KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form DEF 14A
April 11, 2014

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

Kratos Defense & Security Solutions, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

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(1) Title of each class of securities to which transaction applies:

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

April 11, 2014

Dear Stockholder:

You are cordially invited to attend the 2014 Annual Meeting of Kratos Defense & Security Solutions, Inc. ("Kratos"), which will be held at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121, on Wednesday, May 14, 2014, at 9:00 a.m. local time. We hope you will be able to attend the meeting in person.

At our annual meeting, our stockholders will be asked to elect the seven directors named herein to our Board of Directors; to ratify the Board's selection of Deloitte & Touche LLP as our independent registered public accounting firm; to approve the adoption of the Company's 2014 Equity Incentive Plan; to cast an advisory vote to approve the compensation of our named executive officers; and to transact such other business as may properly come before the meeting or any adjournment thereof. Following the formal annual meeting, we will also present a report on our operations and activities, and management will be pleased to answer your questions about us and our business.

Whether or not you plan to attend the annual meeting personally, and regardless of the number of shares of Kratos common stock you own, it is important that your shares be represented at the annual meeting. The Notice of Annual Meeting and Proxy Statement accompanying this letter describe the matters on which our stockholders will be asked to vote at the annual meeting, and we urge you to read these materials carefully. You can cast your vote by completing the enclosed proxy card and returning it in the postage-prepaid envelope provided or by utilizing the telephone or Internet voting systems.

Sincerely,

Eric DeMarco
President and Chief Executive Officer

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

4820 EASTGATE MALL, SUITE 200
SAN DIEGO, CA 92121
(858) 812-7300

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To be held on May 14, 2014

To the Stockholders of Kratos Defense & Security Solutions, Inc.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of Kratos Defense & Security Solutions, Inc. (the "Company") will be held on Wednesday, May 14, 2014, at 9:00 a.m. local time at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121 for the following purposes:

1. To elect the following seven nominees as directors to serve until the next annual meeting, or until their successors are duly elected and qualified: Scott Anderson, Bandel Carano, Eric DeMarco, William Hoglund, Scot Jarvis, Jane Judd, and Samuel Liberatore.

2. To ratify the selection of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending December 28, 2014.

3. To approve the adoption of the Company's 2014 Equity Incentive Plan.

4. An advisory (non-binding) vote to approve the compensation of our named executive officers as presented in the proxy statement accompanying this Notice.

5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

Our Board of Directors unanimously recommends a vote "**FOR**" each of the director nominees and "**FOR**" each of the other proposals listed above. The foregoing items of business are more fully described in the proxy statement accompanying this Notice.

Our Board of Directors has fixed the close of business on March 27, 2014 as the record date for the determination of stockholders entitled to notice of and to vote at this annual meeting and at any adjournment or postponement thereof. All stockholders are invited to attend the meeting. You must present your proxy, voter instruction card or meeting notice for admission.

By Order of the Board of Directors,

Eric DeMarco
President and Chief Executive Officer

April 11, 2014

ALL STOCKHOLDERS ARE CORDIALLY INVITED TO ATTEND THE MEETING IN PERSON.

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY OR VOTE OVER THE INTERNET OR BY TELEPHONE AS INSTRUCTED IN THESE MATERIALS AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE MEETING.

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 14, 2014: Our proxy statement and our 2013 Annual Report to Stockholders are available at www.proxyvote.com.

2014 PROXY SUMMARY

This summary highlights information contained elsewhere in this proxy statement. This summary does not contain all of the information that you should consider, and you should read the entire proxy statement carefully before voting.

Annual Meeting of Stockholders

Time & Date:	9:00 a.m., May 14, 2014
Place:	Irvine Amenities Center 9540 Towne Centre Drive, Suite 175 San Diego, CA 92121
Record Date:	March 27, 2014
Voting:	You may vote either in person at the Annual Meeting or by telephone, the Internet or mail. See the section entitled "How to Vote" below for more detailed information regarding how you may vote your shares.
Admission:	Everyone attending the Annual Meeting will be required to present both proof of ownership of the Company's common stock and a valid picture identification, such as a driver's license or passport. If your shares are held in the name of a bank, broker or other financial institution, you will need a recent brokerage statement or letter from such entity reflecting your stock ownership as of the record date. If you do not have both proof of ownership of the Company's common stock and a valid picture identification, you may be denied admission to the Annual Meeting. Cameras and electronic recording devices are not permitted at the Annual Meeting.

Meeting Agenda and Voting Recommendations

Proposal		**Board Vote Recommendation**	**Page References (for more detail)**
1.	Election of Directors	FOR EACH DIRECTOR NOMINEE	19
2.	Ratification of Deloitte & Touche as our independent registered public accounting firm for the fiscal year ending December 28, 2014	FOR	22
3.	Approval of the adoption of the Company's 2014 Equity Incentive Plan	FOR	24
4.	Advisory (non-binding) vote to approve the compensation of our named executive officers	FOR	36

Proposal 1: Director Nominees

The following table provides summary information about each director nominee. Each director nominee will be elected to serve until the next annual meeting of stockholders.

Name	Age	Director Since	Occupation	Independent	Committees
Scott Anderson	55	1997	Principal, Cedar Grove Partners, LLC	x	Audit (Chair); Nominating & Corporate Governance
Bandel Carano	52	1998	Managing Partner, Oak Investment Partners LLC	x	Compensation; Nominating & Corporate Governance (Chair)
Eric DeMarco	50	2003	President & Chief Executive Officer, Kratos		
William Hoglund (Chairman)	60	2001	Member, Safeboats International, LLP	x	Audit; Compensation; Nominating & Corporate Governance
Scot Jarvis	53	1997	Principal, Cedar Grove Partners, LLC	x	Audit; Compensation (Chair); Nominating & Corporate Governance
Jane Judd	67	2011	Senior Financial Executive (Ret.), Titan Corporation	x	Audit
Samuel Liberatore	76	2009	Senior Vice President (Ret.), Madison Research Division of Kratos	x	Nominating & Corporate Governance

Proposal 2: Ratification of Auditors

As a matter of good corporate governance, we are asking our stockholders to ratify the Audit Committee's selection of Deloitte & Touche as our independent registered public accounting firm for the fiscal year ending December 28, 2014 (please review the complete Proposal No. 2 beginning on page 22 of this proxy statement).

Proposal 3: 2014 Equity Incentive Plan

We are asking the Company's stockholders to approve the adoption of the Company's 2014 Equity Incentive Plan (the "2014 Plan"), which will initially have 1,550,000 shares of common stock for issuance under the 2014 Plan. Subject to stockholder approval, the 2014 Plan will be the successor to all of the Company's Prior Plans (as defined in Proposal 3), such that no additional stock awards will be granted under the Prior Plans. Additionally, without increasing the Company's current equity award overhang, any of the 5,511,322 shares subject to outstanding stock awards granted under the Prior Plans or granted outside of a Prior Plan that, at any time after March 27, 2014, expire or terminate, are forfeited, cancelled, or otherwise returned, or are reacquired or withheld (as more thoroughly discussed in the 2014 Plan) will be added to the share reserve of the 2014 Plan and available for issuance pursuant to stock awards granted under the 2014 Plan. A copy of the 2014 Plan is attached as Appendix A to this proxy statement. We are asking our stockholders to approve the 2014 Plan so that we will have additional shares of common stock available to attract and encourage the continued employment and service of our officers, employees, directors, and other individuals by offering those persons an opportunity to acquire or increase a direct proprietary interest in our operations and future success and to further align their interests with our stockholders' interests.

The 2014 Plan includes provisions that are designed to protect our stockholders' interests and to reflect corporate governance best practices, including:

Repricing is not allowed without stockholder approval. The 2014 Plan prohibits the repricing of outstanding equity awards and the cancelation of any outstanding equity awards that have an exercise price or strike price greater than the current fair market value of our common stock in exchange for cash or other stock awards under the 2014 Plan without prior stockholder approval.

Stockholder approval is required for additional shares. The 2014 Plan authorizes a fixed number of shares, so that stockholder approval is required to issue any additional shares, allowing our stockholders to have direct input on our equity compensation programs.

No liberal change in control provisions. The definition of change in control in our 2014 Plan requires the consummation of an actual transaction so that no vesting acceleration benefits may occur without an actual change in control transaction occurring.

No discounted stock options or stock appreciation rights. All stock options and stock appreciation rights must have an exercise price equal to or greater than the fair market value of our common stock on the date the stock option or stock appreciation right is granted.

Proposal 4: Advisory Vote to Approve Compensation of Named Executive Officers

We are asking our stockholders to provide an advisory vote relating to the compensation of our named executive officers. The Compensation Committee has developed our executive compensation strategy to achieve the following principal compensation objectives:

align executive compensation with our stockholders' interests, including placing a majority of compensation "at risk" and requiring that a significant portion of the CEO's and other executive management's equity awards vest in a manner that is directly tied to the Company's stock performance;

recognize individual initiative and achievements and successful execution of the Company's strategic plan, as approved by the Company's Board;

attract, motivate and retain highly qualified executives; and

create incentives that drive the entire executive management team to achieve challenging corporate goals that drive superior long-term performance.

Fiscal Year 2013 was an extremely challenging year for the overall U.S. federal government contracting industry and for the Company. During 2013, there was an extended Continuing Resolution Authorization ("CRA") for the first and final three months of the year, with no overall federal or Department of Defense ("DoD") budget in place. When a CRA is in place, no new contract awards can be made. Additionally, in 2013 the initial Sequestration cuts from the Budget Control Act were implemented, with the base DoD budget being reduced by approximately $25 billion from 2012 levels, to approximately $505 billion. The DoD budget was cut further, to approximately $497 billion for Fiscal Year 2014. Approximately 65% of Kratos' revenues are generated from U.S. federal government customers, funding and agencies. As a result, the Company's revenues, Adjusted EBITDA (as defined below) and cash flows were all adversely impacted by this challenging industry environment throughout 2013.

Despite the adverse federal government budgetary environment and the significant investments the Company made in 2013, management delivered a strong 2013 total stockholder return ("TSR") of 49%. The Company believes that this stock performance was due in part to the important progress Kratos' management team made on a number of strategic initiatives as noted in more detail below, and which include:

- Investing in key defense-related long-term growth opportunities;
- Diversifying away from reliance on defense-related spending; and
- Taking significant cost reduction actions.

Kratos believes that these actions, if successful, could result in significant revenue, EBITDA, and cash flow growth and a related valuation increase for the Company's stockholders.

Despite this federal government budgetary environment in 2013, the Company made significant discretionary investments in certain large, new growth areas to help position the Company for longer-term success, including unmanned systems, electronic warfare and satellite communications. This was due in part to certain new and large program opportunities moving forward, including Next Generation Jammer ("NGJ"), Air and Missile Defense Radar ("AMDR"), and Surface Electronic Warfare Improvement Program ("SEWIP"). These are all expected to be long term, multi-year national security priority programs. In addition, to protect the Company's and its customers' intellectual property and sensitive information, the Company increased its internal spending on cybersecurity and cyber protection as a result of significant and increasing cybersecurity threats, especially as related to government contractors. All of these important and required investments had a negative impact on the Company's 2013 EBITDA and cash flow, although they reflect sound strategic choices for enhancing Kratos' long-term success. Through Kratos management's interaction and routine discussions with the Company's stockholders, we believe that these strategic initiatives in the unmanned systems, electronic warfare and satellite communications areas are very important to delivering continued value creation to our equity holders.

Additionally in 2013, the Company continued its successful customer diversification initiative, with Kratos' commercial, international and non-U.S. federal government revenues making up approximately 35% of the Company's business. Kratos' management is executing on this customer diversification strategy in response to declining DoD budgets. An important aspect and contributor to our management's diversification strategy is Kratos' Public Safety & Security ("KPSS") business, which represented approximately 22% of our revenues in 2013. KPSS grew 12.7% from 2012 to 2013. Furthermore, Kratos' commercial satellite communications business grew 31.6% over 2012. The successful execution of this diversification initiative has helped the Company maintain its overall consolidated revenues at approximately $950 million for 2013, a less than approximate 1% decrease from 2012, in spite of the significantly reduced DoD budget that impacted the entire industry. We believe that the Company's success in maintaining its consolidated revenues in this difficult environment demonstrates that its 2013 performance was among the best in its peer group.

In 2013, our management remained focused on reducing costs and increasing operating efficiencies. For example, Kratos' work force has been reduced by 11.6% from 2012 to 2013, with a total headcount reduction of 502 personnel, from 4,317 to 3,815 employees. We have significantly reduced the number of leased facilities and overall square footage that we occupy, significantly reducing the Company's cost of facilities and improving efficiencies.

The Company's Board and Compensation Committee take into consideration the performance of our management team and the Company, among other factors, in their consideration of executive compensation. In summary, Kratos' executive management team has successfully:

- Managed the Company through significantly declining U.S. federal government and DoD budgets;

Significantly diversified the business, whereby approximately 35% of Kratos' revenues are generated from commercial or international customers, and such diversified business is organically growing;

Made important progress in large, new growth and opportunity areas, including unmanned systems, electronic warfare and satellite communications;

Managed and reduced the Company's overall cost structure, employee headcount and facility requirement, in response to the current challenging U.S. federal contracting industry environment; and

Generated real stockholder value through all of the efforts and initiatives noted above, and as represented by the 49% increase in the Company's TSR or stock price from 2012 to 2013.

