# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

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

**For the Quarterly Period Ended March 27, 2011**

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

**Commission file number 0-27231**

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# KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **13-3818604** |

| | |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**4820 Eastgate Mall**

**San Diego, CA 92121**

**(858) 812-7300**

(Address, including zip code, and telephone number, including

area code, of Registrant s principal executive offices)

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

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

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of April 29, 2011 23,870,467 shares of the registrant s common stock were outstanding.

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**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED March 27, 2011**

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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)**

**(Unaudited)**

| | December 26, 2010 | March 27, 2011 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 10.8 | $ 45.5 |
| Restricted cash | 8.5 | 112.3 |
| Accounts receivable, net | 125.8 | 161.8 |
| Inventoried costs | 25.9 | 72.4 |
| Prepaid expenses | 7.1 | 9.9 |
| Other current assets | 6.1 | 11.8 |
| Total current assets | 184.2 | 413.7 |
| Property, plant and equipment, net | 28.4 | 58.1 |
| Goodwill | 226.4 | 368.7 |
| Intangible assets, net | 89.1 | 122.8 |
| Other assets | 8.0 | 20.1 |
| Total assets | $ 536.1 | $ 983.4 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 45.6 | $ 57.5 |
| Accrued expenses | 21.4 | 37.0 |
| Accrued compensation | 21.7 | 36.6 |
| Billings in excess of costs and earnings on uncompleted contracts | 17.2 | 16.4 |
| Other current liabilities | 12.5 | 23.6 |
| Total current liabilities | 118.4 | 171.1 |
| Long-term debt, net of current portion | 225.0 | 516.5 |
| Other long-term liabilities | 22.8 | 47.9 |
| Total liabilities | 366.2 | 735.5 |
| Commitments and contingencies | | |
| Stockholders equity: | | |

| | | | | |
|---|---|---|---|---|
| Preferred stock, 5,000,000 shares authorized Series B Convertible Preferred Stock, $.001 par value, 10,000 shares outstanding at December 26, 2010 and 0 shares outstanding at March 27, 2011 (liquidation preference $5.0 million at December 26, 2010) (see note 5) | | | | |
| Common stock, $.001 par value, 195,000,000 shares authorized; 18,616,023 and 23,828,726 shares issued and outstanding at December 26, 2010 and March 27, 2011, respectively | | | | |
| Additional paid-in capital | | 553.5 | | 618.1 |
| Accumulated deficit | | (383.6) | | (387.1) |
| Total Kratos Defense & Security Solutions, Inc. stockholders equity | | 169.9 | | 231.0 |
| Noncontrolling interest | | | | 16.9 |
| Total stockholders equity | | 169.9 | | 247.9 |
| Total liabilities and stockholders equity | $ | 536.1 | $ | 983.4 |

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

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**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(in millions, except per share amounts)**

**(Unaudited)**

| | Three months ended March 28, 2010 | Three months ended March 27, 2011 |
|---|---|---|
| Service revenues | $ 64.6 | $ 79.8 |
| Product sales | 4.1 | 43.0 |
| Total revenues | 68.7 | 122.8 |
| Cost of service revenue | 49.9 | 60.3 |
| Cost of product sales | 3.5 | 35.1 |
| Total costs | 53.4 | 95.4 |
| Gross profit | 15.3 | 27.4 |
| Selling, general and administrative expenses | 11.1 | 19.6 |
| Merger and acquisition expenses and other | | 5.8 |
| Research and development expenses | 0.6 | 0.6 |
| Operating income from continuing operations | 3.6 | 1.4 |
| Other income (expense): | | |
| Interest expense, net | (3.9) | (6.7) |
| Other income | 0.2 | 0.3 |
| Total other expense, net | (3.7) | (6.4) |
| Loss from continuing operations before income taxes | (0.1) | (5.0) |
| Provision (benefit) for income taxes from continuing operations | 0.3 | (1.2) |
| Loss from continuing operations | (0.4) | (3.8) |
| Net income from discontinued operations | 0.6 | 0.3 |
| Net income (loss) | $ 0.2 | $ (3.5) |
| Basic income (loss) per common share: | | |
| Loss from continuing operations | $ (0.02) | $ (0.18) |
| Net income from discontinued operations | 0.04 | 0.01 |
| Net income (loss) per common share: | $ 0.02 | $ (0.17) |
| Diluted income (loss) per common share: | | |
| Loss from continuing operations | $ (0.02) | $ (0.18) |
| Net income from discontinued operations | 0.04 | 0.01 |
| Net income (loss) per common share: | $ 0.02 | $ (0.17) |
| Weighted average common shares outstanding: | | |
| Basic | 15.9 | 21.3 |
| Diluted | 15.9 | 21.3 |

