profit	—	162.0	17.4	—	179.4
Selling, general and administrative expenses	8.4	136.7	10.4	—	155.5
Research and development expenses	—	17.4	1.2	—	18.6
Operating income (loss) from continuing operations	(8.4)	7.9	5.8	—	5.3
Other income (expense):			.		
Interest income (expense), net	(39.3)	0.3	(0.2)	—	(39.2)
Loss on extinguishment of debt	(39.1)	—	—	—	(39.1)
Other income (expense), net	—	(2.0)	3.2	—	1.2
Total other income (expense), net	(78.4)	(1.7)	3.0	—	(77.1)
Income (loss) from continuing operations before income taxes	(86.8)	6.2	8.8	—	(71.8)
Provision for income taxes from continuing operations	0.6	2.8	0.5	—	3.9
Income (loss) from continuing operations	(87.4)	3.4	8.3	—	(75.7)
Income (loss) from discontinued operations	(14.7)	9.3	3.1	—	(2.3)
Equity in net income (loss) of subsidiaries	24.1	11.4	—	(35.5)	—
Net income (loss)	$ (78.0)	$ 24.1	$ 11.4	$ (35.5)	$ (78.0)
Comprehensive income (loss)	$ (78.9)	$ 23.6	$ 11.0	$ (34.6)	$ (78.9)

Condensed Consolidating Statement of Cash Flows
Year Ended December 25, 2016
(in million)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Net cash provided by (used in) operating activities from continuing operations	$ (26.3)	$ 16.6	$ (2.7)	$ —	$ (12.4)
Investing activities:					
Investment in affiliated companies	—	(3.0)	—	3.0	—
Cash paid for acquisitions, net of cash acquired	—	(5.1)	—	—	(5.1)
Change in restricted cash	—	0.3	—	—	0.3
Capital expenditures	(0.5)	(7.1)	(1.6)	—	(9.2)
Proceeds from sale of assets	—	0.1	—	—	0.1
Net cash provided by (used in) investing activities from continuing operations	(0.5)	(14.8)	(1.6)	3.0	(13.9)
Financing activities:					
Extinguishment of long-term debt	(14.1)	—	—	—	(14.1)
Repayment of debt	—	—	(1.0)	—	(1.0)
Proceeds from the issuance of common stock	76.2	—	—	—	76.2
Proceeds from the sale of employee stock purchase plan shares	2.0	—	—	—	2.0
Financings from affiliated companies	3.0	—	—	(3.0)	—
Net cash provided by (used in) financing activities from continuing operations	67.1	—	(1.0)	(3.0)	63.1
Net cash flows of continuing operations	40.3	1.8	(5.3)	—	36.8
Net operating cash flows from discontinued operations	0.4	(0.3)	—	—	0.1
Net investing cash flows from discontinued operations	4.0	—	—	—	4.0
Effect of exchange rate changes on cash and cash equivalents	—	—	(0.3)	—	(0.3)
Net increase (decrease) in cash and cash equivalents	$ 44.7	$ 1.5	$ (5.6)	$ —	$ 40.6

Condensed Consolidating Statement of Cash Flows
Year Ended December 27, 2015
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Net cash provided by (used in) operating activities from continuing operations	$ (2.0)	$ (30.8)	$ 3.1	$ —	$ (29.7)
Investing activities:					
Change in restricted cash	—	4.7	—	—	4.7
Investment in affiliated companies	(33.8)	—	—	33.8	—
Capital expenditures	(1.0)	(9.5)	(0.8)	—	(11.3)
Proceeds from the sale of assets	—	0.9	—	—	0.9
Net cash provided by (used in) investing activities from continuing operations	(34.8)	(3.9)	(0.8)	33.8	(5.7)
Financing activities:					
Extinguishment of long-term debt	(175.0)	—	—	—	(175.0)
Repayment of debt	(41.0)	—	(1.0)	—	(42.0)
Proceeds from the sale of employee stock purchase plan shares	3.4	—	—	—	3.4
Financings from affiliated companies	—	33.8	—	(33.8)	—
Other, net	—	(1.1)	—	—	(1.1)
Net cash provided by (used in) financing activities from continuing operations	(212.6)	32.7	(1.0)	(33.8)	(214.7)
Net cash flows of continuing operations	(249.4)	(2.0)	1.3	—	(250.1)
Net operating cash flows from discontinued operations	—	3.1	(0.3)	—	2.8
Net investing cash flows from discontinued operations	243.2	(0.4)	(0.3)	—	242.5
Effect of exchange rate changes on cash and cash equivalents	—	—	(0.2)	—	(0.2)
Net increase (decrease) in cash and cash equivalents	$ (6.2)	$ 0.7	$ 0.5	$ —	$ (5.0)

Condensed Consolidating Statement of Cash Flows
Year Ended December 28, 2014
(in millions)

	Parent Company	Subsidiary Guarantors on a Combined Basis	Non-Guarantors on a Combined Basis	Eliminations	Consolidated
Net cash provided by (used in) operating activities from continuing operations	$ (73.0)	$ 76.8	$ (1.3)	$ —	$ 2.5
Investing activities:					
Cash paid for acquisitions, net of cash acquired	—	(2.6)	—	—	(2.6)
Change in restricted cash	—	(0.4)	—	—	(0.4)
Investment in affiliated companies	—	(68.5)	—	68.5	—
Capital expenditures	(0.8)	(9.7)	(1.1)	—	(11.6)
Net cash provided by (used in) investing activities from continuing operations	(0.8)	(81.2)	(1.1)	68.5	(14.6)
Financing activities:					
Proceeds from the issuance of long-term debt	618.5	—	—	—	618.5
Extinguishment of long-term debt	(661.5)	—	—	—	(661.5)
Credit agreement borrowings	41.0	—	—	—	41.0
Repayment of debt	—	—	(1.0)	—	(1.0)
Debt issuance costs	(10.0)	—	—	—	(10.0)
Financing from affiliated companies	68.5	—	—	(68.5)	—
Proceeds from the sale of employee stock purchase plan shares	3.3	—	—	—	3.3
Net cash provided by (used in) financing activities from continuing operations	59.8	—	(1.0)	(68.5)	(9.7)
Net cash flows of continuing operations	(14.0)	(4.4)	(3.4)	—	(21.8)
Net operating cash flows from discontinued operations	—	3.8	0.3	—	4.1
Net investing cash flows from discontinued operations	—	(2.2)	(0.4)	—	(2.6)
Effect of exchange rate changes on cash and cash equivalents	—	—	(0.4)	—	(0.4)
Net decrease in cash and cash equivalents	$ (14.0)	$ (2.8)	$ (3.9)	$ —	$ (20.7)

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED ARE TRUE AND CORRECT COPIES OF ALL DOCUMENTS FILED FROM AND INCLUDING THE RESTATED CERTIFICATE OR A MERGER WITH A RESTATED CERTIFICATE ATTACHED OF "KRATOS DEFENSE & SECURITY SOLUTIONS, INC." AS RECEIVED AND FILED IN THIS OFFICE.

THE FOLLOWING DOCUMENTS HAVE BEEN CERTIFIED:

RESTATED CERTIFICATE, FILED THE TENTH DAY OF NOVEMBER, A.D. 1999, AT 3:30 O`CLOCK P.M.

CERTIFICATE OF DESIGNATION, FILED THE TWENTY-NINTH DAY OF OCTOBER, A.D. 2001, AT 3:15 O`CLOCK P.M.

CERTIFICATE OF DESIGNATION, FILED THE THIRTIETH DAY OF MAY, A.D. 2002, AT 1 O`CLOCK P.M.

CERTIFICATE OF CORRECTION, FILED THE THIRTIETH DAY OF MAY, A.D. 2002, AT 5 O`CLOCK P.M.

CERTIFICATE OF DESIGNATION, FILED THE SIXTEENTH DAY OF DECEMBER, A.D. 2004, AT 5:52 O`CLOCK P.M.

/s/ Jeffrey W. Bullock

Jeffrey W. Bullock, Secretary of State

2762925 8100X Authentication: 203332063

SR# 20166626634 Date: 11-14-16

You may verify this certificate online at corp.delaware.gov/authver.shtml

Delaware

The First State

CERTIFICATE OF CHANGE OF REGISTERED AGENT, FILED THE FIFTH DAY OF MAY, A.D. 2005, AT 4:23 O`CLOCK P.M.

CERTIFICATE OF OWNERSHIP, CHANGING ITS NAME FROM "WIRELESS FACILITIES, INC." TO "KRATOS DEFENSE & SECURITY SOLUTIONS, INC.", FILED THE TWELFTH DAY OF SEPTEMBER, A.D. 2007, AT 10:57 O`CLOCK A.M.

CERTIFICATE OF AMENDMENT, FILED THE TENTH DAY OF SEPTEMBER, A.D. 2009, AT 11:48 O`CLOCK A.M.

CERTIFICATE OF OWNERSHIP, FILED THE FOURTH DAY OF APRIL, A.D. 2011, AT 2:40 O`CLOCK P.M.

/s/ Jeffrey W. Bullock

Jeffrey W. Bullock, Secretary of State

2762925 8100X Authentication: 203332063

SR# 20166626634 Date: 11-14-16

You may verify this certificate online at corp.delaware.gov/authver.shtml

AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION

WIRELESS FACILITIES, INC., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "Corporation"), hereby certifies as follows:

1. The name of the Corporation is Wireless Facilities, Inc.

2. The original name of this Corporation is Wireless Facilities, Inc. and the date of filing the original Certificate of Incorporation of this Corporation with the Secretary of State of the State of Delaware was July 7, 1997.

3. The Amended and Restated Certificate of Incorporation of this Corporation, in the form attached hereto as Exhibit A, has been duly adopted by the Board of Directors and by the stockholders of the corporation in accordance with Sections 228, 242 and 245 of the General Corporation Law of the State of Delaware.

4. The Amended and Restated Certificate of Incorporation so adopted reads in full as set forth in Exhibit A attached hereto and hereby incorporated by reference.

IN WITNESS WHEREOF, Wireless Facilities, Inc. has caused this Amended and Restated Certificate of Incorporation to be signed by its Chief Executive Officer and Secretary this 2nd day of November, 1999.

/s/ Massih Tayebi

Massih Tayebi, Ph.D.
Chief Executive Officer and Secretary

Exhibit A

AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
WIRELESS FACILITIES, INC.

I.

The name of this corporation is Wireless Facilities, Inc.

II.

The address of the registered office of the corporation in the State of Delaware is 9 East Loockerman Street, City of Dover, County of Kent, and the name of the registered agent of the corporation in the State of Delaware at such address is National Registered Agents, Inc.

III.

The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of the State of Delaware.

IV.

A. This corporation is authorized to issue two classes of stock to be designated, respectively, "Common Stock" and "Preferred Stock." The total number of shares which the corporation is authorized to issue is two hundred million (200,000,000) shares. One hundred ninety five million (195,000,000) shares shall be Common Stock, each having a par value of one tenth of one cent ($0.001). Five million (5,000,000) shares shall be Preferred Stock, each having a par value of one tenth of one cent ($0.001).

B. The Preferred Stock may be issued from time to time in one or more series. The Board of Directors is hereby authorized, by filing a certificate (a "Preferred Stock Designation") pursuant to the Delaware General Corporation Law, to fix or alter from time to time the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions of any wholly unissued series of Preferred Stock, and to establish from time to time the number of shares constituting any such series or any of them; and to increase or decrease the number of shares of any series subsequent to the issuance of shares of that series, but not below the number of shares of such series then outstanding. In case the number of shares of any series shall be decreased in accordance with the foregoing sentence, the shares constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series.

V.

For the management of the business and for the conduct of the affairs of the corporation, and in further definition, limitation and regulation of the powers of the corporation, of its directors and of its stockholders or any class thereof, as the case may be, it is further provided that:

A. 1. The management of the business and the conduct of the affairs of the corporation shall be vested in its Board of Directors. The number of directors which shall constitute the whole Board of Directors shall be fixed exclusively by one or more resolutions adopted by the Board of Directors.

2. Board of Directors

a. Directors shall be elected at each annual meeting of stockholders to hold office until the next annual meeting. Each director shall hold office either until the expiration of the term for which elected or appointed and until a successor has been elected and qualified, or until such director's death, resignation or removal. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

b. No person entitled to vote at an election for directors may cumulate votes to which such person is entitled, unless, at the time of such election, the corporation (i) is subject to Section 2115(b) of the California General Corporation Law ("CGCL") and (ii) is not a "listed" corporation or ceases to be a "listed" corporation under Section 301.5 of the CGCL. During this time, every stockholder entitled to vote at an election for directors may cumulate such stockholder's votes and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which such stockholder's shares are otherwise entitled, or distribute the stockholder's votes on the same principle among as many candidates as such stockholder thinks fit. No stockholder, however, shall be entitled to so cumulate such stockholder's votes unless (i) the names of such candidate or candidates have been placed in nomination prior to the voting and (ii) the stockholder has given notice at the meeting, prior to the voting, of such stockholder's intention to cumulate such stockholder's votes. If any stockholder has given proper notice to cumulate votes, all stockholders may cumulate their votes for any candidates who have been properly placed in nomination. Under cumulative voting, the candidates receiving the highest number of votes, up to the number of directors to be elected, are elected.

3. Removal of Directors

a. During such time or times that the corporation is subject to Section 2115(b) of the CGCL, the Board of Directors or any individual director may be removed from office at any time without cause by the affirmative vote of the holders of at least a majority of the outstanding shares entitled to vote on such removal; provided, however, that unless the entire Board is removed, no individual director may be removed when the votes cast against such director's removal, or not consenting in writing to such removal, would be sufficient to elect that director if voted cumulatively at an election which the same total number of votes were cast (or, if such action is taken by written consent, all shares entitled to vote were voted) and the entire number of directors authorized at the time of such director's most recent election were then being elected.

b. At any time or times that the corporation is not subject to Section 2115(b) of the CGCL and subject to any limitations imposed by law, Section A(3)(a) above shall not apply and the Board of Directors or any director may be removed from office at any time with or without cause by the affirmative vote of the holders of a majority of the voting power of all then-outstanding shares of voting stock of the corporation, entitled to vote at an election of directors.

4. Vacancies

c. Subject to the rights of the holders of any series of Preferred Stock, any vacancies on the Board of Directors resulting from death, resignation, disqualification, removal or other causes and any newly created directorshipsresulting from any increase in the number of directors, shall, unless the Board of Directors determines by resolution that any such vacancies or newly created directorships shall be filled by the stockholders, except as otherwise provided by law, be filled only by the affirmative vote of a majority of the directors then in office, even though less than a quorum of the Board of Directors, and not by the stockholders (except as stockholders may have such rights as described below). Any director elected in accordance with the preceding sentence shall hold office for the remainder of the full term of the director for which the vacancy was created or occurred and until such director's successor shall have been elected and qualified.

d. If at the time of filling any vacancy or any newly created directorship, the directors then in office shall constitute less than a majority of the whole board (as constituted immediately prior to any such increase), the Delaware Court of Chancery may, upon application of any stockholder or stockholders holding at least ten percent (10%) of the total number of the shares at the time outstanding having the right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorships, or to replace the directors chosen by the directors then in offices as aforesaid, which election shall be governed by Section 211 of the DGCL.

e. At any time or times that the Corporation is subject to Section 2115(b) of the CGCL, if, after the filling of any vacancy by the directors then in office, where the number of such directors voting to fill, such vacancy who have been elected by stockholders shall constitute less than a majority of the directors then in office, then

(i) Any holder or holders of an aggregate of five percent (5%) or more of the total number of shares at the time outstanding having the right to vote for those directors may call a special meeting of stockholders; or

(ii) The Superior Court of the proper county shall, upon application of such stockholder or stockholders, summarily order a special meeting of stockholders, to be held to elect the entire board, all in accordance with Section 305(c) of the CGCL. The term of office of any director shall terminate upon that election of a successor.

B. 1. Subject to paragraph (h) of Section 43 of the Bylaws, the Bylaws may be altered or amended or new Bylaws adopted by the affirmative vote of at least sixty-six and two-thirds percent (66-2/3%) of the voting power of all of the then-outstanding shares of the voting stock of the Corporation entitled to vote. The Board of Directors shall also have the power to adopt, amend, or repeal Bylaws.

2. The directors of the Corporation need not be elected by written ballot unless the Bylaws so provide.

3. No action shall be taken by the stockholders of the Corporation except at an annual or special meeting of stockholders called in accordance with the Bylaws. No action shall be taken by the stockholders by written consent.

4. Advance notice of stockholder nominations for the election of directors and of business to be brought by stockholders before any meeting of the stockholders of the Corporation shall be given in the manner provided in the Bylaws of the Corporation.

VI.

A. The liability of the directors for monetary damages shall be eliminated to the fullest extent under applicable law.

B. This corporation is authorized to provide indemnification of agents (as defined in Section 317 of the CGCL) for breach of duty to the corporation and its shareholders through bylaw provisions or through agreements with the agents, or through shareholder resolutions, or otherwise, in excess of the indemnification otherwise permitted by Section 317 of the CGCL, subject, at any time or times the corporation is subject to Section 2115(b) to the limits on such excess indemnification set forth in Section 204 of the CGCL.

C. Any repeal or modification of this Article VI shall be prospective and shall not affect the rights under this Article VI in effect at the time of the alleged occurrence of any act or omission to act giving rise to liability or indemnification.

VII.

A. The corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, except as provided in paragraph B of this Article VII, and all rights conferred upon the stockholders herein are granted subject to this reservation.

B. Notwithstanding any other provisions of this Certificate of Incorporation or any provision of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class or series of the voting stock required by law, this Certificate of Incorporation or any Preferred Stock Designation, the affirmative vote of the holders of at least sixty-six and two-thirds percent (66-2/3%) of the voting power of all of the then-outstanding shares of the voting stock, voting together as a single class, shall be required to alter, amend or repeal Articles V, VI, and VII.

CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS

of

SERIES A PREFERRED STOCK

of

WIRELESS FACILITIES, INC.

I, Masood K. Tayebi, Chief Executive Officer of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), in accordance with the provisions of Section 151 of the Delaware General Corporation Law, DO HEREBY CERTIFY:

That pursuant to the authority conferred upon the Board of Directors of the Corporation (the "Board of Directors") by the Certificate of Incorporation of the Corporation and by Section 151(g) of the Delaware General Corporation Law, on October 9, 2001, the Board of Directors adopted the following resolution, creating a series of shares of convertible preferred stock, Series A, designated as "Series A Preferred Stock":

"RESOLVED, that pursuant to the authority vested in the Board of Directors (the "Board of Directors") of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), by the Certificate of Incorporation of the Corporation (the "Certificate of Incorporation"), the Board of Directors does hereby provide for the authorization and issuance of a series of convertible preferred stock, Series A, par value U.S.$0.001 per share, of the Corporation, to be designated "Series A Preferred Stock," initially consisting of 63,637 shares, and to the extent that the designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions of the Series A Preferred Stock are not stated and expressed in the Certificate of Incorporation, the Board of Directors does hereby fix and herein state and express such designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions thereof, as follows:

1. Designation and Rank.

(a) Sixty-three thousand six hundred thirty-seven (63,637) shares of the preferred stock of the Corporation, par value $0.001 per share, shall be designated and known as the "Series A Preferred Stock."

(b) The Series A Preferred Stock shall rank senior and prior to the common stock, par value U.S.$0.001 per share, of the Corporation (the "Common Stock"), and all other classes or series of the capital stock (other than preferred stock) of the Corporation (now or hereafter authorized or issued), with respect to the payment of any dividends, the conversion rights set forth herein and any payment upon liquidation or redemption. The Corporation may not issue any additional classes or series of preferred stock with liquidation, redemption or conversion rights or right of payment of any kind that is senior to the Series A Preferred Stock, except pursuant to Section 12.

2. Dividend Rights.

From and after the date hereof, when and if the Board of Directors declares a dividend or distribution payable with respect to the then-outstanding shares of Common Stock (other than in additional shares of Common Stock or Common Stock Equivalents (as defined in Section 4(e)(i) below), the holders of the Series A Preferred Stock shall be entitled to the amount of dividends per share in the same form as such Common Stock dividends that would be payable on the largest number of whole shares of Common Stock into which a holder's aggregate shares of Series A Preferred Stock could then be converted pursuant to Section 4 hereof (such number to be determined as of the record date for the determination of holders of Common Stock entitled to receive such dividend).