	Fiscal Year 2013 ($)	Fiscal Year 2012 ($)	Fiscal Year 2011 ($)
Gross Revenues	$ 950.6	$ 969.2	$ 713.9
Cost of Sales	710.6	712.0	522.7
Selling, General and Administrative Expense	193.0	193.1	191.2
Research and Development Expense	21.4	17.8	8.6
Adjusted EBITDA(1)	100.3	115.4	93.0
Operating Cash Flow	22.6	52.3	5.2
Backlog	1,100.0	1,300.0	1,100.0

(1) Earnings before interest, taxes, depreciation, and amortization ("EBITDA") excluding acquisition related items and non-cash items such as impairment of goodwill, intangibles, and stock based compensation expense. Please see our Form 8-K filed with the SEC on March 11, 2014 for information reconciling Adjusted EBITDA to EBITDA. See page 50 for additional information.

At the 2013 Annual Meeting, an overwhelming percentage of our stockholders indicated approval of the compensation of our named executive officers, with 96.4% of the votes cast in favor of the advisory vote. We were very pleased with the voting results since the Compensation Committee and the Company's management embarked on an effort in 2012 to gather feedback from key stockholders regarding our executive compensation and took several actions to more closely align pay with performance and modify long-term incentives to align the interests of our executives with our stockholders. As a result of the multi-pronged effort to gather feedback from key stockholders regarding our executive compensation that management and the Compensation Committee undertook in 2012, our Compensation Committee took several actions related to our 2012 pay programs and made additional substantial changes to our compensation programs for 2013. Throughout 2013 and into 2014, we continued to regularly solicit feedback from the Company's stockholders regarding our performance, progress on executing the Company's strategic plan and our executive compensation philosophy and programs. As a result, our Compensation Committee took the following actions:

2013 Executive Pay Highlights: For 2013, the Compensation Committee implemented a number of key changes that provided more clear alignment between pay and performance, including:

Payment of Earned 2012 Annual Incentives as Stock Options Granted in 2013: The Compensation Committee granted stock options to our corporate named executive officers in recognition of the Company's achievement of 2012 financial objectives (comprising 35% of the target incentive award) that were met or exceeded for fiscal year 2012 but for which there was no payment under the annual incentive plan since the minimum 90% target EBITDA objective was not achieved. Despite the major headwinds the Company and the broader defense sector faced in 2012, including an uncertain DoD budget, the looming threat of sequestration, and a debt ceiling that was expected to be reached in the first half of 2013, the Company performed

strongly in 2012. The Compensation Committee recognized these achievements by granting corporate named executive officers stock options, which reflected the Company's pay for performance philosophy and aligned executive officer interests with that of stockholders. The stock option grants were issued on January 4, 2013 with an exercise price equal to the Company's closing market price of $4.98 on the grant date and with 25% vesting on each of the first four anniversary dates from the grant date.

Base Salary: The Compensation Committee froze the base salaries of all of our corporate named executive officers and certain of our business unit executive officers at 2012 compensation levels in order to construct a compensation program with additional emphasis on performance-based and long-term incentives.

Long-term Equity Incentives: In 2013, the Company issued a 50%/50% share mix of performance-based and time-based stock options to incentivize the Company's executive officers to build long-term equity value and to align the interests of our executive officers with our stockholders' interests. The Compensation Committee applied aggressive performance measures for the vesting of the 2013 performance-based options, which were unusual metrics and approaches in the Company's industry but reflected the Compensation Committee's desire to recognize payment for performance and alignment of executive officers' interests with stockholders' interests. The performance-based options granted in 2013 vest upon the Company's common stock reaching $15.00 per share, an approximate 201% increase in equity value above the grant date market price of $4.98 per share. The time-vesting stock options cliff vest at the end of five years and also require appreciation in stock price to generate value, so the time-vesting options provide a strong performance emphasis in addition to serving as a retention tool.

Change in Control Agreements: The Compensation Committee eliminated excise tax gross-ups in any new change in control agreements or renewals or material amendments of existing change in control agreements beginning in 2013. In addition, beginning in 2013, equity awards have "double-trigger" requirements, such that they will not accelerate in the event of a change in control unless also accompanied by a qualifying termination of employment.

Anti-Hedging and Anti-Pledging Policy: Beginning in March 2013, the Company implemented a policy that prohibits any hedging and pledging transactions by directors and executive officers.

Stock Ownership Target Guideline: Effective March 2013, the Compensation Committee implemented a stock ownership target guideline for our Chief Executive Officer of 1% of our outstanding shares of common stock, including all shares held through options, restricted stock units, Employee Stock Purchase Plan purchases, open market purchases and 401(k) holdings.

2014 Executive Pay Highlights: For 2014, the Compensation Committee continued to focus on clear alignment between pay and performance:

Base Salary: In recognition of the strong performance of the Company over the course of 2013, the Compensation Committee increased the base salaries of certain of our corporate named executive officers and of our business unit executive officers from the previously frozen base salary levels from 2012 compensation levels, in recognition of the strong performance and individual contributions of these executives and of the Company's performance. Most notably, the Company's common stock trading price increased 49% from 2012 to 2013. The Compensation Committee believes the stock price increase was due in part to the Company's strategic positioning on investment in key defense-related growth sectors, diversification away from defense-dependent spending, and continued discipline in cost reductions. The increases for our named executive officers ranged from a salary freeze at 2013 compensation levels to an increase of 10% over 2013 compensation levels. The intent of the Compensation Committee was to construct a compensation program that continues to place significant emphasis on performance-based and long-term incentives, while providing salaries that align with peer compensation data. The Compensation Committee strives for executive compensation to be at or near the median average of peer companies' executive compensation. As a result, the Company's 2014 compensation has been set at or near the median of its peer group compensation.

Long-term Equity Incentives: In 2013, the Company issued a 50%/50% mix of performance-based and time-based equity incentives, and the Company followed the same practice in 2014 to incentivize the Company's executive officers to build long-term equity value and closely align the interests of our executive officers with our stockholders' interests. For long-term equity incentives granted in 2014, the performance-based restricted stock units ("RSUs") vest 20% for every 10% increase in the Company's common stock above the grant date price of $8.10, provided that certain other conditions are met. The time-vesting RSU awards cliff vest 100% at the end of five years, which the Compensation Committee believes provides a strong long-term retention tool.

Additional information about our compensation philosophy and program, including the compensation actions summarized above, can be found in the "Compensation Discussion and Analysis" section beginning on page 43 of this proxy statement. Our Board of Directors and Compensation Committee believe that the compensation of our named executive officers for fiscal year 2013 was appropriate and reasonable and that our compensation policies and procedures are sound and in the best interests of the Company and its stockholders. Additionally, the Compensation Committee believes that our compensation policies and procedures are effective in achieving the Company's goals of rewarding sustained financial and operating performance and leadership excellence, aligning the executives' long-term interests with those of our stockholders and motivating our executive officers to remain with the Company for long and productive careers.

Cautionary Statement. Any statements in this proxy statement that do not describe historical facts may constitute forward-looking statements. These forward-looking statements are based on current expectations but are subject to a number of risks and uncertainties. The factors that could cause our actual future results to differ materially from current expectations are identified and described in more detail in our filings with the Securities and Exchange Commission (the "SEC"), including our annual report on Form 10-K for the fiscal year ended December 29, 2013. You should not place undue reliance on these forward-looking statements, which speak only as of the date that they were made. Except as required by applicable law, we do not intend to update any of the forward-looking statements to conform these statements to reflect actual results, later events or circumstances.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

4820 EASTGATE MALL, SUITE 200
SAN DIEGO, CA 92121

PROXY STATEMENT

FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON MAY 14, 2014

General

The enclosed proxy is solicited on behalf of our Board of Directors (the "Board") for use at the 2014 Annual Meeting of Stockholders (the "Annual Meeting") of Kratos Defense & Security Solutions, Inc., to be held on May 14, 2014 at 9:00 a.m. local time and at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting. The Annual Meeting will be held at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121.

We intend to mail our proxy statement and accompanying proxy card to all stockholders of record entitled to vote at the Annual Meeting on or about April 11, 2014.

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

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 14, 2014:

Our proxy statement and our 2013 Annual Report to Stockholders are available at www.proxyvote.com. This website address contains the following documents: the Notice of Annual Meeting, our proxy statement and our 2013 Annual Report on Form 10-K. You are encouraged to access and review all of the important information contained in the proxy materials before voting.

Solicitation and Revocation of Proxy

Our Board is soliciting the accompanying proxy. In accordance with unanimous recommendations of our Board, the individuals named in the proxy will vote all shares represented by proxies in the manner designated, or, if no designation is made, they will vote the proxies FOR the election of all of the director nominees and FOR each of the other proposals. In their discretion, the proxy holders named in the proxy are authorized to vote on any matters that may properly come before the Annual Meeting and at any continuation, postponement or adjournment of the Annual Meeting. As of the date of this proxy statement, our Board does not know of any other items of business that will be presented for consideration at the Annual Meeting other than those described in this proxy statement. The individuals acting as proxies will not vote on a particular matter if the proxy card representing those shares instructs them to abstain from voting on that matter or to the extent a proxy card is marked to show that some of the shares represented by the proxy card are not to be voted.

If you give a proxy, you may revoke it at any time before the final vote at the Annual Meeting, either:

(1) by revoking it in person at the Annual Meeting;

(2) by sending a written notice that you are revoking your proxy to our Corporate Secretary at 4820 Eastgate Mall, Suite 200, San Diego, California, 92121; or

(3) by submitting another properly completed and executed proxy card with a later date to us at the above noted address.

Your presence at the meeting will not automatically revoke your proxy, but if you attend the meeting and cast a ballot, your proxy will be revoked as to the matters on which the ballot is cast.

Shares Outstanding and Voting Rights

Only stockholders of record as of the record date, March 27, 2014, will be entitled to notice of and to vote at the Annual Meeting or at any continuation, postponement or adjournment of the original meeting. On the record date, our only class of voting stock outstanding was common stock. On March 27, 2014, 57,420,366 shares of common stock were issued and outstanding. Each outstanding share of common stock entitles the holder to one vote on all matters to be voted upon at the Annual Meeting.

How to Vote

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote by attending the Annual Meeting and voting in person. You will be given a ballot at the Annual Meeting.

If you do not wish to vote in person or you will not be attending the Annual Meeting, you may vote by proxy. You may vote by proxy using the enclosed proxy card, vote by proxy on the Internet or vote by proxy over the telephone. The procedures for voting by proxy are as follows:

- To vote via the Internet, go to the Internet address stated on your proxy card.
- To vote by telephone, call the number stated on your proxy card.
- To vote by mail, simply mark your proxy card, date and sign it and return it in the postage-prepaid envelope.

Votes submitted via the Internet or by telephone must be received by 11:59 P.M. Eastern Time on May 13, 2014. Submitting your proxy via the Internet or by telephone will not affect your right to vote in person should you decide to attend the Annual Meeting. Even if you plan to attend the Annual Meeting, we encourage you to submit your proxy to vote your shares in advance of the Annual Meeting.

We provide Internet and telephone proxy voting with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. However, please be aware that you must bear any costs associated with your Internet and telephone access, such as usage charges from Internet access providers and telephone companies.

Beneficial Owner: Shares Registered in the Name of Your Broker, Bank or Other Agent

If at the close of business on March 27, 2014 your shares of common stock were not held in your name, but rather in an account at a brokerage firm, bank, dealer or other similar organization, then you are the beneficial owner of shares held in "street name," and you will receive a proxy card and voting instructions from that organization. Your broker, bank or other nominee will allow you to deliver your voting instructions via the Internet and may also permit you to submit your voting instructions by telephone.

Please note that if your shares are held of record by a broker, bank or other nominee and you decide to attend and vote at the Annual Meeting, your vote in person at the Annual Meeting will not be effective unless you present a legal proxy issued in your name from your broker, bank or other nominee.

Voting Kratos Shares Held Through the Kratos 401(k) Plan

The Kratos 401(k) Plan provides that the trustee of the plan will vote the shares of our common stock that are not directly voted by the participants in the plan. If the trustee does not receive voting instructions from participants in the Kratos 401(k) Plan, the trustee may vote the shares of our common stock under such plan in the same proportion as the shares voted by all other respective plan participants. If the trustee receives a signed but not voted proxy card, the trustee will vote such shares of our common stock according to the Board's recommendations.

Counting of Votes; Quorum

The inspector of election appointed for the meeting by our Board will count the votes cast by proxy or in person at the Annual Meeting. The inspector will count those votes to determine whether or not a quorum is present.

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if at least a majority of our outstanding shares of common stock entitled to vote are represented by votes at the Annual Meeting or by proxy. At the close of business on March 27, 2014, the record date for the Annual Meeting, there were 57,420,366 shares of common stock outstanding and entitled to vote at the Annual Meeting.

