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

FORM 10-Q

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

For the Quarterly Period Ended June 27, 2021
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________
Commission file number 001-34460

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

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

1 Chisholm Trail, Suite 3200
Round Rock, TX 78681
(512) 238-9840
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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

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

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

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

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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

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

As of July 30, 2021, 123,957,536 shares of the registrant's common stock were outstanding.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 27, 2021

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par value and number of shares)

	June 27, 2021 (Unaudited)	December 27, 2020
Assets		
Current assets:		
Cash and cash equivalents	$ 369.3	$ 380.8
Restricted cash	—	0.7
Accounts receivable, net	80.0	95.3
Unbilled receivables, net	185.0	177.0
Inventoried costs	90.7	81.2
Prepaid expenses	13.4	12.0
Other current assets	30.3	17.8
Total current assets	768.7	764.8
Property, plant and equipment, net	145.5	143.8
Operating lease right-of-use assets	40.1	42.9
Goodwill	483.7	483.9
Intangible assets, net	40.4	43.0
Other assets	83.9	84.4
Total assets	$ 1,562.3	$ 1,562.8
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 59.9	$ 55.4
Accrued expenses	27.2	34.7
Accrued compensation	46.2	48.1
Accrued interest	1.5	1.5
Billings in excess of costs and earnings on uncompleted contracts	43.5	34.0
Current portion of operating lease liabilities	9.3	8.9
Other current liabilities	11.8	11.9
Current liabilities of discontinued operations	2.7	3.1
Total current liabilities	202.1	197.6
Long-term debt	300.3	301.0
Operating lease liabilities, net of current portion	35.3	38.6
Other long-term liabilities	71.6	83.0
Long-term liabilities of discontinued operations	2.5	2.5
Total liabilities	611.8	622.7
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interest	14.6	14.8
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, 0 shares outstanding at June 27, 2021 and December 27, 2020	—	—
Common stock, $0.001 par value, 195,000,000 shares authorized; 123,807,616 and 123,047,147 shares issued and outstanding at June 27, 2021 and December 27, 2020, respectively	—	—
Additional paid-in capital	1,563.1	1,556.3
Accumulated other comprehensive income	2.2	1.4
Accumulated deficit	(629.4)	(632.4)
Total stockholders' equity	935.9	925.3
Total liabilities and stockholders' equity	$ 1,562.3	$ 1,562.8

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

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Service revenues	$ 58.0	$ 62.9	$ 115.3	$ 126.5
Product sales	147.1	107.5	284.0	212.8
Total revenues	205.1	170.4	399.3	339.3
Cost of service revenues	41.3	46.2	83.8	91.4
Cost of product sales	111.8	78.2	212.5	156.1
Total costs	153.1	124.4	296.3	247.5
Gross profit	52.0	46.0	103.0	91.8
Selling, general and administrative expenses	38.2	36.0	76.1	70.9
Merger and acquisition expenses	0.1	1.0	0.3	1.4
Research and development expenses	10.2	6.0	18.2	11.7
Restructuring expenses and other	0.2	0.1	0.2	0.2
Operating income	3.3	2.9	8.2	7.6
Other expense:				
Interest expense, net	(5.7)	(5.6)	(11.6)	(11.0)
Other income (expense), net	—	0.3	0.2	(0.2)
Total other expense, net	(5.7)	(5.3)	(11.4)	(11.2)
Loss from continuing operations before income taxes	(2.4)	(2.4)	(3.2)	(3.6)
Benefit for income taxes from continuing operations	(3.6)	(1.8)	(6.3)	(3.2)
Income (loss) from continuing operations	1.2	(0.6)	3.1	(0.4)
Discontinued operations:				
Loss from discontinued operations before income taxes	(0.4)	(0.4)	(0.4)	(0.8)
Income tax benefit	0.1	0.2	0.1	0.2
Loss from discontinued operations	(0.3)	(0.2)	(0.3)	(0.6)
Net income (loss)	0.9	(0.8)	2.8	(1.0)
Less: Net loss attributable to noncontrolling interest	(0.2)	(0.1)	(0.2)	(0.1)
Net income (loss) attributable to Kratos	$ 1.1	$ (0.7)	$ 3.0	$ (0.9)
Basic income (loss) per common share attributable to Kratos:				
Income (loss) from continuing operations	$ 0.01	$ (0.01)	$ 0.02	$ —
Loss from discontinued operations	—	—	—	(0.01)
Net income (loss) per common share	$ 0.01	$ (0.01)	$ 0.02	$ (0.01)
Diluted income (loss) per common share attributable to Kratos:				
Income (loss) from continuing operations	$ 0.01	$ (0.01)	$ 0.02	$ —
Loss from discontinued operations	—	—	—	(0.01)
Net income (loss) per common share	$ 0.01	$ (0.01)	$ 0.02	$ (0.01)
Weighted average common shares outstanding:				
Basic	124.7	108.3	124.4	107.8
Diluted	127.7	108.3	127.8	107.8

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

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Net income (loss)	$ 0.9	$ (0.8)	$ 2.8	$ (1.0)
Change in cumulative translation adjustment	0.6	(0.3)	0.8	(0.1)
Comprehensive income (loss)	1.5	(1.1)	3.6	(1.1)
Less: Comprehensive loss attributable to noncontrolling interest	(0.2)	(0.1)	(0.2)	(0.1)
Comprehensive income (loss) attributable to Kratos	$ 1.7	$ (1.0)	$ 3.8	$ (1.0)

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

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the three months ended June 27, 2021 and June 28, 2020
(in millions)
(Unaudited)

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
Balance, March 29, 2020	$ 15.0	107.0	$ —	$ 1,292.6	$ (0.2)	$ (712.2)	$ 580.2
Stock-based compensation	—	—	—	4.8	—	—	4.8
Issuance of common stock for cash	—	15.5	—	240.5	—	—	240.5
Net loss	(0.1)	—	—	—	—	(0.7)	(0.7)
Other comprehensive loss, net of tax	—	—	—	—	(0.3)	—	(0.3)
Balance, June 28, 2020	$ 14.9	122.5	$ —	$ 1,537.9	$ (0.5)	$ (712.9)	$ 824.5

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
Balance, March 28, 2021	$ 14.8	123.7	$ —	$ 1,557.9	$ 1.6	$ (630.5)	$ 929.0
Stock-based compensation	—	—	—	6.6	—	—	6.6
Restricted stock issued and related taxes	—	0.1	—	(1.4)	—	—	(1.4)
Net income (loss)	(0.2)	—	—	—	—	1.1	1.1
Other comprehensive income, net of tax	—	—	—	—	0.6	—	0.6
Balance, June 27, 2021	$ 14.6	123.8	$ —	$ 1,563.1	$ 2.2	$ (629.4)	$ 935.9

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the six months ended June 27, 2021 and June 28, 2020
(in millions)
(Unaudited)

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
Balance, December 29, 2019	$ 15.0	106.6	$ —	$ 1,286.5	$ (0.4)	$ (712.0)	$ 574.1
Stock-based compensation	—	—	—	9.5	—	—	9.5
Issuance of common stock for employee stock purchase plan, options and warrants	—	0.2	—	2.6	—	—	2.6
Restricted stock issued and related taxes	—	0.2	—	(1.2)	—	—	(1.2)
Issuance of common stock for cash	—	15.5	—	240.5	—	—	240.5
Net loss	(0.1)	—	—	—	—	(0.9)	(0.9)
Other comprehensive loss, net of tax	—	—	—	—	(0.1)	—	(0.1)
Balance, June 28, 2020	$ 14.9	122.5	$ —	$ 1,537.9	$ (0.5)	$ (712.9)	$ 824.5

	Redeemable Noncontrolling Interest	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
		Shares	Amounts				
Balance, December 27, 2020	$ 14.8	123.0	$ —	$ 1,556.3	$ 1.4	$ (632.4)	$ 925.3
Stock-based compensation	—	—	—	12.8	—	—	12.8
Issuance of common stock for employee stock purchase plan, options and warrants	—	0.2	—	2.5	—	—	2.5
Restricted stock issued and related taxes	—	0.6	—	(8.5)	—	—	(8.5)
Net income (loss)	(0.2)	—	—	—	—	3.0	3.0
Other comprehensive income, net of tax	—	—	—	—	0.8	—	0.8
Balance, June 27, 2021	$ 14.6	123.8	$ —	$ 1,563.1	$ 2.2	$ (629.4)	$ 935.9

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

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

	Six Months Ended	
	June 27, 2021	June 28, 2020
Operating activities:		
Net income (loss)	$ 2.8	$ (1.0)
Loss from discontinued operations	(0.3)	(0.6)
Income (loss) from continuing operations	3.1	(0.4)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	13.3	12.3
Deferred income taxes	(0.9)	(1.1)
Amortization of lease right-of-use assets	4.5	5.3
Stock-based compensation	12.8	9.5
Amortization of deferred financing costs	0.5	0.5
Provision for (recovery of) doubtful accounts	(0.2)	0.2
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	15.5	24.7
Unbilled receivables	(7.9)	(6.8)
Inventoried costs	(6.8)	(4.5)
Prepaid expenses and other assets	(2.2)	(10.8)
Operating lease liabilities	(4.5)	(6.0)
Accounts payable	5.8	(9.1)
Accrued expenses	(7.5)	(4.2)
Accrued compensation	(1.8)	1.4
Billings in excess of costs and earnings on uncompleted contracts	9.6	(0.5)
Income tax receivable and payable	(6.1)	(3.0)
Other liabilities	(5.2)	3.3
Net cash provided by operating activities from continuing operations	22.0	10.8
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(6.2)	(15.5)
Proceeds from sale of assets	—	0.1
Capital expenditures	(20.5)	(14.1)
Net cash used in investing activities from continuing operations	(26.7)	(29.5)
Financing activities:		
Proceeds from the issuance of common stock, net of issuance costs	—	240.5
Repayment of debt	—	(0.1)
Payments under finance leases	(0.4)	(0.3)
Payments of employee taxes withheld from share-based awards	(8.5)	(1.2)
Proceeds from shares issued under equity plans	2.5	2.6
Net cash provided by (used in) financing activities from continuing operations	(6.4)	241.5
Net cash flows of continuing operations	(11.1)	222.8
Net operating cash flows of discontinued operations	(0.8)	1.7
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(0.3)	0.1
Net increase (decrease) in cash, cash equivalents and restricted cash	(12.2)	224.6
Cash, cash equivalents and restricted cash at beginning of period	381.5	172.6
Cash, cash equivalents and restricted cash at end of period	$ 369.3	$ 397.2