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

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**KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in millions)**

**(Unaudited)**

| | Three months ended March 28, 2010 | Three months ended March 27, 2011 |
|---|---|---|
| Operating activities: | | |
| Net income (loss) | $ 0.2 | $ (3.5) |
| Less: Income from discontinued operations | 0.6 | 0.3 |
| Loss from continuing operations | (0.4) | (3.8) |
| Adjustments to reconcile loss from continuing operations to net cash used in operating activities from continuing operations: | | |
| Depreciation and amortization | 1.9 | 4.8 |
| Stock-based compensation | 0.4 | 0.6 |
| Mark to market on swaps | (0.2) | (0.3) |
| Deferred income taxes | | 0.3 |
| Change in accrual for unused office space | (0.4) | |
| Amortization of deferred financing costs | 2.3 | 0.4 |
| Provision for doubtful accounts | 0.1 | |
| Changes in assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (15.1) | 3.0 |
| Inventoried costs | (0.4) | 1.3 |
| Prepaid expenses and other assets | (5.7) | 0.9 |
| Accounts payable | 0.3 | 3.1 |
| Accrued expenses | (0.6) | (9.0) |
| Accrued compensation | 3.0 | 2.0 |
| Billings in excess of costs and earnings on uncompleted contracts | 14.2 | (4.3) |
| Income tax receivable and payable | | (2.2) |
| Other liabilities | (0.1) | |
| Net cash used in operating activities from continuing operations | (0.7) | (3.2) |
| Investing activities: | | |
| Cash paid for acquisitions, net of cash acquired | | (224.1) |
| Increase in restricted cash | | (101.1) |
| Other, net | (0.3) | (0.5) |
| Net cash used in investing activities from continuing operations | (0.3) | (325.7) |
| Financing activities: | | |
| Proceeds from the issuance of long-term debt | | 314.0 |
| Proceeds from the issuance of common stock | | 61.5 |
| Borrowings under credit facility | 57.9 | |
| Repayments under credit facility | (58.8) | |
| Debt issuance costs | (1.9) | (13.0) |

| | | | | |
|---|---|---|---|---|
| Other | | 0.6 | | 1.2 |
| Net cash provided by (used in) financing activities from continuing operations | | (2.2) | | 363.7 |
| Net cash flows of continuing operations | | (3.2) | | 34.8 |
| Net operating cash flows of discontinued operations | | (0.4) | | (0.1) |
| Net increase in cash and cash equivalents | | (3.6) | | 34.7 |
| Cash and cash equivalents at beginning of period | | 9.9 | | 10.8 |
| Cash and cash equivalents at end of period | $ | 6.3 | $ | 45.5 |

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

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**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 and for the three months ended March 27, 2011 and March 28, 2010 is unaudited. The condensed consolidated balance sheet as of December 26, 2010 was derived from the Company s audited consolidated financial statements at that date. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the interim periods presented. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the U.S. ( GAAP ). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company s audited annual consolidated financial statements for the fiscal year ended December 26, 2010, included in the Company s Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission on March 2, 2011 (the Form 10-K ). Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

**(b) Principles of Consolidation**

The condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries for which all inter-company transactions have been eliminated in consolidation. The Company and its subsidiaries are collectively referred to herein as the Company.

**(c) Fiscal Year**

The Company has a 52/53 week fiscal year ending on the last Sunday of the year, with interim fiscal periods ending on the last Sunday of the last month of each calendar quarter. The three months ended March 28, 2010 and March 27, 2011 consisted of 13 week periods. There are 52 calendar weeks in the fiscal years ending on December 26, 2010 and December 25, 2011.