3. Liquidation Rights.

(a) Liquidation Events. The occurrence of any of the following events shall be deemed a "Liquidation": (i) any liquidation, dissolution, or winding-up of the affairs of the Corporation; (ii) any transaction or series of related transactions in which securities of the Corporation representing 50% or more of the combined voting power of the Corporation's then outstanding voting securities are acquired by a person, entity or group of related persons or entities, excluding any consolidation or merger effected exclusively to change the domicile of the Corporation; (iii) any consolidation, merger or reorganization of the Corporation with or into any other corporation or other entity or person pursuant to which the holders of the Corporation's outstanding securities receive, pursuant to such transaction, securities in the surviving entity that represent less than 50% of the voting power of such surviving entity; or (iv) any sale, lease, exclusive license or other disposition of all or substantially all of the assets of the Corporation.

(b) Liquidation Preference.

(i) In the event of any Liquidation, whether voluntary or involuntary, before any payment of cash or distribution of other property shall be made to the holders of Common Stock, or any other class or series of stock subordinate in liquidation preference to the Series A Preferred Stock, the holders of the Series A Preferred Stock shall be entitled to receive out of the assets of the Corporation legally available for distribution to its stockholders, on behalf of each share of Series A Preferred Stock held by such holder, U.S.$550.00 (the "Original Issue Price") (as appropriately adjusted for any combinations, divisions, or similar recapitalizations affecting the Series A Preferred Stock after issuance) and all accumulated or accrued and unpaid dividends thereon (collectively, the "Series A Liquidation Preference").

(ii) If, upon any Liquidation, the assets of the Corporation available for distribution to its stockholders are insufficient to pay the holders of the Series A Preferred Stock the full amounts to which they are entitled pursuant to clause (b)(i) above, the holders of the Series A Preferred Stock shall share pro rata in any distribution of assets in proportion to the respective amounts which would be payable to the holders of the Series A Preferred Stock and any other class or series of capital stock of the Corporation ranking on par with the Series A Preferred Stock in respect of the shares held by them if all amounts payable to them in respect of such were paid in full pursuant to clause (b)(i) above.

(iii) After the distributions described in clause (b)(i) or (b)(ii) above have been paid, subject to the rights of any other class or series of capital stock of the Corporation that may from time to time come into existence, the remaining assets of the Corporation available for distribution to stockholders shall be distributed among the holders of Common Stock pro rata based on the number of shares of Common Stock held by each.

(c) Non-Cash Distributions. If any distribution to be made pursuant to this Section 3 is to be paid other than in cash or Common Stock or Common Stock Equivalents, the value of such distribution will be deemed its fair market value as determined in good faith by the Board of Directors. Any securities shall be valued as follows:

(i) Securities not subject to investment letter or other similar restrictions on free marketability covered by clause (ii) below:

(1) if traded on a securities exchange or through the Nasdaq National Market, the value shall be deemed to be the average of the closing prices of the securities on such quotation system over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation;

(2) if actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sale prices (whichever is applicable) over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation; and

(3) if there is no active public market, the value shall be the fair market value thereof, as determined by the Board of Directors.

(ii) The method of valuation of securities subject to investment letter or other restrictions on free marketability (other than restrictions arising solely by virtue of a stockholder's status as an affiliate or former affiliate) shall be to effectuate an appropriate discount from the market value, as determined by clause (i)(1), (2) or (3) of this Section 3(c), so as to reflect the approximate fair market value thereof, as determined by the Board of Directors.

(iii) The holders of at least a majority of the outstanding Series A Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 3(c), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

4. Conversion Rights.

The holders of the Series A Preferred Stock shall have conversion rights as follows (the "Conversion Right"):

(a) Conversion Price. The "Conversion Price" shall, initially, be U.S. $5.50 per share and shall be subject to adjustment as set forth below in Sections 4(e) and 4(f).

(b) Automatic Conversion. If the closing price for the shares of the Corporation's Common Stock (trading on a securities exchange or through Nasdaq National Market or other national exchange or market) exceeds $11.00 per share (as adjusted for events described in Section 4(e)(ii) and 4(e)(iii) below) for any thirty consecutive trading day period that begins after July 29, 2004, then, upon such occurrence, each share of Series A Preferred Stock shall be automatically converted into such number of fully paid and non-assessable shares of Common Stock as is determined by dividing (x) the Original Issue Price of such share of Series A Preferred Stock (including any accumulated or accrued but unpaid dividends thereon) by (y) the Conversion Price. The date of such conversion is herein referred to as the "Conversion Date."

(c) Optional Conversion. The holders of the Series A Preferred Stock shall have the right, at any time, to convert the shares of Series A Preferred Stock held by such holder into that number of shares of Common Stock into which such shares are convertible pursuant to Section 4(b) ("Optional Conversion"). In the event of any Optional Conversion, the date of the such conversion shall be referred to as the "Optional Conversion Date."

(d) Mechanics of Conversion. On the Conversion Date or Optional Conversion Date, as the case may be, (x) each holder shall tender such holder's shares of Series A Preferred Stock to the Corporation for cancellation, free and clear of encumbrances of any type or nature, and (y) the Corporation shall cause to be delivered to such holder a number of shares of Common Stock as calculated pursuant to Section 4(b) above, free and clear of encumbrances of any type or nature. Each holder and the Corporation shall take all other necessary or appropriate actions in connection with or to effect such closing.

(e) Certain Adjustments. To the extent that the holders of Series A Preferred Stock do not participate fully with other stockholders of the Corporation with respect to dividends paid pursuant to Section 2 hereof, the following adjustments shall be made to the Conversion Price:

(i) Adjustment for Common Stock Dividends and Distributions. If, at any time after the original issue date of the Series A Preferred Stock (the "Original Issue Date"), the Corporation makes, or fixes a record date for the determination of holders of Common Stock entitled to receive, a dividend or other distribution payable in additional shares of Common Stock or Common Stock Equivalents, in each such event the Conversion Price that is then in effect shall be decreased as of the time of such issuance or, in the event such record date is fixed, as of the close of business on such record date, by multiplying the Conversion Price then in effect by a fraction (i) the numerator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date, and (ii) the denominator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date plus the number of shares of Common Stock or Common Stock Equivalents issuable in payment of such dividend or distribution; provided, however, that if such record date is fixed and such dividend is not fully paid or if such distribution is not fully made on the date fixed therefor, the Conversion Price shall be recomputed accordingly as of the close of business on such record date and thereafter the Conversion Price shall be adjusted pursuant to this Section 4(e)(i) to reflect the actual payment of such dividend or distribution.

A "Common Stock Equivalent" shall mean each share of Common Stock into which securities or property or rights are convertible, exchangeable or exercisable for or into shares of Common Stock, or otherwise entitle the holder thereof to receive directly or indirectly, any of the foregoing.

(ii) Adjustments for Stock Splits, Stock Subdivisions and Combinations. If, at any time after the Original Issue Date, the Corporation subdivides or combines the Common Stock without making a corresponding subdivision or combination of the Series A Preferred Stock, (A) in the case of a subdivision (including a stock split), the Conversion Price in effect immediately prior to such event shall be proportionately decreased and the number of shares of Common Stock purchasable thereunder shall be proportionately increased, and (B) in the case of a combination (including a reverse stock split), the Conversion Price in effect immediately prior to such event shall be proportionately increased and the number of shares of Common Stock purchasable thereunder shall be proportionately decreased. Any adjustment under this Section 4(e)(ii) shall become effective at the close of business on the date the subdivision or combination becomes effective.

(iii) Adjustments for Reclassification, Reorganization and Consolidation. In case of (A) any reclassification, reorganization, change or conversion of securities of the class issuable upon conversion of the Series A Preferred Stock (other than a change in par value, or from par value to no par value) into other shares or securities of the Corporation, or (B) any merger or consolidation of the Corporation with or into another entity (other than a Liquidation or a merger or consolidation with another entity in which the Corporation is the acquiring and the surviving entity and that does not result in any reclassification or change of outstanding securities issuable upon conversion of the Series A Preferred Stock) each holder of shares of Series A Preferred Stock shall have the right to receive, in lieu of the shares of Common Stock otherwise issuable upon the conversion of its shares of Series A Preferred Stock (and accumulated or accrued and unpaid dividends then-outstanding thereunder) in accordance with Section 4(b), the kind and amount of shares of stock and other securities, money and property receivable upon such reclassification, reorganization, change, merger or consolidation upon conversion by a holder of the maximum number of shares of Common Stock into which such shares of Series A Preferred Stock could have been converted immediately prior to such reclassification, reorganization, change, merger or consolidation, all subject to further adjustment as provided herein or with respect to such other securities or property by the terms thereof. The provisions of this clause (iii) shall similarly attach to successive reclassifications, reorganizations, changes, mergers and consolidations.

(f) Antidilution Adjustments. To the extent that (i) the Corporation issues after the Original Issue Date and before April 29, 2003, Additional Shares of Common Stock (as defined below) (in one or more transactions, whether or not related), (ii) each such issuance is at an Effective Price (as defined below) per share less than Conversion Price then in effect and (iii) the aggregate gross proceeds of such issuances exceed $15 million, then the Conversion Price shall be adjusted to equal the lowest Effective Price received by the Corporation pursuant to any such issuance. The previous sentence will apply to any issuances of Additional Shares of Common Stock after the $15 million threshold has been met (provided any such issuance is below the Conversion Price then in effect) but will not apply to any issuance of Additional Shares of

Common Stock occurring after April 29, 2003. Notwithstanding the foregoing, the Conversion Price shall in no event be lower than U.S.$3.77.

(i) For the purpose of making any adjustment required under Section 4(f), the consideration received by the Company for any issue or sale of securities shall (A) to the extent it consists of cash, be computed at the net amount of cash received by the Company after deduction of any underwriting or similar commissions, compensation or concessions paid or allowed by the Company in connection with such issue or sale but without deduction of any expenses payable by the Company (except for purposes of determining if the $15 million threshold referred to above has been met, in which case the consideration received will be deemed to be the aggregate gross proceeds received by the Company), (B) to the extent it consists of property other than cash, be computed at the fair value of that property as determined in good faith by the Board of Directors, and (C) if Additional Shares of Common Stock, Convertible Securities (as defined below) or rights or options to purchase either Additional Shares of Common Stock or Convertible Securities are issued or sold together with other stock or securities or other assets of the Company for a consideration which covers both, be computed as the portion of the consideration so received that may be reasonably determined in good faith by the Board of Directors to be allocable to such Additional Shares of Common Stock, Convertible Securities or rights or options; provided, however, that the holders of at least a majority of the outstanding Series A Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 4(f)(i), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

(ii) For the purpose of the adjustment required under this Section 4(f), if the Company issues or sells (A) stock or other securities convertible into, Additional Shares of Common Stock (such convertible stock or securities being herein referred to as "Convertible Securities") or (B) rights or options for the purchase of Additional Shares of Common Stock or Convertible Securities and if the Effective Price of such Additional Shares of Common Stock is less than the Conversion Price, in each case the Company shall be deemed to have issued at the time of the issuance of such rights or options or Convertible Securities the maximum number of Additional Shares of Common Stock issuable upon exercise or conversion thereof and to have received as consideration for the issuance of such shares an amount equal to the total amount of the consideration, if any, received by the Company for the issuance of such rights or options or Convertible Securities, plus, in the case of such rights or options, the minimum amounts of consideration, if any, payable to the Company upon the exercise of such rights or options, plus, in the case of Convertible Securities, the minimum amounts of consideration, if any, payable to the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) upon the conversion thereof; provided that if in the case of Convertible Securities the minimum amounts of such consideration cannot be ascertained, but are a function of antidilution or similar protective clauses, the Company shall be deemed to have received the minimum amounts of consideration without reference to such clauses; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of rights, options or Convertible Securities is reduced over time or on the occurrence or non-occurrence of specified events other than by reason of antidilution adjustments, the Effective Price shall be recalculated using the figure to which such minimum amount of consideration is

reduced; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities is subsequently increased, the Effective Price shall be again recalculated using the increased minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities. No further adjustment of the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be made as a result of the actual issuance of Additional Shares of Common Stock on the exercise of any such rights or options or the conversion of any such Convertible Securities. If any such rights or options or the conversion privilege represented by any such Convertible Securities shall expire without having been exercised, the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be readjusted to the Conversion Price which would have been in effect had an adjustment been made on the basis that the only Additional Shares of Common Stock so issued were the Additional Shares of Common Stock, if any, actually issued or sold on the exercise of such rights or options or rights of conversion of such Convertible Securities, and such Additional Shares of Common Stock, if any, were issued or sold for the consideration actually received by the Company upon such exercise, plus the consideration, if any, actually received by the Company for the granting of all such rights or options, whether or not exercised, plus the consideration received for issuing or selling the Convertible Securities actually converted, plus the consideration, if any, actually received by the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) on the conversion of such Convertible Securities.

"Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Company or deemed to be issued pursuant to this Section 4(f), whether or not subsequently reacquired or retired by the Company other than (A) shares of Common Stock and/or options, warrants or other Common Stock purchase rights, and the Common Stock issued or issuable pursuant to such options, warrants or other rights to employees, officers or directors of, or consultants or advisors to the Company or any subsidiary pursuant to stock purchase or stock option plans or other arrangements that are approved by the Board; (B) shares of Common Stock issued or issuable pursuant to any equipment loan or leasing arrangement, or debt financing from a bank or similar financial institution; (C) shares of Common Stock issued or issuable in connection with licensing transactions involving the Company and other entities, including (1) joint ventures, manufacturing, marketing or distribution arrangements or (2) technology transfer or development arrangements; provided that such transactions in (1) and (2) and the issuance of shares therein has been approved by a majority of the members of the Company's Board of Directors and the aggregate number of shares so issued does not exceed four million (4,000,000)(as adjusted for stock splits, stock dividends, stock combinations, recapitalizatons and the like); and (D) any other issuances approved by the holders of a majority of the Series A Preferred Stock then outstanding.

The "Effective Price" of Additional Shares of Common Stock shall mean the quotient determined by dividing the total number of Additional Shares of Common Stock issued or sold, or deemed to have been issued or sold by the Company under this Section 4(f), into the aggregate consideration received, or deemed to have been received by the Company for such issue under this Section 4(f), for such Additional Shares of Common Stock.

5. Other Distributions.

In the event the Corporation provides the holders of its Common Stock with consideration that is not otherwise addressed in Section 4 (including, without limitation, declaring a distribution payable in securities, assets, cash or evidences of indebtedness issued by other persons or the Corporation (excluding cash dividends declared and paid by the Corporation out of retained earnings)), then, in each such case, the holders of the Series A Preferred Stock shall be entitled to a pro rata share of any such distribution as though such holders were holders of the number of shares of Common Stock of the Corporation as though the Series A Preferred Stock had been converted in whole as of the record date fixed for the determination of the holders of Common Stock of the Corporation entitled to receive such distribution.

6. Recapitalizations.

If at any time there occurs a recapitalization of the Common Stock (other than a subdivision, combination, or merger or sale of assets provided for in Section 4 hereof), the holders of the Series A Preferred Stock shall be entitled to receive upon conversion of the Series A Preferred Stock the number of shares of capital stock or other securities or property of the Corporation or otherwise to which a holder of the Common Stock deliverable upon conversion would have been entitled on such recapitalization. In any such case, appropriate adjustment shall be made in the application of the provisions of Section 4 hereof with respect to the rights of the holders of the Series A Preferred Stock after the recapitalization to the end that the provisions of Section 4 hereof (including adjustment of the Conversion Price then in effect and the number of shares purchasable upon conversion of the Series A Preferred Stock) shall be applicable after that event as nearly equivalent as may be practicable.

7. No Impairment.

The Corporation will not, by amendment of the Certificate of Incorporation or through any reorganization, recapitalization, transfer of assets, consolidation, merger, dissolution, issuance or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions hereof and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Right of the holders of the Series A Preferred Stock against impairment.

8. No Fractional Shares and Certificate as to Adjustments.

(a) No fractional shares of Common Stock will be issued upon the conversion of any share or shares of the Series A Preferred Stock. All shares of Common Stock (including fractions thereof) issuable upon conversion of more than one share of Series A Preferred Stock by a holder shall be aggregated for purposes of determining whether the conversion would result in the issuance of any fractional share. If, after the aforementioned aggregation, the conversion would result in the issuance of a fraction of a share of Common Stock, the Corporation shall, in lieu of issuing any fractional share, pay the holder otherwise entitled to such fraction a sum in cash equal to such fraction multiplied by the closing price of the Corporation's Common Stock on the Nasdaq National Market (or any other national securities exchange on which the Common

Stock is then traded) on the day immediately preceding the conversion. All calculations under Section 4 hereof and this Section 8(a) shall be made to the nearest cent or to the nearest share, as the case may be.

(b) Upon the occurrence of each adjustment or readjustment of the Conversion Price pursuant to Section 4 hereof, the Corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each holder of shares of Series A Preferred Stock a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the written request at any time of any holder of Series A Preferred Stock, use its reasonable best efforts to furnish or cause to be furnished to such holder a like certificate setting forth (i) such adjustment or readjustment, (ii) the Conversion Price at the time in effect, and (iii) the number of shares of Common Stock and the amount, if any, of other property which at the time would be received upon the conversion of a share of Series A Preferred Stock.

9. Reservation of Stock Issuable Upon Conversion.

The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock, solely for the purpose of effecting the conversion of the shares of the Series A Preferred Stock, such number of its shares of Common Stock that shall from time to time be sufficient to effect the conversion of all outstanding shares of the Series A Preferred Stock; and if at any time the number of authorized but unissued shares of Common Stock not otherwise reserved for issuance shall not be sufficient to effect the conversion of all then outstanding shares of the Series A Preferred Stock, the Corporation shall take such corporate action that may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite stockholder approval of any necessary amendment to its Certificate of Incorporation.

10. Notices.

Any notice required by the provisions hereof to be given to the holders of shares of Series A Preferred Stock shall be given in writing and shall be deemed to have been given (i) in the case of personal or hand delivery, on the date of such delivery, (ii) in the case of an internationally-recognized overnight delivery courier, on the second business day after the date when sent, (iii) in the case of mailing, on the fifth business day following that day on which the piece of mail containing such communication is posted and (iv) in the case of facsimile transmission, the date of telephone confirmation of receipt.

11. Voting Rights.

Holders of Series A Preferred Stock shall be entitled to vote on all matters submitted to a vote of the holders of the Corporation's Common Stock, including with respect to the election of directors of the Corporation, on an as if converted to Common Stock basis; provided, however, that the number of votes to which the Series A Preferred Stock is entitled shall be based on a conversion price of $5.50 per share, giving effect to any future adjustments pursuant to Section

4(e) above, but without giving any effect to any future adjustments pursuant to Section 4(f) above.

12. Protective Provisions.

Subject to the rights of any series of preferred stock that may from time to time come into existence, so long as any shares of Series A Preferred Stock are outstanding, the Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then-outstanding shares of Series A Preferred Stock, voting separately as a series:

(a) amend its Certificate of Incorporation (including the filing of a Certificate of Designations) so as to (i) increase the number of authorized shares of the Corporation's preferred stock or (ii) affect adversely the shares of Series A Preferred Stock or any holder thereof, including, without limitation, by creating any additional series of preferred stock (or issuing shares under any such series) that is senior or pari passu in liquidation preference, redemption right, conversion rights or right of payment to the Series A Preferred Stock;

(b) after the date of this Certificate of Designation, create any new debt instrument or create or increase any new or existing bank line (or similar arrangement pursuant to which the Company is or becomes indebted), so that the Company's total indebtedness pursuant to such instruments, lines or arrangements exceeds $105,000,000 in the aggregate; or

(c) change the rights of the holders of the Series A Preferred Stock in any other respect;

provided, however, that the authorization and issuance of additional shares of Common Stock, and creation of any series of preferred stock (or issuing shares under any such series) that is junior in right of payment upon liquidation, redemption, conversion and payment rights and otherwise to the Series A Preferred Stock shall not be deemed to adversely affect the rights, preferences or privileges of the Series A Preferred Stock or any holder thereof or change the rights of the holders of the Series A Preferred Stock in any other respect.

The Series A Preferred Stock shall have no preemptive rights pursuant hereto.