Your shares will be counted toward the quorum only if you submit a valid proxy (or if one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the Annual Meeting. Abstentions will be counted toward the quorum requirement. Broker non-votes will also be counted toward the quorum requirement. If there is no quorum, a majority of the shares present at the Annual Meeting may adjourn the Annual Meeting to another date to provide the Company with the opportunity to establish a quorum.

Required Vote

The following is a summary of the voting requirements that apply to the proposals discussed in this proxy statement:

Proposal	**Vote Required**	**Discretionary Voting Allowed?**
1. Election of Directors	Plurality	No
2. Ratification of Auditor	Majority	Yes
3. Adoption of the 2014 Equity Incentive Plan	Majority	No
4. Advisory Vote to Approve the Compensation of Our Named Executive Officers	Majority	No

Our Board of Directors unanimously recommends a vote "**FOR**" each of the proposals listed above.

A "plurality" means, with regard to the election of directors, that the seven nominees for director receiving the greatest number of "for" votes from our shares entitled to vote will be elected.

A "majority" means that a proposal receives a number of "for" votes that is a majority of the shares of common stock present in person or represented by proxy and entitled to vote at the Annual Meeting.

"Discretionary voting" occurs when a bank, broker, or other holder of record does not receive voting instructions from the beneficial owner and votes those shares in its discretion on any proposal as to which rules permit such bank, broker, or other holder of record to vote. As noted below, when banks, brokers, and other holders of record are *not* permitted under the rules to vote the beneficial owner's shares, the affected shares are referred to as "broker non-votes."

Although the advisory vote on Proposal No. 4 is non-binding, as provided by law, our Board and Compensation Committee will review the results of the votes and, consistent with our record of stockholder engagement, will take the results into account in making a determination concerning executive compensation.

Effect of Abstentions and Broker Non-Votes

Abstentions: Under Delaware law (under which Kratos is incorporated), abstentions are counted as shares present and entitled to vote at the Annual Meeting. Therefore, abstentions will have the same effect as a vote "against": Proposal No. 2 Ratification of Auditor; Proposal No. 3 Adoption of the 2014 Equity Incentive Plan; and Proposal No. 4 Advisory Vote to Approve the Compensation of our Named Executive Officers. With respect to Proposal No. 1 Election of Directors, abstentions will have no effect on the election of directors because, under plurality voting rules, the seven director nominees receiving the highest number of "for" votes will be elected.

Broker Non-Votes: Under rules that govern banks, brokers and others who have record ownership of company stock held in brokerage accounts for their clients who beneficially own the shares, these banks, brokers and other such holders who do not receive voting instructions from their clients have the discretion to vote uninstructed shares on certain matters ("discretionary matters") but do not have discretion to vote uninstructed shares as to certain other matters ("non-discretionary matters"). A broker may return a proxy card on behalf of a beneficial owner from whom the broker has not received voting instructions that casts a vote with regard to discretionary matters but expressly states that the broker is not voting as to non-discretionary matters. The broker's inability to vote the non-discretionary matters with respect to which the broker has *not* received voting instructions from the beneficial owner is referred to as a "broker non-vote."

As a result of a change in rules related to discretionary voting and broker non-votes, banks, brokers, and other such record holders are no longer permitted to vote the uninstructed shares of their customers on a discretionary basis in the election of directors, amendments to equity plans or on executive compensation matters. Because broker non-votes are not considered under Delaware law to be entitled to vote at the Annual Meeting, they will have no effect on the outcome of the vote on: Proposa1 No. 1 Election of Directors; Proposal No. 3 Adoption of the 2014 Equity Incentive Plan; and Proposal No. 4 Advisory Vote to Approve the Compensation of our Named Executive Officers. As a result, if you hold your shares in street name and you do not instruct your bank, broker, or other such holder how to vote your shares in the election of directors, adoption of the 2014 Equity Incentve Plan, and on the advisory vote to approve the compensation of our named executive officers, no votes will be cast on your behalf on these proposals. **Therefore, it is critical that you indicate your vote on these proposals if you want your vote to be counted.** The proposal to ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 28, 2014 should be considered a routine matter. Therefore, your broker will be able to vote on this proposal even if it does not receive instructions from you, so long as it holds your shares in its name.

Delivery of Multiple Proxy Materials

If you received more than one package of proxy materials, this means that you have multiple accounts holding shares of Kratos common stock. These may include: accounts with our transfer agent, Wells Fargo Shareowner Services; shares held in Kratos' 401(k) Plan or Employee Stock Purchase Plan; and accounts with a broker, bank or other holder of record. Please vote all proxy cards and voting instruction forms that you receive with each package of proxy materials to ensure that all of your shares are voted.

Cost and Method of Solicitation

We will bear the entire cost of solicitation of proxies, including preparation, assembly, printing and mailing of this proxy statement, the proxy card and any additional information furnished to our stockholders. Solicitation of proxies by mail may be supplemented by telephone or personal solicitation by our directors, officers, other employees, or consultants. No additional compensation will be paid to directors, officers or other regular employees for such services. Copies of solicitation materials will be furnished to banks, brokerage houses, fiduciaries and custodians holding in their names shares of our common stock beneficially owned by others to forward to such beneficial owners. We may reimburse such persons for their costs in forwarding the solicitation materials to such beneficial owners.

Stockholder List

A complete list of registered stockholders entitled to vote at the meeting will be available for examination by any stockholder, for any purpose related to the meeting, for ten days prior to the date of the annual meeting during ordinary business hours at our principal offices located at 4820 Eastgate Mall, Suite 200, San Diego, California 92121.

Admission to the Annual Meeting

Everyone attending the Annual Meeting will be required to present both proof of ownership of the Company's common stock and a valid picture identification, such as a driver's license or passport. If your shares are held in the name of a bank, broker or other financial institution, you will need a recent brokerage statement or letter from such entity reflecting your stock ownership as of the record date. If you do not have both proof of ownership of the Company's common stock and a valid picture identification, you may be denied admission to the Annual Meeting. Cameras and electronic recording devices are not permitted at the Annual Meeting.

Voting Results

Voting results are expected to be announced at the Annual Meeting and will also be disclosed in a Current Report on Form 8-K (the "Form 8-K") that we will file with the Securities and Exchange Commission (the "SEC") within four business days of the date of the Annual Meeting. In the event the results disclosed in our Form 8-K are preliminary, we will subsequently amend the Form 8-K to report the final voting results within four business days of the date that such results are known.

CORPORATE GOVERNANCE

Overview

We are committed to maintaining the highest standards of business conduct and corporate governance, which we believe are fundamental to the overall success of our business, serving our stockholders well and maintaining our integrity in the marketplace. Our Corporate Governance Guidelines and Code of Ethics, together with our certificate of incorporation, Bylaws and the charters of our Board Committees, form the basis for our corporate governance framework. As discussed below, our Board of Directors has established three standing committees to assist it in fulfilling its responsibilities to the Company and its stockholders: the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee.

Corporate Governance Guidelines

Our Board has adopted Corporate Governance Guidelines to assist it in the exercise of its responsibilities and to serve the interests of the Company and our stockholders. The Corporate Governance Guidelines are available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance.

Director Independence

Our Board has unanimously determined that six of our directors standing for re-election, Messrs. Anderson, Carano, Hoglund, Jarvis, and Liberatore and Ms. Judd, who constitute a majority of the Board, are "independent" directors as that term is defined by NASDAQ Marketplace Rule 5605(a)(2). In making this determination, the Board has affirmatively determined, considering broadly all relevant facts and circumstances regarding each independent director, that none of the independent directors has a material relationship with us (either directly or as a partner, stockholder, officer or affiliate of an organization that has a relationship with us) that could compromise the director's ability to act independently and in the best interests of the Company and its stockholders. In addition, based upon NASDAQ Marketplace Rule 5605(a)(2), the Board determined that Mr. DeMarco is not "independent" because he is the Company's President and Chief Executive Officer.

Nominations for Directors

The Nominating and Corporate Governance Committee is responsible for screening potential director candidates and recommending qualified candidates to the Board for nomination. The committee will consider and evaluate any recommendation for director nominees proposed by a stockholder who has continuously held at least 1% of the outstanding shares of our common stock entitled to vote at the annual meeting of stockholders for at least one year by the date the stockholder makes the recommendation and who satisfies the notice, information and consent provisions set forth in our Bylaws. The Nominating and Corporate Governance Committee will use the same evaluation process for director nominees recommended by stockholders as it uses for other director nominees.

In addition, our Bylaws set forth a process for stockholders to nominate individuals for election to the Board. See "Stockholder Proposals" below for additional information regarding the content and timing of the information that must be received by our Corporate Secretary for a director nominee to be considered for election at our 2015 Annual Meeting. A printed copy of our Bylaws may be obtained by any stockholder upon request to our Corporate Secretary at Kratos Defense & Security Solutions, Inc., 4820 Eastgate Mall, Suite 200, San Diego, California 92121.

The goal of the Nominating and Corporate Governance Committee is to assemble a board of directors that brings a variety of perspectives and skills derived from high quality business and professional experience to Kratos. As stated in our Corporate Governance Guidelines, nominees for director are to be selected on the basis of, among other criteria, experience, knowledge, skills, expertise, integrity, absence of conflicts of interests with the Company, diversity, ability to make analytical inquiries, understanding of or familiarity with our business, products or markets or similar businesses, products or markets, and willingness to devote adequate time and effort to Board responsibilities. Although we do not have a written policy with respect to Board diversity, the Nominating and Corporate Governance Committee and the Board believe that a diverse board leads to improved Company performance by encouraging new ideas, expanding the knowledge base available to management and fostering a boardroom culture that promotes innovation and vigorous deliberation.

Additionally, our Bylaws provide that in order to be eligible for election or appointment to the Board, an individual must (i) be at least 21 years of age, (ii) have the ability to be present, in person, at all regular and special meetings of the Board, and (iii) either (a) have substantial relevant experience in the national defense and security industry or (b) have, or be able to obtain, a U.S. government issued security clearance relevant to the business of the corporation. In addition to the foregoing, no person shall be eligible for election or appointment to the Board if such person has been convicted of a crime involving dishonesty or breach of trust or if such person is currently charged with the commission of or participation in such a crime. The Nominating and Corporate Governance Committee may also consider such other factors as it may deem are in Kratos' best interests and that of our stockholders. The Nominating and Corporate Governance Committee does, however, recognize that under applicable regulatory requirements at least one member of our Board must meet the criteria for an "audit committee financial expert" as defined by SEC rules, and that at least a majority of the members of our Board must meet the definition of "independent director" under the NASDAQ Marketplace Rules or the listing standards of any other applicable self-regulatory organization. The Nominating and Corporate Governance Committee also believes it to be appropriate for certain key members of our management to participate as members of our Board.

The Nominating and Corporate Governance Committee identifies nominees by first evaluating the current members of our Board willing to continue to serve. Current members of our Board with skills and experience that are relevant to our business and who are willing to continue in service are considered for re-nomination, balancing the value of continuity of service by existing members of our Board with that of obtaining a new perspective. If any member of our Board does not wish to be considered for re-election at an upcoming annual meeting of stockholders, the Nominating and Corporate Governance Committee identifies the desired skills and experience of a new nominee in light of the criteria above. In such cases, all of the members of our Board are polled for suggestions as to individuals meeting the criteria for nomination to our Board. Research may also be performed to identify qualified individuals. If the Nominating and Corporate Governance Committee believes that our Board requires additional candidates for nomination, it may explore alternative sources for identifying additional candidates. This may include engaging, as appropriate, a third party search firm to assist in identifying qualified candidates.

All directors and director nominees are required to submit a completed form of directors' and officers' questionnaire as part of the nominating process. At the discretion of the Nominating and Corporate Governance Committee, the nominating process may also include interviews and additional background and reference checks for non-incumbent nominees.

Stockholder Communications with Directors

The Board has adopted a Stockholder Communications with Directors Policy. The Stockholder Communications with Directors Policy is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance. Stockholders and other interested parties may communicate with one or more members of the Board or the non-management directors as a group in writing by regular mail. Those who wish to send such communications may do so by addressing their communication to: Chairman of the Board or Board of Directors, c/o Corporate

Secretary, Kratos Defense & Security Solutions, Inc., 4820 Eastgate Mall, Suite 200, San Diego, California 92121.

The Board has instructed the Corporate Secretary to review all communications so received and to exercise her discretion not to forward to the Board correspondence that is inappropriate such as business solicitations, frivolous communications and advertising, routine business matters and personal grievances. However, any director may at any time request the Corporate Secretary to forward any and all communications received by the Corporate Secretary but not forwarded to the directors.

Code of Ethics

Our Board has adopted a Code of Ethics that applies to all of our directors, officers and employees. The Code of Ethics is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance and is also available in print, without charge, to any stockholder who requests a copy by writing to us at Kratos Defense & Security Solutions, Inc., 4820 Eastgate Mall, Suite 200, San Diego, California, 92121, Attention: Investor Relations. Each of our directors, employees and officers, including our chief executive officer, chief financial officer and corporate controller, and all of our other principal executive officers, are required to comply with the Code of Ethics. The Audit Committee is responsible for reviewing and approving all amendments to the Code of Ethics and all waivers of the Code of Ethics for executive officers or directors and providing for prompt disclosure of all amendments and waivers required to be disclosed under applicable law. We will disclose future amendments to our Code of Ethics or waivers required to be disclosed under applicable law from our Code of Ethics for our principal executive officer, principal financial officer, principal accounting officer or controller, and our other executive officers and our directors on our website, *www.kratosdefense.com*, within four business days following the date of the amendment or waiver. There have not been any waivers of the Code of Ethics relating to any of our executive officers or directors in the past year.