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

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

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

(a) Basis of Presentation

The information as of June 27, 2021 and for the three and six months ended June 27, 2021 and June 28, 2020 is unaudited. The condensed consolidated balance sheet as of December 27, 2020 was derived from the Company's audited consolidated financial statements at that date. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the interim periods presented. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the U.S. ("GAAP"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's audited annual consolidated financial statements for the fiscal year ended December 27, 2020, included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the "SEC") on February 25, 2021 (the "Form 10-K"). Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

(b) Principles of Consolidation

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

(c) Fiscal Year

The Company has a 52/53 week fiscal year ending on the last Sunday of the calendar year. The three month periods ended June 27, 2021 and June 28, 2020 consisted of 13-week periods. The six month periods ended June 27, 2021 and June 28, 2020 consisted of 26-week periods. There are 52 calendar weeks in the fiscal years ending on December 26, 2021 and December 27, 2020.

(d) Accounting Estimates

There have been no significant changes in the Company's accounting estimates for the six months ended June 27, 2021 as compared to the accounting estimates described in the Form 10-K.

(e) Accounting Standards Updates

In December 2019, the Financial Accounting Standards Board ("FASB") issued ASU No. 2019-12 ("ASU 2019-12"), *Income taxes (Topic 740): Simplifying the Accounting for Income Taxes*. ASU 2019-12, in an effort to reduce the complexity in accounting for income taxes, removes certain exceptions for measuring intraperiod tax allocations, foreign subsidiary equity method investments and interim period tax losses. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020. The Company adopted ASU 2019-12 effective December 28, 2020. The implementation of this guidance did not have a material effect on its unaudited condensed consolidated financial statements.

(f) Fair Value of Financial Instruments

The carrying amounts and the related estimated fair values of the Company's long-term debt financial instruments not measured at fair value on a recurring basis at June 27, 2021 and December 27, 2020 are presented in Note 10. The carrying value of all other financial instruments, including cash equivalents, accounts receivable, unbilled receivables, accounts payable, accrued expenses, billings in excess of cost and earnings on uncompleted contracts, income taxes payable and short-term debt, approximated their estimated fair values at June 27, 2021 and December 27, 2020 due to the short-term nature of these instruments.

Note 2. Acquisitions

Technical Directions, Inc.

On February 24, 2020, the Company acquired Technical Directions, Inc. ("TDI"), a turbine technology company focused on tactical unmanned aerial drones, missile and other systems for approximately $10.5 million in cash, subject to adjustments for transaction expenses, indebtedness, cash on hand, and post-closing working capital adjustments. Working capital adjustments of $0.3 million were settled in the third quarter of 2020. The operating results of the acquisition have been included in the Company's results of operations from the effective acquisition date. Had the acquisition occurred as of December 30, 2019, net sales, net loss from consolidated operations, net loss attributable to Kratos, and basic and diluted net loss per share attributable to Kratos on a pro forma basis for the six months ended June 28, 2020 would not have been materially different than the reported amounts. TDI is included in the Kratos Unmanned Systems ("US") segment.

Optimized Performance Machining, Inc.

On April 17, 2020, the Company acquired Optimized Performance Machining, Inc. ("OPM"), a company that primarily operates in the industrial machinery and equipment repair business industry for approximately $1.8 million in cash, subject to adjustments for transaction expenses, indebtedness, cash on hand, and post-closing working capital adjustments. Working capital adjustments of $0.03 million were settled in the third quarter of 2020. The operating results of the acquisition have been included in the Company's results of operations from the effective acquisition date. Had the acquisition occurred as of December 30, 2019, net sales, net loss from consolidated operations, net loss attributable to Kratos, and basic and diluted net loss per share attributable to Kratos on a pro forma basis for the six months ended June 28, 2020 would not have been materially different than the reported amounts. OPM is included in the Kratos US segment.

CPI ASC Signal Division, Inc.

On June 15, 2020, Kratos Integral Holdings, LLC entered into a Stock Purchase Agreement to acquire CPI ASC Signal Division, Inc. ("ASC Signal") from Communications & Power Industries LLC for approximately $35 million in cash, subject to adjustments for transaction expenses, indebtedness, cash on hand, and working capital adjustments. ASC Signal is a manufacturer of high-performance, highly engineered antenna systems for satellite communications, radar, electronic warfare, and high frequency applications. On June 30, 2020, the acquisition was completed following the satisfaction of all closing conditions, including receipt of regulatory approval from all required government authorities. The adjustments for transaction expenses, indebtedness, cash on hand and working capital were settled by the parties in January 2021, resulting in a net payment due to the Company of approximately $1.4 million. ASC Signal is included in the Kratos Space, Training and Cyber, ("KSTC") Division of the Kratos Government Solutions ("KGS") segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The goodwill represents the value the Company expects to be created by integrating ASC Signal's existing business with Kratos' related products and customers.

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

Accounts receivable	$	5.7
Unbilled receivables		0.9
Inventoried costs		10.4
Other current assets		1.8
Property and equipment		10.0
Intangible assets		4.3
Goodwill		10.8
Total identifiable net assets acquired		43.9
Total identifiable net liabilities assumed		(11.0)
Net assets acquired, excluding cash	$	32.9

Based on the Company's estimate of fair value, as of June 30, 2020, net liabilities included $9.1 million of current liabilities. The identifiable intangible assets include trade names of $0.1 million with a remaining useful life of 1 year, customer relationships of $2.0 million with remaining useful lives of 5 years, and developed technology of $2.2 million with a remaining useful life of 7 years. The Company also established a deferred tax liability of $1.1 million for the difference between the financial statement basis and tax basis of the acquired assets of ASC Signal and a corresponding increase in goodwill. The goodwill recorded in this transaction is not expected to be tax-deductible.

The amounts of revenue and operating income of ASC Signal included in the Company's condensed consolidated statement of operations for the six months ended June 27, 2021 were $20.4 million and $0.7 million, respectively.

A summary of the consideration paid for the acquired ownership in ASC Signal is as follows:

Cash paid	$	34.9
Less: Cash acquired		(2.0)
Total consideration	$	32.9

Pro Forma Financial Information

The following tables summarize the supplemental condensed consolidated statements of operations information on an unaudited pro forma basis as if the acquisition of ASC Signal occurred on December 30, 2019 and include adjustments that were directly attributable to the foregoing transaction. There are no material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenues and loss. The pro forma results are for illustrative purposes only for the applicable period and do not purport to be indicative of the actual results that would have occurred had the transaction been completed as of the beginning of the period, nor are they indicative of results of operations that may occur in the future.

For the six months ended June 28, 2020 (all amounts, except per share amounts, are in millions):

Pro forma revenues	$	357.1
Pro forma net loss before tax	$	(8.3)
Pro forma net loss	$	(5.9)
Pro forma net loss attributable to Kratos	$	(5.8)
Basic pro forma loss per share attributable to Kratos	$	(0.05)
Diluted pro forma loss per share attributable to Kratos	$	(0.05)

5-*D Systems, Inc.*

On November 18, 2020, the Company acquired 5-D Systems, Inc. ("5-D Systems"), a leading National Security Solutions provider and industry-leading provider of high-performance, jet-powered unmanned aerial systems for an aggregate of approximately $10.0 million. The purchase price was $5.0 million in cash, subject to adjustments for transaction expenses, indebtedness, cash on hand, and post-closing working capital adjustments, and 250,374 shares of common stock (with a value of approximately $5.0 million). The allocation of the total consideration for this acquisition to the tangible and identifiable intangible assets acquired and liabilities assumed is preliminary until the Company obtains final information regarding their fair values. However, the Company does not expect any adjustment to such allocations to be material to the Company's consolidated financial statements. The operating results of the acquisition have been included in the Company's results of operations from the effective acquisition date. Had the acquisition occurred as of December 30, 2019, net sales, net loss from consolidated operations, net loss attributable to Kratos, and basic and diluted net loss per share attributable to Kratos on a pro forma basis for six months ended June 28, 2020 would not have been materially different than the reported amounts. 5-D Systems is included in the Kratos US segment.

Note 3. Revenue Recognition

Effective January 1, 2018, the Company adopted the FASB ASU 2014-09, Revenue from Contracts with Customers, and the related amendments, which are codified into Accounting Standards Codification ("ASC") 606 ("ASC 606").

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

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

For the majority of contracts, the Company satisfies the underlying performance obligations over time as the customer obtains control or receives benefits as work is performed on the contract. As a result, under ASC 606 revenue is recognized over a time using the cost-to-cost method (cost incurred relative to total estimated cost at completion).