13. Legend.

The Series A Preferred Stock and any underlying shares of Common Stock will be issued under an exemption or exemptions from registration under the Act. Accordingly, the certificates evidencing the Series A Preferred Stock and the underlying Common Stock shall, upon issuance, contain a legend, substantially in the form as follows:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE STATE SECURITIES LAWS AND NO INTEREST HEREIN MAY BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS (1) A REGISTRATION STATEMENT WITH RESPECT TO SUCH SECURITIES SHALL BE EFFECTIVE UNDER

THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS OR (2) SUCH SECURITIES ARE TRANSFERRED PURSUANT TO RULE 144 PROMULGATED UNDER THE ACT (OR ANY SUCCESSOR RULE) OR (3) THE ISSUER OF THESE SECURITIES SHALL HAVE RECEIVED AN OPINION OF COUNSEL FOR THE HOLDER OF THESE SECURITIES REASONABLY SATISFACTORY TO THE ISSUER THAT NO VIOLATION OF THE ACT OR SIMILAR STATE SECURITIES LAWS WILL BE INVOLVED IN SUCH TRANSFER.

14. Status of Converted Stock.

In the event any shares of Series A Preferred Stock shall be converted pursuant to Section 4 hereof, the shares so converted shall be canceled and shall not be reissuable by the Corporation.

[Signature page follows]

IN WITNESS WHEREOF, said Wireless Facilities, Inc. has caused this Certificate of Designations to be signed by Masood K. Tayebi, its Chief Executive Officer, as of October 29, 2001.

WIRELESS FACILITIES, INC.

By: /s/ Masood K. Tayebi

Name: Masood K. Tayebi
Title: Chief Executive Officer

FORM OF CERTIFICATE OF DESIGNATIONS
CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS
of
SERIES B PREFERRED STOCK
of
WIRELESS FACILITIES, INC.

I, Masood K. Tayebi, Chief Executive Officer of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation" or the "Company")), in accordance with the provisions of Section 151 of the Delaware General Corporation Law, DO HEREBY CERTIFY:

That pursuant to the authority conferred upon the Board of Directors of the Corporation (the "Board of Directors") by the Certificate of Incorporation of the Corporation and by Section 151(g) of the Delaware General Corporation Law, on May 16, 2002, the Board of Directors adopted the following resolution, creating a series of shares of convertible preferred stock, Series B, designated as "Series B Preferred Stock":

"RESOLVED, that pursuant to the authority vested in the Board of Directors (the "Board of Directors") of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), by the Certificate of Incorporation of the Corporation (the "Certificate of Incorporation"), the Board of Directors does hereby provide for the authorization and issuance of a series of convertible preferred stock, Series B, par value U.S.$0.001 per share, of the Corporation, to be designated "Series B Preferred Stock," initially consisting of 90,000 shares, and to the extent that the designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions of the Series B Preferred Stock are not stated and expressed in the Certificate of Incorporation, the Board of Directors does hereby fix and herein state and express such designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions thereof, as follows:

1. Designation and Rank.

(a) Ninety thousand (90,000) shares of the preferred stock of the Corporation, par value $0.001 per share, shall be designated and known as the "Series B Preferred Stock."

(b) The Series B Preferred Stock shall rank senior and prior to the common stock, par value U.S.$0.001 per share, of the Corporation (the "Common Stock"), and all other classes or series of the capital stock (other than preferred stock) of the Corporation (now or hereafter authorized or issued), with respect to the payment of any dividends, the conversion rights set forth herein and any payment upon liquidation or redemption. The Series B Preferred Stock shall rank on par with the Series A Preferred Stock of the Corporation with respect to the payment of any dividends, the conversion rights set forth herein and any payment upon liquidation or redemption. The Corporation may not issue any additional classes or series of preferred stock with liquidation, redemption or conversion rights or right of payment of any kind that is senior to the Series B Preferred Stock, except pursuant to Section 12.

2. Dividend Rights.

From and after the date hereof, when and if the Board of Directors declares a dividend or distribution payable with respect to the then-outstanding shares of Common Stock (other than in additional shares of Common Stock or Common Stock Equivalents (as defined in Section 4(e)(i) below), the holders of the Series B Preferred Stock shall be entitled to the amount of dividends per share in the same form as such Common Stock dividends that would be payable on the largest number of whole shares of Common Stock into which a holder's aggregate shares of Series B Preferred Stock could then be converted pursuant to Section 4 hereof (such number to be determined as of the record date for the determination of holders of Common Stock entitled to receive such dividend).

3. Liquidation Rights.

(a) Liquidation Events. The occurrence of any of the following events shall be deemed a "Liquidation": (i) any liquidation, dissolution, or winding-up of the affairs of the Corporation; (ii) any transaction or series of related transactions in which securities of the Corporation representing 50% or more of the combined voting power of the Corporation's then outstanding voting securities are acquired by a person, entity or group of related persons or entities, excluding any consolidation or merger effected exclusively to change the domicile of the Corporation; (iii) any consolidation, merger or reorganization of the Corporation with or into any other corporation or other entity or person pursuant to which the holders of the Corporation's outstanding securities receive, pursuant to such transaction, securities in the surviving entity that represent less than 50% of the voting power of such surviving entity; or (iv) any sale, lease, exclusive license or other disposition of all or substantially all of the assets of the Corporation.

(b) Liquidation Preference.

(i) In the event of any Liquidation, whether voluntary or involuntary, before any payment of cash or distribution of other property shall be made to the holders of Common Stock, or any other class or series of stock subordinate in liquidation preference to the Series B Preferred Stock, the holders of the Series B Preferred Stock shall be entitled to receive out of the assets of the Corporation legally available for distribution to its stockholders, on behalf of each share of Series B Preferred Stock held by such holder, U.S.$500.00 (the "Original Issue Price") (as appropriately adjusted for any combinations, divisions, or similar recapitalizations affecting the Series B Preferred Stock after issuance) and all accumulated or accrued and unpaid dividends thereon (collectively, the "Series B Liquidation Preference").

(ii) If, upon any Liquidation, the assets of the Corporation available for distribution to its stockholders are insufficient to pay the holders of the Series B Preferred Stock the full amounts to which they are entitled pursuant to clause (b)(i) above, the holders of the Series B Preferred Stock shall share pro rata in any distribution of assets in proportion to the respective amounts which would be payable to the holders of the Series B Preferred Stock and any other class or series of capital stock of the Corporation ranking on par with the Series B Preferred Stock in respect of the shares held by them if all amounts payable to them in respect of such were paid in full pursuant to clause (b)(i) above.

(iii) After the distributions described in clause (b)(i) or (b)(ii) above have been paid, subject to the rights of any other class or series of capital stock of the Corporation that may from time to time come into existence, the remaining assets of the Corporation available for distribution to stockholders shall be distributed among the holders of Common Stock pro rata based on the number of shares of Common Stock held by each.

(c) Non-Cash Distributions. If any distribution to be made pursuant to this Section 3 is to be paid other than in cash or Common Stock or Common Stock Equivalents, the value of such distribution will be deemed its fair market value as determined in good faith by the Board of Directors. Any securities shall be valued as follows:

(i) Securities not subject to investment letter or other similar restrictions on free marketability covered by clause (ii) below:

(1) if traded on a securities exchange or through the Nasdaq National Market, the value shall be deemed to be the average of the closing prices of the securities on such quotation system over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation;

(2) if actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sale prices (whichever is applicable) over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation; and

(3) if there is no active public market, the value shall be the fair market value thereof, as determined by the Board of Directors.

(ii) The method of valuation of securities subject to investment letter or other restrictions on free marketability (other than restrictions arising solely by virtue of a stockholder's status as an affiliate or former affiliate) shall be to effectuate an appropriate discount from the market value, as determined by clause (i)(1), (2) or (3) of this Section 3(c), so as to reflect the approximate fair market value thereof, as determined by the Board of Directors.

(iii) The holders of at least a majority of the outstanding Series B Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 3(c), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

4. Conversion Rights.

The holders of the Series B Preferred Stock shall have conversion rights as follows (the "Conversion Right"):

(a) Conversion Price. The "Conversion Price" shall, initially, be U.S.$5.00 per share and shall be subject to adjustment as set forth below in Sections 4(e) and 4(f).

(b) Automatic Conversion. If the closing price for the shares of the Corporation's Common Stock (trading on a securities exchange or through Nasdaq National Market or other national exchange or market) exceeds $11.00 per share (as adjusted for events described in Section 4(e)(ii) and 4(e)(iii) below) for any thirty consecutive trading day period that begins after February 28, 2005, then, upon such occurrence, each share of Series B Preferred Stock shall be automatically converted into such number of fully paid and non-assessable shares of Common Stock as is determined by dividing (x) the Original Issue Price of such share of Series B Preferred Stock (including any accumulated or accrued but unpaid dividends thereon) by (y) the Conversion Price. The date of such conversion is herein referred to as the "Conversion Date."

(c) Optional Conversion. The holders of the Series B Preferred Stock shall have the right, at any time, to convert the shares of Series B Preferred Stock held by such holder into that number of shares of Common Stock into which such shares are convertible pursuant to Section 4(b) ("Optional Conversion"). In the event of any Optional Conversion, the date of such conversion shall be referred to as the "Optional Conversion Date."

(d) Mechanics of Conversion. On the Conversion Date or Optional Conversion Date, as the case may be, (x) each holder shall tender such holder's shares of Series B Preferred Stock to the Corporation for cancellation, free and clear of encumbrances of any type or nature, and (y) the Corporation shall cause to be delivered to such holder a number of shares of Common Stock as calculated pursuant to Section 4(b) above, free and clear of encumbrances of any type or nature. Each holder and the Corporation shall take all other necessary or appropriate actions in connection with or to effect such closing.

(e) Certain Adjustments. To the extent that the holders of Series B Preferred Stock do not participate fully with other stockholders of the Corporation with respect to dividends paid pursuant to Section 2 hereof, the following adjustments shall be made to the Conversion Price:

(i) Adjustment for Common Stock Dividends and Distributions. If, at any time after the original issue date of the Series B Preferred Stock (the "Original Issue Date"), the Corporation makes, or fixes a record date for the determination of holders of Common Stock entitled to receive, a dividend or other distribution payable in additional shares of Common Stock or Common Stock Equivalents, in each such event the Conversion Price that is then in effect shall be decreased as of the time of such issuance or, in the event such record date is fixed, as of the close of business on such record date, by multiplying the Conversion Price then in effect by a fraction (i) the numerator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date, and (ii) the denominator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date plus the number of shares of Common Stock or Common Stock Equivalents issuable in payment of such dividend or distribution; provided, however, that if such record date is fixed and such dividend is not fully paid or if such distribution is not fully made on the date fixed therefor, the Conversion Price shall be recomputed accordingly as of the close of business on such record date and thereafter the Conversion Price shall be adjusted pursuant to this Section 4(e)(i) to reflect the actual payment of such dividend or distribution.

A "Common Stock Equivalent" shall mean each share of Common Stock into which securities or property or rights are convertible, exchangeable or exercisable for or into shares of Common Stock, or otherwise entitle the holder thereof to receive directly or indirectly, any of the foregoing.

(ii) Adjustments for Stock Splits, Stock Subdivisions and Combinations. If, at any time after the Original Issue Date, the Corporation subdivides or combines the Common Stock without making a corresponding subdivision or combination of the Series B Preferred Stock, (A) in the case of a subdivision (including a stock split), the Conversion Price in effect immediately prior to such event shall be proportionately decreased and the number of shares of Common Stock purchasable thereunder shall be proportionately increased, and (B) in the case of a combination (including a reverse stock split), the Conversion Price in effect immediately prior to such event shall be proportionately increased and the number of shares of Common Stock purchasable thereunder shall be proportionately decreased. Any adjustment under this Section 4(e)(ii) shall become effective at the close of business on the date the subdivision or combination becomes effective.

(iii) Adjustments for Reclassification, Reorganization and Consolidation. In case of (A) any reclassification, reorganization, change or conversion of securities of the class issuable upon conversion of the Series B Preferred Stock (other than a change in par value, or from par value to no par value) into other shares or securities of the Corporation, or (B) any merger or consolidation of the Corporation with or into another entity (other than a Liquidation or a merger or consolidation with another entity in which the Corporation is the acquiring and the surviving entity and that does not result in any reclassification or change of outstanding securities issuable upon conversion of the Series B Preferred Stock) each holder of shares of Series B Preferred Stock shall have the right to receive, in lieu of the shares of Common Stock otherwise issuable upon the conversion of its shares of Series B Preferred Stock (and accumulated or accrued and unpaid dividends then-outstanding thereunder) in accordance with Section 4(b), the kind and amount of shares of stock and other securities, money and property receivable upon such reclassification, reorganization, change, merger or consolidation upon conversion by a holder of the maximum number of shares of Common Stock into which such shares of Series B Preferred Stock could have been converted immediately prior to such reclassification, reorganization, change, merger or consolidation, all subject to further adjustment as provided herein or with respect to such other securities or property by the terms thereof. The provisions of this clause (iii) shall similarly attach to successive reclassifications, reorganizations, changes, mergers and consolidations.

(f) Antidilution Adjustments. To the extent that (i) the Corporation issues after the Original Issue Date and before November 28, 2003, Additional Shares of Common Stock (as defined below) (in one or more transactions, whether or not related), (ii) each such issuance is at an Effective Price (as defined below) per share less than Conversion Price then in effect and (iii) the aggregate gross proceeds of such issuances exceed $15 million, then the Conversion Price shall be adjusted to equal the lowest Effective Price received by the Corporation pursuant to any such issuance. The previous sentence will apply to any issuances of Additional Shares of Common Stock after the $15 million threshold has been met (provided any such issuance is below the Conversion Price then in effect) but will not apply to any issuance of Additional

Shares of Common Stock occurring after November 28, 2003. Notwithstanding the foregoing, the Conversion Price shall in no event be lower than U.S.$[4.17].

(i) For the purpose of making any adjustment required under Section 4(f), the consideration received by the Company for any issue or sale of securities shall (A) to the extent it consists of cash, be computed at the net amount of cash received by the Company after deduction of any underwriting or similar commissions, compensation or concessions paid or allowed by the Company in connection with such issue or sale but without deduction of any expenses payable by the Company (except for purposes of determining if the $15 million threshold referred to above has been met, in which case the consideration received will be deemed to be the aggregate gross proceeds received by the Company), (B) to the extent it consists of property other than cash, be computed at the fair value of that property as determined in good faith by the Board of Directors, and (C) if Additional Shares of Common Stock, Convertible Securities (as defined below) or rights or options to purchase either Additional Shares of Common Stock or Convertible Securities are issued or sold together with other stock or securities or other assets of the Company for a consideration which covers both, be computed as the portion of the consideration so received that may be reasonably determined in good faith by the Board of Directors to be allocable to such Additional Shares of Common Stock, Convertible Securities or rights or options; provided, however, that the holders of at least a majority of the outstanding Series B Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 4(f)(i), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

(ii) For the purpose of the adjustment required under this Section 4(f), if the Company issues or sells (A) stock or other securities convertible into, Additional Shares of Common Stock (such convertible stock or securities being herein referred to as "Convertible Securities") or (B) rights or options for the purchase of Additional Shares of Common Stock or Convertible Securities and if the Effective Price of such Additional Shares of Common Stock is less than the Conversion Price, in each case the Company shall be deemed to have issued at the time of the issuance of such rights or options or Convertible Securities the maximum number of Additional Shares of Common Stock issuable upon exercise or conversion thereof and to have received as consideration for the issuance of such shares an amount equal to the total amount of the consideration, if any, received by the Company for the issuance of such rights or options or Convertible Securities, plus, in the case of such rights or options, the minimum amounts of consideration, if any, payable to the Company upon the exercise of such rights or options, plus, in the case of Convertible Securities, the minimum amounts of consideration, if any, payable to the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) upon the conversion thereof; provided that if in the case of Convertible Securities the minimum amounts of such consideration cannot be ascertained, but are a function of antidilution or similar protective clauses, the Company shall be deemed to have received the minimum amounts of consideration without reference to such clauses; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of rights, options or Convertible Securities is reduced over time or on the occurrence or non-occurrence of specified events other than by reason of antidilution adjustments, the Effective Price shall be recalculated using the figure to which such minimum amount of consideration is

reduced; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities is subsequently increased, the Effective Price shall be again recalculated using the increased minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities. No further adjustment of the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be made as a result of the actual issuance of Additional Shares of Common Stock on the exercise of any such rights or options or the conversion of any such Convertible Securities. If any such rights or options or the conversion privilege represented by any such Convertible Securities shall expire without having been exercised, the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be readjusted to the Conversion Price which would have been in effect had an adjustment been made on the basis that the only Additional Shares of Common Stock so issued were the Additional Shares of Common Stock, if any, actually issued or sold on the exercise of such rights or options or rights of conversion of such Convertible Securities, and such Additional Shares of Common Stock, if any, were issued or sold for the consideration actually received by the Company upon such exercise, plus the consideration, if any, actually received by the Company for the granting of all such rights or options, whether or not exercised, plus the consideration received for issuing or selling the Convertible Securities actually converted, plus the consideration, if any, actually received by the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) on the conversion of such Convertible Securities.

"Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Company or deemed to be issued pursuant to this Section 4(f), whether or not subsequently reacquired or retired by the Company other than (A) shares of Common Stock and/or options, warrants or other Common Stock purchase rights, and the Common Stock issued or issuable pursuant to such options, warrants or other rights to employees, officers or directors of, or consultants or advisors to the Company or any subsidiary pursuant to stock purchase or stock option plans or other arrangements that are approved by the Board; (B) shares of Common Stock issued or issuable pursuant to any equipment loan or leasing arrangement, or debt financing from a bank or similar financial institution; (C) shares of Common Stock issued or issuable in connection with licensing transactions involving the Company and other entities, including (1) joint ventures, manufacturing, marketing or distribution arrangements or (2) technology transfer or development arrangements; provided that such transactions in (1) and (2) and the issuance of shares therein has been approved by a majority of the members of the Company's Board of Directors and the aggregate number of shares so issued does not exceed four million (4,000,000)(as adjusted for stock splits, stock dividends, stock combinations, recapitalizatons and the like); and (D) any other issuances approved by the holders of a majority of the Series B Preferred Stock then outstanding.

The "Effective Price" of Additional Shares of Common Stock shall mean the quotient determined by dividing the total number of Additional Shares of Common Stock issued or sold, or deemed to have been issued or sold by the Company under this Section 4(f), into the aggregate consideration received, or deemed to have been received by the Company for such issue under this Section 4(f), for such Additional Shares of Common Stock.

5. Other Distributions.

In the event the Corporation provides the holders of its Common Stock with consideration that is not otherwise addressed in Section 4 (including, without limitation, declaring a distribution payable in securities, assets, cash or evidences of indebtedness issued by other persons or the Corporation (excluding cash dividends declared and paid by the Corporation out of retained earnings)), then, in each such case, the holders of the Series B Preferred Stock shall be entitled to a pro rata share of any such distribution as though such holders were holders of the number of shares of Common Stock of the Corporation as though the Series B Preferred Stock had been converted in whole as of the record date fixed for the determination of the holders of Common Stock of the Corporation entitled to receive such distribution.

6. Recapitalizations.

If at any time there occurs a recapitalization of the Common Stock (other than a subdivision, combination, or merger or sale of assets provided for in Section 4 hereof), the holders of the Series B Preferred Stock shall be entitled to receive upon conversion of the Series B Preferred Stock the number of shares of capital stock or other securities or property of the Corporation or otherwise to which a holder of the Common Stock deliverable upon conversion would have been entitled on such recapitalization. In any such case, appropriate adjustment shall be made in the application of the provisions of Section 4 hereof with respect to the rights of the holders of the Series B Preferred Stock after the recapitalization to the end that the provisions of Section 4 hereof (including adjustment of the Conversion Price then in effect and the number of shares purchasable upon conversion of the Series B Preferred Stock) shall be applicable after that event as nearly equivalent as may be practicable.

7. No Impairment.

The Corporation will not, by amendment of the Certificate of Incorporation or through any reorganization, recapitalization, transfer of assets, consolidation, merger, dissolution, issuance or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions hereof and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Right of the holders of the Series B Preferred Stock against impairment.