Meetings and Committees of the Board

Our Board is responsible for overseeing the management of our business. We keep our directors informed of our business at meetings and through reports and analyses presented to the Board and the committees of the Board. Regular communications between our directors and management also occur apart from meetings of the Board and committees of the Board.

Meeting Attendance

Our Board normally meets quarterly but may hold additional meetings as required. During fiscal year 2013, the Board held four regularly scheduled meetings, one special meeting and acted by unanimous written consent five times. Each of our directors attended at least 75% of the aggregate of the total number of Board meetings and the total number of meetings of each committee of the Board on which he or she was serving. All seven of our directors attended last year's annual meeting of stockholders.

Our Board has adopted a "Director Attendance at Annual Meeting Policy," which is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance.

Executive Sessions

Executive sessions of independent non-employee directors are held in connection with each regularly scheduled Board meeting and at other times as necessary, and are chaired by our Chairman of the Board. The Board's policy is to hold executive sessions without the presence of management, including the Chief Executive Officer and other non-independent directors, if any. The Committees of our Board may also meet in executive session at the end of each Committee meeting.

Committees of the Board of Directors

Our Board currently has three standing committees to facilitate and assist the Board in the execution of its responsibilities: the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee.

Audit Committee

Our Audit Committee consists of Messrs. Anderson (Chairperson), Hoglund and Jarvis and Ms. Judd. Our Board has affirmatively determined that each member of the Audit Committee is independent under NASDAQ Marketplace Rule 5605(a)(2) and meets the independence and all other qualifications under NASDAQ Marketplace Rule 5605(c), the Sarbanes-Oxley Act of 2002 and applicable rules of the SEC. Our Board has also affirmatively determined that Ms. Judd qualifies as an "audit committee financial expert" as such term is defined in Regulation S-K under the Securities Act of 1933, as amended. During 2013, the Audit Committee met nine times.

The Audit Committee acts pursuant to a written charter, which is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance. The responsibilities of the Audit Committee include overseeing, reviewing and evaluating our financial statements, accounting and financial reporting processes, internal control functions and the audits of our financial statements. The Audit Committee is also responsible for the appointment, compensation, retention, and as necessary, the termination of our independent auditors. Additional information regarding the Audit Committee is set forth below in the Report of the Audit Committee.

Compensation Committee

Our Compensation Committee consists of Messrs. Carano, Hoglund and Jarvis (Chairperson). Our Board has affirmatively determined that each member of the Compensation Committee is independent as such term is defined under NASDAQ Marketplace Rule 5605(a)(2) and meets the independence and all other qualifications under Nasdaq Marketplace Rule 5605(d). During 2013, the Compensation Committee met five times. Our Board has adopted a charter for the Compensation Committee, which is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance. The Compensation Committee reviews and makes recommendations to our Board concerning the compensation and benefits of our executive officers, including the Chief Executive Officer and directors, oversees the administration of our stock option and employee benefits plans, and reviews general policies relating to compensation and benefits. In accordance with Nasdaq Marketplace Rule 5605(d), the Compensation Committee evaluates the independence of each compensation consultant, outside counsel and advisor retained by or providing advice to the Compensation Committee. The Compensation Discussion and Analysis section below provides additional information regarding the Compensation Committee's processes and procedures for considering and determining executive compensation.

Nominating and Corporate Governance Committee

Our Nominating and Corporate Governance Committee consists of Messrs. Anderson, Carano (Chairperson), Hoglund, Jarvis and Liberatore. Our Board has affirmatively determined that each member of the Nominating and Corporate Governance Committee is independent as such term is defined under NASDAQ Marketplace Rule 5605(a)(2). The Nominating and Corporate Governance Committee evaluates and recommends to the Board nominees for each election of directors. The Nominating and Corporate Governance Committee met four times in 2013. Our Board has adopted a charter for the Nominating and Corporate Governance Committee, which is available for review on our website at www.kratosdefense.com/about-kratos/corporate-governance. The responsibilities of the Nominating and Corporate Governance Committee include making recommendations to the Board with respect to the nominations or elections of directors and providing oversight of our corporate governance policies and practices.

Board and Committee Effectiveness

The Board and each of its Committees performs an annual self-assessment to evaluate their effectiveness in fulfilling their obligations. The Board and Committee evaluations cover a wide range of topics, including, among others, the fulfillment of the Board and Committee responsibilities identified in the Corporate Governance Guidelines and charters for each Committee.

Board Leadership Structure

The Board believes that its current independent Board structure is best for our Company and provides good corporate governance and accountability. The Board does not have a fixed policy regarding the separation of the roles of the Chairman of the Board and the Chief Executive Officer because it believes the Board should be able to freely select the Chairman of the Board based on criteria that it deems to be in the best interests of the Company and its stockholders. The functions of the Board are carried out by the full Board, and when delegated, by the Board committees. Each director is a full and equal participant in the major strategic and policy decisions of our Company.

The Board believes that the current structure of a separate chairman of the board and chief executive officer is the optimum structure for the Company at this time, taking into consideration Mr. DeMarco's active role in pursuing the Company's business and growth strategies.

Board Role in Risk Management

The risk oversight function of the Board is carried out by both the Board and each of its Committees, with the primary responsibility for identifying and managing risk at the Company resting with senior management. While the risk oversight function and matters of strategic risk are considered by the Board as a whole, each of the Committees has the following risk oversight responsibilities:

- As provided in its charter, the Audit Committee meets periodically with management to discuss our major financial and operating risk exposures and the steps, guidelines and policies taken or implemented relating to risk assessment and risk management. Each quarter, our Director of Internal Audit has reported directly to the Audit Committee on the activities of our internal audit function and at least annually our General Counsel reports directly to the Audit Committee on our ethics and compliance program. Management also reports to the Audit Committee on legal, finance, accounting and tax matters at least quarterly. The Board is provided with reports on legal matters at least quarterly and on other matters related to risk oversight on an as-needed basis.

- As provided in its charter, the Nominating and Corporate Governance Committee considers risks related to regulatory and compliance matters.

- As provided in its charter, the Compensation Committee considers risks related to the design of the Company's compensation programs for our executives.

Compensation Committee Interlocks and Insider Participation

During fiscal year 2013, no members of our Compensation Committee were officers or employees of Kratos or any of our subsidiaries or had any relationship otherwise requiring disclosure hereunder. In addition, none of our executive officers serves on the board of directors or compensation committee of a company that has an executive officer that serves on our Board or our Compensation Committee.

Certain Relationships and Related Party Transactions

During fiscal year 2013, there were no transactions to which the Company was or is a party in which the amount involved exceeded $120,000 and in which any director, officer or beneficial holder of more than 5% of any class of our voting securities or member of such person's immediate family had or will have a direct or indirect material interest.

Procedures for Approval of Related Party Transactions

Under its charter, the Audit Committee is charged with reviewing all potential related party transactions. Our policy has been that the Audit Committee, which is comprised solely of independent, disinterested directors, reviews and then recommends such related party transactions to the entire Board for further review and approval. All such related party transactions are then required to be reported under applicable SEC rules. Aside from this policy, we have not adopted additional procedures for review of, or standards for approval of, related party transactions but instead review such transactions on a case-by-case basis.

PROPOSAL NO. 1

ELECTION OF DIRECTORS

Our Board currently consists of seven directors, six of whom are independent directors within the meaning of the listing standards of The NASDAQ Stock Market ("NASDAQ"), and all of whom are standing for re-election to the Board at the Annual Meeting. All directors are elected at each annual meeting of stockholders and serve until the next annual meeting of stockholders or until their successor has been duly elected and qualified, or until their earlier death, resignation or removal.

Our Board has designated the persons named below as nominees for election of directors. All nominees are currently serving as directors of the Company. If elected at the Annual Meeting, each of the nominees will serve until our 2015 Annual Meeting of Stockholders.

Information Regarding Directors

Nominees for Election to the Board:

Name	Age	Committees
Scott Anderson	55	Audit Committee (Chair) Nominating and Corporate Governance Committee
Bandel Carano	52	Compensation Committee Nominating and Corporate Governance Committee (Chair)
Eric DeMarco	50	
William Hoglund, Chairman	60	Audit Committee Compensation Committee Nominating and Corporate Governance Committee
Scot Jarvis	53	Audit Committee Compensation Committee (Chair) Nominating and Corporate Governance Committee
Jane Judd	67	Audit Committee
Samuel Liberatore	76	Nominating and Corporate Governance Committee

Scott Anderson

Scott Anderson has served as a director since March 1997. Mr. Anderson has been President and CEO of NE Wireless Networks, LLC, a wireless telecommunications provider in Maine, since September 2013. Mr. Anderson has been a principal of Cedar Grove Partners, LLC, an investment and advisory concern, since 1997, and a principal of Cedar Grove Investments, LLC, a private seed capital firm, since 1998. Mr. Anderson was with McCaw Cellular/AT&T Wireless, most recently as Senior Vice President of the Acquisitions and Development group, from 1986 until 1997. Before joining McCaw Cellular in 1986, Mr. Anderson was engaged in private law practice. More recently, Mr. Anderson served on the board of directors and was Audit Committee Chairman of SunCom Wireless Holdings, Inc. until its acquisition by T-Mobile USA, Inc. in February 2008. In addition, Mr. Anderson served on other public company boards prior to 2002. Mr. Anderson was also a director of TC Global, Inc., a public registrant, from July 2010 to November 2013. He currently serves on the board of directors of several private companies, including NE Wireless Networks, LLC, mInfo, Inc., Digital Scirocco, Inc., Globys, Inc., Root Wireless, Inc., and Anvil Corp. Mr. Anderson received a bachelor's degree in History from the University of Washington, *magna cum laude*, and a law degree from the University of Washington Law School, with highest honors. Mr. Anderson's formal legal training, extensive experience in mergers and acquisitions, experience with litigation matters, and experience on public company boards and audit committees provide important resources in his service on our Board and in his capacity as the chairman of our Audit Committee.

Bandel Carano

Bandel Carano originally served as a director from August 1998 to June 2001 and re-joined our Board in October 2001. Mr. Carano joined Oak Investment Partners, a multi-stage venture capital firm, in 1985 and became a General Partner in 1987. Mr. Carano's investment focus is on Information Technology. In addition to Kratos, Mr. Carano is currently on the Boards of Airspan Networks, NeoPhotonics, and numerous private companies. He also currently serves on the Investment Advisory Board of the Stanford Engineering Venture Fund. Prior to Oak Investment Partners, Mr. Carano joined Morgan Stanley's Venture Capital Group in 1983. He was responsible for advising Morgan Stanley on high-tech new business development, as well as sponsoring venture investments. Mr. Carano received bachelor's and master's degrees in Electrical Engineering from Stanford University. Mr. Carano's technical engineering background and experience with several companies in the defense electronics industry is particularly relevant to his understanding of our current service and product offerings and overall long-term strategy of future offerings. He also has significant expertise in evaluating various merger and acquisition targets for synergistic technical platforms.

Eric DeMarco

Eric DeMarco joined Kratos in November 2003 as President and Chief Operating Officer. Mr. DeMarco was appointed as a director and assumed the role of Chief Executive Officer effective April 1, 2004. Prior to joining the Company, Mr. DeMarco most recently served as President and Chief Operating Officer of The Titan Corporation ("Titan"), then a NYSE-listed corporation, prior to its acquisition by L-3 Communications. Prior to his being named President and Chief Operating Officer, Mr. DeMarco served as Executive Vice President and Chief Financial Officer of Titan. Prior to joining Titan, Mr. DeMarco served in a variety of public accounting positions primarily focusing on large multi-national corporations and publicly traded companies. Mr. DeMarco received a bachelor's degree in Business Administration and Finance, *summa cum laude*, from the University of New Hampshire. Under Mr. DeMarco, we successfully transitioned from a wireless communications company to a national defense and homeland security product solutions business through both organic growth and strategic acquisitions. Mr. DeMarco's in-depth knowledge of our business and operations, his experience in the defense contracting industry, and his experience with publicly traded companies position him well to serve as our Chief Executive Officer and a member of our Board.

William Hoglund

William Hoglund has served as a director since February 2001 and Chairman of the Board since June 2009. Mr. Hoglund has been a member and owner of SAFE Boats International, a leading manufacturer of vessels for military, law enforcement, and commercial purposes, since 2000. From 1994 to 2000, Mr. Hoglund served as Vice President and Chief Financial Officer of Eagle River, LLC, a private investment company. During his tenure at Eagle River, Mr. Hoglund served as a director of Nextel Communications, Inc. and Nextlink Communications, Inc. From 1977 to 1994, Mr. Hoglund worked for J.P. Morgan & Co. and several of its subsidiaries. Mr. Hoglund held a variety of positions in J.P. Morgan's commercial and investment banking operations. Mr. Hoglund received a bachelor's degree in Management Science and German Literature, *cum laude*, from Duke University and an MBA from the University of Chicago. Mr. Hoglund's financial experience and expertise in both the public and private marketplace make him well suited for his role as a member of the Audit Committee. He also brings significant experience in the defense contracting industry. He has served on various independent committees of the Board, has taken an active leadership role, and is well qualified to serve as the Chairman of the Board.