Remaining Performance Obligations

The Company calculates revenues from remaining performance obligations as the dollar value of the remaining performance obligations on executed contracts. On June 27, 2021, the Company had approximately $865.6 million of remaining performance obligations. The Company expects to recognize approximately 39% of the remaining performance obligations as revenue in 2021, an additional 27% in 2022, and the balance thereafter.

Contract Estimates

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

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

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

As a result of the EAC process, any quarterly adjustments to revenues, cost of sales, and the related impact to operating income are recognized as necessary in the period they become known. These adjustments may result from positive program performance, and may result in an increase in operating income during the performance of individual performance obligations, if it is determined the Company will be successful in mitigating risks surrounding the technical, schedule and cost aspects of those performance obligations or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating income if it is determined the Company will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, cost of sales and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods. A significant change in one or more of these estimates could affect the profitability of one or more of the Company's contracts. When estimates of total costs to be incurred on a performance obligation exceed total estimates of revenue to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined. No cumulative catch-up adjustment on any one contract was material to the Company's unaudited condensed consolidated financial statements for the three and six-month periods ended June 27, 2021, and June 28, 2020. Likewise, total cumulative catch-up adjustments were not material for the three and six-month periods ended June 27, 2021, and June 28, 2020.

Contract Assets and Liabilities

For each of the Company's contracts, the timing of revenue recognition, customer billings, and cash collections results in a net contract asset or liability at the end of each reporting period. Fixed-price contracts are typically billed to the customer either using progress payments, whereby amounts are billed monthly as costs are incurred or work is completed, or performance based payments, which are based upon the achievement of specific, measurable events or accomplishments defined and valued at contract inception. Cost-type contracts are typically billed to the customer on a monthly or semi-monthly basis.

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

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

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

	June 27, 2021	December 27, 2020	Net Change
Contract assets	$ 185.0	$ 177.0	$ 8.0
Contract liabilities	$ 43.5	$ 34.0	$ 9.5
Net contract assets	$ 141.5	$ 143.0	$ (1.5)

Contract assets increased $8.0 million during the six months ended June 27, 2021, primarily due to the recognition of revenue related to the satisfaction or partial satisfaction of performance obligations for which the Company has not yet billed the customers. There were no significant impairment losses related to any receivables or contract assets arising from the Company’s contracts with customers during the six months ended June 27, 2021. Contract liabilities increased $9.5 million during the six months ended June 27, 2021, primarily due to payments received in excess of revenue recognized on these performance obligations. For the three and six months ended June 27, 2021 the Company recognized revenue of $5.9 million and $22.9 million, respectively, that was previously included in the contract liabilities that existed at December 27, 2020. For the three and six months ended June 28, 2020 the Company recognized revenue of $5.7 million and $20.0 million, respectively, that was previously included in the contract liabilities that existed at December 29, 2019.

In November 2019, a large training solutions program was terminated for convenience (“T for C”) by the customer. Under a T for C, a contractor is entitled to seek specified costs through a termination settlement process including (1) the contract price for completed supplies and services accepted by the government but not previously paid for; (2) the cost incurred in the performance of work terminated plus a reasonable profit on those costs; and (3) its costs incurred in settling with subcontractors and preparing and settling the termination proposal. Under a T for C, the Company would not be able to collect the total withheld amounts until the settlement terms of the T for C have been negotiated and agreed to with the customer. At June 27, 2021, approximately $11.5 million in unbilled receivables remained outstanding on this project. In addition, the Company is currently in dispute with an international customer in the US segment over approximately $10.0 million in unbilled receivables outstanding as of June 27, 2021. The dispute with the international customer concerns the completion of certain system requirements and certain contractual milestones. The Company alleges breach of contract, as well as other claims against the customer, and seeks damages and other equitable relief. The customer has asserted counterclaims seeking liquidated damages and additional relief. Management has evaluated the present facts of the matters and performed a reassessment of the contractual amounts due and has determined that no adjustment to previously recognized revenue, or the corresponding unbilled receivables, is necessary at June 27, 2021.

Disaggregation of Revenue

The following series of tables presents the Company's revenue disaggregated by several categories. For the majority of contracts, revenue is recognized over time as work is performed on the contract. Revenue by contract type was as follows (in millions):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Kratos Government Solutions				
Fixed price	$ 107.1	$ 98.2	$ 206.6	$ 202.6
Cost plus fee	28.0	20.8	56.6	35.2
Time and materials	9.7	9.4	19.9	17.5
Total Kratos Government Solutions	144.8	128.4	283.1	255.3
Unmanned Systems				
Fixed price	36.4	28.6	73.6	55.9
Cost plus fee	23.4	12.8	41.3	26.9
Time and materials	0.5	0.6	1.3	1.2
Total Unmanned Systems	60.3	42.0	116.2	84.0
Total Revenues	$ 205.1	$ 170.4	$ 399.3	$ 339.3

Revenue by customer was as follows (in millions):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Kratos Government Solutions				
U.S. Government [(1)]	$ 91.8	$ 90.0	$ 184.4	$ 174.7
International [(2)]	35.8	24.9	67.5	52.9
U.S. Commercial and other customers	17.2	13.5	31.2	27.7
Total Kratos Government Solutions	144.8	128.4	283.1	255.3
Unmanned Systems				
U.S. Government [(1)]	54.4	39.4	104.0	78.8
International [(2)]	5.5	2.5	11.8	4.9
U.S. Commercial and other customers	0.4	0.1	0.4	0.3
Total Unmanned Systems	60.3	42.0	116.2	84.0
Total Revenues	$ 205.1	$ 170.4	$ 399.3	$ 339.3

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

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

Note 4. Discontinued Operations

On February 28, 2018, the Company entered into a Stock Purchase Agreement to sell the operations of Kratos Public Safety & Security Solutions, Inc., a Delaware corporation and wholly owned subsidiary of the Company ("PSS"), to Securitas Electronic Security, Inc., a Delaware corporation ("Buyer"). On June 11, 2018, the Company completed the sale of all of the issued and outstanding capital stock of PSS to Buyer for a purchase price of $69 million in cash, subject to a closing net working capital adjustment (the "Transaction"). To date, the Company has received approximately $70 million of aggregate net cash proceeds from the Transaction, after taking into account amounts that were paid by the Company pursuant to a negotiated transaction services agreement between the Company and the Buyer, receipt of approximately $6.9 million in net working capital retained by the Company, and associated transaction fees and expenses, excluding the impact of the final settlement and determination of the closing net working capital adjustment. The Company and the Buyer are currently in a dispute regarding the closing net working capital adjustment. The amount in dispute is approximately $8 million. The Company has recorded a net break-even on the sale of the PSS business which includes the aggregate net proceeds described above that have been collected, excluding the impact of the final settlement and determination of the closing net working capital adjustment. The resolution of the ongoing dispute will be recorded in future periods when resolved.

Note 5. Goodwill and Intangible Assets

(a) Goodwill

The carrying amounts of goodwill as of June 27, 2021 and December 27, 2020 by reportable segment are as follows (in millions):

	As of June 27, 2021		
	KGS	US	Total
Gross value	$ 609.6	$ 127.4	$ 737.0
Less accumulated impairment	239.5	13.8	253.3
Net	$ 370.1	$ 113.6	$ 483.7

	As of December 27, 2020		
	KGS	US	Total
Gross value	$ 609.6	$ 127.6	$ 737.2
Less accumulated impairment	239.5	13.8	253.3
Net	$ 370.1	$ 113.8	$ 483.9

(b) Purchased Intangible Assets

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

	As of June 27, 2021			As of December 27, 2020		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets:						
Customer relationships	$ 75.3	$ (56.7)	$ 18.6	$ 75.3	$ (55.7)	$ 19.6
Contracts and backlog	33.4	(32.2)	1.2	33.4	(31.0)	2.4
Developed technology and technical know-how	29.9	(25.5)	4.4	29.9	(25.3)	4.6
Trade names	2.0	(2.0)	—	2.0	(1.9)	0.1
In-process research and development	9.4	(0.1)	9.3	9.4	—	9.4
Total finite-lived intangible assets	150.0	(116.5)	33.5	150.0	(113.9)	36.1
Indefinite-lived trade names	6.9	—	6.9	6.9	—	6.9
Total intangible assets	$ 156.9	$ (116.5)	$ 40.4	$ 156.9	$ (113.9)	$ 43.0

Consolidated amortization expense related to intangible assets subject to amortization was $1.2 million and $1.8 million for the three months ended June 27, 2021 and June 28, 2020, respectively, and $2.6 million and $3.7 million for the six months ended June 27, 2021 and June 28, 2020, respectively.

Note 6. Inventoried Costs

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

	June 27, 2021	December 27, 2020
Raw materials	$ 56.1	$ 47.3
Work in process	30.5	30.1
Finished goods	4.1	3.8
Total inventoried costs	$ 90.7	$ 81.2

Note 7. Net Income (Loss) per Common Share

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

Shares from stock options and awards, excluded from the calculation of diluted net loss per share because their inclusion would have been anti-dilutive, were 0.8 million and 0.8 million for the three and six months ended June 28, 2020, respectively.