8. No Fractional Shares and Certificate as to Adjustments.

(a) No fractional shares of Common Stock will be issued upon the conversion of any share or shares of the Series B Preferred Stock. All shares of Common Stock (including fractions thereof) issuable upon conversion of more than one share of Series B Preferred Stock by a holder shall be aggregated for purposes of determining whether the conversion would result in the issuance of any fractional share. If, after the aforementioned aggregation, the conversion would result in the issuance of a fraction of a share of Common Stock, the Corporation shall, in lieu of issuing any fractional share, pay the holder otherwise entitled to such fraction a sum in cash equal to such fraction multiplied by the closing price of the Corporation's Common Stock on the Nasdaq National Market (or any other national securities exchange on which the Common

Stock is then traded) on the day immediately preceding the conversion. All calculations under Section 4 hereof and this Section 8(a) shall be made to the nearest cent or to the nearest share, as the case may be.

(b) Upon the occurrence of each adjustment or readjustment of the Conversion Price pursuant to Section 4 hereof, the Corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each holder of shares of Series B Preferred Stock a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the written request at any time of any holder of Series B Preferred Stock, use its reasonable best efforts to furnish or cause to be furnished to such holder a like certificate setting forth (i) such adjustment or readjustment, (ii) the Conversion Price at the time in effect, and (iii) the number of shares of Common Stock and the amount, if any, of other property which at the time would be received upon the conversion of a share of Series B Preferred Stock.

9. Reservation of Stock Issuable Upon Conversion.

The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock, solely for the purpose of effecting the conversion of the shares of the Series B Preferred Stock, such number of its shares of Common Stock that shall from time to time be sufficient to effect the conversion of all outstanding shares of the Series B Preferred Stock; and if at any time the number of authorized but unissued shares of Common Stock not otherwise reserved for issuance shall not be sufficient to effect the conversion of all then outstanding shares of the Series B Preferred Stock, the Corporation shall take such corporate action that may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite stockholder approval of any necessary amendment to its Certificate of Incorporation.

10. Notices.

Any notice required by the provisions hereof to be given to the holders of shares of Series B Preferred Stock shall be given in writing and shall be deemed to have been given (i) in the case of personal or hand delivery, on the date of such delivery, (ii) in the case of an internationally-recognized overnight delivery courier, on the second business day after the date when sent, (iii) in the case of mailing, on the fifth business day following that day on which the piece of mail containing such communication is posted, and (iv) in the case of facsimile transmission, the date of telephone confirmation of receipt.

11. Voting Rights.

Holders of Series B Preferred Stock shall be entitled to vote on all matters submitted to a vote of the holders of the Corporation's Common Stock, including with respect to the election of directors of the Corporation, on an as if converted to Common Stock basis; provided, however, that the number of votes to which the Series B Preferred Stock is entitled shall be based on a conversion price of $5.00 per share, giving effect to any future adjustments pursuant to Section

4(e) above, but without giving any effect to any future adjustments pursuant to Section 4(f) above.

12. Protective Provisions.

Subject to the rights of any series of preferred stock that may from time to time come into existence, so long as any shares of Series B Preferred Stock are outstanding, the Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then-outstanding shares of Series B Preferred Stock, voting separately as a series:

(a) amend its Certificate of Incorporation (including the filing of a Certificate of Designations) so as to (i) increase the number of authorized shares of the Corporation's preferred stock or (ii) affect adversely the shares of Series B Preferred Stock or any holder thereof, including, without limitation, by creating any additional series of preferred stock (or issuing shares under any such series) that is senior or pari passu in liquidation preference, redemption right, conversion rights or right of payment to the Series B Preferred Stock;

(b) after the date of this Certificate of Designation, create any new debt instrument or create or increase any new or existing bank line (or similar arrangement pursuant to which the Company is or becomes indebted), so that the Company's total indebtedness pursuant to such instruments, lines or arrangements exceeds $105,000,000 in the aggregate; or

(c) change the rights of the holders of the Series B Preferred Stock in any other respect;

provided, however, that the authorization and issuance of additional shares of Common Stock, and creation of any series of preferred stock (or issuing shares under any such series) that is junior in right of payment upon liquidation, redemption, conversion and payment rights and otherwise to the Series B Preferred Stock shall not be deemed to adversely affect the rights, preferences or privileges of the Series B Preferred Stock or any holder thereof or change the rights of the holders of the Series B Preferred Stock in any other respect.

The Series B Preferred Stock shall have no preemptive rights pursuant hereto.

13. Legend.

The Series B Preferred Stock and any underlying shares of Common Stock will be issued under an exemption or exemptions from registration under the Act. Accordingly, the certificates evidencing the Series B Preferred Stock and the underlying Common Stock shall, upon issuance, contain a legend, substantially in the form as follows:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE STATE SECURITIES LAWS AND NO INTEREST HEREIN MAY BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS (1) A REGISTRATION STATEMENT WITH RESPECT TO SUCH SECURITIES SHALL BE EFFECTIVE UNDER

THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS OR (2) SUCH SECURITIES ARE TRANSFERRED PURSUANT TO RULE 144 PROMULGATED UNDER THE ACT (OR ANY SUCCESSOR RULE) OR (3) THE ISSUER OF THESE SECURITIES SHALL HAVE RECEIVED AN OPINION OF COUNSEL FOR THE HOLDER OF THESE SECURITIES REASONABLY SATISFACTORY TO THE ISSUER THAT NO VIOLATION OF THE ACT OR SIMILAR STATE SECURITIES LAWS WILL BE INVOLVED IN SUCH TRANSFER.

14. Status of Converted Stock.

In the event any shares of Series B Preferred Stock shall be converted pursuant to Section 4 hereof, the shares so converted shall be canceled and shall not be reissuable by the Corporation.

[Signature page follows]

IN WITNESS WHEREOF, said Wireless Facilities, Inc. has caused this Certificate of Designations to be signed by Masood K. Tayebi, its Chief Executive Officer, as of May 28, 2002.

WIRELESS FACILITIES, INC.

By:/s/Masood K. Tayebi

Name: Masood K. Tayebi
Title: Chief Executive Officer

CERTIFICATE OF CORRECTION OF THE CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS OF SERIES B PREFERRED STOCK OF WIRELESS FACILITIES, INC.

WIRELESS FACILITIES, INC. (the ***"Corporation"***), a corporation organized and existing under and by virtue of the Delaware General Corporation Law, DOES HEREBY CERTIFY:

1. The name of the Corporation is Wireless Facilities, Inc.

1. The instrument being corrected is entitled: Certificate of Designations, Preferences and Rights of Series B Preferred Stock of Wireless Facilities, Inc., which was filed on May 30, 2002 with the Secretary of State of the State of Delaware (the ***"Certificate of Designations"***).

2. The caption for the second paragraph was inadvertently omitted. The caption should be inserted to read "FIRST:".

3. Article 1, Section 4(f) of the Certificate of Designations had a typographical error. The dollar amount in the last sentence should be U.S.$4.17 not U.S.$4.72.

5. The penultimate paragraph was inadvertently omitted. It should read in its entirety as follows:

> "SECOND: That the authorization of, and the filing of this Certificate of Designations relating to, the Series B Preferred Stock has been duly approved by the holders of the Company's Series A Preferred Stock in accordance with the Company's Amended and Restated Certificate of Incorporation, as amended by the Certificate of Designations filed on October 29, 2001, and Section 242 of the Delaware General Corporation Law."

6. The Certificate of Designations, Preferences and Rights of Series B Preferred Stock, as corrected, is set forth in its entirety as **Exhibit A** hereto.

IN WITNESS WHEREOF, Wireless Facilities, Inc., acting pursuant to Section 103(f) of the Delaware General Corporation Law, has caused this Corrected Certificate of Designations, Preferences and Rights of Series B Preferred Stock to be signed by its Vice President, Legal Affairs, General Counsel and Secretary this 30th day of May, 2002.

Wireless Facilities, Inc.

By: /s/ Wm. Bradford Weller
Wm. Bradford Weller
Vice President, Legal Affairs, General Counsel and Secretary

CORRECTED
FORM OF CERTIFICATE OF DESIGNATIONS
CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS
of
SERIES B PREFERRED STOCK
of
WIRELESS FACILITIES, INC.

I, Masood K. Tayebi, Chief Executive Officer of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation" or the "Company")), in accordance with the provisions of Section 151 of the Delaware General Corporation Law, DO HEREBY CERTIFY:

FIRST: That pursuant to the authority conferred upon the Board of Directors of the Corporation (the "Board of Directors") by the Certificate of Incorporation of the Corporation and by Section 151(g) of the Delaware General Corporation Law, on May 16, 2002, the Board of Directors adopted the following resolution, creating a series of shares of convertible preferred stock, Series B, designated as "Series B Preferred Stock":

"RESOLVED, that pursuant to the authority vested in the Board of Directors (the "Board of Directors") of WIRELESS FACILITIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), by the Certificate of Incorporation of the Corporation (the "Certificate of Incorporation"), the Board of Directors does hereby provide for the authorization and issuance of a series of convertible preferred stock, Series B, par value U.S.$0.001 per share, of the Corporation, to be designated "Series B Preferred Stock," initially consisting of 90,000 shares, and to the extent that the designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions of the Series B Preferred Stock are not stated and expressed in the Certificate of Incorporation, the Board of Directors does hereby fix and herein state and express such designations, powers, preferences, and relative participating, optional, or other special rights, and the qualifications, limitations, and restrictions thereof, as follows:

1. Designation and Rank.

(a) Ninety thousand (90,000) shares of the preferred stock of the Corporation, par value $0.001 per share, shall be designated and known as the "Series B Preferred Stock."

(b) The Series B Preferred Stock shall rank senior and prior to the common stock, par value U.S.$0.001 per share, of the Corporation (the "Common Stock"), and all other classes or series of the capital stock (other than preferred stock) of the Corporation (now or hereafter authorized or issued), with respect to the payment of any dividends, the conversion rights set forth herein and any payment upon liquidation or redemption. The Series B Preferred Stock shall rank on par with the Series A Preferred Stock of the Corporation with respect to the payment of any dividends, the conversion rights set forth herein and any payment upon liquidation or redemption. The Corporation may not issue any additional classes or series of preferred stock with liquidation, redemption or conversion rights or right of payment of any kind that is senior to the Series B Preferred Stock, except pursuant to Section 12.

2. Dividend Rights.

From and after the date hereof, when and if the Board of Directors declares a dividend or distribution payable with respect to the then-outstanding shares of Common Stock (other than in additional shares of Common Stock or Common Stock Equivalents (as defined in Section 4(e)(i) below), the holders of the Series B Preferred Stock shall be entitled to the amount of dividends per share in the same form as such Common Stock dividends that would be payable on the largest number of whole shares of Common Stock into which a holder's aggregate shares of Series B Preferred Stock could then be converted pursuant to Section 4 hereof (such number to be determined as of the record date for the determination of holders of Common Stock entitled to receive such dividend).

3. Liquidation Rights.

(a) Liquidation Events. The occurrence of any of the following events shall be deemed a "Liquidation": (i) any liquidation, dissolution, or winding-up of the affairs of the Corporation; (ii) any transaction or series of related transactions in which securities of the Corporation representing 50% or more of the combined voting power of the Corporation's then outstanding voting securities are acquired by a person, entity or group of related persons or entities, excluding any consolidation or merger effected exclusively to change the domicile of the Corporation; (iii) any consolidation, merger or reorganization of the Corporation with or into any other corporation or other entity or person pursuant to which the holders of the Corporation's outstanding securities receive, pursuant to such transaction, securities in the surviving entity that represent less than 50% of the voting power of such surviving entity; or (iv) any sale, lease, exclusive license or other disposition of all or substantially all of the assets of the Corporation.

(b) Liquidation Preference.

(i) In the event of any Liquidation, whether voluntary or involuntary, before any payment of cash or distribution of other property shall be made to the holders of Common Stock, or any other class or series of stock subordinate in liquidation preference to the Series B Preferred Stock, the holders of the Series B Preferred Stock shall be entitled to receive out of the assets of the Corporation legally available for distribution to its stockholders, on behalf of each share of Series B Preferred Stock held by such holder, U.S.$500.00 (the "Original Issue Price") (as appropriately adjusted for any combinations, divisions, or similar recapitalizations affecting the Series B Preferred Stock after issuance) and all accumulated or accrued and unpaid dividends thereon (collectively, the "Series B Liquidation Preference").

(ii) If, upon any Liquidation, the assets of the Corporation available for distribution to its stockholders are insufficient to pay the holders of the Series B Preferred Stock the full amounts to which they are entitled pursuant to clause (b)(i) above, the holders of the Series B Preferred Stock shall share pro rata in any distribution of assets in proportion to the respective amounts which would be payable to the holders of the Series B Preferred Stock and any other class or series of capital stock of the Corporation ranking on par with the Series B Preferred Stock in respect of the shares held by them if all amounts payable to them in respect of such were paid in full pursuant to clause (b)(i) above.

(iii) After the distributions described in clause (b)(i) or (b)(ii) above have been paid, subject to the rights of any other class or series of capital stock of the Corporation that may from time to time come into existence, the remaining assets of the Corporation available for distribution to stockholders shall be distributed among the holders of Common Stock pro rata based on the number of shares of Common Stock held by each.

(c) Non-Cash Distributions. If any distribution to be made pursuant to this Section 3 is to be paid other than in cash or Common Stock or Common Stock Equivalents, the value of such distribution will be deemed its fair market value as determined in good faith by the Board of Directors. Any securities shall be valued as follows:

(i) Securities not subject to investment letter or other similar restrictions on free marketability covered by clause (ii) below:

(1) if traded on a securities exchange or through the Nasdaq National Market, the value shall be deemed to be the average of the closing prices of the securities on such quotation system over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation;

(2) if actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sale prices (whichever is applicable) over the thirty (30) trading day period ending three (3) trading days prior to the occurrence of the Liquidation; and

(3) if there is no active public market, the value shall be the fair market value thereof, as determined by the Board of Directors.

(ii) The method of valuation of securities subject to investment letter or other restrictions on free marketability (other than restrictions arising solely by virtue of a stockholder's status as an affiliate or former affiliate) shall be to effectuate an appropriate discount from the market value, as determined by clause (i)(1), (2) or (3) of this Section 3(c), so as to reflect the approximate fair market value thereof, as determined by the Board of Directors.

(iii) The holders of at least a majority of the outstanding Series B Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 3(c), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

4. Conversion Rights.

The holders of the Series B Preferred Stock shall have conversion rights as follows (the "Conversion Right"):

(a) Conversion Price. The "Conversion Price" shall, initially, be U.S.$5.00 per share and shall be subject to adjustment as set forth below in Sections 4(e) and 4(f).

(b) Automatic Conversion. If the closing price for the shares of the Corporation's Common Stock (trading on a securities exchange or through Nasdaq National Market or other national exchange or market) exceeds $11.00 per share (as adjusted for events described in Section 4(e)(ii) and 4(e)(iii) below) for any thirty consecutive trading day period that begins after February 28, 2005, then, upon such occurrence, each share of Series B Preferred Stock shall be automatically converted into such number of fully paid and non-assessable shares of Common Stock as is determined by dividing (x) the Original Issue Price of such share of Series B Preferred Stock (including any accumulated or accrued but unpaid dividends thereon) by (y) the Conversion Price. The date of such conversion is herein referred to as the "Conversion Date."

(c) Optional Conversion. The holders of the Series B Preferred Stock shall have the right, at any time, to convert the shares of Series B Preferred Stock held by such holder into that number of shares of Common Stock into which such shares are convertible pursuant to Section 4(b) ("Optional Conversion"). In the event of any Optional Conversion, the date of such conversion shall be referred to as the "Optional Conversion Date."

(d) Mechanics of Conversion. On the Conversion Date or Optional Conversion Date, as the case may be, (x) each holder shall tender such holder's shares of Series B Preferred Stock to the Corporation for cancellation, free and clear of encumbrances of any type or nature, and (y) the Corporation shall cause to be delivered to such holder a number of shares of Common Stock as calculated pursuant to Section 4(b) above, free and clear of encumbrances of any type or nature. Each holder and the Corporation shall take all other necessary or appropriate actions in connection with or to effect such closing.

(e) Certain Adjustments. To the extent that the holders of Series B Preferred Stock do not participate fully with other stockholders of the Corporation with respect to dividends paid pursuant to Section 2 hereof, the following adjustments shall be made to the Conversion Price:

(i) Adjustment for Common Stock Dividends and Distributions. If, at any time after the original issue date of the Series B Preferred Stock (the "Original Issue Date"), the Corporation makes, or fixes a record date for the determination of holders of Common Stock entitled to receive, a dividend or other distribution payable in additional shares of Common Stock or Common Stock Equivalents, in each such event the Conversion Price that is then in effect shall be decreased as of the time of such issuance or, in the event such record date is fixed, as of the close of business on such record date, by multiplying the Conversion Price then in effect by a fraction (i) the numerator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date, and (ii) the denominator of which is the total number of shares of Common Stock and Common Stock Equivalents issued and outstanding immediately prior to the time of such issuance or the close of business on such record date plus the number of shares of Common Stock or Common Stock Equivalents issuable in payment of such dividend or distribution; provided, however, that if such record date is fixed and such dividend is not fully paid or if such distribution is not fully made on the date fixed therefor, the Conversion Price shall be recomputed accordingly as of the close of business on such record date and thereafter the Conversion Price shall be adjusted pursuant to this Section 4(e)(i) to reflect the actual payment of such dividend or distribution.

A "Common Stock Equivalent" shall mean each share of Common Stock into which securities or property or rights are convertible, exchangeable or exercisable for or into shares of Common Stock, or otherwise entitle the holder thereof to receive directly or indirectly, any of the foregoing.

(ii) Adjustments for Stock Splits, Stock Subdivisions and Combinations. If, at any time after the Original Issue Date, the Corporation subdivides or combines the Common Stock without making a corresponding subdivision or combination of the Series B Preferred Stock, (A) in the case of a subdivision (including a stock split), the Conversion Price in effect immediately prior to such event shall be proportionately decreased and the number of shares of Common Stock purchasable thereunder shall be proportionately increased, and (B) in the case of a combination (including a reverse stock split), the Conversion Price in effect immediately prior to such event shall be proportionately increased and the number of shares of Common Stock purchasable thereunder shall be proportionately decreased. Any adjustment under this Section 4(e)(ii) shall become effective at the close of business on the date the subdivision or combination becomes effective.

(iii) Adjustments for Reclassification, Reorganization and Consolidation. In case of (A) any reclassification, reorganization, change or conversion of securities of the class issuable upon conversion of the Series B Preferred Stock (other than a change in par value, or from par value to no par value) into other shares or securities of the Corporation, or (B) any merger or consolidation of the Corporation with or into another entity (other than a Liquidation or a merger or consolidation with another entity in which the Corporation is the acquiring and the surviving entity and that does not result in any reclassification or change of outstanding securities issuable upon conversion of the Series B Preferred Stock) each holder of shares of Series B Preferred Stock shall have the right to receive, in lieu of the shares of Common Stock otherwise issuable upon the conversion of its shares of Series B Preferred Stock (and accumulated or accrued and unpaid dividends then-outstanding thereunder) in accordance with Section 4(b), the kind and amount of shares of stock and other securities, money and property receivable upon such reclassification, reorganization, change, merger or consolidation upon conversion by a holder of the maximum number of shares of Common Stock into which such shares of Series B Preferred Stock could have been converted immediately prior to such reclassification, reorganization, change, merger or consolidation, all subject to further adjustment as provided herein or with respect to such other securities or property by the terms thereof. The provisions of this clause (iii) shall similarly attach to successive reclassifications, reorganizations, changes, mergers and consolidations.

(f) Antidilution Adjustments. To the extent that (i) the Corporation issues after the Original Issue Date and before November 30, 2003, Additional Shares of Common Stock (as defined below) (in one or more transactions, whether or not related), (ii) each such issuance is at an Effective Price (as defined below) per share less than Conversion Price then in effect and (iii) the aggregate gross proceeds of such issuances exceed $15 million, then the Conversion Price shall be adjusted to equal the lowest Effective Price received by the Corporation pursuant to any such issuance. The previous sentence will apply to any issuances of Additional Shares of Common Stock after the $15 million threshold has been met (provided any such issuance is below the Conversion Price then in effect) but will not apply to any issuance of Additional

Shares of Common Stock occurring after November 30, 2003. Notwithstanding the foregoing, the Conversion Price shall in no event be lower than U.S.$4.17.