Scot Jarvis

Scot Jarvis has served as a director since February 1997. Mr. Jarvis co-founded Cedar Grove Partners, LLC in 1997, an investment and consulting/advisory partnership with a focus on wireless communications investments. Prior to co-founding Cedar Grove, Mr. Jarvis served as a senior executive of Eagle River, Inc., an investment firm owned by Craig McCaw. While at Eagle River he founded Nextlink Communications on behalf of McCaw and served on its board of directors. He has also served on the board of directors of Nextel Communications, NextG Networks, Inc., Wavelink Communications, Inc., NextWeb, Inc., Leap Wireless, and Cantata Technologies, Inc. From 1985 to 1994, Mr. Jarvis served in several executive capacities at McCaw Cellular Communications until it was sold to AT&T. Mr. Jarvis currently serves on the board of directors of Vitesse Semiconductor, Airspan Networks, and several private companies. Mr. Jarvis is a venture partner with Oak Investment Partners, a venture capital firm. Mr. Jarvis holds a bachelor's degree in Business Administration from the University of Washington. Mr. Jarvis has extensive experience with mergers and acquisitions transactions, which has been of particular significance to the Board during the Company's pursuit of growth strategies through mergers and acquisitions.

Jane Judd

Jane Judd has served as a director since January 2011. Prior to her retirement in 2006, Ms. Judd served as Senior Vice President, Chief Financial Officer, and a member of the board of directors of Telisimo International, a communications company, from May 1996 to November 2006. Prior to that, Ms. Judd was Vice President and Corporate Controller of The Titan Corporation from April 1986 to May 1996. Titan was a publicly traded major national defense services and solutions provider before its acquisition by L-3 Communications in 2005. Ms. Judd is a Certified Public Accountant, and she received a bachelor's degree from the University of Utah in 1976. Ms. Judd brings financial experience and expertise to the Board with her background in public accounting and financial leadership roles, which includes experience in the defense services industry. With these skills, Ms. Judd is well qualified to serve as the designated financial expert for our Board.

Samuel Liberatore

Samuel Liberatore has served as a director since January 2009. Prior to that time, Mr. Liberatore was the Chief Operating Officer for Madison Research Corporation, building it from approximately $3 million in annual revenues to $64 million, until its acquisition by Kratos in 2006, and was President of Kratos' Weapon Systems Solutions (Madison Research) division until he retired in December 2008. Beginning in July 1994 and until June 2001, Mr. Liberatore served as Program Manager and lead engineer in support of the PAC-3 missile program for Madison Research Corporation. From 1989 to 1994, he served as Director of Ballistic Missile Defense of BDM International. Mr. Liberatore served for 30 years in the U.S. Army, where he held a variety of positions related to weapon system operations, research, development and acquisition before retiring as a Colonel in 1989. He holds a bachelor's degree in Mathematics from Loyola College, Baltimore and a master's degree in Guided Missile Engineering from the University of Texas, El Paso. In addition to normal operational and command assignments, Mr. Liberatore was the Project Manager for the HAWK missile system and Chief of Missiles and Air Defense Systems at Headquarters Department of the Army for the research, development and acquisition of all U.S. Army missile and air defense systems. Mr. Liberatore brings to the Board prior experience as a military officer, extensive experience and expertise working in the missile defense industry, and recent experience working in the defense contracting industry.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE *FOR* THE ELECTION OF EACH OF THE NOMINEES FOR DIRECTOR.

PROPOSAL NO. 2

RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Our Audit Committee has selected Deloitte & Touche LLP ("Deloitte") as our independent registered public accounting firm for the fiscal year ending December 28, 2014. Deloitte was appointed as our independent registered public accounting firm in June 2013. Representatives of Deloitte are expected to be present at the Annual Meeting, will have an opportunity to make a statement if they so desire, and will be available to respond to appropriate questions.

Stockholder ratification of the selection of Deloitte as our independent registered public accounting firm is not required by our Second Amended and Restated Bylaws ("Bylaws") or otherwise. However, the Board is submitting the selection of Deloitte to the stockholders for ratification as a matter of good corporate practice. If the stockholders do not ratify the selection, the Audit Committee will reconsider whether or not to retain Deloitte. Even if the selection is ratified, the Audit Committee may, in its discretion, direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in our and our stockholders' best interests.

Audit Related Matters

As previously disclosed, the Audit Committee completed a competitive process to review the appointment of the Company's independent registered public accounting firm for the fiscal year ended December 29, 2013. The Audit Committee invited proposals from several international accounting firms. As a result of this process, on June 10, 2013, the Audit Committee approved the appointment of Deloitte as the Company's independent registered public accounting firm for the fiscal year ended December 29, 2013. Also on that date, the Audit Committee dismissed Grant Thornton, LLP as the Company's independent registered public accounting firm.

The reports of Grant Thornton on the Company's financial statements for each of the two fiscal years ended December 25, 2011 and December 30, 2012 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. In connection with the audits of the Company's financial statements for the fiscal years ended December 25, 2011 and December 30, 2012 and in the subsequent interim period through June 10, 2013, the Company had (i) no "disagreements" (as defined in Item 304(a)(1)(iv) of Regulation S-K) with Grant Thornton on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of Grant Thornton would have caused Grant Thornton to make reference to the subject matter in their reports for such years, and (ii) there were no "reportable events" (as defined in Item 304(a)(1)(v) of Regulation S-K). Grant Thornton provided the Company with a letter addressed to the SEC confirming that it agreed with these statements.

During the Company's fiscal years ended December 25, 2011 and December 30, 2012 and through June 10, 2013, neither the Company nor anyone acting on its behalf consulted Deloitte regarding the application of accounting principles to a specified transaction, either completed or proposed; the type of audit opinion that might be rendered with respect to the Company's financial statements, and no written report or oral advice was provided to the Company by Deloitte that Deloitte concluded was an important factor considered by the Company in reaching a decision as to any accounting, auditing or financial reporting issues; or any matter that was the subject of a "disagreement" or "reportable event" (as those terms are defined in Item 304(a)(1)(iv) and (v) of Regulation S-K).

Audit and All Other Fees

As part of its duties, the Audit Committee considers whether the provision of services, other than audit services, during the fiscal year ended December 29, 2013 by the Company's independent registered public accounting firm is compatible with maintaining their independence.

The following table sets forth the aggregate fees for services provided to us by Deloitte and Grant Thornton for the fiscal year ended December 29, 2013 and by Grant Thornton for the fiscal year ended December 30, 2012. All fees described below were approved by the Audit Committee.

		Fiscal 2012	Fiscal 2013	
		Grant Thornton	Grant Thornton	Deloitte
Audit Fees(1)	$	2,094,132	501,790	1,342,728
Tax Fees				181,970
All Other Fees(2)		4,900		
TOTAL	$	2,099,032	501,790	1,524,698

(1) *Audit Fees* consist of fees billed and expected to be billed for professional services rendered for the integrated audit of Kratos' consolidated annual financial statements and review of the interim consolidated financial statements included in quarterly reports, services related to compliance with the provisions of the Sarbanes-Oxley Act, Section 404, and services that are normally provided by Grant Thornton in connection with statutory and regulatory filings or engagements. The amount in 2012 includes $400,000 related to the audit fee overrun for 2012 that was paid in May 2013, $192,500 for professional services rendered for the filing of a Form S-8 and for the integrated audit of the amendment to our 2011 10-K and 2012 Q1 and Q2 10-Qs to reflect the reclassification of discontinued operations and the condensed consolidating footnote disclosure related to the non-guarantor subsidiaries of our Senior Notes, and for services rendered for reviewing the Company's responses to comment letters received by the SEC. Audit fees for 2013 paid to Grant Thornton include $291,336 for work performed for the Company's quarterly report for the first quarter, $75,000 related to workpaper access provided to Deloitte as the Company's successor auditor, $110,454 for professional services rendered related to the refinancing process of our senior notes, and $25,000 for professional services rendered for the filing of a Form S-8. Audit fees for 2013 paid to Deloitte include $49,117 for professional services rendered for the refinancing process of our senior notes and $9,625 for professional services rendered for the filing of a Form S-8.

(2) *All Other Fees* consist of fees for products and services other than the services reported above.

Audit Committee Pre-Approval Policy

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by our independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services. The Audit Committee has delegated pre-approval authority to the Audit Committee Chairperson. The independent auditor and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditor in accordance with this pre-approval.

Since June 2013, each new engagement of Deloitte has been approved in advance by the Audit Committee.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE *FOR* THE RATIFICATION OF SELECTION OF DELOITTE & TOUCHE LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 28, 2014.

PROPOSAL NO. 3

APPROVAL OF THE ADOPTION OF THE KRATOS DEFENSE & SECURITY SOLUTIONS, INC. 2014 EQUITY INCENTIVE PLAN

The 2014 Equity Incentive Plan (the "2014 Plan") was adopted by our Board on March 28, 2014, subject to stockholder approval. The 2014 Plan is the successor to the Kratos Defense & Security Solutions, Inc. 2011 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. Amended and Restated 2005 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. 2000 Nonstatutory Stock Option Plan, the Kratos Defense & Security Solutions, Inc. 1999 Equity Incentive Plan, the Amended and Restated Integral Systems, Inc. 2008 Stock Incentive Plan, the Amended and Restated Herley Industries, Inc. 2010 Stock Plan, the Herley Industries, Inc. 2003 Stock Option Plan, the Henry Bros. Electronics, Inc. 2007 Stock Option Plan, the Henry Bros. Electronics, Inc. 2006 Stock Option Plan, the Amended and Restated 2005 Digital Fusion, Inc. Equity Incentive Plan, the 2000 Digital Fusion, Inc. Stock Option Plan, the 1999 Digital Fusion, Inc. Stock Option Plan, and the 1998 Digital Fusion, Inc. Stock Option Plan (collectively, the "Prior Plans"). If this Proposal 3 is approved, the aggregate number of shares of our common stock that may be issued pursuant to stock awards under the 2014 Plan will not exceed 1,550,000 shares plus the number of Returning Shares (as defined below) that may become available.

If this Proposal 3 is approved by our stockholders, the 2014 Plan will become effective May 14, 2014 and no additional stock awards will be granted under the Prior Plans on and after April 1, 2014. All outstanding stock awards granted subject to the terms of the Prior Plans will continue to be subject to the terms and conditions as set forth in the agreements evidencing such stock awards and the terms of the respective Prior Plans. Any shares subject to outstanding stock awards granted under the Prior Plans or granted outside of a Prior Plan that, at any time after March 27, 2014, (i) expire or terminate for any reason prior to exercise or settlement; (ii) are forfeited, cancelled or otherwise returned to the Company because of the failure to meet a contingency or condition required to vest such shares; or (iii) are reacquired, withheld (or not issued) to satisfy a tax withholding obligation in connection with an award or to satisfy the purchase price or exercise price of a stock award (collectively, the "Returning Shares") will immediately be added to the share reserve of the 2014 Plan and become available for issuance pursuant to stock awards granted under the 2014 Plan. In the event that our stockholders do not approve this Proposal 3, the 2014 Plan will not become effective and each of the Prior Plans and non-plan grants will continue in their current form.

As of March 27, 2014, there were 2,306,256 shares remaining available for issuance under the Prior Plans, consisting of (i) 576,871 shares remaining available for issuance under the Kratos Defense & Security Solutions, Inc. 2011 Equity Incentive Plan; (ii) 362,490 shares remaining available for issuance under the Kratos Defense & Security Solutions, Inc. Amended and Restated 2005 Equity Incentive Plan Amended, (iii) 1,041,846 shares remaining available under the Restated Integral Systems, Inc. 2008 Stock Incentive Plan for issuance to individuals who were employees of Integral Systems, Inc. and its subsidiaries prior to its acquisition by Kratos on July 27, 2011 and Kratos employees hired after July 27, 2011; and (iv) 325,049 shares remaining available under the Amended and Restated Herley Industries, Inc. 2010 Stock Plan for issuance to individuals who were employees of Herley Industries, Inc. and its subsidiaries prior to its acquisition by Kratos on March 30, 2011 and Kratos employees hired after March 30, 2011. The total number of awards outstanding under all of the Prior Plans and outside of any Prior Plan was 5,511,322 as of March 27, 2014. If approved by stockholders, the 2014 Plan would decrease the number of shares remaining available for issuance under its equity compensation plans from 2,306,256 to 1,550,000. Although, per the 2014 Plan, up to 5,511,322 shares subject to outstanding awards under the Prior Plans and non-plan grants could potentially become Returning Shares available for issuance under the 2014 Plan, such shares are already part of the Company's total overhang. Currently, the total potential dilution (the shares available for issuance and number of awards outstanding as a percentage of Company common stock outstanding as of March 27, 2014) is 13.61%. If the 2014 Plan is approved, the total potential dilution would decrease by 1.31% to 12.30%.