Note 8. Leases

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

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

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

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Amortization of right of use assets - finance leases	$ 0.6	$ 0.5	$ 1.1	$ 1.0
Interest on lease liabilities - finance leases	0.7	0.7	1.3	1.3
Operating lease cost	2.8	2.9	5.7	6.4
Short-term lease cost	0.2	0.2	0.4	0.4
Variable lease cost (cost excluded from lease payments)	0.1	0.1	0.1	0.1
Sublease income	(0.1)	(0.2)	(0.1)	(1.0)
Total lease cost	$ 4.3	$ 4.2	$ 8.5	$ 8.2

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

	June 27, 2021	December 27, 2020
Operating Leases:		
Operating lease right-of-use assets	$ 40.1	$ 42.9
Current portion of operating lease liabilities	$ 9.3	$ 8.9
Operating lease liabilities, net of current portion	$ 35.3	$ 38.6
Finance leases:		
Property, plant and equipment, net	$ 33.0	$ 36.5
Other current liabilities	$ 0.9	$ 0.9
Other long-term liabilities	$ 38.3	$ 38.8

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

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Finance lease - cash paid for interest	$ 0.7	$ 0.7	$ 1.3	$ 1.3
Finance lease - financing cash flows	$ 0.2	$ 0.1	$ 0.4	$ 0.3
Operating lease - operating cash flows (fixed payments)	$ 3.0	$ 3.2	$ 5.8	$ 7.3

Other supplemental noncash information (in millions):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Operating lease liabilities arising from obtaining right-of-use assets	$ 1.7	$ 0.5	$ 1.9	$ 1.0
Finance lease liabilities arising from obtaining right-of-use assets	$ —	$ —	$ —	$ 0.4
Weighted-average remaining lease term (in years):				
Operating leases			5.09	5.59
Finance leases			17.22	18.43
Weighted-average discount rate:				
Operating leases			6.50 %	6.47 %
Finance leases			6.51 %	6.52 %

The maturity of lease liabilities is (in millions):

	Operating Leases	Finance Leases
2021 [1]	$ 6.0	$ 1.7
2022	11.1	3.5
2023	10.7	3.5
2024	8.4	3.5
2025	7.3	3.6
Thereafter	9.0	51.3
Total lease payments	52.5	67.1
Less: imputed interest	(7.9)	(27.9)
Total present value of lease liabilities	$ 44.6	$ 39.2

[1] Excludes the six months ended June 27, 2021.

Note 9. Income Taxes

A reconciliation of the total income tax benefit to the amount computed by applying the statutory federal income tax rate of 21% to income from continuing operations before income taxes for the three and six months ended June 27, 2021 and June 28, 2020 is as follows (in millions):

	For the Three Months Ended		For the Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Income tax benefit at federal statutory rate	$ (0.5)	$ (0.5)	$ (0.7)	$ (0.8)
State and foreign taxes, net of federal tax benefit and valuation allowance	(1.5)	(0.4)	(1.5)	(0.7)
Release of valuation allowance due to acquisitions	—	—	—	(0.9)
Nondeductible expenses and other	(2.0)	(1.2)	(2.2)	(1.3)
Impact of deferred tax liabilities for indefinite-lived assets	—	(0.6)	—	(0.6)
Increase (decrease) in reserves for uncertain tax positions	0.1	(0.8)	0.1	(1.0)
Stock compensation - excess tax benefits	(0.2)	—	(2.6)	—
Federal impact of research & development tax credits	0.5	—	0.6	—
Increase in federal valuation allowance	—	1.7	—	2.1
Benefit for income taxes from continuing operations	$ (3.6)	$ (1.8)	$ (6.3)	$ (3.2)

During the fourth quarter of 2020, the Company evaluated all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets was still needed. Evidence evaluated by the Company included, but was not limited to, the fact that it was in a three-year cumulative income position and no longer had cumulative losses in recent years, the results and trend of pretax book income from core operations, and its forecast of taxable income for 2021 and beyond. As a result, the Company had determined that it is more likely than not that sufficient taxable income will exist to realize the majority of its U.S. deferred tax assets and reversed a significant portion of the valuation allowance previously recorded against those deferred tax assets as of December 27, 2020. The remaining valuation allowance on the Company’s U.S. deferred tax assets relates primarily to state net operating loss and capital loss carryforwards the Company estimates are not more likely than not to be utilized in future periods.

In assessing the Company’s ability to realize deferred tax assets, management considers, on a periodic basis, whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. In making this assessment, the Company has concluded that positive evidence continues to outweigh the negative evidence as of June 27, 2021.

Federal and state income tax laws impose restrictions on the utilization of net operating loss (“NOL”) and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code of 1986, as amended (“Section 382”). In general, an ownership change occurs when shareholders owning 5% or more of a “loss corporation” (a corporation entitled to use NOLs or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any three-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation's value at the time of the ownership change by the greater of the long-term tax-exempt rate determined by the Internal Revenue Service in the month of the ownership change or the two preceding months. This base limitation is subject to adjustments, including an increase for built-in gains recognized in the five-year period after the ownership change.

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

For the six months ended June 27, 2021, there was no impact of such limitations on the income tax provision, since the amount of taxable income did not exceed the annual limitation amount. However, future equity offerings or acquisitions that have equity as a component of the purchase price could also cause an "ownership change." If and when any other "ownership change" occurs, utilization of the NOLs or other tax attributes may be further limited.

The Company is subject to taxation in the U.S. and various state and foreign tax jurisdictions. The Company's tax years for 2000 and later are subject to examination by the U.S. and state tax authorities due to the existence of the NOL carryforwards. Generally, the Company's tax years for 2015 and later are subject to examination by various foreign tax authorities as well.

As of December 27, 2020, the Company had $25.4 million of unrecognized tax benefits that, if recognized, would impact the Company's effective income tax rate. During the six months ended June 27, 2021 unrecognized tax benefits decreased by $0.3 million relating to various current year tax positions.

The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. For the six months ended June 27, 2021 and June 28, 2020, the Company recorded an expense for interest and penalties of $0.5 million and $0.1 million, respectively. For the six months ended June 27, 2021 and June 28, 2020, there was no material benefit recorded related to the removal of interest and penalties. The Company believes that it is reasonably possible that as much as $0.3 million of the liabilities for uncertain tax positions will expire within the next twelve months due to the expiration of various applicable statutes of limitations.

Note 10. Debt

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

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

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

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

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

The 6.5% Notes are redeemable by the Company, in whole or in part, at the respective redemption prices specified in the Indenture. The Company may also be required to make an offer to purchase the 6.5% Notes upon a change of control and certain sales of its assets.

The Indenture contains covenants limiting, among other things, the Company's ability and the Subsidiary Guarantors' ability to: (a) pay dividends on or make distributions or repurchase or redeem the Company's capital stock or make other restricted payments; (b) incur additional debt and guarantee debt; (c) prepay, redeem or repurchase certain debt; (d) issue certain preferred stock or similar equity securities; (e) make loans and investments; (f) sell assets; (g) incur liens; (h) consolidate, merge, sell or otherwise dispose of all or substantially all of the Company's assets; (i) enter into transactions with affiliates; and (j) enter into agreements restricting the Company's ability and certain of its subsidiaries' ability to pay dividends. These covenants are subject to a number of exceptions. As of June 27, 2021, the Company was in compliance with the covenants contained in the Indenture governing the 6.5% Notes.

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

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

As of June 27, 2021, there was $300.0 million of 6.5% Notes outstanding.

(b) Other Indebtedness

Credit and Security Agreement

On November 20, 2017, the Company entered into an amended and restated credit and security agreement (as amended, the "Credit Agreement"), with the lenders named therein, SunTrust Bank, as Agent (the "Agent"), and SunTrust Robinson Humphrey, Inc., as Lead Arranger and Sole Book Runner. The Credit Agreement established a five-year senior secured revolving credit facility in the aggregate principal amount of $90.0 million (subject to a potential increase of the aggregate principal amount to $115.0 million, subject to the Agent's and applicable lenders' approval), 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.

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

The measurement of a minimum fixed charge coverage ratio is required to be measured if Excess Availability, as defined in the Credit Agreement, is less than fifty percent of the lesser of the Borrowing Base or the Total Commitment Amount, each as defined in the Credit Agreement.

As of June 27, 2021, there were no borrowings outstanding on the Credit Agreement and $5.9 million was outstanding on letters of credit, resulting in net borrowing base availability of $64.4 million. The Company was in compliance with the financial covenants of the Credit Agreement and its amendments as of June 27, 2021.

Israel Debt

During August 2020, the Company entered into two 5-year term loans with two banks in Israel representing an aggregate principal amount of approximately $5.1 million. These loans were subsidized by the State of Israel as part of a COVID-19 relief package with interest at Israeli NIS prime interest, plus a margin of 1.5%. The first year of interest is paid by the State of Israel with subsequent interest and principal payments due monthly, commencing in August 2021. The Company intends to repay the outstanding balance of the loan in August 2021.

5-D Systems Loan

In connection with the acquisition of 5-D Systems, the Company assumed a loan in the amount of approximately $0.5 million with an interest rate of 1.0% that had been obtained under the Small Business Administration Paycheck Protection Program as part of a COVID-19 relief package. Payment of interest and principal is due monthly with the balance due in April 2022. The sellers of 5-D Systems applied for forgiveness of this loan and, as part of the purchase of 5-D Systems by the Company, agreed to indemnify Kratos in the event the application for forgiveness of the loan was not accepted. The application was accepted and the loan was forgiven in July 2021.

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 June 27, 2021 and December 27, 2020 are presented in the following table:

	As of June 27, 2021			As of December 27, 2020		
$ in millions	**Principal**	**Carrying Amount**	**Fair Value**	**Principal**	**Carrying Amount**	**Fair Value**
Total long-term debt including current portion	$ 305.6	$ 301.9	$ 319.3	$ 305.6	$ 301.5	$ 319.6

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 June 27, 2021, the difference between the carrying amount of $301.9 million and the principal amount of $305.6 million presented in the table above is the unamortized debt issuance costs of $3.7 million, which are being accreted to interest expense over the term of the related debt. As of December 27, 2020, the difference between the carrying amount of $301.5 million and the principal amount of $305.6 million presented in the above table also related to the same unamortized debt issuance costs of $4.1 million.