(i) For the purpose of making any adjustment required under Section 4(f), the consideration received by the Company for any issue or sale of securities shall (A) to the extent it consists of cash, be computed at the net amount of cash received by the Company after deduction of any underwriting or similar commissions, compensation or concessions paid or allowed by the Company in connection with such issue or sale but without deduction of any expenses payable by the Company (except for purposes of determining if the $15 million threshold referred to above has been met, in which case the consideration received will be deemed to be the aggregate gross proceeds received by the Company), (B) to the extent it consists of property other than cash, be computed at the fair value of that property as determined in good faith by the Board of Directors, and (C) if Additional Shares of Common Stock, Convertible Securities (as defined below) or rights or options to purchase either Additional Shares of Common Stock or Convertible Securities are issued or sold together with other stock or securities or other assets of the Company for a consideration which covers both, be computed as the portion of the consideration so received that may be reasonably determined in good faith by the Board of Directors to be allocable to such Additional Shares of Common Stock, Convertible Securities or rights or options; provided, however, that the holders of at least a majority of the outstanding Series B Preferred Stock shall have the right to challenge any determination by the Board of Directors of fair market value pursuant to this Section 4(f)(i), in which case the determination of fair market value shall be made by an independent appraiser selected jointly by the Board of Directors and the challenging parties, the cost of such appraisal to be borne equally by the Corporation and the challenging parties.

(ii) For the purpose of the adjustment required under this Section 4(f), if the Company issues or sells (A) stock or other securities convertible into, Additional Shares of Common Stock (such convertible stock or securities being herein referred to as "Convertible Securities") or (B) rights or options for the purchase of Additional Shares of Common Stock or Convertible Securities and if the Effective Price of such Additional Shares of Common Stock is less than the Conversion Price, in each case the Company shall be deemed to have issued at the time of the issuance of such rights or options or Convertible Securities the maximum number of Additional Shares of Common Stock issuable upon exercise or conversion thereof and to have received as consideration for the issuance of such shares an amount equal to the total amount of the consideration, if any, received by the Company for the issuance of such rights or options or Convertible Securities, plus, in the case of such rights or options, the minimum amounts of consideration, if any, payable to the Company upon the exercise of such rights or options, plus, in the case of Convertible Securities, the minimum amounts of consideration, if any, payable to the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) upon the conversion thereof; provided that if in the case of Convertible Securities the minimum amounts of such consideration cannot be ascertained, but are a function of antidilution or similar protective clauses, the Company shall be deemed to have received the minimum amounts of consideration without reference to such clauses; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of rights, options or Convertible Securities is reduced over time or on the occurrence or non-occurrence of specified events other than by reason of antidilution adjustments, the Effective Price shall be recalculated using the figure to which such minimum amount of consideration is

reduced; provided further that if the minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities is subsequently increased, the Effective Price shall be again recalculated using the increased minimum amount of consideration payable to the Company upon the exercise or conversion of such rights, options or Convertible Securities. No further adjustment of the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be made as a result of the actual issuance of Additional Shares of Common Stock on the exercise of any such rights or options or the conversion of any such Convertible Securities. If any such rights or options or the conversion privilege represented by any such Convertible Securities shall expire without having been exercised, the Conversion Price, as adjusted upon the issuance of such rights, options or Convertible Securities, shall be readjusted to the Conversion Price which would have been in effect had an adjustment been made on the basis that the only Additional Shares of Common Stock so issued were the Additional Shares of Common Stock, if any, actually issued or sold on the exercise of such rights or options or rights of conversion of such Convertible Securities, and such Additional Shares of Common Stock, if any, were issued or sold for the consideration actually received by the Company upon such exercise, plus the consideration, if any, actually received by the Company for the granting of all such rights or options, whether or not exercised, plus the consideration received for issuing or selling the Convertible Securities actually converted, plus the consideration, if any, actually received by the Company (other than by cancellation of liabilities or obligations evidenced by such Convertible Securities) on the conversion of such Convertible Securities.

"Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Company or deemed to be issued pursuant to this Section 4(f), whether or not subsequently reacquired or retired by the Company other than (A) shares of Common Stock and/or options, warrants or other Common Stock purchase rights, and the Common Stock issued or issuable pursuant to such options, warrants or other rights to employees, officers or directors of, or consultants or advisors to the Company or any subsidiary pursuant to stock purchase or stock option plans or other arrangements that are approved by the Board; (B) shares of Common Stock issued or issuable pursuant to any equipment loan or leasing arrangement, or debt financing from a bank or similar financial institution; (C) shares of Common Stock issued or issuable in connection with licensing transactions involving the Company and other entities, including (1) joint ventures, manufacturing, marketing or distribution arrangements or (2) technology transfer or development arrangements; provided that such transactions in (1) and (2) and the issuance of shares therein has been approved by a majority of the members of the Company's Board of Directors and the aggregate number of shares so issued does not exceed four million (4,000,000)(as adjusted for stock splits, stock dividends, stock combinations, recapitalizatons and the like); and (D) any other issuances approved by the holders of a majority of the Series B Preferred Stock then outstanding.

The "Effective Price" of Additional Shares of Common Stock shall mean the quotient determined by dividing the total number of Additional Shares of Common Stock issued or sold, or deemed to have been issued or sold by the Company under this Section 4(f), into the aggregate consideration received, or deemed to have been received by the Company for such issue under this Section 4(f), for such Additional Shares of Common Stock.

5. Other Distributions.

In the event the Corporation provides the holders of its Common Stock with consideration that is not otherwise addressed in Section 4 (including, without limitation, declaring a distribution payable in securities, assets, cash or evidences of indebtedness issued by other persons or the Corporation (excluding cash dividends declared and paid by the Corporation out of retained earnings)), then, in each such case, the holders of the Series B Preferred Stock shall be entitled to a pro rata share of any such distribution as though such holders were holders of the number of shares of Common Stock of the Corporation as though the Series B Preferred Stock had been converted in whole as of the record date fixed for the determination of the holders of Common Stock of the Corporation entitled to receive such distribution.

6. Recapitalizations.

If at any time there occurs a recapitalization of the Common Stock (other than a subdivision, combination, or merger or sale of assets provided for in Section 4 hereof), the holders of the Series B Preferred Stock shall be entitled to receive upon conversion of the Series B Preferred Stock the number of shares of capital stock or other securities or property of the Corporation or otherwise to which a holder of the Common Stock deliverable upon conversion would have been entitled on such recapitalization. In any such case, appropriate adjustment shall be made in the application of the provisions of Section 4 hereof with respect to the rights of the holders of the Series B Preferred Stock after the recapitalization to the end that the provisions of Section 4 hereof (including adjustment of the Conversion Price then in effect and the number of shares purchasable upon conversion of the Series B Preferred Stock) shall be applicable after that event as nearly equivalent as may be practicable.

7. No Impairment.

The Corporation will not, by amendment of the Certificate of Incorporation or through any reorganization, recapitalization, transfer of assets, consolidation, merger, dissolution, issuance or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions hereof and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Right of the holders of the Series B Preferred Stock against impairment.

8. No Fractional Shares and Certificate as to Adjustments.

(a) No fractional shares of Common Stock will be issued upon the conversion of any share or shares of the Series B Preferred Stock. All shares of Common Stock (including fractions thereof) issuable upon conversion of more than one share of Series B Preferred Stock by a holder shall be aggregated for purposes of determining whether the conversion would result in the issuance of any fractional share. If, after the aforementioned aggregation, the conversion would result in the issuance of a fraction of a share of Common Stock, the Corporation shall, in lieu of issuing any fractional share, pay the holder otherwise entitled to such fraction a sum in cash equal to such fraction multiplied by the closing price of the Corporation's Common Stock on the Nasdaq National Market (or any other national securities exchange on which the Common

Stock is then traded) on the day immediately preceding the conversion. All calculations under Section 4 hereof and this Section 8(a) shall be made to the nearest cent or to the nearest share, as the case may be.

(b) Upon the occurrence of each adjustment or readjustment of the Conversion Price pursuant to Section 4 hereof, the Corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each holder of shares of Series B Preferred Stock a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the written request at any time of any holder of Series B Preferred Stock, use its reasonable best efforts to furnish or cause to be furnished to such holder a like certificate setting forth (i) such adjustment or readjustment, (ii) the Conversion Price at the time in effect, and (iii) the number of shares of Common Stock and the amount, if any, of other property which at the time would be received upon the conversion of a share of Series B Preferred Stock.

9. Reservation of Stock Issuable Upon Conversion.

The Corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock, solely for the purpose of effecting the conversion of the shares of the Series B Preferred Stock, such number of its shares of Common Stock that shall from time to time be sufficient to effect the conversion of all outstanding shares of the Series B Preferred Stock; and if at any time the number of authorized but unissued shares of Common Stock not otherwise reserved for issuance shall not be sufficient to effect the conversion of all then outstanding shares of the Series B Preferred Stock, the Corporation shall take such corporate action that may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite stockholder approval of any necessary amendment to its Certificate of Incorporation.

10. Notices.

Any notice required by the provisions hereof to be given to the holders of shares of Series B Preferred Stock shall be given in writing and shall be deemed to have been given (i) in the case of personal or hand delivery, on the date of such delivery, (ii) in the case of an internationally-recognized overnight delivery courier, on the second business day after the date when sent, (iii) in the case of mailing, on the fifth business day following that day on which the piece of mail containing such communication is posted, and (iv) in the case of facsimile transmission, the date of telephone confirmation of receipt.

11. Voting Rights.

Holders of Series B Preferred Stock shall be entitled to vote on all matters submitted to a vote of the holders of the Corporation's Common Stock, including with respect to the election of directors of the Corporation, on an as if converted to Common Stock basis; provided, however, that the number of votes to which the Series B Preferred Stock is entitled shall be based on a conversion price of $5.00 per share, giving effect to any future adjustments pursuant to Section

4(e) above, but without giving any effect to any future adjustments pursuant to Section 4(f) above.

12. Protective Provisions.

Subject to the rights of any series of preferred stock that may from time to time come into existence, so long as any shares of Series B Preferred Stock are outstanding, the Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then-outstanding shares of Series B Preferred Stock, voting separately as a series:

(a) amend its Certificate of Incorporation (including the filing of a Certificate of Designations) so as to (i) increase the number of authorized shares of the Corporation's preferred stock or (ii) affect adversely the shares of Series B Preferred Stock or any holder thereof, including, without limitation, by creating any additional series of preferred stock (or issuing shares under any such series) that is senior or pari passu in liquidation preference, redemption right, conversion rights or right of payment to the Series B Preferred Stock;

(b) after the date of this Certificate of Designation, create any new debt instrument or create or increase any new or existing bank line (or similar arrangement pursuant to which the Company is or becomes indebted), so that the Company's total indebtedness pursuant to such instruments, lines or arrangements exceeds $105,000,000 in the aggregate; or

(c) change the rights of the holders of the Series B Preferred Stock in any other respect;

provided, however, that the authorization and issuance of additional shares of Common Stock, and creation of any series of preferred stock (or issuing shares under any such series) that is junior in right of payment upon liquidation, redemption, conversion and payment rights and otherwise to the Series B Preferred Stock shall not be deemed to adversely affect the rights, preferences or privileges of the Series B Preferred Stock or any holder thereof or change the rights of the holders of the Series B Preferred Stock in any other respect.

The Series B Preferred Stock shall have no preemptive rights pursuant hereto.

13. Legend.

The Series B Preferred Stock and any underlying shares of Common Stock will be issued under an exemption or exemptions from registration under the Act. Accordingly, the certificates evidencing the Series B Preferred Stock and the underlying Common Stock shall, upon issuance, contain a legend, substantially in the form as follows:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE STATE SECURITIES LAWS AND NO INTEREST HEREIN MAY BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS (1) A REGISTRATION STATEMENT WITH RESPECT TO SUCH SECURITIES SHALL BE EFFECTIVE UNDER

THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS OR (2) SUCH SECURITIES ARE TRANSFERRED PURSUANT TO RULE 144 PROMULGATED UNDER THE ACT (OR ANY SUCCESSOR RULE) OR (3) THE ISSUER OF THESE SECURITIES SHALL HAVE RECEIVED AN OPINION OF COUNSEL FOR THE HOLDER OF THESE SECURITIES REASONABLY SATISFACTORY TO THE ISSUER THAT NO VIOLATION OF THE ACT OR SIMILAR STATE SECURITIES LAWS WILL BE INVOLVED IN SUCH TRANSFER.

14. Status of Converted Stock.

In the event any shares of Series B Preferred Stock shall be converted pursuant to Section 4 hereof, the shares so converted shall be canceled and shall not be reissuable by the Corporation.

SECOND: That the authorization of, and the filing of this Certificate of Designations relating to, the Series B Preferred Stock has been duly approved by the holders of the Company's Series A Preferred Stock in accordance with the Company's Amended and Restated Certificate of Incorporation, as amended by the Certificate of Designations filed on October 29, 2001, and Section 242 of the Delaware General Corporation Law.

[Signature page follows]

IN WITNESS WHEREOF, said Wireless Facilities, Inc. has caused this Certificate of Designations to be signed by Masood K. Tayebi, its Chief Executive Officer, as of May 30, 2002.

WIRELESS FACILITIES, INC.

By: /s/ Masood K. Tayebi

Name: Masood K. Tayebi
Title: Chief Executive Officer

CERTIFICATE OF DESIGNATION
OF THE
SERIES C PREFERRED STOCK
OF
WIRELESS FACILITIES, INC.

Pursuant to Section 151 of the General Corporation Law of the State of Delaware

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The undersigned officers of Wireless Facilities, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "*Corporation*"), in accordance with the provisions of Section 103 thereof, **DO HEREBY CERTIFY**:

That, pursuant to the authority conferred upon the Board of Directors of the Corporation by its Amended and Restated Certificate of Incorporation (the "*Certificate*"), the said Board of Directors unanimously adopted the following resolution by written consent on December 16, 2004, which resolution remains in full force and effect on the date hereof, creating a series of Preferred Stock having a par value of $0.001 per share, designated as Series C Preferred Stock (the "*Series C Preferred Stock*") out of the Corporation's shares of preferred stock of the par value of $0.001 per share (the "*Preferred Stock*"):

RESOLVED, that pursuant to the authority vested in the Board of Directors in accordance with the provisions of its Certificate, the Board of Directors does hereby create, authorize and provide for 1,200,000 shares of its authorized Preferred Stock to be designated and issued as the Series C Preferred Stock, having the voting powers, designation, relative, participating, optional and other special rights, preferences and qualifications, limitations and restrictions that are set forth as follows:

2. Voting Rights. The holders of one one-hundredth (1/100) of a share (a "*Unit*") of Series C Preferred Stock shall have the following voting rights:

(A) Subject to the provision for adjustment hereinafter set forth, each Unit of Series C Preferred Stock shall entitle the holder thereof to one vote on all matters submitted to a vote of the stockholders of the Corporation. In the event the Corporation shall, at any time after the December 16, 2004 (the "*Rights Declaration Date*"), (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the number of votes per Unit to which holders of Units of Series C Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction (y) the numerator of which shall be the number of shares of Common Stock outstanding immediately after such event and (z) the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event; and

(B) Except as otherwise provided herein, in the Certificate or the Bylaws of the Corporation or as required by law, the holders of Units of Series C Preferred Stock and the holders of shares of Common Stock shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation.

3. Reacquired Shares. Any Units of Series C Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and cancelled promptly after the acquisition thereof. All such Units shall, upon their cancellation, become authorized but unissued shares (or fractions of shares) of Preferred Stock and may be reissued as part of a new series of Preferred Stock to be created by resolution or resolutions of the Board of Directors, subject to the conditions and restrictions on issuance set forth herein.

4. Liquidation, Dissolution or Winding Up. (A) Upon any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, no distribution shall be made (i) to the holders of shares of junior stock, unless the holders of Units of Series C Preferred Stock shall have received, subject to adjustment as hereinafter provided in paragraph (B), the greater of either (a) $0.01 per Unit plus an amount equal to accrued and unpaid dividends and distributions thereon to the date of such payment, or (b) the amount equal to the aggregate per share amount to be distributed to holders of shares of Common Stock, or (ii) to the holders of shares of parity stock, unless simultaneously therewith distributions are made ratably on Units of Series C Preferred Stock and all other shares of such parity stock in proportion to the total amounts to which the holders of Units of Series C Preferred Stock are entitled under clause (i)(a) of this sentence and to which the holders of shares of such parity stock are entitled, in each case upon such liquidation, dissolution or winding up.

(B) In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock, or (iii) combine outstanding shares of Common Stock into a smaller number of shares, then in each such case the aggregate amount to which holders of Units of Series C Preferred Stock were entitled immediately prior to such event pursuant to clause (i)(b) of paragraph (A) of this Section 3 shall be adjusted by multiplying such amount by a fraction (y) the numerator of which shall be the number of shares of Common Stock that are outstanding immediately after such event and (z) the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

6. Consolidation, Merger, etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or converted into other stock or securities, cash and/or any other property, then in any such case Units of Series C Preferred Stock shall at the same time be similarly exchanged for or converted into an amount per Unit (subject to the provision for adjustment hereinafter set forth) equal to the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is converted or exchanged. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide outstanding shares of Common Stock, or (iii) combine outstanding Common Stock into a smaller number of shares, then in each such case the amount set forth in

the immediately preceding sentence with respect to the exchange or conversion of Units of Series C Preferred Stock shall be adjusted by multiplying such amount by a fraction (y) the numerator of which shall be the number of shares of Common Stock that are outstanding immediately after such event and (z) the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

7. Redemption. The Units of Series C Preferred Stock and shares of Series C Preferred Stock shall not be redeemable.

8. Ranking. The Units of Series C Preferred Stock and shares of Series C Preferred Stock shall rank junior to all other series and any other class of Preferred Stock (now or hereafter authorized or issued by the Corporation) as to the payment of dividends, conversion, redemption or liquidation rights and the distribution of assets, unless the terms of any such series or class shall provide otherwise.

9. Fractional Shares. The Series C Preferred Stock may be issued in Units or other fractions of a share, which Units or fractions shall entitle the holder, in proportion to such holder's units or fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series C Preferred Stock.

10. Amendment. At any time when any Units of Series C Preferred Stock are outstanding, neither the Certificate of the Corporation nor this Certificate of Designation shall be amended in any manner that would materially alter or change the powers, preferences or special rights of the Units of Series C Preferred Stock so as to affect them adversely without the affirmative vote of the holders of a majority or more of the outstanding Units of Series C Preferred Stock, voting separately as a class.

11. Certain Definitions. As used in this resolution with respect to the Series C Preferred Stock, the following terms shall have the following meanings:

(A) The term "Common Stock" shall mean the class of stock designated as the common stock, par value $0.001 per share, of the Corporation at the date hereof or any other class of stock resulting from successive changes or reclassification of the common stock.

(B) The term "junior stock" shall mean the Common Stock and any other class or series of capital stock of the Corporation over which the Series C Preferred Stock has preference or priority in the distribution of assets on any liquidation, dissolution or winding up of the Corporation.

(C) The term "parity stock" shall mean any class or series of capital stock ranking *pari passu* with the Series C Preferred Stock in the distribution of assets on any liquidation, dissolution or winding up.

IN WITNESS WHEREOF, Wireless Facilities, Inc. has caused this Certificate of Designation to be signed by its Chief Executive Officer and President and its Sr. Vice President and Chief Financial Officer this 16th day of December, 2004.

WIRELESS FACILITIES, INC.

By: /s/Eric M. DeMarco

Name: Eric M. DeMarco

Title: *Chief Executive Officer and President*

By: /s/Deanna H. Lund

Name: Deanna H. Lund

Title: *Senior Vice President and Chief Financial Officer*

CERTIFICATE OF CHANGE OF LOCATION OF REGISTERED OFFICE AND OF REGISTERED AGENT OF

WIRELESS FACILITIES, INC.

It is hereby certified that:

1. The name of the corporation (hereinafter called the "corporation") is:

WIRELESS FACILITIES, INC.

1. The registered office of the corporation within the State of Delaware is hereby changed to 2711 Centerville Road, Suite 400, City of Wilmington 19808, County of New Castle.