Approval of the 2014 Plan will allow us to continue to grant stock awards at levels determined appropriate by our Board and Compensation Committee. The 2014 Plan will allow us to utilize a broad array of equity incentives and performance cash incentives in order to secure and retain the services of our employees, consultants and directors, and to provide long-term incentives that align the interests of our employees, consultants and directors with the interests of our stockholders. As discussed in this Proxy Statement, the Compensation Committee uses stock options and restricted stock units as forms of long-term equity compensation, and the Compensation Committee views these awards as critical to achieving its compensation objectives for executives and the broader employee population.

The 2014 Plan includes provisions that are designed to protect our stockholders' interests and to reflect corporate governance best practices, including:

Repricing is not allowed without stockholder approval. The 2014 Plan prohibits the repricing of outstanding equity awards and the cancelation of any outstanding equity awards that have an exercise price or strike price greater than the current fair market value of our common stock in exchange for cash or other stock awards under the 2014 Plan without prior stockholder approval.

Stockholder approval is required for additional shares. The 2014 Plan authorizes a fixed number of shares, so that stockholder approval is required to issue any additional shares, allowing our stockholders to have direct input on our equity compensation programs.

No liberal change in control provisions. The definition of change in control in our 2014 Plan requires the consummation of an actual transaction so that no vesting acceleration benefits may occur without an actual change in control transaction occurring.

No discounted stock options or stock appreciation rights. All stock options and stock appreciation rights must have an exercise price equal to or greater than the fair market value of our common stock on the date the stock option or stock appreciation right is granted.

On or after April 1, 2014, the Company will not grant any new equity awards under the Prior Plans unless the stockholders do not approve this Proposal 3.

The Company's historic burn rate of equity grants as a percentage of the weighted average number of common shares outstanding (as reported in the Company's Form 10-K filed March 11, 2014) has been 6.41% for 2011, 5.67% for 2012, and 1.80% for 2013. The burn rate of equity grants was higher than normal in 2011 and 2012 because of the Company's acquisition of Herley Industries, Inc. ("Herley"), Integral Systems, Inc. ("Integral"), and SecureInfo Corporation ("SecureInfo") in 2011 and Composite Engineering, Inc. ("CEI") in 2012. In connection with the acquisitions in 2011 and 2012, the Company assumed options granted by the acquired companies prior to acquisition and issued initial equity grants for certain key employees joining the Company as a result of these acquisitions in order to induce these individuals to join the Company and as a retention tool to retain key employees of the acquired companies. Excluding the impact of (a) assuming 1,210,964 options that were granted by Herley and Integral prior to acquisition and (b) granting 149,000 RSUs to certain key employees from Herley, Integral and SecureInfo for joining Kratos, the burn rate for 2011 would have been 1.45%. Excluding the acquisition impact of issuing 2,000,000 RSUs to certain key CEI employees as long-term retention incentives, the 2012 burn rate would have been 1.41%.

Under the Institutional Shareholder Services ("ISS") burn rate calculation methodology, where stock options count as one share for each share underlying the stock option award and restricted stock units and other "full value awards" count as two shares for each share underlying such award, the Company's historic burn rate of equity grants as a percentage of the weighted average number of common shares was 8.38% for 2011, 11.33% for 2012, and 1.82% for 2013. ISS applies a 3.2% burn rate cap for the Company's industry. As noted above, the burn rates for 2011 and 2012 are higher than normal because of the Company's acquisitions. Excluding the impact of the equity awards granted and assumed in connection with the Herley, Integral and SecureInfo acquisitions, the 2011 burn rate would have been 2.87% under the ISS calculation methodology; and excluding the impact of the equity awards granted in connection with the CEI acquisition, the 2012 burn rate would have been 2.80% under the ISS calculation methodology. Were it not for the equity awards granted or assumed in connection with the acquisitions in 2011 and 2012, the Company's burn rate for those years would have been below the burn rate cap ISS applies for the Company's industry.

In connection with our stock-based compensation programs, we seek to balance the need to maintain a talented resource pool in a highly competitive business with efforts to closely monitor our stock award burn rate. In connection with the approval of the 2014 Plan and in order to address any potential stockholder concerns regarding the number of stock awards we intend to grant in a given year, the Company commits that, with respect to the number of shares subject to awards granted over the next three fiscal years (2014-2016), we will maintain an average annual burn rate over that period that does not exceed 3.20% of weighted common shares outstanding. For purposes of calculating the number of shares granted in a particular year, all awards will first be converted into option-share equivalents. In this case, each share that is subject to an award other than an option will count as equivalent to 2.0 option shares. The amount and timing for future grants is not currently known, but the Company's 2013 and 2014 equity grants are discussed in this Proxy Statement. In determining the number of shares available for grant under the 2014 Plan, the Compensation Committee received information from the Company's management and outside legal advisors indicating that the 1,550,000 shares to be available under the 2014 Plan (without accounting for the outstanding awards that may potentially become Returning Shares) would meet the Company's needs for at least one year (assuming the current headcount of the Company, Compensation Committee compensation philosophy, the Company's anticipated burn rate, and industry standards). The Board considered the dilution and burn rate in approving the 2014 Plan.

Description of the 2014 Plan

The material features of the 2014 Plan are outlined below. This summary is qualified in its entirety by reference to the complete text of the 2014 Plan. Stockholders are urged to read the actual text of the 2014 Plan in its entirety, which is appended as Appendix A to the copy of this Proxy Statement filed with the SEC.

Types of Awards

The terms of the 2014 Plan provide for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance awards, and other stock awards that may be settled in cash, stock, or other property.

Shares Available for Awards

If this Proposal 3 is approved, the aggregate number of shares of our common stock that may be issued pursuant to stock awards under the 2014 Plan will not exceed 1,550,000 shares plus the number of Returning Shares, which could potentially include up to 5,511,322 shares.

The number of shares available for issuance under the 2014 Plan will be reduced by (1) one share for each share of common stock issued pursuant to an equity award granted under the 2014 Plan.

If a stock award under the 2014 Plan or any portion thereof (i) expires or otherwise terminates without all of the shares covered by such stock award having been issued or (ii) is settled in cash (*i.e.*, the participant receives cash rather than stock), such expiration, termination or settlement will not reduce (or otherwise offset) the number of shares of common stock that may be available for issuance under the 2014 Plan. If any shares of common stock issued pursuant to a stock award under the 2014 Plan are forfeited back to or repurchased by the Company because of the failure to meet a contingency or condition required to vest such shares in the participant, then the shares that are forfeited or repurchased will revert to and again become available for issuance under the 2014 Plan. Any shares reacquired by the Company in satisfaction of tax withholding obligations on a stock award or as consideration for the exercise or purchase price of a stock award will again become available for issuance under the 2014 Plan.

On or after April 1, 2014, the Company will not grant any new equity awards under the Prior Plans unless the stockholders do not approve this Proposal 3. Furthermore, as of March 27, 2014, stock options to purchase approximately 1,679,682 shares were outstanding and awards other than stock options covering an aggregate of 3,831,640 shares were outstanding. The weighted-average exercise price of all stock options outstanding as of March 27, 2014 was $13.40, and the weighted-average remaining term of such stock options was 5.73 years. As of March 27, 2014, the closing price of our common stock as reported on the NASDAQ Global Market was $7.30 per share and a total of 57,420,366 shares of our common stock were outstanding.

Eligibility

All of our employees, non-employee directors and consultants are eligible to participate in the 2014 Plan and may receive all types of awards, provided that incentive stock options may be granted under the 2014 Plan only to our employees (including officers) and employees of our affiliates. As of March 27, 2014, we have approximately 3,720 employees and six non-employee directors.

Grant Limits

Under the 2014 Plan, a maximum of 2,000,000 shares of our common stock may be granted to any one participant during any one calendar year pursuant to stock options, stock appreciation rights and other stock awards whose value is determined by reference to an increase over an exercise price or strike price of at least 100% of the fair market value of our common stock on the date of grant and that are intended to be treated as performance-based compensation under Section 162(m) of the Internal Revenue Code. The maximum amount covered by performance awards that may be granted to any one participant in any one calendar year (whether the grant, vesting or exercise is contingent upon the attainment during a performance period of the performance goals described below) is 2,000,000 shares of our common stock in the case of performance stock awards and $1,000,000 in the case of performance cash awards that are intended to be treated as performance-based compensation under Section 162(m) of the Internal Revenue Code. Such limits are designed to allow us to grant awards that are exempt from the $1 million limitation on the income tax deductibility of compensation paid per covered employee imposed by Section 162(m) of the Internal Revenue Code.

Administration

The 2014 Plan is administered by our Board, which may in turn delegate authority to administer the 2014 Plan to a committee. Our Board has delegated concurrent authority to administer the 2014 Plan to the Compensation Committee but may, at any time, revert in itself some or all of the power previously delegated to the Compensation Committee. Each of the Board and the Compensation Committee are considered to be the "Plan Administrator" for purposes of this Proposal. Subject to the terms of the 2014 Plan, the Plan Administrator may determine the recipients, numbers and types of awards to be granted, and terms and conditions of the awards, including the period of their exercisability and vesting. Subject to the limitations set forth below, the Plan Administrator also determines the fair market value applicable to a stock award and the exercise price of stock options and stock appreciation rights granted under the 2014 Plan.

The Plan Administrator may also delegate to one or more of our officers the authority to designate employees who are not officers to be recipients of certain stock awards and the number of shares subject to such stock awards, provided that such delegation must specify the total number of shares of our common stock that may be subject to the stock awards granted by such officer and such officer may not grant a stock award to himself or herself.

Repricing; Cancellation and Re-Grant of Stock Awards

Under the 2014 Plan, the Plan Administrator does not have the authority to reprice any outstanding stock option or stock appreciation right by reducing the exercise, purchase or strike price of the stock option or stock appreciation right without obtaining the approval of our stockholders within 12 months prior to the repricing event.

Stock Options

Stock options may be granted under the 2014 Plan pursuant to stock option agreements. The 2014 Plan permits the grant of stock options that qualify as incentive stock options "ISOs" and nonstatutory stock options "NSOs." Individual stock option agreements may be more restrictive as to any or all of the permissible terms described in this section.

The exercise price of NSOs may not be less than 100% of the fair market value of the common stock subject to the stock option on the date of grant. The exercise price of ISOs may not be less than 100% of the fair market value of the common stock subject to the stock option on the date of grant and, in some cases (see "Limitations" below), may not be less than 110% of such fair market value.

The term of stock options granted under the 2014 Plan may not exceed ten years. Except as explicitly provided otherwise in an optionholder's stock option agreement, stock options granted under the 2014 Plan generally terminate three months after termination of the optionholder's service unless (i) termination is due to the optionholder's disability, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the termination of service) at any time within 12 months following termination; (ii) the optionholder dies before the optionholder's service has terminated, or within the period (if any) specified in the stock option agreement after termination of service for a reason other than death, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the optionholder's death) within 18 months following the optionholder's death by the person or persons to whom the rights to such stock option have passed; (iii) the optionholder is terminated for cause, in which case the stock option will cease to be exercisable immediately upon the optionholder's termination, or (iv) the stock option by its terms specifically provides otherwise. A stock option term may be extended in the event that exercise of the stock option following termination of service is prohibited by applicable securities laws or if the sale of stock received upon exercise of a stock option would violate our insider trading policy. In no event may a stock option be exercised after its original expiration date.

Acceptable forms of consideration for the purchase of our common stock pursuant to the exercise of a stock option under the 2014 Plan will be determined by the Plan Administrator and may include (i) cash, check, bank draft or money order made payable to us, (ii) payment pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board, (iii) common stock previously owned by the optionholder, (iv) a net exercise feature (for NSOs only), or (v) other legal consideration approved by the Plan Administrator.

Stock options granted under the 2014 Plan may become exercisable in cumulative increments, or "vest," as determined by the Plan Administrator at the rate specified in the stock option agreement. Shares covered by different stock options granted under the 2014 Plan may be subject to different vesting schedules as the Plan Administrator may determine. The Plan Administrator also has flexibility to provide for accelerated vesting of stock options in certain events.

Generally, an optionholder may not transfer a stock option other than by will or the laws of descent and distribution or a domestic relations order with the approval of the Plan Administrator or a duly authorized officer. Additionally, an optionholder may, with the approval of the Plan Administrator or a duly authorized officer, designate a beneficiary who may exercise the stock option following the optionholder's death.

Limitations on Incentive Stock Options

The aggregate fair market value, determined at the time of grant, of shares of our common stock with respect to ISOs that are exercisable for the first time by an optionholder during any calendar year under all of our stock plans may not exceed $100,000. The stock options or portions of stock options that exceed this limit are treated as NSOs. No ISO may be granted to any person who, at the time of the grant, owns or is deemed to own stock possessing more than 10% of our total combined voting power or that of any affiliate unless the following conditions are satisfied:

- the exercise price of the ISO must be at least 110% of the fair market value of the stock subject to the ISO on the date of grant; and

- the term of the ISO must not exceed five years from the date of grant.