**(d) Cash and Cash Equivalents**

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

The Company had restricted cash accounts of approximately $8.5 million at December 26, 2010, which were required to collateralize a credit card program, a seller escrow account related to the acquisition of Gichner Holdings, Inc. ( Gichner ), and a deposit relating to the run out of a now terminated self-insured workers compensation program. As of March 27, 2011, the Company had restricted cash of $112.3 million. The increase in restricted cash was primarily a result of the terms of the $285.0 million in aggregate principal amount of 10% Senior Secured Notes due 2017 (the Stage I Notes ) that the Company issued through its wholly-owned subsidiary, Acquisition Co. Lanza Parent (the Stage I Issuer ), on March 25, 2011, in an unregistered offering pursuant to Rule 144A and Regulation S under the Securities Act of 1993, as amended (the Securities Act ), to finance the acquisition of Herley Industries, Inc. ( Herley ). The Stage I Notes were guaranteed only by the assets of the Stage I Issuer and not by the assets of the Company. Pursuant to the terms of the indenture governing the Stage I Notes, approximately $314.0 million in cash proceeds from the offering together with cash contributions of $45.0 million from the Company were required to be deposited in an account of the Stage I Issuer. These proceeds were used to provide collateral for the Stage I Notes, finance the acquisition of all of the outstanding shares of common stock of Herley (see Note 2), and pay related fees and expenses. These proceeds could only be used for these purposes and could not be transferred to the Company for general corporate purposes until the acquisition of Herley was complete and as such were restricted. On April 4, 2011, after the acquisition of Herley was complete, the Stage I Issuer was merged with and into the Company, all assets and liabilities of the Stage I Issuer became assets and liabilities of the Company and the previously restricted proceeds became unrestricted.

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**(e) Accounting Policies**

There have been no changes in the Company s significant accounting policies for the three months ended March 27, 2011 as compared to the significant accounting policies described in the Form 10-K.

**(f) Concentrations and Uncertainties**

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

Financial instruments, which subject the Company to potential concentrations of credit risk, consist principally of the Company s billed and unbilled accounts receivable. The Company s accounts receivable result from sales to customers within the federal government, state and local agencies and with commercial customers in various industries. The Company performs ongoing credit evaluations of its commercial customers. Credit is extended based on evaluation of the customer s financial condition and collateral is not required. Accounts receivable are recorded at the invoiced amount and do not bear interest. See Note 12 for a discussion of the Company s significant customers.

The Company has outstanding 10% Senior Secured Notes with an aggregate principal amount of $510.0 million which is due on June 1, 2017. The Company pays interest at the rate of 10% per annum semi-annually, in arrears, on June 1 and December 1 of each year. As of March 27, 2011, the principal amount of $510.0 million is outstanding under these notes. In addition, the Company has $32.6 million available under its existing revolving credit agreement. See Note 9 for a complete description of the Company s debt.

The Company intends to fund its cash requirements with cash on hand, cash flows from operating activities and borrowings under its existing revolving credit facility, and management believes these sources of liquidity should be sufficient to meet the Company s cash needs for at least the next 12 months. The Company s quarterly and annual operating results have fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to its control. If the conditions in its industry deteriorate or its customers cancel or postpone projects or if the Company is unable to sufficiently increase its revenues or further reduce its expenses, the Company may experience, in the future, a significant long-term negative impact to its financial results and cash flows from operations. In such a situation, the Company could fall out of compliance with its financial and other covenants which, if not waived, could limit its liquidity and capital resources.

**(g) Reclassifications**

Certain amounts in the March 28, 2010 condensed consolidated statement of operations have been reclassified to conform to the March 27, 2011 presentation.

**Note 2. Acquisitions**

*Herley Industries, Inc.*

On March 25, 2011 (the Acquisition Date ), pursuant to an Agreement and Plan of Merger dated as of February 7, 2011 (the Herley Merger Agreement ), by and among the Company, Lanza Acquisition Co. ( Herley Merger Sub ) and Herley, Herley Merger Sub acquired approximately 13.2 million shares of Herley common stock representing approximately 94% of the total outstanding shares of Herley common stock in a tender offer to purchase all of the outstanding shares of Herley common stock (the Offer ). On March 30, 2011, following purchases in a subsequent offering period, Herley Merger Sub was merged with and into Herley, with Herley continuing as a wholly-owned subsidiary of the Company (the Herley Merger ). The shares of Herley common stock were purchased at a price of $19.00 per share. Accordingly, the Company paid approximately $245.5 million in cash consideration as of March 27, 2011 and as of April 15, 2011 had paid total aggregate cash consideration of $270.6 million in respect of the shares of Herley common stock and certain in-the-money options, which were exercised upon the change in control. In addition, upon completion of the merger, all unexercised options to purchase Herley common stock were assumed by the Company and converted into options to purchase Kratos common stock, entitling the holders thereof to receive 1.3495 shares of Kratos common stock for each share of Herley common stock underlying the options. The Company assumed each Herley Option in accordance with the terms (as in effect as of the date of the Herley Merger Agreement) of the applicable Herley equity plan and the option agreement pursuant to which such Herley Option was granted. The options will be exercisable for an aggregate of approximately 0.8 million shares of the Company s common stock. All options were fully vested upon the change in control and the fair value of the options assumed was $1.4 million. The total aggregate consideration for the purchase of Herley was $272.1 million. The fair value of the non-controlling interest related to Herley as of March 25, 2011 was $16.9 million, which represents the market trading price of $19.00 per share multiplied by the approximately 0.9 million shares that were not tendered as of March 25, 2011. In addition, the Company assumed change in control obligations of $4.0 million related to the transaction, the majority of which will be paid in 2011, and combined transaction expenses of $11.1 million.