Note 11. Segment Information

The Company operates in two reportable segments. The KGS reportable segment is comprised of an aggregation of KGS operating business units, including the Company's microwave electronic products, space and satellite communications, training and cybersecurity, C5ISR/modular systems, turbine technologies and defense and rocket support services operating segments. The US reportable segment consists of the Company's unmanned aerial, unmanned ground, unmanned 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 U.S. Department of Defense (the "DoD"), intelligence agencies and classified agencies, and to a lesser degree, international government agencies and domestic and international commercial customers.

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

Revenues, depreciation and amortization, and operating income generated by the Company's reportable segments for the three and six month periods ended June 27, 2021 and June 28, 2020 are as follows (in millions):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Revenues:				
Kratos Government Solutions				
Service revenues	$ 56.7	$ 62.9	$ 112.8	$ 126.5
Product sales	88.1	65.5	170.3	128.8
Total Kratos Government Solutions	144.8	128.4	283.1	255.3
Unmanned Systems				
Service revenues	1.3	—	2.5	—
Product sales	59.0	42.0	113.7	84.0
Total Unmanned Systems	60.3	42.0	116.2	84.0
Total revenues	$ 205.1	$ 170.4	$ 399.3	$ 339.3
Depreciation & amortization:				
Kratos Government Solutions	$ 4.5	$ 4.4	$ 8.9	$ 9.1
Unmanned Systems	2.5	1.6	4.4	3.2
Total depreciation and amortization	$ 7.0	$ 6.0	$ 13.3	$ 12.3
Operating income from continuing operations:				
Kratos Government Solutions	$ 5.9	$ 7.7	$ 13.0	$ 17.0
Unmanned Systems	4.1	1.0	8.3	1.5
Corporate activities	(6.7)	(5.8)	(13.1)	(10.9)
Total operating income from continuing operations	$ 3.3	$ 2.9	$ 8.2	$ 7.6

Note 12. Redeemable Noncontrolling Interest

On February 27, 2019, the Company acquired 80.1% of the issued and outstanding shares of capital stock of Florida Turbine Technologies Inc., a Florida corporation ("FTT Inc."), and 80.1% of the membership interests in FTT CORE, LLC, a Delaware limited liability company ("FTT Core" and, together with FTT Inc. and their respective subsidiaries, "FTT"), for an aggregate purchase price of approximately $60 million. In connection with the Company's acquisition of FTT, (i) beginning in January 2024, the holders (the "Holders") of the minority interests in FTT Inc. and FTT Core (the "Minority Interests") will have an annual right (the "Put Right") to sell all of the Minority Interests to the Company at a purchase price based on a specified multiple of the trailing 12 months EBITDA of FTT Inc., FTT Core and each of their respective subsidiaries (the "Acquired Companies"), subject to adjustment as set forth in the Exchange Agreement entered into by and among the Company, the Acquired Companies and the Holders (the "Exchange Agreement") (provided, however, that following certain events, including a change of control, the Put Right will be accelerated and the Minority Interest Purchase Price (as defined in the Exchange Agreement) will be a specified increased multiple of the trailing 12 months EBITDA of the Acquired Companies); and (ii) beginning in January 2025, the Company will have an annual right to purchase all of the Minority Interests from the Holders at the Minority Interest Purchase Price.

The Company adjusts the carrying value of such redeemable noncontrolling interest based on an allocation of subsidiary earnings based on ownership interest. Redeemable noncontrolling interest is recorded outside of permanent equity at the higher of its carrying value or management's estimate of the amount (the "Redemption Amount") that the Company could be required to pay in connection with the Put Right. Adjustments to the Redemption Amount will have a corresponding effect on net income per share attributable to Kratos shareholders. As of June 27, 2021, no adjustment of the carrying value of the redeemable noncontrolling interest was required.

Note 13. Stockholders' Equity – Common Stock

On June 23, 2020, the Company sold 15,525,000 shares of its common stock at a public offering price of $16.25 per share in an underwritten public offering. The Company received gross proceeds of approximately $252.3 million. After deducting underwriting fees and other offering expenses, the Company received approximately $240.4 million in net proceeds. The Company expects to use the net proceeds for general corporate purposes, including for potential strategic "tuck-in" acquisitions, to further position the Company for projected growth from new and anticipated increased production and to facilitate its long-term strategy.

Note 14. Significant Customers

Revenue from the U.S. Government, which includes foreign military sales contracted through the U.S. Government, includes revenue from contracts for which the Company is the prime contractor as well as those for which the Company is a subcontractor and the ultimate customer is the U.S. Government. The KGS and US segments have substantial revenue from the U.S. Government. Sales to the U.S. Government amounted to approximately $146.2 million and $129.4 million, or 71% and 76% of total Kratos revenue, for the three months ended June 27, 2021 and June 28, 2020, respectively, and $288.4 million and $253.5 million, or 72% and 75% of total Kratos revenue, for the six months ended June 27, 2021 and June 28, 2020, respectively.

Note 15. Commitments and Contingencies

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

Legal and Regulatory Matters

U.S. Government Cost Claims

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

Other Litigation Matters

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

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

This Quarterly Report on Form 10-Q (this "Quarterly Report") contains "forward-looking statements" relating to our future financial performance, the market for our services and our expansion plans and opportunities. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," or "continue," the negative of such terms or other comparable terminology. These forward-looking statements reflect our current beliefs, expectations and projections, are based on assumptions, and are subject to known and unknown risks and uncertainties that could cause our actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of these factors are beyond our ability to control or predict. As a result, you should not place undue reliance on forward-looking statements. Important risks and uncertainties that could cause our actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements include, but are not limited to: changes or cutbacks in spending or the appropriation of funding by the federal government, including the U.S. Department of Defense (the "DoD"), which could cause delays, cancellations or reductions of key government contracts; bid protests; changes in the scope or timing of our projects; the timing, rescheduling or cancellation of significant customer contracts and agreements; failure by our subcontractors or suppliers to perform their contractual obligations; our failure to meet performance obligations; if the unmanned systems markets do not experience significant growth, if we cannot expand our customer base or if our products do not achieve broad acceptance which could impact our ability to achieve our anticipated level of growth; consolidation by or the loss of key customers; risks of adverse regulatory action or litigation; risks associated with debt leverage; failure to successfully achieve our acquisition, integration, cost reduction or divestiture strategies; risks related to security breaches, cybersecurity attacks or other significant disruptions of our information systems; risks associated with pandemics, epidemics or other public health emergencies, such as the outbreak of COVID-19;risks related to unknown defects or errors in our products; and competition in the marketplace, which could reduce revenues and profit margins, as well as the additional risks and uncertainties described in this Quarterly Report, in "Item 1A-Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended December 27, 2020 filed with the U.S. Securities and Exchange Commission (the "SEC") on February 25, 2021 (the "Form 10-K"), and in other reports that we have filed with the SEC. These forward-looking statements reflect our views and assumptions only as of the date such forward-looking statements are made. Except as required by law, we assume no responsibility for updating any forward-looking statements, whether as a result of new information, future events or otherwise.

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

Overview

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

Industry Update

In May 2021, the Biden administration released a $6.011 trillion federal budget proposal for the U.S. Government's 2022 fiscal year ("FY") that begins on October 1, 2021, which includes $753 billion in National Security funding, an increase of 1.6 percent over FY 2021, and $715 billion for the DoD. The 2022 National Security request amounts to a slight decrease for the Pentagon when adjusted for inflation, and is also slightly below the previous administration's $722 billion FY 2022 DoD request. The FY 2022 proposal also ends the "off-budget" funding tool known as the Overseas Contingency Operations, or OCO, account. A five-year Future Years Defense Program strategic priority spending plan that is typically submitted annually along with that year's annual budget request, has not been submitted at this time. The FY 2022 National Security budget includes a focus on research and development for new technologies to address peer and near peer threats, including specifically China. The FY 2022 budget request prioritizes defense research and development, test and evaluation funding to invest in breakthrough technologies that are also focused on innovation and the development of next generation defense capabilities. The FY 2022 budget request also supports the DoD's plan to divest legacy systems and programs in order to redirect the related resources to innovation, new technology and new programs, platforms and systems.

On December 27, 2020, the Consolidated Appropriations Act, 2021, was signed into law. The $2.3 trillion spending bill combines $900 billion in stimulus relief for the COVID-19 pandemic in the United States with a $1.4 trillion omnibus spending bill for the FY 2021 (combining 12 separate annual appropriations bills). The bills allocate $695.9 billion for the DoD, a decrease of $9.7 billion from FY 2020. Also, the federal budget and debt ceiling are expected to continue to be the subject of considerable debate, which could have a significant impact on defense spending broadly and the Company's programs in particular. The U.S. Government's fiscal year ends September 30.

The budget environment, including COVID-19 spending increases proposed by the Biden administration, and uncertainty surrounding the debt ceiling and the appropriations process, remain significant short and long-term risks. Considerable uncertainty exists regarding how future budget and program decisions will unfold, including the defense spending priorities of the Administration and Congress and what challenges budget reductions (required by the Budget Control Act of 2011 ("BCA") and otherwise) will present for the defense industry. If annual appropriations bills are not timely enacted, the U.S. Government may again operate under continuing resolution authority ("CRA"), restricting new contract or program starts, restricting increased funding or additional quantities on existing contracts, presenting resource allocation and forecasting challenges and placing limitations on some planned program budgets, and we may face another government shutdown of unknown duration. If a prolonged government shutdown of the DoD were to occur, it could result in program cancellations, disruptions and/or stop work orders and could limit the U.S. Government's ability to effectively progress programs and to make timely payments, and our ability to perform on our U.S. Government contracts and successfully compete for new work.