The aggregate maximum number of shares of common stock that may be issued pursuant to the exercise of ISOs granted under the 2014 Plan is 3,200,000 shares.

Restricted Stock Awards

Restricted stock awards may be granted under the 2014 Plan pursuant to restricted stock award agreements. A restricted stock award may be granted in consideration for cash, check, bank draft or money order payable to us, the recipient's services performed for us or an affiliate of ours, or any other form of legal consideration acceptable to the Plan Administrator. Shares of our common stock acquired under a restricted stock award may be subject to forfeiture to us in accordance with a vesting schedule to be determined by the Plan Administrator. Rights to acquire shares of our common stock under a restricted stock award may be transferred only upon such terms and conditions as are set forth in the restricted stock award agreement. Except as otherwise provided in the applicable restricted stock award agreement, restricted stock awards that have not vested will be forfeited upon the participant's termination of continuous service for any reason.

Restricted Stock Unit Awards

Restricted stock unit awards may be granted under the 2014 Plan pursuant to restricted stock unit award agreements. Payment of any purchase price may be made in any legal form acceptable to the Plan Administrator. We will settle a payment due to a recipient of a restricted stock unit award by delivery of shares of our common stock, by cash, by a combination of cash and stock, or in any other form of consideration determined by the Plan Administrator and set forth in the restricted stock unit award agreement. Dividend equivalents may be credited in respect of shares of our common stock covered by a restricted stock unit award. Restricted stock unit awards may be subject to vesting in accordance with a vesting schedule to be determined by the Plan Administrator. Except as otherwise provided in the applicable restricted stock unit award agreement, restricted stock units that have not vested will be forfeited upon the participant's termination of continuous service for any reason.

Stock Appreciation Rights

Stock appreciation rights may be granted under the 2014 Plan pursuant to stock appreciation right agreements. Each stock appreciation right is denominated in common stock share equivalents. The strike price of each stock appreciation right will be determined by the Plan Administrator but will in no event be less than 100% of the fair market value of the stock subject to the stock appreciation right at the time of grant. The Plan Administrator may also impose restrictions or conditions upon the vesting of stock appreciation rights that it deems appropriate. Stock appreciation rights may be paid in our common stock, in cash, in a combination of cash and stock, or in any other form of legal consideration approved by the Plan Administrator and set forth in the stock appreciation right agreement. Stock appreciation rights will be subject to the same conditions upon termination and restrictions on transfer as stock options under the 2014 Plan.

Performance Awards

The 2014 Plan allows us to grant cash and stock based performance awards that may qualify as performance-based compensation that is not subject to the $1 million limitation on the income tax deductibility of compensation paid per covered employee imposed by Section 162(m) of the Code. Performance awards may be granted, vest or be exercised based upon the attainment during a specified period of time of specified performance goals. The length of any performance period, the performance goals to be achieved during the performance period, and the measure of whether and to what degree such performance goals have been attained will be determined by the Compensation Committee, except that the Board also may make any such determinations to the extent that the award is not intended to comply with Section 162(m) of the Code.

In granting a performance award intended to qualify as "performance-based compensation" under Section 162(m) of the Code, the Compensation Committee will set a period of time, or a performance period, over which the attainment of one or more goals, or performance goals, will be measured. Within the time period prescribed by Section 162(m) of the Code, at a time when the achievement of the performance goals remains substantially uncertain (typically no later than the earlier of the 90th day of a performance period and the date on which 25% of the performance period has elapsed), the Compensation Committee will establish the performance goals, based upon one or more criteria, or performance criteria, enumerated in the 2014 Plan and described below. As soon as administratively practicable following the end of the performance period, the Compensation Committee will certify (in writing) whether the performance goals have been satisfied.

Performance goals under the 2014 Plan will be based on any one or more of the following performance criteria: (i) earnings (including earnings per share and net earnings); (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization ("EBITDA"); (iv) growth of earnings before interest and taxes; (v) EBITDA margin, adjusted EBITDA margin, or adjusted EBITDA; (vi) total stockholder return; (vii) return on equity or average stockholder's equity; (viii) return on assets, net assets, investment, or capital employed; (ix) stock price; (x) margin (including gross margin); (xi) income (before or after taxes); (xii) net income or operating income; (xiii) operating income after taxes; (xiv) pre-tax profit or after-tax profit; (xv) operating cash flow; (xvi) revenue or sales (including revenue or sales targets; (xvii) increases in revenue or product revenue; (xviii) expenses and costs (including expenses and cost reduction goals); (xix) improvement in or attainment of working capital levels; (xx) economic value added (or an equivalent metric); (xxi) market share; (xxii) cash flow; (xxiii) cash flow per share; (xxiv) earnings per share; (xxv) share price or share price performance; (xxvi) debt reduction; (xxvii) implementation or completion of projects or processes; (xxviii) customer satisfaction; (xxix) number of customers; (xxx) stockholders' equity; (xxxi) return on stockholders' equity; (xxxii) capital expenditures; (xxxiii) debt levels; (xxxiv) operating profit or net operating profit; (xxxv) workforce diversity; (xxxvi) growth of net income or operating income; (xxxvii) billings; (xxxviii) days sales outstanding; and (xxxix) to the extent that an Award is not intended to comply with Section 162(m) of the Code, other measures of performance selected by the Board.

Performance goals may be based on a company-wide basis, with respect to one or more business units, divisions, affiliates, or business segments, and in either absolute terms or relative to the performance of one or more comparable companies or the performance of one or more relevant indices. In establishing a performance goal, the Compensation Committee (and the Board, to the extent that an award is not intended to comply with Section 162(m) of the Code) may provide that performance will be appropriately adjusted as follows: (1) to exclude restructuring and/or other nonrecurring charges; (2) to exclude exchange rate effects, as applicable, for non-U.S. dollar denominated performance goals; (3) to exclude the effects of changes to generally accepted accounting principles; (4) to exclude the effects of any statutory adjustments to corporate tax rates; and (5) to exclude the effects of any "extraordinary items" as determined under generally accepted accounting principles. In addition, the Board retains the discretion to reduce or eliminate the compensation or economic benefit due upon attainment of performance goals and to define the manner of calculating the performance criteria it selects to use for a performance period.

Other Stock Awards

Other forms of stock awards valued in whole or in part with reference to our common stock may be granted either alone or in addition to other stock awards under the 2014 Plan. The Plan Administrator will have sole and complete authority to determine the persons to whom and the time or times at which such other stock awards will be granted, the number of shares of our common stock to be granted and all other conditions of such other stock awards. Other forms of stock awards may be subject to vesting in accordance with a vesting schedule to be determined by the Plan Administrator.

Transferability of Stock Awards

Generally, the holder of a stock award may not transfer the stock award other than by will or the laws of descent and distribution or a domestic relations order with the approval of the Plan Administrator or a duly authorized officer. Additionally, the holder of a stock award may, with the approval of the Plan Administrator or a duly authorized officer, designate a beneficiary who may receive the underlying stock following such holder's death.

Clawback/Recovery

Stock awards granted under the 2014 Plan will be subject to recoupment in accordance with any clawback policy we may be required to adopt pursuant to applicable law and listing requirements. In addition, the Board may impose such other clawback, recovery or recoupment provisions in any stock award agreement as it determines necessary or appropriate.

Changes to Capital Structure

In the event of certain capitalization adjustments, the Plan Administrator will appropriately adjust: (i) the class(es) and maximum number of securities subject to the 2014 Plan; (ii) the class(es) and maximum number of securities that may be issued pursuant to the exercise of ISOs; (iii) the class(es) and maximum number of securities that may be awarded to any person pursuant to Section 162(m) limits; (iv) the class(es) and maximum number of securities that may be awarded to any non-employee director; and (v) the class(es) and number of securities and price per share of stock subject to outstanding stock awards.

Corporate Transactions; Change in Control

In the event of a corporate transaction (as defined in the 2014 Plan and described below) or change in control (as defined in the 2014 Plan and described below), unless otherwise provided in an award agreement, outstanding stock awards under the 2014 Plan may be assumed, continued, or substituted by the surviving or acquiring corporation (or its parent company). If the surviving or acquiring corporation (or its parent company) does not assume, continue, or substitute such stock awards, then (i) any such stock awards that are held by participants whose continuous service has not terminated immediately prior to the effective time of the corporate transaction or change in control will become fully vested and exercisable, and such stock awards will be terminated if not exercised prior to the effective date of the corporate transaction or change in control and any reacquisition or repurchase rights held by us with respect to such stock awards will lapse, and (ii) all other stock awards will be terminated if not exercised on or prior to the effective date of the corporate transaction or change in control, provided that any reacquisition or repurchase rights held by us with respect to such stock awards will not terminate and may continue to be exercised. If a stock award will terminate if not exercised on or prior to the effective date of the corporate transaction or change in control, the Board has the discretion to provide that the holder of any stock award not exercised prior to the effective date will receive a payment in exchange for the stock award. The Board is not obligated to treat all stock awards or portions of stock awards in the same manner. The Board may take different actions with respect to the vested and unvested portions of a stock award.

Under the 2014 Plan, a stock award may be subject to additional acceleration of vesting and exercisability upon or after a change in control as may be provided in the stock award agreement or other written agreement with the participant, but in the absence of such provision, no such acceleration will occur.

For purposes of the 2014 Plan, a corporate transaction generally means the consummation of (i) a sale or other disposition of all or substantially all of our consolidated assets, (ii) a sale or other disposition of at least 90% of our outstanding securities, (iii) a merger, consolidation or similar transaction following which we are not the surviving corporation, or (iv) a merger, consolidation or similar transaction following which we are the surviving corporation but the shares of our common stock outstanding immediately prior to such transaction are converted or exchanged into other property by virtue of the transaction.

For purposes of the 2014 Plan, a change in control generally means (i) the acquisition by a person or entity of more than 50% of our combined voting power other than by merger, consolidation or similar transaction; (ii) a consummated merger, consolidation or similar transaction immediately after which our stockholders cease to own more than 50% of the combined voting power of the surviving entity; (iii) a consummated sale, lease or exclusive license or other disposition of all or substantially all of our consolidated assets; or (iv) when a majority of our board becomes comprised of individuals whose nomination, appointment, or election was not approved by a majority of the board or their approved successors.

Plan Amendments and Termination

Our Board will have the authority to amend or terminate the 2014 Plan at any time. However, except as otherwise provided in the 2014 Plan, no amendment or termination of the 2014 Plan may materially impair any rights under awards already granted to a participant unless agreed to by the affected participant. We will obtain stockholder approval of any amendment to the 2014 Plan as required by applicable law and listing requirements. No ISOs may be granted under the 2014 Plan after the tenth anniversary of the earlier of the date the 2014 Plan was adopted by the Board or approved by our stockholders.

U.S. Federal Income Tax Consequences

The information set forth below is a summary only and does not purport to be complete. The information is based upon current federal income tax rules and therefore is subject to change when those rules change. Because the tax consequences to any recipient may depend on his or her particular situation, each recipient should consult the recipient's tax adviser regarding the federal, state, local, and other tax consequences of the grant or exercise of an award or the disposition of stock acquired as a result of an award. The 2014 Plan is not qualified under the provisions of Section 401(a) of the Code and is not subject to any of the provisions of the Employee Retirement Income Security Act of 1974. Our ability to realize the benefit of any tax deductions described below depends on our generation of taxable income as well as the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligations.

Nonstatutory Stock Options

Generally, there is no taxation upon the grant of an NSO if the stock option is granted with an exercise price equal to the fair market value of the underlying stock on the grant date. On exercise, an optionholder will recognize ordinary income equal to the excess, if any, of the fair market value on the date of exercise of the stock over the exercise price. If the optionholder is employed by us or one of our affiliates, that income will be subject to withholding taxes. The optionholder's tax basis in those shares will be equal to their fair market value on the date of exercise of the stock option, and the optionholder's capital gain holding period for those shares will begin on that date.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the optionholder.

Incentive Stock Options

The 2014 Plan provides for the grant of stock options that qualify as "incentive stock options," as defined in Section 422 of the Code. Under the Code, an optionholder generally is not subject to ordinary income tax upon the grant or exercise of an ISO. If the optionholder holds a share received on exercise of an ISO for more than two years from the date the stock option was granted and more than one year from the date the stock option was exercised, which is referred to as the required holding period, the difference, if any, between the amount realized on a sale or other taxable disposition of that share and the holder's tax basis in that share will be long-term capital gain or loss.

If, however, an optionholder disposes of a share acquired on exercise of an ISO before the end of the required holding period, which is referred to as a disqualifying disposition, the optionholder generally will recognize ordinary income in the year of the disqualifying disposition equal to the excess, if any, of the fair market value of the share on the date the ISO was exercised over the exercise price. However, if the sales proceeds are less than the fair market value of the share on the date of exercise of the stock option, the amount of ordinary income recognized by the optionholder will not exceed the gain, if any, realized on the sale. If the amount realized on a disqualifying disposition exceeds the fair market value of the share on the date of exercise of the stock option, that excess will be short-term or long-term capital gain, depending on whether the holding period for the share exceeds one year.