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On February 11, 2011, the Company completed the sale of approximately 4.9 million shares of its common stock at a purchase price of $13.25 per share in an underwritten public offering, and on March 25, 2011, the Stage I Issuer issued the Stage I Notes (see Note 1). The proceeds of the underwritten public offering and sale and issuance of the Stage I Notes were used to fund the acquisition of Herley. The Company received gross proceeds from the equity offering of approximately $64.8 million and after deducting underwriting and other offering expenses received approximately $61.1 million in net proceeds. The Stage I Notes were offered at a premium of 107%, for an effective interest rate of 8.5% and the gross proceeds were approximately $314.0 million, which includes approximately $20.0 million of issuance premium and $9.0 million of accrued interest. The Company obtained the consent of the holders of a majority of the 10% Senior Secured Notes due 2017 issued by the Company on May 19, 2010 in the aggregate principal amount of $225.0 million (as subsequently exchanged on August 11, 2010, the Existing Kratos Notes ) and entered into a supplemental indenture to the indenture governing the Existing Kratos Notes (as supplemented, the Existing Kratos Indenture ) in which such holders agreed to permit the Company to issue the Stage I Notes in an aggregate principal amount not to exceed $285.0 million in connection with the acquisition of Herley and for general corporate purposes irrespective of whether such notes may be issued in compliance with the minimum consolidated fixed charge coverage ratio test contained in the limitation of incurrence of additional indebtedness covenant in the Existing Kratos Indenture. A consent fee of $1.1 million was paid to all holders of the Existing Kratos Notes on April 1, 2011.

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

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

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

| | | |
|---|---|---|
| Cash | $ | 21.8 |
| Accounts receivable | | 39.1 |
| Inventoried costs | | 47.9 |
| Deferred tax assets | | 15.8 |
| Other assets | | 7.5 |
| Property and equipment | | 30.4 |
| Intangible assets | | 37.0 |
| Goodwill | | 142.3 |
| Total assets | | 341.8 |
| Current liabilities | | (38.4) |
| Deferred tax liabilities | | (16.1) |
| Debt | | (9.5) |
| Long-term liabilities | | (5.7) |
| Net assets acquired | $ | 272.1 |

The goodwill recorded in this transaction is not tax deductible.

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As of March 27, 2011, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $39.3 million, of which $0.2 million is not expected to be collectible. There were no contingent liabilities associated with the acquisition of Herley.

There have been no amounts of revenue or income before taxes included in the Company s condensed consolidated statement of operations from the Acquisition Date to March 27, 2011.

*Henry Bros. Electronics, Inc.*

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

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

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

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

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

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

The goodwill recorded in this transaction is not tax deductible.

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

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

The amounts of revenue and net income of HBE included in the Company s condensed consolidated statement of operations for the three months ended March 27, 2011 are $16.8 million and $1.5 million, respectively.

*Southside Container & Trailer, LLC*

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

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

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

The fair value of the SCT Contingent Consideration of $1.2 million was estimated by applying the income approach, which is based on significant inputs that are not observable in the market, which *Financial Accounting Standards Board ( FASB ) Accounting Standards Code ( ASC ) Topic 820, Fair Value Measurements and Disclosures ( Topic 820 )* refers to as Level 3 inputs. Key assumptions include a discount rate of 6.1%, a market participant cost of debt at the date of acquisition, and probability-adjusted levels for EBITDA. Any change in the fair value of the SCT Contingent Consideration subsequent to December 7, 2010, including changes from events after such date, will be recognized in earnings in the period the estimated fair value changes. The SCT Contingent Consideration as of March 27, 2011 of $1.2 million is reflected in long-term liabilities in the consolidated balance sheet.

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

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

| | | |
|---|---|---|
| Cash | $ | 0.4 |
| Accounts receivable | | 0.2 |
| Other current assets | | 0.5 |
| Property and equipment | | 2.8 |
| Intangible assets | | 3.6 |
| Goodwill | | 6.9 |
| Total assets | | 14.4 |
| Current liabilities | | (0.7) |
| Net assets acquired | $ | 13.7 |

The goodwill recorded in this transaction is tax deductible.

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

The amounts of revenue and net income of SCT included in the Company s condensed consolidated statement of operations for the three months ended March 27, 2011 are $2.6 million and $0.5 million, respectively.