2. The registered agent of the corporation within the State of Delaware is hereby changed to Corporation Service Company, the business office of which is identical with the registered office of the corporation as hereby changed.

3. The corporation has authorized the changes hereinbefore set forth by resolution of its Board of Directors.

Signed on May 2, 2005.

Name: /s/James R. Edwards
Title: Senior Vice President

CERTIFICATE OF OWNERSHIP AND MERGER
OF
KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
(A DELAWARE CORPORATION)
INTO
WIRELESS FACILITIES, INC.
(A DELAWARE CORPORATION)

It is hereby certified that:

1. Wireless Facilities, Inc. (hereinafter sometimes. referred to as the “Corporation”) is a business corporation of the State of Delaware.
2. The Corporation is the owner of all of the outstanding shares of the common stock of Kratos Defense & Security Solutions, Inc. which is also a business corporation of the State of Delaware.
3. On September 5, 2007, the Board of Directors of the Corporation adopted the following resolutions to merge Kratos Defense & Security Solutions, Inc. into the Corporation:

NOW THEREFORE, BE IT RESOLVED, that Kratos Defense & Security Solutions, Inc. be merged into this Corporation, and that all of the estate, property, rights, privileges, powers and franchises of Kratos Defense & Security Solutions, Inc. be vested in and held and enjoyed by this Corporation as fully and entirely and without change or diminution as the same were before held and enjoyed by Kratos Defense & Security Solutions, Inc. in its name;

RESOLVED FURTHER, that this Corporation shall assume all of the obligations of Kratos Defense & Security Solutions, Inc.;

RESOLVED FURTHER, that this Corporation shall cause to be executed and filed and/or recorded the documents prescribed by the laws of the State of Delaware and by the laws of any other appropriate jurisdiction and will cause to be performed all necessary acts within the State of Delaware and within any other appropriate jurisdiction;

RESOLVED FURTHER, that this Corporation shall change its corporate name to Kratos Defense & Security Solutions, Inc.;

RESOLVED FURTHER, that the effective time of the Certificate of Ownership and Merger setting forth a copy of these resolutions, and the time when the merger therein provided for, shall become effective shall be September 12, 2007.

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Executed on September 7th, 2007

WIRELESS FACILITIES, INC.

By: /s/ James R. Edwards

CERTIFICATE OF AMENDMENT TO
AMENDED AND RESTATED CERTIFICATE OF INCORPORATION
OF
KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

Kratos Defense & Security Solutions, Inc., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the “Corporation”), does hereby certify:

FIRST: The name under which the Corporation was originally incorporated was Wireless Facilities, Inc.

SECOND: The date on which the Certificate of Incorporation of the Corporation was originally filed with the Secretary of State of the State of Delaware was July 7, 1997.

THIRD: The Board of Directors of the Corporation, acting in accordance with the provisions of Section 141 and 142 of the General Corporation Law of the State of Delaware adopted resolutions to amend paragraph (A) of ARTICLE IV of the Amended and Restated Certificate of Incorporation of the Corporation to read in its entirety as follows:

> “A. This corporation is authorized to issue two classes of stock to be designated, respectively, “Common Stock” and “Preferred Stock.” The total number of shares which the corporation is authorized to issue is two hundred million (200,000,000) shares. One hundred ninety five million (195,000,000) shares shall be Common Stock, each having a par value of one tenth of one cent ($0.001). Five million (5,000,000) shares shall be Preferred Stock, each having a par value of one tenth of one cent ($0.001). Effective as of 5:00 p.m., Eastern Time, on the date this Certificate of Amendment to Amended and Restated Certificate of Incorporation is filed with the Secretary of State of the State of Delaware, each ten (10) shares of this corporation’s Common Stock, par value $0.001 per share, issued and outstanding shall, automatically and without any action on the part of the respective holders thereof, be combined and converted into one (1) share of Common Stock, par value $0.001 per share, of this corporation. No fractional shares shall be issued and, in lieu thereof, any holder of less than one share of Common Stock shall be entitled to receive cash for such holder’s fractional share based upon the fair market value of the Common Stock as of the date this Certificate of Amendment is filed with the Secretary of State of the State of Delaware as determined by this corporation’s Board of Directors.”

FOURTH: This Certificate of Amendment to Amended and Restated Certificate of Incorporation was submitted to the stockholders of the Corporation and was duly approved by the required vote of the stockholders of the Corporation in accordance with Sections 222 and 242 of the Delaware General Corporation Law.

IN WITNESS WHEREOF, Kratos Defense & Security Solutions, Inc. has caused this Certificate of Amendment to be signed by its Executive Vice President and Chief Financial Officer as of September 10, 2009.

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

CERTIFICATE OF OWNERSHIP AND MERGER MERGING
ACQUISITION CO. LANZA PARENT
(a Delaware corporation) WITH AND INTO
KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
(a Delaware corporation) April4 , 2011

Pursuant to Section 253 of the General Corporation Law of the State of Delaware (the "DGCL"), Kratos Defense & Security Solutions, Inc., a Delaware corporation (the "Company"), hereby certifies the following information relating to the merger (the "Merger") of Acquisition Co. Lanza Parent, a Delaware corporation (the "Sub"), with and into the Company:

1. The Company is the owner of 100% of the outstanding shares of common stock, par value $0.00 l per share (the "Common Stock") of Sub. The Common Stock constitutes the sole outstanding class of capital stock of Sub.

2. The board of directors of the Company, at a meeting held on March 10, 2011, duly adopted the resolutions attached hereto as Exhibit A, which have not been amended or rescinded and are now in full force and effect, to merge Sub with and into the Company, with the Company being the surviving corporation (the "Surviving Corporation").

3. The Merger shall become effective upon the filing of this Certificate of Ownership and Merger.

[Remainder of this page intentionally left blank]

IN WITNESS WHEREOF , the Company has caused this Certificate of Ownership and Merger to be executed by its duly authorized officer on the date first written above.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

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

SECOND AMENDED AND RESTATED

BYLAWS

OF

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

a Delaware corporation

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SECOND AMENDED AND RESTATED
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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

ARTICLE 1

Offices

Section 1.1 Registered Office.

The registered office of the corporation in the State of Delaware shall be in the City of Dover, County of Kent.

Section 1.2 Other Offices.

The corporation may also have and maintain offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

ARTICLE 2

Stockholders' Meetings

Section 2.1 Place of Meetings.

(a) Meetings of the stockholders of the corporation shall be held at such place, either within or without the State of Delaware, as may be designated from time to time by the Board of Directors, or, if not so designated, then at the office of the corporation required to be maintained pursuant to Section 1.2 of Article I hereof. The Board of Directors may, in its sole discretion, determine that the meeting shall not be held at any place, but may instead be held solely by means of remote communication as authorized by paragraph (b) of this Section 2.1.

(b) If authorized by the Board of Directors in its sole discretion, and subject to such guidelines and procedures as the Board of Directors may adopt, stockholders and proxyholders not physically present at a meeting of stockholders may, by means of remote communication:

(1) Participate in a meeting of stockholders; and

(2) Be deemed present in person and vote at a meeting of stockholders whether such meeting is to be held at a designated place or solely by means of remote communication, provided that (A) the corporation shall implement reasonable measures to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a stockholder or proxyholder, (B) the corporation shall implement reasonable measures to provide such stockholders and proxyholders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings, and (C) if any stockholder or proxyholder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation.

(c) For purposes of this Section 2.1, "remote communication" shall include (1) telephone or other voice communications and (2) electronic mail or other form of written or visual electronic communications or transmission.

Section 2.2 Annual Meetings.

The annual meetings of the stockholders of the corporation, for the purpose of election of directors and for such other business as may lawfully come before it, shall be held on such date and at such time as may be designated from time to time by the Board of Directors.

Section 2.3 Special Meetings.

Special meetings of stockholders of the corporation may be called only by the Board of Directors pursuant to a resolution adopted by a majority of the total number of directors then in office.

Section 2.4 Notice of Meetings.

(a) Except as otherwise provided by law or the Certificate of Incorporation, written notice of each meeting of stockholders, specifying the place, if any, date and hour and purpose or purposes of the meeting, and the means of remote communication, if any, by which stockholders and proxyholders may be deemed to be present in person and vote at such meeting, shall be given not less than 10 nor more than 60 days before the date of the meeting to each stockholder entitled to vote thereat, directed to his address as it appears upon the books of the corporation.

(b) If at any meeting action is proposed to be taken which, if taken, would entitle stockholders fulfilling the requirements of section 262(d) of the Delaware General Corporation Law to an appraisal of the fair value of their shares, the notice of such meeting shall contain a statement of that purpose and to that effect and shall be accompanied by a copy of that statutory section.

(c) When a meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time, place, if any, thereof, and the means of remote communication, if any, by which stockholders and proxyholders may be deemed to be present in person and vote at such adjourned meeting, are announced at the meeting at which the adjournment is taken unless the adjournment is for more than 30 days, or unless after the adjournment a new record date is fixed for the adjourned meeting, in which event a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

(d) Notice of the time, place and purpose of any meeting of stockholders may be waived in writing, either before or after such meeting, and, to the extent permitted by law, will be waived by any stockholder by his attendance thereat, in person or by proxy. Any stockholder so waiving notice of such meeting shall be bound by the proceedings of any such meeting in all respects as if due notice thereof had been given.

(e) Without limiting the manner by which notice otherwise may be given effectively to stockholders, any notice to stockholders given by the corporation under any provision of Delaware General Corporation Law, the certificate of incorporation, or these Bylaws shall be effective if given by a form of electronic transmission consented to by the stockholder to whom the notice is given. Any such consent shall be revocable by the stockholder by written notice to the corporation. Any such consent shall be deemed revoked if (i) the corporation is unable to deliver by electronic transmission two consecutive notices given by the corporation in accordance with such consent, and (ii) such inability becomes known to the secretary or an assistant secretary of the corporation or to the transfer agent or other person responsible for the giving of notice; provided, however, the inadvertent failure to treat such inability as a revocation shall not invalidate any meeting or other action. Notice given pursuant to this subparagraph (e) shall be deemed given: (1) if by facsimile telecommunication, when directed to a number at which the stockholder has consented to receive notice; (2) if by electronic mail, when directed to an electronic mail address at which the stockholder has consented to receive notice; (3) if by a posting on an electronic network together with separate notice to the stockholder of such specific posting, upon the later of (A) such posting and (B) the giving of such separate notice; and (4) if by any other form of electronic transmission, when directed to the stockholder. An affidavit of the secretary or an assistant secretary or of the transfer agent or other agent of the corporation that the notice has been given by a form of electronic transmission shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of these Bylaws, "electronic transmission" means any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

Section 2.5 Quorum and Voting.

(a) At all meetings of stockholders except where otherwise provided by law, the Certificate of Incorporation or these Bylaws, the presence, in person or by proxy duly authorized, of the holders of a majority of the outstanding shares of stock entitled to vote shall constitute a quorum for the transaction of business. Shares, the voting of which at said meeting have been enjoined, or which for any reason cannot be lawfully voted at such meeting, shall not be counted to determine a quorum at said meeting. In the absence of a quorum, any meeting of stockholders may be adjourned, from time to time, by vote of the holders of a majority of the shares represented thereat, but no other business shall be transacted at such meeting. At such adjourned meeting at which a quorum is present or represented, any business may be transacted which might have been transacted at the original meeting. The stockholders present at a duly called or convened meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum.

(b) Except as otherwise provided by law, the Certificate of Incorporation or these Bylaws, all action taken by the holders of a majority of the voting power represented at any meeting at which a quorum is present shall be valid and binding upon the corporation.

(c) Where a separate vote by a class or classes is required, a majority of the outstanding shares of such class or classes present in person or represented by proxy shall constitute a quorum entitled to take action with respect to that vote on that matter, and the affirmative vote of the majority of shares of such class or classes present in person or represented by proxy at the meeting shall be the act of such class.

Section 2.6 Voting Rights.

(a) Except as otherwise provided by law, only persons in whose names shares entitled to vote stand on the stock records of the corporation on the record date for determining the stockholders entitled to vote at said meeting shall be entitled to vote at such meeting. Shares standing in the names of two or more persons shall be voted or represented in accordance with the determination of the majority of such persons, or, if only one of such persons is present in person or represented by proxy, such person shall have the right to vote such shares and such shares shall be deemed to be represented for the purpose of determining a quorum.

(b) Every person entitled to vote or to execute consents shall have the right to do so either in person or by an agent or agents authorized by a written proxy executed by such person or his duly authorized agent, which proxy shall be filed with the Secretary of the corporation at or before the meeting at which it is to be used. Said proxy so appointed need not be a stockholder. No proxy shall be voted on after three (3) years from its date unless the proxy provides for a longer period. Unless and until voted, every proxy shall be revocable at the pleasure of the person who executed it or of his legal representatives or assigns, except in those cases where an irrevocable proxy permitted by statute has been given.

(c) Without limiting the manner in which a stockholder may authorize another person or persons to act for him as proxy pursuant to subsection (b) of this section, the following shall constitute a valid means by which a stockholder may grant such authority:

(1) A stockholder may execute a writing authorizing another person or persons to act for him as proxy. Execution may be accomplished by the stockholder or his authorized officer, director, employee or agent signing such writing or causing his or her signature to be affixed to such writing by any reasonable means including, but not limited to, by facsimile signature.

(2) A stockholder may authorize another person or persons to act for him as proxy by transmitting or authorizing the transmission of a telephone or other means of electronic transmission to the person who will be the holder of the proxy or to a proxy solicitation firm, proxy support service organization or like agent duly authorized by the person who will be the holder of the proxy to receive such transmission, provided that any such telephone or other means of electronic transmission must either set forth or be submitted with information from which it can be determined that the telephone or other electronic transmission was authorized by the stockholder. Such authorization can be established by the signature of the stockholder on the proxy, either in writing or by a signature stamp or facsimile signature, or by a number or symbol from which the identity of the stockholder can be determined, or by any other procedure deemed appropriate by the inspectors or other persons making the determination as to due authorization. If it is determined that such electronic transmissions are valid, the inspectors or, if there are no inspectors, such other persons making that determination shall specify the information upon which they relied.

(d) Any copy, facsimile telecommunication or other reliable reproduction of the writing or transmission created pursuant to subsection (c) of this section may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy, facsimile telecommunication or other reproduction shall be a complete reproduction of the entire original writing or transmission.

Section 2.7 Voting Procedures and Inspectors of Elections.

(a) The corporation shall, in advance of any meeting of stockholders, appoint one or more inspectors to act at the meeting and make a written report thereof. The corporation may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of stockholders, the person presiding at the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his ability.

(b) The inspectors shall (i) ascertain the number of shares outstanding and the voting power of each, (ii) determine the shares represented at a meeting and the validity of proxies and ballots, (iii) count all votes and ballots, (iv) determine and retain for a reasonable period a record of the disposition of any challenges made to any determination by the inspectors, and (v) certify their determination of the number of shares represented at the meeting and their count of all votes and ballots. The inspectors may appoint or retain other persons or entities to assist the inspectors in the performance of the duties of the inspectors.

(c) The date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting shall be announced at the meeting. No ballot, proxies or votes, nor any revocations thereof or changes thereto, shall be accepted by the inspectors after the closing of the polls unless the Court of Chancery upon application by a stockholder shall determine otherwise.

(d) In determining the validity and counting of proxies and ballots, the inspectors shall be limited to an examination of the proxies, any envelopes submitted with those proxies, any information provided in accordance with Sections 211(e) or 212(c)(2) of the Delaware General Corporation Law, or any information provided pursuant to Section 211(a)(2)(B)(i) or (iii) thereof, ballots and the regular books and records of the corporation, except that the inspectors may consider other reliable information for the limited purpose of reconciling proxies and ballots submitted by or on behalf of banks, brokers, their nominees or similar persons which represent more votes than the holder of a proxy is authorized by the record owner to cast or more votes than the stockholder holds of record. If the inspectors consider other reliable information for the limited purpose permitted herein, the inspectors at the time they make their certification pursuant to subsection (b)(v) of this section shall specify the precise information considered by them including the person or persons from whom they obtained the information, when the information was obtained, the means by which the information was obtained and the basis for the inspectors' belief that such information is accurate and reliable.

Section 2.8 List of Stockholders.

The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at said meeting, arranged in alphabetical order, showing the address of and the number of shares registered in the name of each stockholder. The corporation need not include electronic mail addresses or other electronic contact information on such list. Such list shall be open to the examination of any stockholder for any purpose germane to the meeting for a period of at least 10 days prior to the meeting: (i) on a reasonably accessible electronic network, provided that the information required to gain access to such list is provided with the notice of the meeting, or (ii) during ordinary business hours at the principal place of business of the corporation. In the event that the corporation determines to make the list available on an electronic network, the corporation may take reasonable steps to ensure that such information is available only to stockholders of the corporation. If the meeting is to be held at a place, then the list shall be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present. If the meeting is to be held solely by means of remote communication, then the list shall also be open to the examination of any stockholder during the whole time of the meeting on a reasonably accessible electronic network, and the information required to access such list shall be provided with the notice of the meeting.

Section 2.9 Stockholder Proposals at Annual or Special Meetings.

At an annual or special meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before a meeting, business must be specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, otherwise properly brought before the meeting by or at the direction of the Board of Directors, or otherwise properly brought before the meeting by a stockholder, but, in the case of a special meeting, if and only if the notice of the meeting provides for business to be brought before the meeting by a stockholder. In addition to any other applicable requirements for business to be properly brought before a meeting by a stockholder, whether or not the stockholder is seeking to have a proposal included in the corporation's proxy statement or information statement under any applicable rule of the Securities and Exchange Commission (the "SEC"), including, but not limited to, Regulation 14A or Regulation 14C under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), the stockholder must have given timely notice thereof in writing to the Secretary of the corporation. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the corporation not less than 120 days prior to the date on which the corporation first mailed its proxy materials (or, in the absence of proxy materials, its notice of the meeting) for the previous year's annual meeting of stockholders (or not later than the tenth day following the date on which the corporation mails the notice of meeting for the current year if during the prior year the corporation did not hold an annual meeting or if the date of the annual meeting was changed more than 30 days from the prior year, or in the event of a special meeting).

A stockholder’s notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and record address of the stockholder proposing such business, (iii) the class and number of shares of the corporation which are beneficially owned by the stockholder, (iv) any material interest of the stockholder in such business, (v) as to the stockholder giving the notice and any Stockholder Associated Person (as defined below), whether and the extent to which any hedging or other transaction or series of transactions has been entered into by or on behalf of, or any other agreement, arrangement or understanding (including, but not limited to, any short position or any borrowing or lending of shares of stock) has been made, the effect or intent of which is to mitigate loss or increase profit to or manage the risk or benefit of stock price changes for, or to increase or decrease the voting power of, such stockholder or any such Stockholder Associated Person with respect to any share of stock of the corporation (each, a “Relevant Hedge Transaction”), and (vi) as to the stockholder giving the notice and any Stockholder Associated Person, to the extent not set forth pursuant to the immediately preceding clause, (a) whether and the extent to which such stockholder or Stockholder Associated Person has direct or indirect beneficial ownership of any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any class or series of shares of the corporation, whether or not such instrument or right shall be subject to settlement in the underlying class or series of capital stock of the corporation or otherwise, or any other direct or indirect opportunity to profit or share in any profit derived from any increase or decrease in the value of shares of the corporation (a “Derivative Instrument”), (b) any rights to dividends on the shares of the corporation owned beneficially by such stockholder that are separated or separable from the underlying shares of the corporation, (c) any proportionate interest in shares of the corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership in which such stockholder is a general partner or, directly or indirectly, beneficially owns an interest in a general partner and (d) any performance-related fees (other than an asset-based fee) that such stockholder is entitled to based on any increase or decrease in the value of shares of the corporation or Derivative Instruments, if any, as of the date of such notice, including without limitation any such interests held by members of such stockholder’s immediate family sharing the same household (which information shall be supplemented by such stockholder and beneficial owner, if any, not later than 10 days after the record date for the meeting to disclose such ownership as of the record date).

For purposes of this Section 2.9 and Section 2.10, “Stockholder Associated Person” of any stockholder shall mean (i) any person controlling or controlled by, directly or indirectly, or acting in concert with, such stockholder, (ii) any beneficial owner of shares of stock of the corporation owned of record or beneficially by such stockholder and (iii) any person controlling, controlled by or under common control with such Stockholder Associated Person.