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

Additionally, funding for certain programs in which we currently participate may be reduced, delayed or cancelled, and budget uncertainty or funding cuts globally could adversely affect the viability of our partners, teammates, subcontractors and suppliers, and our employee base. While we believe that our business is well-positioned in areas that the DoD and other customers indicate are priorities for future defense spending, including in the 2018 and 2020 National Defense Strategy documents, the short and long-term impact of federal budgetary uncertainty, CRAs, the BCA, other defense spending cuts, challenges in the appropriations process, the debt ceiling and the ongoing fiscal debates remain uncertain. Such a challenging federal and DoD budgetary environment may negatively impact our business and programs and could have a material adverse effect on our forecasts, estimates, financial position, results of operations and/or cash flows.

The nature of our operations expose us to risks associated with pandemics, epidemics or other public health emergencies, such as the outbreak of COVID-19. In March 2020, the World Health Organization categorized COVID-19 as a pandemic, and the President of the United States declared the COVID-19 outbreak a national emergency. The outbreak has resulted in governments around the world, including the U.S. Government and the DoD, implementing measures to help control the spread of the virus, including quarantines, "shelter in place" and "stay at home" orders, travel restrictions, business curtailments, school closures, and other measures. In addition, governments and central banks in several parts of the world have enacted fiscal and monetary stimulus measures to counteract the impacts of COVID-19.

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

The ability of our employees, our suppliers' and our customers' employees to work may be significantly impacted by individuals contracting or being exposed to COVID-19, or as a result of the control measures noted above, which may significantly hamper our production, operations, including throughout the supply chain. On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act, a $2 trillion economic relief bill, was signed into law. Subsequently, on March 11, 2021, the American Rescue Plan Act, a $1.9 trillion economic stimulus bill was enacted. We are continuing to evaluate the impact of these two budget packages including related stimulus and economic relief actions on our business.

Since the end of the first quarter of 2020, COVID-19 has continued to impact our customers, markets and operations, including supply chain disruptions, delays of certain supplier deliveries, difficulties gaining access to certain locations, difficulties gaining access to customers, including instances related to previously scheduled drone and rocket system flights, demonstrations and exercises, and decreased demand requirements of certain of our commercial aero, power and satcom customers. Importantly, COVID-19 customer and contractor-related travel and social distancing restrictions have delayed a number of our target drone, tactical drone and rocket system programs, missions and exercises. The extent to which COVID-19 may further impact our business depends on future developments, which are highly uncertain and unpredictable, including new information concerning the severity of the outbreak and the effectiveness of actions globally to contain or mitigate its effects. While we currently do not expect this matter to have a material impact on our results of operations, cash flows and financial position, the current level of uncertainty over the economic, business and operational impacts of COVID-19 means the related financial impact cannot be reasonably estimated at this time. Our Condensed Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations reflect estimates and assumptions made by management as of June 27, 2021. Events and changes in circumstances arising after June 27, 2021, including those resulting from the continuing impacts of COVID-19, will be reflected in management's estimates for future periods.

Reportable Segments

The Company currently operates in two reportable segments. The Kratos Government Solutions ("KGS") reportable segment is comprised of an aggregation of KGS operating segments, including our microwave electronic products, space and satellite communications, training and cybersecurity, C5ISR/modular systems, turbine technologies, and defense and rocket support services operating segments. The Unmanned Systems ("US") reportable segment consists of our unmanned aerial, unmanned ground, unmanned seaborne and command, control and communications system businesses.

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

Comparison of Results for the Three Months Ended June 27, 2021 to the Three Months Ended June 28, 2020

Revenues. Revenues by operating segment for the three months ended June 27, 2021 and June 28, 2020 are as follows (dollars in millions):

	June 27, 2021	June 28, 2020	$ change	% change
Kratos Government Solutions				
Service revenues	$ 56.7	$ 62.9	$ (6.2)	(9.9)%
Product sales	88.1	65.5	22.6	34.5 %
Total Kratos Government Solutions	144.8	128.4	16.4	12.8 %
Unmanned Systems				
Service revenues	1.3	$ —	$ 1.3	— %
Product sales	59.0	42.0	17.0	40.5 %
Total Unmanned Systems	60.3	42.0	18.3	43.6 %
Total revenues	$ 205.1	$ 170.4	$ 34.7	20.4 %
Total service revenues	$ 58.0	$ 62.9	$ (4.9)	(7.8)%
Total product sales	147.1	107.5	39.6	36.8 %
Total revenues	$ 205.1	$ 170.4	$ 34.7	20.4 %

Revenues increased $34.7 million to $205.1 million for the three months ended June 27, 2021 from $170.4 million for the three months ended June 28, 2020. Revenues in our KGS segment increased $16.4 million due to the contribution from the acquisition of CPI ASC Signal Division, Inc. ("ASC Signal"), which contributed approximately $11.8 million and organic growth in our microwave products, space and satellite communications, and rocket support businesses, partially offset by decreases in our training solutions business as a result of a reduction in scope of certain international training contracts which resulted in decreased revenues of approximately $4.7 million. Revenues in our US segment increased $18.3 million to $60.3 million for the three months ended June 27, 2021 primarily due to work performed on our SSAT 177 production contracts and Valkyrie programs, and due to contributions of approximately $2.1 million from the Technical Directions, Inc. ("TDI") and 5-D Systems, Inc. ("5-D Systems") acquisitions.

Product sales increased $39.6 million to $147.1 million for the three months ended June 27, 2021 from $107.5 million for the three months ended June 28, 2020 primarily as a result of increased production in certain US drone programs as well as the contribution from the ASC Signal acquisition. As a percentage of total revenue, product sales were 71.7% for the three months ended June 27, 2021 as compared to 63.1% for the three months ended June 28, 2020. Service revenues decreased by $4.9 million to $58.0 million for the three months ended June 27, 2021 from $62.9 million for the three months ended June 28, 2020. The decrease was primarily related to lower turbine technologies service revenue (which was offset by higher turbine technologies product sales) as well as the previously mentioned reduction in scope of certain international training contracts.

Cost of Revenues. Cost of revenues increased $28.7 million to $153.1 million for the three months ended June 27, 2021 from $124.4 million for the three months ended June 28, 2020. The increase in cost of revenues was primarily a result of the increase in product sales discussed above.

Gross margin decreased to 25.4% for the three months ended June 27, 2021 from 27.0% for the three months ended June 28, 2020. Margins on services increased to 28.8% for the three months ended June 27, 2021 from 26.6% for the three months ended June 28, 2020, due primarily to a more favorable mix of revenues. Margins on products decreased to 24.0% for the three months ended June 27, 2021 from 27.3% for the three months ended June 28, 2020, primarily due to a less favorable mix of certain programs with increased activity on certain developmental programs for the three months ended June 27, 2021. Margins in the KGS segment decreased to 27.2% for the three months ended June 27, 2021 from 28.7% for the three months ended June 28, 2020, primarily due to a less favorable mix of revenues. Margins in the US segment decreased to 20.9% for the three months ended June 27, 2021 from 21.9% for the three months ended June 28, 2020, primarily due to a less favorable mix of products produced and shipped in the three months ended June 27, 2021.

Selling, General and Administrative ("SG&A") Expenses. SG&A expense increased to $38.2 million for the three months ended June 27, 2021 from $36.0 million for the three months ended June 28, 2020, primarily due to increased costs as a result of the TDI, Optimized Performance Machining, Inc. ("OPM"), ASC Signal and 5-D Systems acquisitions in 2020. As a percentage of revenues, SG&A decreased to 18.6% at June 27, 2021 from 21.1% at June 28, 2020. Included in SG&A was an increase of $1.8 million of stock compensation expense from $4.8 million for the three months ended June 28, 2020 to $6.6 million for the three months ended June 27, 2021.

Research and Development (“R&D”) Expenses. R&D expenses increased $4.2 million to $10.2 million for the three months ended June 27, 2021 from $6.0 million for the three months ended June 28, 2020, with the primary increases in expenses being in our space and satellite communications business. As a percentage of revenues, R&D increased to 5.0% for the three months ended June 27, 2021 from 3.5% for the three months ended June 28, 2020. R&D expenses are made by the Company, typically in conjunction with our customers, for the Company to achieve a “first to market” position with our products or technology. We also invest in R&D expenses to achieve market leading “designed in” positions on major programs, platforms or systems.

Restructuring Expenses and Other. Restructuring expenses and other increased to $0.2 million from $0.1 million for the three months ended June 27, 2021 and June 28, 2020, respectively.

Total Other Expense, Net. Total other expense, net increased to $5.7 million from $5.3 million for the three months ended June 27, 2021 and June 28, 2020, respectively.

Benefit for Income Taxes from Continuing Operations. The income tax benefit from continuing operations for the three months ended June 27, 2021 and June 28, 2020 was $3.6 million and $1.8 million, respectively. For the three months ended June 27, 2021, a $0.2 million tax benefit was recorded resulting from the federal and state impact of stock-based compensation related to restricted stock units. The remaining $3.4 million benefit was a function of the estimated effective tax rate for the year. The estimated effective tax rate is driven by estimated foreign taxes, estimated federal and state taxes, permanent book/tax differences, and the projected income or loss for the year.

Loss from Discontinued Operations. The loss from discontinued operations was $0.3 million for the three months ended June 27, 2021, and $0.2 million for the three months ended June 28, 2020.