*DEI Services Corporation*

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

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

Pursuant to the terms of the applicable agreement and plan of merger (the DEI Agreement ), upon achievement of certain cash receipts, revenue, EBITDA and backlog amounts in 2010, 2011 and 2012, the Company will be obligated to pay certain additional contingent consideration (the DEI Contingent Consideration ). The potential undiscounted amount of all future DEI Contingent Consideration that may be payable by the

Company under the DEI Agreement is between zero and $12.3 million. The DEI Contingent Consideration will be reduced in the event certain anticipated cash receipts are not collected within agreed upon time periods, which could decrease the future payments by approximately $8.6 million.

The fair value of the DEI Contingent Consideration of $5.0 million was estimated by applying the income approach, which is based on significant inputs that are not observable in the market, which *Topic 820* refers to as Level 3 inputs. Key assumptions include a discount rate of 5.8%, a market participant cost of debt at the date of acquisition, and probability-adjusted levels of cash receipts, revenue, EBITDA and backlog. Any change in the fair value of the DEI Contingent Consideration subsequent to August 9, 2010, including changes from events after such date, such as changes in the meeting of performance goals, will be recognized in earnings in the period the estimated fair value changes. The balance of the DEI Contingent Consideration as of March 27, 2011 of $4.6 million is reflected in long-term liabilities in the consolidated balance sheet.

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

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

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

The goodwill recorded in this transaction is not tax deductible.

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

The amounts of revenue and net income of DEI included in the Company s condensed consolidated statement of operations for the three months ended March 27, 2011 are $4.2 million and $0.7 million, respectively.

*Gichner Holdings, Inc.*

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

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

Upon completion of the Gichner transaction, the Company deposited $8.1 million of the purchase price into an escrow account as security for Gichner s indemnification obligations as set forth in the Gichner Agreement. In addition, the Gichner Agreement provides that the purchase price will be (i) increased on a dollar for dollar basis if the working capital on the closing date (as defined in the Gichner Agreement) exceeds $17.5 million or (ii) decreased on a dollar for dollar basis if the working capital is less than $17.1 million. The Company and Altus Capital Partners, Inc., the seller s representative under the Gichner Agreement (the Seller s Representative ) have agreed to a working capital adjustment of $0.3 million owed to the Company. The Seller s Representative is disputing an additional working capital adjustment of $0.9 million to which the Company believes it is entitled.

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

| | | |
|---|---|---|
| Cash | $ | 0.1 |
| Accounts receivable | | 15.2 |
| Inventoried costs | | 24.2 |
| Other current assets | | 8.7 |
| Property and equipment | | 19.0 |
| Intangible assets | | 46.3 |
| Goodwill | | 68.4 |
| Other assets | | 1.8 |
| Total assets | | 183.7 |
| Current liabilities | | (29.7) |
| Other liabilities | | (21.0) |
| Net assets acquired | $ | 133.0 |

The goodwill recorded in this transaction is not tax deductible.

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

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

The amounts of revenue and net income of Gichner included in the Company s condensed consolidated statement of operations for the three months ended March 27, 2011 are $34.0 million and $1.8 million, respectively.

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

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***Intangible Assets related to recent acquisitions***

The following tables summarize the fair value of identifiable intangible assets acquired in connection with the Company s acquisition of Herley, HBE, SCT, DEI, and Gichner and the weighted average amortization period of each class of intangible assets (in millions):

| **Herley** | | **Gross Value** | **Estimated Weighted Average Amortization Period (in years)** |
|---|---|---|---|
| Trade name | $ | 0.7 | 5.8 |
| Funded backlog | | 16.1 | 0.8 |
| Customer relationships | | 20.2 | 4.3 |
| Total | $ | 37.0 | |

| **HBE** | | **Gross Value** | **Estimated Weighted Average Amortization Period (in years)** |
|---|---|---|---|
| Trade name | $ | 15.8 | Indefinite |
| Customer contracts | | 2.8 | 3 |
| Total | $ | 18.6 | |

| **SCT** | | **Gross Value** | **Estimated Weighted Average Amortization Period (in years)** |
|---|---|---|---|
| Customer relationships | $ | 3.4 | 7 |
| Funded backlog | | 0.2 | 1 |
| Total | $ | 3.6 | |

| **DEI** | | **Gross Value** | **Estimated Weighted Average Amortization Period (in years)** |
|---|---|---|---|
| Customer relationships | $ | 1.6 | 5.4 |
| Backlog | | 1.8 | 2.4 |
| Total | $ | 3.4 | |

**Gichner**