Notwithstanding anything in the Bylaws to the contrary, no business shall be conducted at the annual meeting except in accordance with the procedures set forth in Section 2.1 and this Section 2.9, provided, however, that nothing in this Section 2.9 shall be deemed to preclude discussion by any stockholder of any business properly brought before the annual meeting in accordance with said procedure.

The Chairman of an annual meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the provisions of Section 2.1 and this Section 2.9, and if he should so determine he shall so declare to the meeting, and any such business not properly brought before the meeting shall not be transacted.

Nothing in this Section 2.9 shall affect the right of a stockholder to request inclusion of a proposal in the corporation’s proxy statement or information statement to the extent that such right is provided by an applicable rule of the SEC.

Section 2.10 Nominations of Persons for Election to the Board of Directors.

In addition to any other applicable requirements, only persons who meet the qualifications set forth in Section 3.2 of these Bylaws and are nominated in accordance with the following procedures shall be eligible for election as directors. Nominations of persons for election to the Board of Directors of the corporation may be made by or at the direction of the Board of Directors, by any nominating committee or person appointed by the Board of Directors or by any stockholder of the corporation entitled to vote for the election of directors at the meeting who complies with the notice procedures set forth in this Section 2.10. Such nominations, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the corporation, which shall be the exclusive means for a stockholder to make nominations whether or not the stockholder is seeking to have a proposal included in the corporation’s proxy statement or information statement under an applicable rule of the SEC, including, but not limited to, Regulation 14A or Regulation 14C under the Exchange Act. To be timely, a stockholder’s notice must be delivered to or mailed and received at the principal executive offices of the corporation, not less than 120 days prior to the date on which the corporation first mailed its proxy materials (or, in the absence of proxy materials, its notice of the meeting) for the previous year’s annual meeting of stockholders (or not later than the tenth day following the date on which the corporation mails the notice of meeting for the current year if during the prior year the corporation did not hold an annual meeting or if the date of the annual meeting was changed more than 30 days from the prior year), or, in the case of a special meeting, not more than 90 days prior to such meeting nor less than the later of 70 days prior to such meeting or ten days following the day on which the date of such meeting was first announced.

Such stockholder’s notice shall set forth (a) as to each person whom the stockholder proposes to nominate for election or re-election as a director, (i) the name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class and number of shares of the corporation which are beneficially owned by the person, and (iv) any other information relating to the person that is required to be disclosed in solicitations for proxies for election of directors pursuant to Regulation 14A under the Exchange Act; (b) as to the stockholder giving the notice, (i) the name and record address of the stockholder, and (ii) the class and number of shares of the corporation which are beneficially owned by the stockholder; (c) as to the stockholder giving the notice and any Stockholder Associated Person (as defined in Section 2.9), to the extent not set forth pursuant to the immediately preceding clause, whether and the extent to which any Relevant Hedge Transaction (as defined in Section 2.9) has been entered into, and (d) as to the stockholder giving the notice and any Stockholder Associated Person, (1) whether and the extent to which any Derivative Instrument (as defined in Section 2.9) is directly or indirectly beneficially owned, (2) any rights to dividends on the shares of the corporation owned beneficially by such stockholder that are separated or separable from the underlying shares of the corporation, (3) any proportionate interest in shares of the corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership in which such stockholder is a general partner or, directly or indirectly, beneficially owns an interest in a general partner and (4) any performance-related fees (other than an asset-based fee) that such stockholder is entitled to based on any increase or decrease in the value of shares of the corporation or Derivative Instruments, if any, as of the date of such notice, including without limitation any such interests held by members of such stockholder’s immediate family sharing the same household (which information shall be supplemented by such stockholder and beneficial owner, if any, not later than 10 days after the record date for the meeting to disclose such ownership as of the record date). Such stockholder’s notice shall include, with respect to each nominee for election or reelection to the Board of Directors, a completed and signed questionnaire, representation and agreement as required by Section 2.12 of these Bylaws. The corporation may require any proposed nominee to furnish such other information as may reasonably be required by the corporation to determine the eligibility of such proposed nominee to serve as a director of the corporation. No person shall be eligible for election as a director of the corporation unless nominated in accordance with the procedures set forth herein. These provisions shall not apply to nomination of any persons entitled to be separately elected by holders of preferred stock.

The Chairman of the meeting shall, if the facts warrant, determine and declare to the meeting that a nomination was not made in accordance with the foregoing procedure, and if he should so determine, he shall so declare to the meeting and the defective nomination shall be disregarded.

The provisions of this Section 2.10 with respect to stockholder notices of intent to nominate a candidate for election to the Board of Directors shall not apply to a prospective nomination as to which a notice of intent for the stockholder to receive access to the form of proxy and proxy statement of the Board of Directors of the corporation is received in accordance with Exchange Act Rule 14a-11 to the extent, and only to the extent, that it is not feasible to comply with both requirements or the effectiveness of this Section 2.10 to such prospective nomination is as a matter of law superseded by Rule 14a-11. If notice is provided under Rule 14a-11 and the effectiveness of this Section 2.10 to a prospective nomination is superseded in part by Rule 14a-11, the notifying stockholder shall continue to comply with the requirements of this Section 2.10 that have not been superseded.

Section 2.11 Action Without Meeting.

Any action required or permitted to be taken by the stockholders of the corporation must be effected at a duly called annual or special meeting of stockholders of the corporation and may not be effected by any consent in writing by such stockholders.

Section 2.12 Submission of Questionnaire, Representation and Agreement.

To be eligible to be a nominee for election or reelection to the Board of Directors, a person must deliver (in accordance with the time periods prescribed for delivery of notice under Section 2.10 of these Bylaws) to the Secretary, at the principal executive offices of the corporation, a written questionnaire with respect to the background and qualification of such person and the background of any other person or entity on whose behalf his nomination is being made (which questionnaire shall be provided by the Secretary upon written request), and a written representation and agreement (in the form provided by the Secretary upon written request) that such person (a) is not and will not become a party to any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such person, if elected as a director of the corporation, will act or vote on any issue or question that has not been disclosed to the corporation, (b) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the corporation with respect to any direct or indirect compensation, reimbursement or indemnification in connection with service or action as a director that has not been disclosed therein, and (c) except to the extent specifically identified therein, would be in compliance, if elected as a director of the corporation, and will comply, with all applicable corporate governance, conflict of interest, confidentiality and trading policies and guidelines applicable to directors of the corporation publicly disclosed to the date of such representation.

ARTICLE 3

Directors

Section 3.1 Number and Term of Office.

The number of directors shall be fixed from time to time by the Board of Directors pursuant to a resolution adopted by a majority of the total number of directors then in office.

Except as provided in Section 3.3 of this Article III, the directors shall be elected by a plurality vote of the shares represented in person or by proxy, at the stockholders annual meeting in each year and entitled to vote on the election of directors. Elected directors shall hold office until the next annual meeting and until their successors shall be duly elected and qualified.

Section 3.2 Powers of the Board of Directors and Director Qualifications.

The powers of the corporation shall be exercised, its business conducted and its property controlled by or under the direction of the Board of Directors.

To be eligible for election or appointment to the Board of Directors, an individual must (a) be at least 21 years of age, (b) have the ability to be present, in person, at all regular and special meetings of the Board of Directors, and (c) either (i) have substantial relevant experience in the national defense and security industry or (ii) have, or be able to obtain, a U.S. government issued security clearance relevant to the business of the corporation. In addition to the foregoing, no person shall be eligible for election or appointment to the Board of Directors if such person has been convicted of a crime involving dishonesty or breach of trust or if such person is currently charged with the commission of or participation in such a crime. Directors need not be stockholders. Any individual that is deteremined by the nominating committee of the Board of Directors to have met all of the qualifications set forth in this Section 3.2, shall be be deemed to be so qualified as a director of the corporation for all purposes under these Bylaws.

Section 3.3 Vacancies.

Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director, and each director so elected shall hold office for the unexpired portion of the term of the director whose place shall be vacant and until his successor shall have been duly elected and qualified. A vacancy in the Board of Directors shall be deemed to exist under this section in the case of the death, removal or resignation of any director, or if the stockholders fail at any meeting of stockholders at which directors are to be elected (including any meeting referred to in Section 3.4 below) to elect the number of directors then constituting the whole Board.

Section 3.4 Resignations and Removals.

(a) Any director may resign at any time by delivering his resignation to the Secretary in writing or by electronic transmission, such resignation to specify whether it will be effective at a particular time, upon receipt by the Secretary or at the pleasure of the Board of Directors. If no such specification is made it shall be deemed effective at the pleasure of the Board of Directors. When one or more directors shall resign from the Board effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each director so chosen shall hold office for the unexpired portion of the term of the director whose place shall be vacated and until his successor shall have been duly elected and qualified.

(b) At a special meeting of stockholders called for the purpose in the manner hereinabove provided, the Board of Directors or any individual director may be removed from office, with or without cause, and a new director or directors elected by a vote of stockholders holding a majority of the outstanding shares entitled to vote at an election of directors.

Section 3.5 Meetings.

(a) The annual meeting of the Board of Directors shall be held immediately after the annual stockholders' meeting and at the place where such meeting is held or at the place announced by the Chairman at such meeting. No notice of an annual meeting of the Board of Directors shall be necessary, and such meeting shall be held for the purpose of electing officers and transacting such other business as may lawfully come before it.

(b) Except as hereinafter otherwise provided, regular meetings of the Board of Directors shall be held in the office of the corporation required to be maintained pursuant to Section 1.2 of Article I hereof. Regular meetings of the Board of Directors may also be held at any place, within or without the State of Delaware, which has been designated by resolutions of the Board of Directors or the written consent of all directors.

(c) Special meetings of the Board of Directors may be held at any time and place within or without the State of Delaware whenever called by the Chairman of the Board or, if there is no Chairman of the Board, by the Chief Executive Officer, or by any of the directors.

(d) Written notice of the time and place of all regular and special meetings of the Board of Directors shall be delivered personally to each director or sent by facsimile transmission or other form of electronic transmission at least 24 hours before the start of the meeting, or sent by first class mail at least 120 hours before the start of the meeting. Notice of any meeting may be waived in writing at any time before or after the meeting and will be waived by any director by attendance thereat.

Section 3.6 Quorum and Voting.

(a) A quorum of the Board of Directors shall consist of a majority of the total number of directors then in office, but not less than one; provided, however, at any meeting whether a quorum be present or otherwise, a majority of the directors present may adjourn from time to time until the time fixed for the next regular meeting of the Board of Directors, without notice other than by announcement at the meeting.

(b) At each meeting of the Board at which a quorum is present, all questions and business shall be determined by a vote of a majority of the directors present, unless a different vote be required by law, the Certificate of Incorporation, or these Bylaws.

(c) Any member of the Board of Directors, or of any committee thereof, may participate in a meeting by means of conference telephone or other communication equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting by such means shall constitute presence in person at such meeting.

(d) The transactions of any meeting of the Board of Directors, or any committee thereof, however called or noticed, or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice if a quorum be present and if, either before or after the meeting, each of the directors not present shall sign a written waiver of notice, or a consent to holding such meeting, or an approval of the minutes thereof. All such waivers, consents or approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Section 3.7 Action Without Meeting.

Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or of such committee, as the case may be, consent thereto in writing or by electronic transmission, and such writing or writings or electronic transmission or transmissions are filed with the minutes of proceedings of the Board or committee. Such filing shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form.

Section 3.8 Fees and Compensation.

Directors and members of committees may receive such compensation, if any, for their services, and such reimbursement for expenses, as may be fixed or determined by resolution of the Board of Directors.

Section 3.9 Committees.

(a) **Executive Committee**: The Board of Directors may appoint an Executive Committee of not less than one member, each of whom shall be a director. The Executive Committee, to the extent permitted by law, shall have and may exercise when the Board of Directors is not in session all powers of the Board in the management of the business and affairs of the corporation, except such committee shall not have the power or authority to amend these Bylaws or to approve or recommend to the stockholders any action which must be submitted to stockholders for approval under the General Corporation Law.

(b) **Other Committees**: The Board of Directors may from time to time appoint such other committees as may be permitted by law. Such other committees appointed by the Board of Directors shall have such powers and perform such duties as may be prescribed by the resolution or resolutions creating such committee, but in no event shall any such committee have the powers denied to the Executive Committee in these Bylaws.

(c) **Term**: The terms of members of all committees of the Board of Directors shall expire on the date of the next annual meeting of the Board of Directors following their appointment; provided that they shall continue in office until their successors are appointed. The Board, subject to the provisions of subsections (a) or (b) of this Section 3.9, may at any time increase or decrease the number of members of a committee or terminate the existence of a committee; provided that no committee shall consist of less than one member. The membership of a committee member shall terminate on the date of his death or voluntary resignation, but the Board may at any time for any reason remove any individual committee member and the Board may fill any committee vacancy created by death, resignation, removal or increase in the number of members of the committee. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee, and, in addition, in the absence or disqualification of any member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

(d) **Meetings**: Unless the Board of Directors shall otherwise provide, regular meetings of the Executive Committee or any other committee appointed pursuant to this Section 3.9 shall be held at such times and places as are determined by the Board of Directors, or by any such committee, and when notice thereof has been given to each member of such committee, no further notice of such regular meetings need be given thereafter; special meetings of any such committee may be held at the principal office of the corporation required to be maintained pursuant to Section 1.2 of Article I hereof; or at any place which has been designated from time to time by resolution of such committee or by written consent of all members thereof, and may be called by any director who is a member of such committee upon written notice to the members of such committee of the time and place of such special meeting given in the manner provided for the giving of written notice to members of the Board of Directors of the time and place of special meetings of the Board of Directors. Notice of any special meeting of any committee may be waived in writing at any time after the meeting and will be waived by any director by attendance thereat. A majority of the authorized number of members of any such committee shall constitute a quorum for the transaction of business, and the act of a majority of those present at any meeting at which a quorum is present shall be the act of such committee.

Section 3.10 Service on other Boards.

Each member of the corporation's Board of Directors, including the corporation's Chief Executive Officer, shall be subject to specific limits on outside board memberships as set forth in a policy adopted by the Board of Directors.

ARTICLE 4

Officers

Section 4.1 Officers Designated.

The officers of the corporation shall be a Chief Executive Officer, President, Chief Financial Officer and Secretary. The Board of Directors or the President may also appoint a Chairman of the Board, one or more Vice-Presidents, assistant secretaries and such other officers and agents with such powers and duties as it or he shall deem necessary. The order of the seniority of the Vice- Presidents shall be in the order of their nomination unless otherwise determined by the Board of Directors. The Board of Directors may assign such additional titles to one or more of the officers as they shall deem appropriate. Any one person may hold any number of offices of the corporation at any one time unless specifically prohibited therefrom by law. The salaries and other compensation of the officers of the corporation shall be fixed by or in the manner designated by the Board of Directors.

Section 4.2 Tenure and Duties of Officers.

(a) **General**: All officers shall hold office at the pleasure of the Board of Directors and until their successors shall have been duly elected and qualified, unless sooner removed. Any officer elected or appointed by the Board of Directors may be removed at any time by the Board of Directors. If the office of any officer becomes vacant for any reason, the vacancy may be filled by the Board of Directors. Nothing in these Bylaws shall be construed as creating any kind of contractual right to employment with the corporation.

(b) **Duties of the Chairman of the Board of Directors**: The Chairman of the Board of Directors (if there be such an officer appointed) when present shall preside at all meetings of the stockholders and the Board of Directors. The Chairman of the Board of Directors shall perform such other duties and have such other powers as the Board of Directors shall designate from time to time.

(c) **Duties of the Chief Executive Officer**: Unless provided otherwise by a resolution adopted by the Board of Directors, the Chief Executive Officer (i) shall have general active management of the business of the Corporation; (ii) shall, in the absence of the Chairman of the Board of Directors, preside at all meetings of the stockholders and Board of Directors; (iii) shall see that all orders and resolutions of the Board are carried into effect; (iv) may maintain records of and certify proceedings of the Board and stockholders; and (v) shall perform such other duties as may from time to time be assigned by the Board of Directors.

(d) **Duties of President**: Unless otherwise determined by the Board, the President shall be the Chief Executive Officer of the Corporation. If an officer other than the President is designated Chief Executive Officer, the President shall perform such duties as may from time to time be assigned by the Board of Directors or the Chief Executive Officer.

(e) **Duties of Chief Financial Officer**: The Chief Financial Officer shall keep or cause to be kept the books of account of the corporation in a thorough and proper manner, and shall render statements of the financial affairs of the corporation in such form and as often as required by the Board of Directors or the Chief Executive Officer. The Chief Financial Officer, subject to the order of the Board of Directors, shall have the custody of all funds and securities of the corporation. The Chief Financial Officer shall perform all other duties commonly incident to his office and shall perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time. The Chief Executive Officer may direct any Vice-President to assume and perform the duties of the Chief Financial Officer in the absence or disability of the Chief Financial Officer, and each such Vice-President shall perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time. The Chief Financial Officer shall be the Treasurer of the corporation.

(f) **Duties of Vice-Presidents**: The Vice-Presidents, in the order of their seniority, may assume and perform the duties of the Chief Executive Officer in the absence or disability of the Chief Executive Officer or whenever the office of the Chief Executive Officer is vacant. The Vice-Presidents shall perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time.

(g) **Duties of Secretary**: The Secretary shall attend all meetings of the stockholders and of the Board of Directors and any committee thereof, and shall record all acts and proceedings thereof in the minute book of the corporation, which may be maintained in either paper or electronic form. The Secretary shall give notice, in conformity with these Bylaws, of all meetings of the stockholders and of all meetings of the Board of Directors and any Committee thereof requiring notice. The Secretary shall perform such other duties and have such other powers as the Board of Directors shall designate from time to time. The President may direct any assistant secretary to assume and perform the duties of the Secretary in the absence or disability of the Secretary, and each assistant secretary shall perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time.

ARTICLE 5

Execution of Corporate Instruments, and
Voting of Securities Owned by the Corporation

Section 5.1 Execution of Corporate Instruments.

(a) The Board of Directors may in its discretion determine the method and designate the signatory officer or officers, or other person or persons, to execute any corporate instrument or document, or to sign the corporate name without limitation, except where otherwise provided by law, and such execution or signature shall be binding upon the corporation.

(b) Unless otherwise specifically determined by the Board of Directors or otherwise required by law, formal contracts of the corporation, promissory notes, deeds of trust, mortgages and other evidences of indebtedness of the corporation, and other corporate instruments or documents requiring the corporate seal, and certificates of shares of stock owned by the corporation, shall be executed, signed or endorsed by the Chairman of the Board (if there be such an officer appointed) or by the Chief Executive Officer; such documents may also be executed by any Vice-President and by the Secretary, any assistant secretary or Chief Financial Officer. All other instruments and documents requiring the corporate signature but not requiring the corporate seal may be executed as aforesaid or in such other manner as may be directed by the Board of Directors.

(c) All checks and drafts drawn on banks or other depositaries on funds to the credit of the corporation or in special accounts of the corporation shall be signed by such person or persons as the Board of Directors shall authorize so to do.

(d) Execution of any corporate instrument may be effected in such form, either manual, facsimile or electronic signature, as may be authorized by the Board of Directors.

Section 5.2 Voting of Securities Owned by Corporation.

All stock and other securities of other corporations owned or held by the corporation for itself or for other parties in any capacity shall be voted, and all proxies with respect thereto shall be executed, by the person authorized so to do by resolution of the Board of Directors or, in the absence of such authorization, by the Chairman of the Board (if there be such an officer appointed), or by the Chief Executive Officer, the President, or by any Vice-President.

ARTICLE 6

Shares of Stock

Section 6.1 Form and Execution of Certificates.

The shares of the corporation shall be represented by certificates, provided that the Board of Directors may provide by resolution or resolutions that some or all of any or all classes or series of its stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the corporation. Certificates for the shares of stock of the corporation shall be in such form as is consistent with the Certificate of Incorporation and applicable law. Every holder of stock in the corporation shall be entitled to have a certificate signed by, or in the name of the corporation by, the Chairman of the Board (if there be such an officer appointed), or by the President or any Vice-President and by the Chief Financial Officer or the Secretary or assistant secretary, certifying the number of shares owned by him in the corporation. Any or all of the signatures on the certificate may be a facsimile. In case any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent, or registrar before such certificate is issued, it may be issued with the same effect as if he were such officer, transfer agent, or registrar at the date of issue. If the corporation shall be authorized to issue more than one class of stock or more than one series of any class, the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in section 202 of the Delaware General Corporation Law, in lieu of the foregoing requirements, there may be set forth on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

Section 6.2   Lost Certificates.