Comparison of Results for the Six Months Ended June 27, 2021 to the Six Months Ended June 28, 2020

Revenues. Revenues by operating segment for the six months ended June 27, 2021 and June 28, 2020 are as follows (dollars in millions):

	June 27, 2021	June 28, 2020	$ change	% change
Kratos Government Solutions				
Service revenues	$ 112.8	$ 126.5	$ (13.7)	(10.8)%
Product sales	170.3	128.8	41.5	32.2 %
Total Kratos Government Solutions	283.1	255.3	27.8	10.9 %
Unmanned Systems				
Service revenues	2.5	—	2.5	— %
Product sales	113.7	84.0	29.7	35.4 %
Total Unmanned Systems	116.2	84.0	32.2	38.3 %
Total revenues	$ 399.3	$ 339.3	$ 60.0	17.7 %
Total service revenues	$ 115.3	$ 126.5	$ (11.2)	(8.9)%
Total product sales	284.0	212.8	71.2	33.5 %
Total revenues	$ 399.3	$ 339.3	$ 60.0	17.7 %

Revenues increased $60.0 million to $399.3 million for the six months ended June 27, 2021 from $339.3 million for the six months ended June 28, 2020. Revenues in our KGS segment increased $27.8 million due to the contribution from the acquisition of ASC Signal, which contributed approximately $20.4 million, and organic growth across most of our business units including our C5ISR, microwave products, turbine technologies, space and satellite communications, and rocket support businesses, partially offset by decreases in our training solutions business of approximately $8.1 million. Revenues in our US segment increased $32.2 million to $116.2 million for the six months ended June 27, 2021 primarily due to work performed on our SSAT 177 and Valkyrie programs, and due to contributions of approximately $3.7 million from the TDI and 5-D Systems acquisitions.

Product sales increased $71.2 million to $284.0 million for the six months ended June 27, 2021 from $212.8 million for the six months ended June 28, 2020, primarily as a result of increased production activity in our US segment, and increased production in our microwave products, modular systems and space and satellite business. As a percentage of total revenue, product sales were 71.1% for the six months ended June 27, 2021 as compared to 62.7% for the six months ended June 28, 2020. Service revenues decreased by $11.2 million to $115.3 million for the six months ended June 27, 2021 from $126.5 million for the six months ended June 28, 2020. The decrease was primarily related to lower turbine technologies service revenue (which was offset by higher turbine technologies product sales) as well as the previously mentioned reduction in scope of certain international contracts in our training solutions business, and impacts resulting from COVID-19.

Cost of Revenues. Cost of revenues increased $48.8 million to $296.3 million for the six months ended June 27, 2021 from $247.5 million for the six months ended June 28, 2020. The increase in cost of revenues was primarily a result of the increase in product sales discussed above.

Gross margin decreased to 25.8% for the six months ended June 27, 2021 from 27.1% for the six months ended June 28, 2020. Margins on services decreased to 27.3% for the six months ended June 27, 2021 from 27.7% for the six months ended June 28, 2020. Margins on product sales decreased to 25.2% for the six months ended June 27, 2021 from 26.6% for the six months ended June 28, 2020, primarily due to a less favorable mix of certain programs with an increase in developmental programs. Margins in the KGS segment decreased to 27.7% for the six months ended June 27, 2021 from 29.4% for the six months ended June 28, 2020, primarily due to a less favorable mix of products during the six months ended June 27, 2021. Margins in the US segment increased to 21.2% for the six months ended June 27, 2021 from 20.0% for the six months ended June 28, 2020, primarily due to a more favorable mix of products produced and shipped during the six months ended June 27, 2021.

SG&A Expenses. SG&A expense was $76.1 million for the six months ended June 27, 2021 and $70.9 million for the six months ended June 28, 2020. As a percentage of revenues, SG&A decreased to 19.1% at June 27, 2021 from 20.9% at June 28, 2020. Included in SG&A was an increase of $3.3 million of stock compensation expense from $9.5 million for the six months ended June 28, 2020 to $12.8 million for the six months ended June 27, 2021.

R&D Expenses. R&D expenses were $18.2 million for the six months ended June 27, 2021 and $11.7 million for the six months ended June 28, 2020, with the primary increases in expenses being in our space and satellite communications business. As a percentage of revenues, R&D increased to 4.6% for the six months ended June 27, 2021 from 3.4% for the six months ended June 28, 2020. R&D expenses are made by the Company, typically in conjunction with our customers, for the Company to achieve a “first to market” position with our products or technology. We also invest in R&D expenses to achieve market leading “designed in” positions on major programs, platforms or systems.

Restructuring Expenses and Other. Restructuring expenses and other remained the same at $0.2 million for the six months ended June 27, 2021 and June 28, 2020. These expenses are primarily employee termination costs related to personnel reduction actions taken in each period.

Total Other Expense, Net. Total other expense, net, increased to $11.4 million from $11.2 million for the six months ended June 27, 2021 and June 28, 2020, respectively.

Benefit for Income Taxes from Continuing Operations. The income tax benefit from continuing operations for the six months ended June 27, 2021 and June 28, 2020 was $6.3 million and $3.2 million, respectively. For the six months ended June 27, 2021, a $2.6 million tax benefit was recorded resulting from the federal and state impact of stock-based compensation related to restricted stock units. The remaining $3.7 million benefit was a function of the estimated effective tax rate for the year. The estimated effective tax rate is driven by estimated foreign taxes, estimated federal and state taxes, permanent book/tax differences, and the projected income or loss for the year.

Loss from Discontinued Operations. The loss from discontinued operations was $0.3 million for the six months ended June 27, 2021 and $0.6 million for the six months ended June 28, 2020, primarily reflecting the work performed in relation to outstanding tasks on legacy projects retained by us following the sale of the PSS business, as well as legal expenses related to the ongoing closing net working capital adjustment dispute with the buyer of the PSS business.

Backlog

On June 27, 2021, we had approximately $865.6 million of total backlog, of which $630.6 million was funded. We expect to recognize approximately 39% of the remaining total backlog as revenue in 2021, an additional 27% in 2022 and the balance thereafter. Our comparable total backlog balance as of June 28, 2020, was approximately $683.4 million of which $569.6 million was funded.

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

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

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

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

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

Liquidity and Capital Resources

As of June 27, 2021, we had cash and cash equivalents of $369.3 million compared with cash and cash equivalents of $380.8 million as of December 27, 2020, which includes $36.0 million and $29.2 million, respectively, of cash and cash equivalents held by our foreign subsidiaries. We are not presently aware of any restrictions on the repatriation of these funds, however, earnings of these foreign subsidiaries are essentially considered permanently invested in these foreign subsidiaries. If these funds were needed to fund our operations or satisfy obligations in the U.S. they could be repatriated, and their repatriation into the U.S. may cause us to incur additional foreign withholding taxes. We do not currently intend to repatriate these earnings.

Our total long-term debt, including principal due on our 6.5% Notes (as defined below), net of issuance costs of $4.1 million, increased from $301.5 million at December 27, 2020 to $301.9 million at June 27, 2021, due to the amortization of debt issuance costs during the six months ended June 27, 2021 (as more fully described in Note 10 of the accompanying Condensed Consolidated Financial Statements).

We use our operating cash flow to finance trade accounts receivable, fund necessary increases in inventory, fund internal investments of engineering costs, fund capital expenditures, our internal research and development investments and our ongoing operations, service our debt, security infrastructure, including cyber security infrastructure and make strategic acquisitions. Financing trade accounts receivable is necessary because, on average, our customers do not pay us as quickly as we pay our vendors and employees for their goods and services since a number of our receivables are contractually billable and due to us only when certain contractual milestones are achieved. Financing increases in inventory balances is necessary to fulfill shipment requirements to meet delivery schedules of our customers. Cash from continuing operations is primarily derived from our customer contracts in progress and associated changes in working capital components. Our days sales outstanding ("DSO") have decreased from 133 days as of December 27, 2020 to 118 days at June 27, 2021, primarily reflecting the achievement of certain contractual billing milestones. Our DSOs are impacted by the achievement of contractual billing milestones such as equipment shipments and deliveries on certain products, and for certain flight requirements that must be fulfilled on certain aerial target programs, or final billings which are not due until completion on certain projects, and therefore we are unable to contractually bill for amounts outstanding related to those milestones at this time.

In November 2019, a large training solutions program was terminated for convenience ("T for C") by the customer. Under a T for C, a contractor is entitled to seek specified costs through a termination settlement process including (1) the contract price for completed supplies and services accepted by the government but not previously paid for; (2) the cost incurred in the performance of work terminated plus a reasonable profit on those costs; and (3) and its costs incurred in settling with subcontractors and preparing and settling the termination proposal. However, we will not be able to collect the total withheld amounts until the settlement terms of the T for C have been negotiated and agreed to with the customer. At June 27, 2021, approximately $11.5 million in unbilled receivables remain outstanding on this project. In addition, we are currently in dispute with an international customer in our US segment over approximately $10.0 million in unbilled receivables outstanding as of June 27, 2021. The dispute concerns the completion of certain system requirements and contractual milestones. The
Company alleges breach of contract, as well as other claims against the customer and seeks damages and other equitable relief. The customer has asserted counterclaims seeking liquidated damages and additional relief. We have evaluated the present facts of the matters and performed a reassessment of the contractual amounts due, as well as the claims asserted by each of the
parties, and have determined that no adjustment to previously recognized revenue, or the corresponding unbilled receivables, is necessary at June 27, 2021.

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

	Six Months Ended	
	June 27, 2021	June 28, 2020
Net cash provided by operating activities from continuing operations	$ 22.0	$ 10.8
Net cash used in investing activities from continuing operations	(26.7)	(29.5)
Net cash provided by (used in) financing activities from continuing operations	(6.4)	241.5
Net operating cash flows of discontinued operations	(0.8)	1.7

Net cash provided by operating activities from continuing operations increased by $11.2 million to $22.0 million for the six months ended June 27, 2021 compared to $10.8 million for the six months ended June 28, 2020. Net cash provided by operating activities from continuing operations was impacted by an increase in income from continuing operations of $3.5 million to $3.1 million for the six months ended June 27, 2021 compared to a loss from continuing operations of $0.4 million for the six months ended June 28, 2020. This increase was further impacted by increases in stock compensation, depreciation, amortization and other noncash charges of $3.3 million to $30.0 million for the six months ended June 27, 2021 compared to $26.7 million the six months ended June 28, 2020, as well as a reduction in changes in net working capital accounts of $4.4 million to $11.1 million for the six months ended June 27, 2021 as compared to changes of $15.5 million in net working capital accounts for the six months ended June 28, 2020.

Net cash used in investing activities from continuing operations for the six months ended June 27, 2021 is comprised of, a payment due under the FTT acquisition agreement, and capital expenditures, which consist primarily of investments in machinery, computer hardware and software and improvement of our physical properties in order to maintain suitable conditions in which to conduct our business, and include investments we are making to build capital aerial targets and related support equipment. Net cash used in investing activities from continuing operations for the six months ended June 28, 2020 is comprised of the acquisition of TDI, a payment due under the FTT acquisition agreement, and capital expenditures, which consist primarily of investments in machinery, computer hardware and software and improvement of our physical properties in order to maintain suitable conditions in which to conduct our business. During the six months ended June 27, 2021, capital expenditures of approximately $13.2 million were incurred in our US business, primarily related to our unmanned combat target initiative. We expect our capital expenditures for our calendar year 2021 to continue to be significant for investments we are making, specifically in our US business totaling approximately $33 to $37 million, including approximately $20 to $25 million for capital aerial targets and related support equipment.

Net cash used in financing activities from continuing operations was $6.4 million for the six months ended June 27, 2021 and consisted primarily of payroll withholding taxes paid from vested restricted stock traded for taxes of $8.5 million and payments made on financing lease obligations of $0.4 million offset by employee stock purchase plan receipts of $2.5 million. Net cash provided by financing activities from continuing operations was $241.5 million for the six months ended June 28, 2020 and consisted primarily of net proceeds of $240.5 million from our equity offering of approximately 15.5 million shares of common stock.

The net operating cash flows of discontinued operations for the six months ended June 27, 2021 was a use of $0.8 million. The net operating cash flows of discontinued operations for the six months ended June 28, 2020 was $1.7 million and was substantially related to approximately $2.7 million that was collected on amounts due related to the legacy projects retained by us which was partially offset by the loss from operations from our discontinued PSS business unit of $0.6 million.

Contractual Obligations and Commitments

Issuance of 6.5% Senior Secured Notes due 2025

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

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

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

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

The 6.5% Notes are redeemable by the Company, in whole or in part, at the respective redemption prices specified in the Indenture. We may also be required to make an offer to purchase the 6.5% Notes upon a change of control and certain sales of our assets.

The Indenture contains covenants limiting, among other things, our ability and the Subsidiary Guarantors’ ability to: (a) pay dividends on or make distributions or repurchase or redeem our capital stock or make other restricted payments; (b) incur additional debt and guarantee debt; (c) prepay, redeem or repurchase certain debt; (d) issue certain preferred stock or similar equity securities; (e) make loans and investments; (f) sell assets; (g) incur liens; (h) consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; (i) enter into transactions with affiliates; and (j) enter into agreements restricting our ability and certain of its subsidiaries’ ability to pay dividends. These covenants are subject to a number of exceptions. As of June 27, 2021, we were in compliance with the covenants contained in the Indenture governing the 6.5% Notes.

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

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

As of June 27, 2021, there was $300.0 million of 6.5% Notes outstanding.

Other Indebtedness

Credit and Security Agreement

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

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

As of June 27, 2021, there were no borrowings outstanding on the Credit Agreement and $5.9 million was outstanding on letters of credit, resulting in net borrowing base availability of $64.4 million. We were in compliance with the financial covenants of the Credit Agreement as of June 27, 2021.

Israel Debt

During August 2020, we entered into two 5-year term loans with two banks in Israel representing an aggregate principal amount of approximately $5.1 million. These loans were subsidized by the State of Israel as part of a COVID-19 relief package with interest at Israeli NIS prime interest, plus a margin of 1.5%. The first year of interest is paid by the State of Israel with subsequent interest and principal payments due monthly, commencing in August 2021. We intend to repay all amounts outstanding under this debt in the third quarter of 2021.

5-D Systems Loan

In connection with the acquisition of 5-D Systems, we assumed a loan in the amount of approximately $0.5 million with an interest rate of 1.0% that had been obtained under the Small Business Administration Paycheck Protection Program as part of a COVID-19 relief package. Payment of interest and principal is due monthly with the balance due in April 2022. The sellers of 5-D Systems applied for forgiveness of this loan and, as part of the purchase of 5-D Systems by the Company, have agreed to indemnify Kratos in the event the application for forgiveness of the loan was not accepted. The application was accepted and the loan was forgiven in July 2021.

Other Liquidity Matters

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

Critical Accounting Principles and Estimates

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

There have been no significant changes to our “Critical Accounting Policies or Estimates” as compared to the significant accounting policies described in the Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Since December 27, 2020, there have been no material changes in the quantitative or qualitative aspects of our market risk profile. For additional information regarding the Company’s exposure to certain market risks, see “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” included in the Form 10-K.

Item 4. Controls and Procedures.

Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

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

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

Based on the foregoing, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 27, 2021.

Changes in Internal Control Over Financial Reporting

We operate under the COSO (Committee of Sponsoring Organizations) 2013 Framework. There was no change in our internal control over financial reporting during the three months ended June 27, 2021 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 15 of the Notes to Condensed Consolidated Financial Statements contained within this Quarterly Report for a discussion of our legal proceedings.

Item 1A. Risk Factors.

In evaluating us and our common stock, we urge you to carefully consider the risks and other information in this Quarterly Report, as well as the risk factors disclosed in Item 1A. to Part I of the Form 10-K, and other reports that we have filed with the SEC. Any of the risks discussed in such reports, as well as additional risks and uncertainties not currently known to us or that we currently deem immaterial, could materially and adversely affect our results of operations, financial condition or prospects. During the period covered by this Quarterly Report, there have been no material changes in our risk factors as previously disclosed.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Exhibit Description	Incorporated by Reference: Form	Incorporated by Reference: Filing Date/ Period End Date	Incorporated by Reference: Exhibit	Filed-Furnished Herewith
2.1	Stock Purchase Agreement, dated February 28, 2018, among Kratos Defense & Security Solutions, Inc., Kratos Public Safety & Security Solutions, Inc. and Securitas Electronic Security, Inc.	10-Q	05/10/2018 (001-34460)	2.2	
2.2**	Purchase Agreement, dated February 27, 2019, by and among Kratos Defense & Security Solutions, Inc., Shirley Brostmeyer, ("SB"), Joseph Brostmeyer ("JB"), certain trusts established by SB, JB and members of their immediate family, and JB, as the Sellers Representative.	10-Q	05/08/2019 (001-34460)	2.3	
3.1	Amended and Restated Certificate of Incorporation of Kratos Defense & Security Solutions, Inc., as amended.	10-K	02/27/2017 (001-34460)	3.1	
3.2	Second Amended and Restated Bylaws of Kratos Defense & Security Solutions, Inc., as amended.	10-K	02/27/2017 (001-34460)	3.2	
4.1	Specimen Stock Certificate.	10-K	02/27/2017 (001-34460)	4.1	
4.2	Indenture, dated as of November 20, 2017, among Kratos Defense & Security Solutions, Inc., as Issuer, the Guarantors party thereto, and Wilmington Trust, National Association, as Trustee and Collateral Agent.	8-K	11/21/2017 (001-34460)	4.1	
4.3	First Supplemental Indenture, dated as of December 21, 2017, among Kratos Defense & Security Solutions, Inc., as Issuer, the Guarantor as party thereto, and Wilmington Trust, National Association, as Trustee.	10-K	02/28/2018 (001-34460)	4.5	
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.INS	XBRL Instance Document-the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document				*
101.SCH	XBRL Taxonomy Extension Schema Document				*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				*

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

** Certain confidential information contained in this Exhibit has been omitted because it is both (i) not material and (ii) the type of information that the registrant treats as private or confidential.

SIGNATURES

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

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

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

By: /s/ DEANNA H. LUND, CPA
Deanna H. Lund
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

By: /s/ MARIA CERVANTES DE BURGREEN, CPA
Maria Cervantes de Burgreen
Vice President and Corporate Controller
(Principal Accounting Officer)

Date: August 3, 2021

EXHIBIT 31.1

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

I, Eric M. DeMarco, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kratos Defense & Security Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2021

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

I, Deanna H. Lund, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kratos Defense & Security Solutions, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2021

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND

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

EXHIBIT 32.1

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

In connection with the accompanying Quarterly Report of Kratos Defense & Security Solutions, Inc. (the “Company”) on Form 10-Q for the quarter ended June 27, 2021 (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: August 3, 2021

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

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

EXHIBIT 32.2

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

In connection with the accompanying Quarterly Report of Kratos Defense & Security Solutions, Inc. (the “Company”) on Form 10-Q for the quarter ended June 27, 2021 (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: August 3, 2021

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

/s/ DEANNA H. LUND
Deanna H. Lund
Executive Vice President, Chief Financial Officer
(Principal Financial Officer and Acting Principal Accounting Officer)