The Board of Directors may direct a new certificate or certificates (or uncertificated shares in lieu of a new certificate) to be issued in place of any certificate or certificates theretofore issued by the corporation alleged to have been lost or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost or destroyed. When authorizing such issue of a new certificate or certificates (or uncertificated shares in lieu of a new certificate), the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost or destroyed certificate or certificates, or his legal representative, to indemnify the corporation in such manner as it shall require and/or to give the corporation a surety bond in such form and amount as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost or destroyed.

Section 6.3   Transfers.

Transfers of record of shares of stock of the corporation shall be made only upon its books by the holders thereof, in person or by attorney duly authorized, who shall furnish proper evidence of authority to transfer, and in the case of stock represented by a certificate, upon the surrender of a certificate or certificates for a like number of shares, properly endorsed.

Section 6.4   Fixing Record Dates.

(a)   In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which record date shall not be more than 60 nor less than 10 days before the date of such meeting. If no record date is fixed by the Board of Directors, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the date on which the meeting is held. A determination of stockholders of record entitled notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

(b)   In order that the corporation may determine the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or the stockholders entitled to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted, and which record date shall be not more than 60 days prior to such action. If no record date is fixed, the record date for determining stockholders for any such purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

Section 6.5   Registered Stockholders.

The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE 7

Other Securities of the Corporation

All bonds, debentures and other corporate securities of the corporation, other than stock certificates, may be signed by the Chairman of the Board (if there be such an officer appointed), or the President or any Vice-President or such other person as may be authorized by the Board of Directors and the corporate seal impressed thereon or a facsimile of such seal imprinted thereon and attested by the signature of the Secretary or an assistant secretary, or the Chief Financial Officer; provided, however, that where any such bond, debenture or other corporate security shall be authenticated by the manual signature of a trustee under an indenture pursuant to which such bond, debenture or other corporate security shall be issued, the signature of the persons signing and attesting the corporate seal on such bond, debenture or other corporate security may be the imprinted facsimile of the signatures of such persons. Interest coupons appertaining to any such bond, debenture or other corporate security, authenticated by a trustee as aforesaid, shall be signed by the Chief Financial Officer, or such other person as may be authorized by the Board of Directors, or bear imprinted thereon the facsimile signature of such person. In case any officer who shall have signed or attested any bond, debenture or other corporate security, or whose facsimile signature shall appear thereon has ceased to be an officer of the corporation before the bond, debenture or other corporate security so signed or attested shall have been delivered, such bond, debenture or other corporate security nevertheless may be adopted by the corporation and issued and delivered as though the person who signed the same or whose facsimile signature shall have been used thereon had not ceased to be such officer of the corporation.

ARTICLE 8

Corporate Seal

The corporate seal shall consist of a die bearing the name of the corporation and the state and date of its incorporation. Said seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

ARTICLE 9

Indemnification of Officers, Directors, Employees and Agents

Section 9.1 Right to Indemnification.

Each person who was or is a party or is threatened to be made a party to or is involved (as a party, witness, or otherwise), in any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative (hereinafter a "Proceeding"), by reason of the fact that he, or a person of whom he is the legal representative, is or was a director, officer, employee, or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation or of a partnership, joint venture, trust, or other enterprise, including service with respect to employee benefit plans, whether the basis of the Proceeding is alleged action in an official capacity as a director, officer, employee, or agent or in any other capacity while serving as a director, officer, employee, or agent (hereafter an "Agent"), shall be indemnified and held harmless by the corporation to the fullest extent authorized by the Delaware General Corporation Law, as the same exists or may hereafter be amended or interpreted (but, in the case of any such amendment or interpretation, only to the extent that such amendment or interpretation permits the corporation to provide broader indemnification rights than were permitted prior thereto) against all expenses, liability, and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties, and amounts paid or to be paid in settlement, and any interest, assessments, or other charges imposed thereon, and any federal, state, local, or foreign taxes imposed on any Agent as a result of the actual or deemed receipt of any payments under this Article) reasonably incurred or suffered by such person in connection with investigating, defending, being a witness in, or participating in (including on appeal), or preparing for any of the foregoing in, any Proceeding (hereinafter "Expenses"); provided, however, that except as to actions to enforce indemnification rights pursuant to Section 9.3 of this Article, the corporation shall indemnify any Agent seeking indemnification in connection with a Proceeding (or part thereof) initiated by such person only if the Proceeding (or part thereof) was authorized by the Board of Directors of the corporation. The right to indemnification conferred in this Article shall be a contract right.

Section 9.2 Authority to Advance Expenses.

Expenses incurred by an officer or director (acting in his capacity as such) in defending a Proceeding shall be paid by the corporation in advance of the final disposition of such Proceeding, provided, however, that if required by the Delaware General Corporation Law, as amended, such Expenses shall be advanced only upon delivery to the corporation of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in this Article or otherwise. Expenses incurred by other Agents of the corporation (or by the directors or officers not acting in their capacity as such, including service with respect to employee benefit plans) may be advanced upon such terms and conditions as the Board of Directors deems appropriate. Any obligation to reimburse the corporation for Expense advances shall be unsecured and no interest shall be charged thereon.

Section 9.3 Right of Claimant to Bring Suit.

If a claim under Section 9.1 or 9.2 of this Article is not paid in full by the corporation within ninety (90) days after a written claim has been received by the corporation, the claimant may at any time thereafter bring suit against the corporation to recover the unpaid amount of the claim and, if successful in whole or in part, the claimant shall be entitled to be paid also the expense (including attorneys' fees) of prosecuting such claim. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending a Proceeding in advance of its final disposition where the required undertaking has been tendered to the corporation) that the claimant has not met the standards of conduct that make it permissible under the Delaware General Corporation Law for the corporation to indemnify the claimant for the amount claimed. The burden of proving such a defense shall be on the corporation. Neither the failure of the corporation (including its

Board of Directors, independent legal counsel, or its stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper under the circumstances because he has met the applicable standard of conduct set forth in the Delaware General Corporation Law, nor an actual determination by the corporation (including its Board of Directors, independent legal counsel, or its stockholders) that the claimant had not met such applicable standard of conduct, shall be a defense to the action or create a presumption that claimant has not met the applicable standard of conduct.

Section 9.4 Provisions Nonexclusive.

The rights conferred on any person by this Article shall not be exclusive of any other rights that such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, agreement, vote of stockholders or disinterested directors, or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office. To the extent that any provision of the Certificate, agreement, or vote of the stockholders or disinterested directors is inconsistent with these Bylaws, the provision, agreement, or vote shall take precedence.

Section 9.5 Authority to Insure.

The corporation may purchase and maintain insurance to protect itself and any Agent against any Expense, whether or not the corporation would have the power to indemnify the Agent against such Expense under applicable law or the provisions of this Article.

Section 9.6 Survival of Rights.

The rights provided by this Article shall continue as to a person who has ceased to be an Agent and shall inure to the benefit of the heirs, executors, and administrators of such a person.

Section 9.7 Settlement of Claims.

The corporation shall not be liable to indemnify any Agent under this Article (a) for any amounts paid in settlement of any action or claim effected without the corporation's written consent, which consent shall not be unreasonably withheld; or (b) for any judicial award if the corporation was not given a reasonable and timely opportunity, at its expense, to participate in the defense of such action.

Section 9.8 Effect of Amendment.

Any amendment, repeal, or modification of this Article shall not adversely affect any right or protection of any Agent existing at the time of such amendment, repeal, or modification.

Section 9.9 Subrogation.

In the event of payment under this Article, the corporation shall be subrogated to the extent of such payment to all of the rights of recovery of the Agent, who shall execute all papers required and shall do everything that may be necessary to secure such rights, including the execution of such documents necessary to enable the corporation effectively to bring suit to enforce such rights.

Section 9.10 No Duplication of Payments.

The corporation shall not be liable under this Article to make any payment in connection with any claim made against the Agent to the extent the Agent has otherwise actually received payment (under any insurance policy, agreement, vote, or otherwise) of the amounts otherwise indemnifiable hereunder.

ARTICLE 10

Notices

Whenever, under any provisions of these Bylaws, notice is required to be given to any stockholder, the same shall be given either (1) in writing, timely and duly deposited in the United States Mail, postage prepaid, and addressed to his last known post office address as shown by the stock record of the corporation or its transfer agent, or (2) by a means of electronic transmission that satisfies the requirements of Section 2.4(e) of these Bylaws, and has been consented to by the stockholder to whom the notice is given. Any notice required to be given to any director may be given by either of the methods hereinabove stated, except that such notice other than one which is delivered personally, shall be sent to such address or (in the case of electronic communication) such e-mail address, facsimile telephone number or other form of electronic address as such director shall have filed in writing or by electronic communication with the Secretary of the corporation, or, in the absence of such filing, to the last known post office address of such director. If no address of a stockholder or director be known, such notice may be sent to the office of the corporation required to be maintained pursuant to Section 1.2 of Article I hereof. An affidavit of mailing, executed by a duly authorized and competent employee of the corporation or its transfer agent appointed with respect to the class of stock affected, specifying the name and address or the names and addresses of the stockholder or stockholders, director or directors, to whom any such notice or notices was or were given, and the time and method of giving the same, shall be conclusive evidence of the statements therein contained. All notices given by mail, as above provided, shall be deemed to have been given as at the time of mailing and all notices given by means of electronic transmission shall be deemed to have been given as at the sending time recorded by the electronic transmission equipment operator transmitting the same. It shall not be necessary that the same method of giving notice be employed in respect of all directors, but one permissible method may be employed in respect of any one or more, and any other permissible method or methods may be employed in respect of any other or others. The period or limitation of time within which any stockholder may exercise any option or right, or enjoy any privilege or benefit, or be required to act, or within which any director may exercise any power or right, or enjoy any privilege, pursuant to any notice sent him in the manner above provided, shall not be affected or extended in any manner by the failure of such a stockholder or such director to receive such notice. Whenever any notice is required to be given under the provisions of the statutes or of the Certificate of Incorporation, or of these Bylaws, a waiver thereof in writing signed by the person or persons entitled to said notice, or a waiver by electronic transmission by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent thereto. Whenever notice is required to be given, under any provision of law or of the Certificate of Incorporation or Bylaws of the corporation, to any person with whom communication is unlawful, the giving of such notice to such person shall not be required and there shall be no duty to apply to any governmental authority or agency for a license or permit to give such notice to such person. Any action or meeting which shall be taken or held without notice to any such person with whom communication is unlawful shall have the same force and effect as if such notice had been duly given. In the event that the action taken by the corporation is such as to require the filing of a certificate under any provision of the Delaware General Corporation Law, the certificate shall state, if such is the fact and if notice is required, that notice was given to all persons entitled to receive notice except such persons with whom communication is unlawful.

ARTICLE 11

Amendments

These Bylaws may be repealed, altered or amended or new Bylaws adopted at any meeting of the stockholders, either annual or special, by the affirmative vote of at least sixty-six and two-thirds percent (66-2/3%) of the stock entitled to vote at such meeting, unless a larger vote is required by these Bylaws or the Certificate of Incorporation. The Board of Directors shall also have the authority to repeal, alter or amend these Bylaws or adopt new Bylaws by unanimous written consent or at any annual, regular, or special meeting by the affirmative vote of a majority of the whole number of directors, subject to the power of the stockholders to change or repeal such Bylaws.

Article 12

Forum for Certain Actions

Unless the corporation consents in writing to the selection of an alternative forum, the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the corporation to the corporation or the corporation’s stockholders, (iii) any action asserting a claim against the corporation arising pursuant to any provision of the Delaware General Corporation Law or the Amended and Restated Certificate of Incorporation or Bylaws, or (iv) any action involving the internal affairs doctrine shall be the Court of Chancery of the State of Delaware or, if the Court of Chancery determines it does not have jurisdiction, in another state or the federal court located within the State of Delaware, in all cases subject to the court’s having personal jurisdiction over the indispensable parties named as defendants. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the corporation shall be deemed to have notice of and consented to the provisions of this Article XII.

NUMBER

KRA 3330

SHARES

KRATOS

FROM STRENGTH TO SUCCESS℠

DEFENSE & SECURITY SOLUTIONS

THIS CERTIFICATE IS TRANSFERABLE IN SOUTH SAINT PAUL, MN.

INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE

SEE REVERSE SIDE FOR CERTAIN DEFINITIONS

CUSIP 50077B 20 7

THIS CERTIFIES THAT

SPECIMEN

is the owner of

FULLY PAID AND NON-ASSESSABLE COMMON SHARES, $0.001 PAR VALUE, OF

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

transferable on the books of the Corporation by the holder hereof in person or by Attorney upon surrender of this certificate properly endorsed. This certificate is not valid until countersigned and registered by the Transfer Agent and Registrar.

IN WITNESS WHEREOF, the said Corporation has caused this certificate to be signed by facsimile signatures of its duly authorized officers.

Dated:

SECRETARY

PRESIDENT

COUNTERSIGNED AND REGISTERED:
WELLS FARGO BANK, N.A.

TRANSFER AGENT AND REGISTRAR

BY

AUTHORIZED SIGNATURE

AMERICAN FINANCIAL PRINTING INCORPORATED – MINNEAPOLIS

THE BOARD OF THIS CORPORATION HAS THE AUTHORITY TO CREATE AND DETERMINE THE RELATIVE RIGHTS AND PREFERENCES OF CLASSES OR SERIES OF SHARES OF CAPITAL STOCK OTHER THAN COMMON STOCK. THIS CORPORATION WILL FURNISH TO ANY SHAREHOLDER UPON WRITTEN REQUEST SENT TO ITS PRINCIPAL EXECUTIVE OFFICES, AND WITHOUT CHARGE, A FULL STATEMENT OF THE BOARD'S AUTHORITY TO CREATE AND DETERMINE THE RELATIVE RIGHTS AND PREFERENCES OF CLASSES OR SERIES OF SHARES OF CAPITAL STOCK AS WELL AS THE DESIGNATIONS, PREFERENCES, LIMITATIONS AND RELATIVE RIGHTS OF THE SHARES OF EACH CLASS OR SERIES THEN OUTSTANDING OR AUTHORIZED TO BE ISSUED.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM – as tenants in common

TEN ENT – as tenants by entireties

JT TEN – as joint tenants with right of survivorship and not as tenants in common

UTMA – ________ Custodian ________
(Cust) (Minor)
under Uniform Transfers to Minors
Act ________________
(State)

Additional abbreviations may also be used though not in above list.

For value received ____ hereby sell, assign, and transfer unto

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

(PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS INCLUDING ZIP CODE OF ASSIGNEE)

____ *Shares*

of the capital stock represented by the within Certificate, and do hereby irrevocably constitute and appoint ________

____ *Attorney*

to transfer the said stock on the books of the within-named Corporation with full power of substitution in the premises.

Dated ________

X ________________________________

X ________________________________

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER.

SIGNATURE GUARANTEED

ALL GUARANTEES MUST BE MADE BY A FINANCIAL INSTITUTION (SUCH AS A BANK OR BROKER) WHICH IS A PARTICIPANT IN THE SECURITIES TRANSFER AGENTS MEDALLION PROGRAM ("STAMP"), THE NEW YORK STOCK EXCHANGE, INC. MEDALLION SIGNATURE PROGRAM ("MSP"), OR THE STOCK EXCHANGES MEDALLION PROGRAM ("SEMP") AND MUST NOT BE DATED. GUARANTEES BY A NOTARY PUBLIC ARE NOT ACCEPTABLE.

Exhibit 21.1

List of Subsidiaries

Ai Metrix, Inc.	Delaware
Airorlite Communications, Inc.	New Jersey
Avtec Systems, Inc.	Virginia
BSC Partners, LLC	New York
Charleston Marine Containers, Inc.	Delaware
Composite Engineering, Inc.	California
Kratos Systems and Solutions, Inc.	Virginia
Dallastown Realty I, LLC	Delaware
Dallastown Realty II, LLC	Delaware
Defense Systems, Incorporated	Virginia
DEI Services Corporation	Florida
DFI Realty, LLC	Florida
Digital Fusion Solutions, Inc.	Florida
Digital Fusion, Inc.	Delaware
Diversified Security Solutions, Inc.	New York
DTI Associates, Inc.	Virginia
General Microwave Israel (1987) Ltd.	Israel
General Microwave Israel Corporation	Delaware
General Microwave Corporation	New York
Gichner Europe Limited	United Kingdom
Gichner Systems Group, Inc.	Delaware
Gichner Systems International, Inc.	Delaware
Haverstick Consulting, Inc.	Indiana
Haverstick Government Solutions, Inc.	Ohio
Henry Bros. Electronics, Inc.	California
Henry Bros. Electronics, Inc.	Colorado
Henry Bros. Electronics, Inc.	Delaware
Henry Bros. Electronics, Inc.	New Jersey
Henry Bros. Electronics, LLC	Arizona
GMI Eyal Ltd.	Israel
HGS Holdings, Inc.	Indiana
Kratos Holdings UK Ltd.	United Kingdom
Kratos Integral Systems International Ltd.	United Kingdom
Kratos Integral Systems Europe S.A.S.	France
JMA Associates, Inc.	Delaware
KPSS Government Solutions, Inc.	Delaware
Kratos Defense & Rocket Support Services, Inc.	Delaware
Kratos Integral Holdings, LLC	Maryland

Kratos Integral Systems International, Inc.	California
Kratos Networks, Inc.	Delaware
Kratos Norway AS	Norway
Kratos Public Safety & Security Solutions, Inc.	Delaware
Kratos Saudi Arabia, Ltd.	Saudi Arabia
Kratos Southeast, Inc.	Georgia
Kratos Southwest L.P.	Texas
Kratos Technology & Training Solutions, Inc.	California
Kratos Texas, Inc.	Texas
Kratos Unmanned Systems Solutions, Inc.	Delaware
Kratos Space & Missile Defense Systems, Inc.	Delaware
Carlsbad ISI, Inc.	Maryland
LVDM, Inc.	Nevada
Madison Research Corporation	Alabama
Micro Systems, Inc.	Florida
MSI Acquisition Corp.	Delaware
National Safe of California, Inc.	California
Polexis, Inc.	California
Reality Based IT Services Ltd.	Maryland
RealTime Logic, Inc.	Colorado
Rocket Support Services, LLC	Indiana
SAT Corporation	California
Satguard AS	Norway
SCT Acquisition, LLC	Delaware
SCT Real Estate, LLC	Delaware
SecureInfo Corporation	Delaware
Shadow I, Inc.	California
Shadow II, Inc.	California
Summit Research Corporation	Alabama
WFI NMC Corp.	Delaware

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-53014, 333-71618, 333-74108, and 333-198266 on Form S-3, Registration Statement Nos. 333-150165, 333-155604, 333-167840, 333-174745, 333-174760, 333-177493, and 333-198265 on Form S-4, and Registration Statement Nos. 333-54818, 333-71702, 333-90455, 333-91852, 333-116903, 333-124957, 333-127060, 333-155317, 333-157826, 333-167839, 333-171257, 333-173383, 333-177494, 333-179977, 333-182910, 333-191156, 333-198268, and 333-206620 on Form S-8 of our report dated February 27, 2017, relating to the consolidated financial statements of Kratos Defense & Security Solutions, Inc. (the “Company”), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of the Company for the fiscal year ended December 25, 2016.

/s/ DELOITTE & TOUCHE LLP

San Diego, California
February 27, 2017

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 Annual report on Form 10-K 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: February 27, 2017

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 Annual report on Form 10-K 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: February 27, 2017

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 Annual Report of Kratos Defense & Security Solutions, Inc. (the "Company") on Form 10-K for the year ended December 25, 2016 (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: February 27, 2017

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 Annual Report of Kratos Defense & Security Solutions, Inc. (the "Company") on Form 10-K for the year ended December 25, 2016 (the "Report"), I, Deanna H. Lund, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: February 27, 2017

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

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