For purposes of the alternative minimum tax, the amount by which the fair market value of a share of stock acquired on exercise of an ISO exceeds the exercise price of that stock option generally will be an adjustment included in the optionholder's alternative minimum taxable income for the year in which the stock option is exercised. If, however, there is a disqualifying disposition of the share in the year in which the stock option is exercised, there will be no adjustment for alternative minimum tax purposes with respect to that share. In computing alternative minimum taxable income, the tax basis of a share acquired on exercise of an ISO is increased by the amount of the adjustment taken into account with respect to that share for alternative minimum tax purposes in the year the stock option is exercised.

We are not allowed an income tax deduction with respect to the grant or exercise of an ISO or the disposition of a share acquired on exercise of an ISO after the required holding period. If there is a disqualifying disposition of a share, however, we are allowed a deduction in an amount equal to the ordinary income includible in income by the optionholder, subject to Section 162(m) of the Code and provided that amount constitutes an ordinary and necessary business expense for us and is reasonable in amount, and either the employee includes that amount in income or we timely satisfy our reporting requirements with respect to that amount.

Restricted Stock Awards

Generally, the recipient of a restricted stock award will recognize ordinary income at the time the stock is received equal to the excess, if any, of the fair market value of the stock received over any amount paid by the recipient in exchange for the stock. If, however, the stock is not vested when it is received (for example, if the employee is required to work for a period of time in order to have the right to sell the stock), the recipient generally will not recognize income until the stock becomes vested, at which time the recipient will recognize ordinary income equal to the excess, if any, of the fair market value of the stock on the date it becomes vested over any amount paid by the recipient in exchange for the stock. A recipient may, however, file an election with the Internal Revenue Service, within 30 days following his or her receipt of the stock award, to recognize ordinary income, as of the date the recipient receives the award, equal to the excess, if any, of the fair market value of the stock on the date the award is granted over any amount paid by the recipient for the stock.

The recipient's basis for the determination of gain or loss upon the subsequent disposition of shares acquired from stock awards will be the amount paid for such shares plus any ordinary income recognized either when the stock is received or when the stock becomes vested.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

Restricted Stock Unit Awards

Generally, the recipient of a stock unit structured to conform to the requirements of Section 409A of the Code or an exception to Section 409A of the Code will recognize ordinary income at the time the stock is delivered equal to the excess, if any, of the fair market value of the shares of our common stock received over any amount paid by the recipient in exchange for the shares of our common stock. To conform to the requirements of Section 409A of the Code, the shares of our common stock subject to a stock unit award may generally only be delivered upon one of the following events: a fixed calendar date (or dates), separation from service, death, disability or a change in control. If delivery occurs on another date, unless the stock units otherwise comply with or qualify for an exception to the requirements of Section 409A of the Code, in addition to the tax treatment described above, the recipient will owe an additional 20% federal tax and interest on any taxes owed.

The recipient's basis for the determination of gain or loss upon the subsequent disposition of shares acquired from stock units will be the amount paid for such shares plus any ordinary income recognized when the stock is delivered.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

Stock Appreciation Rights

We may grant under the 2014 Plan stock appreciation rights separate from any other award or in tandem with other awards under the 2014 Plan.

Where the stock appreciation rights are granted with a strike price equal to the fair market value of the underlying stock on the grant date, the recipient will recognize ordinary income equal to the fair market value of the stock or cash received upon such exercise. Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock appreciation right.

New Plan Benefits

No awards will be granted under the 2014 Plan prior to its approval by the stockholders of the Company. All awards will be granted at the discretion of the Compensation Committee, and, accordingly, are not yet determinable. Therefore, it is not possible to determine the benefits that will be received in the future by participants in the 2014 Plan or the benefits that would have been received by such participants if the 2014 Plan had been in effect in the year ended December 29, 2013.

Required Vote and Board Recommendation

Approval of Proposal 3 requires the affirmative vote of a majority of the shares present or represented by proxy and entitled to vote at the Annual Meeting. Abstentions will be counted toward the tabulation of votes cast on the proposal and will have the same effect as "Against" votes. Broker non-votes are counted towards a quorum, but will have no effect on the outcome of the vote.

Our Board believes that approval of Proposal 3 is in our best interests and the best interests of our stockholders for the reasons stated above.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE *FOR*
THE ADOPTION OF THE KRATOS DEFENSE & SECURITY SOLUTIONS, INC. 2014 EQUITY INCENTIVE PLAN.

PROPOSAL NO. 4

ADVISORY VOTE TO APPROVE THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

At the 2014 Annual Meeting, our stockholders will be asked to provide an advisory vote relating to the compensation of our named executive officers during fiscal year 2013. The Compensation Committee has developed our executive compensation strategy to achieve the following objectives:

- align executive compensation with our stockholders' interests, including placing a majority of compensation "at risk" and requiring that a significant portion of our CEO's and other executive management's equity grants vest in a manner that is directly tied to the Company's stock performance;
- incentivize individual performance achievements;
- attract, motivate and retain highly qualified executives; and
- create incentives that drive the entire executive management team to achieve challenging corporate goals that drive superior long-term performance.

As a result of the multi-pronged effort to gather feedback from key stockholders regarding our executive compensation that management and the Compensation Committee undertook in 2012, our Compensation Committee took several actions related to our 2012 pay programs and additional substantial changes to our compensation programs for 2013. At the 2013 Annual Meeting, we asked our stockholders to approve, on an advisory basis, the compensation paid to our named executive officers during fiscal year 2012. An overwhelming percentage of our stockholders indicated approval of the compensation of our named executive officers, with 96.4% of the votes cast in favor of the advisory vote to approve named executive officer compensation. We were very pleased with the voting result since the Compensation Committee and management had embarked on this effort to gather feedback from key stockholders regarding our executive compensation and took several actions to more closely align pay with performance and modify long-term incentives to align the interests of our executives and the Company's stockholders. Our Compensation Committee employed many of these same principles in developing our compensation programs for 2014.

Fiscal year 2013 was an extremely challenging year for the overall federal government contracting industry and for the Company. 2013 included an extended CRA for the first and final three months of the year and the implementation of the initial sequestration cuts from the Budget Control Act, resulting in the base DoD budget being reduced by approximately $25 billion from 2012 levels. As a result, the Company's revenues, Adjusted EBITDA and cash flows were all adversely impacted by this challenging industry environment throughout 2013.

Despite the adverse federal government budgetary environment and the significant investments the Company made in 2013, management delivered a strong 2013 TSR of 49%. The Company's Board and Compensation Committee take into consideration the performance of our management team and the Company, among other factors, in their consideration of executive compensation. In summary, Kratos' executive management team has successfully:

- Managed the Company through significantly declining U.S. federal government and DoD budgets;
- Significantly diversified the business, whereby approximately 35% of Kratos' revenues are generated from commercial or international customers, and such diversified business is growing organically;
- Made important progress in large, new growth and opportunity areas, including unmanned systems, electronic warfare and satellite communications;

- Managed and reduced the Company's overall cost structure, employee headcount and facility requirements in response to the current challenging U.S. federal contracting industry environment; and

- Generated real shareholder value through all of the efforts and initiatives noted above and as represented by the 49% increase in the Company's TSR or stock price from 2012 to 2013.

Kratos' Compensation Committee applied its philosophy of paying for performance in several key ways in the 2013 reward actions taken, including:

- Froze 2013 base salaries at 2012 levels for all named executive officers;

- Paid a portion of the earned 2012 bonuses in the form of stock options as opposed to cash awards to reinforce the need to generate stockholder value in order to realize an award;

- Issued a 50%/50% share mix of performance-based and time-based stock options to incentivize the Company's executive officers to build long-term equity value and to align the interests of our executive officers with our stockholders' interests. The Compensation Committee applied aggressive performance measures for the vesting of the 2013 performance-based options, which only vest upon the Company's common stock reaching $15.00 per share, an approximate 201% increase in equity value above the grant date market price of $4.98 per share;

- Eliminated excise tax gross-ups in any new change in control agreements or renewals or material amendments of existing change in control agreements beginning in 2013;

- Adopted double trigger vesting on all equity awards granted in 2013 and beyond;

- Implemented an Anti-Hedging and Anti-Pledging Policy; and

- Adopted a Stock Ownership Target Guideline of 1.0% of common stock outstanding for the CEO.

These changes and the results of our stockholder outreach efforts are discussed in the Compensation Discussion and Analysis section of this proxy statement, which begins on page 43.

We believe that our stockholders will be pleased with the Company's 2014 compensation program since substantially all of the changes were based upon the feedback from our stockholders we received in 2012 and we acted upon in 2013. We applied the same principles that were approved with an overwhelming percentage of stockholder votes in 2013. Refer to 2013 Say-on-Pay Vote Results, Stockholder Feedback, and Compensation Program Decisions on page 46.

The Compensation Committee sets target direct compensation at a level commensurate with the executives' and the Company's performance relative to our Compensation Peer Group (as defined below) utilizing individual and market measures. In addition, the Compensation Committee has determined that a substantial majority of our executives' compensation should be provided in the form of variable, performance-based compensation that directly links our executives' compensation to the Company's long-term performance.

Our Compensation Committee has designed our executive compensation programs to align the goals and objectives of our executive officers with our stockholders. The Company's key strategic goals are to build a specialized National Security business providing mission critical products, services and solutions for United States security priorities and to build and enhance long-term stockholder value. The Board and the Compensation Committee believe that our executive compensation programs have played a material role in the Company's progress in achieving its key strategic goals as well as its ability to drive strong financial results and attract and retain a highly experienced, successful team to manage our Company. Our Compensation Committee has designed our executive compensation programs to align the goals and objectives of our executive management with our stockholders.

Our Compensation Committee believes that our executive compensation programs are structured in the best manner possible to support the Company, our stated strategy and our business objectives.

Our compensation programs are substantially tied to our key business objectives and the success of our stockholders. If the value we deliver to our stockholders declines, so does a primary element of the compensation we deliver to our executives.

We maintain the highest level of corporate governance over our executive pay programs.

We closely monitor the compensation programs and pay levels of executives from companies of similar size and complexity, so that we may ensure that our compensation programs are within the norm of a range of market practices.

Our Compensation Committee, our Chairman and Chief Executive Officer, and our Vice President of Human Resources engage in a rigorous talent review process annually to address succession and executive development for our Chief Executive Officer and other key executives.

In light of the above and as discussed in the Compensation Discussion and Analysis section of this proxy statement, the Board and the Compensation Committee believe that the compensation of our named executive officers for fiscal year 2013 was appropriate and reasonable, and that our compensation policies and procedures are sound and in the best interests of the Company and its stockholders. Additionally, the Board and the Compensation Committee believe that our compensation policies and procedures are effective in achieving the Company's goals of rewarding sustained financial and operating performance and leadership excellence, aligning the executives' long-term interests with those of our stockholders and motivating our executives to remain with the Company for long and productive careers.

Therefore, our Board and Compensation Committee are again seeking input from our stockholders through this advisory vote to approve the compensation of our named executive officers as described in this proxy statement in the section titled "Compensation Discussion and Analysis" beginning on page 43, in the compensation tables beginning on page 59, and in any related narrative discussion contained in this proxy statement.

Accordingly, the following resolution will be submitted for a stockholder vote at the Annual Meeting:

"RESOLVED, that the stockholders of Kratos Defense & Security Solutions, Inc. approve, on an advisory and non-binding basis, the compensation of the Company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion in this Proxy Statement."

While this stockholder vote on executive compensation is merely advisory and will not be binding upon us, our Board or our Compensation Committee, we value the opinions of our stockholders and will consider the outcome of the vote when making future compensation decisions. The next non-binding advisory vote to approve the compensation of our named executive officers will occur at the 2015 Annual Meeting of Stockholders.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE TO *APPROVE* THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS AS DESCRIBED IN THIS PROXY STATEMENT.

REPORT OF THE AUDIT COMMITTEE

As more fully described in its charter, the Audit Committee oversees our financial reporting process and internal control structure on behalf of our Board. Management has the primary responsibility for the financial statements and the reporting process, including our systems of internal controls. The Company's independent registered public accounting firm is responsible for performing an audit of our annual consolidated financial statements in accordance with generally accepted accounting principles (GAAP), for issuing a report on those statements and expressing an opinion on the conformity of these audited financial statements, and for reviewing our interim financial statements in accordance with Statement on Auditing Standards No. 100 (interim financial information). The Audit Committee met nine times during 2013 and met regularly with our independent and internal auditors, both privately and with management present.

In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed with management and the independent auditors the audited and interim financial statements, including Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's Reports on Form 10-K and Form 10-Q. These reviews included a discussion of:

- our critical accounting policies;
- the reasonableness of significant financial reporting judgments made in connection with the financial statements, including the quality (and not just the acceptability) of our accounting principles;
- the clarity and completeness of our financial disclosures;
- the effectiveness of our internal controls over financial reporting, including management's and independent auditor's reports thereon, the basis for the conclusions expressed in those reports and changes made to our internal control over financial reporting during 2013;
- items that could be accounted for using alternative treatments within GAAP, the ramifications thereof and the treatment preferred by the independent auditor;
- the annual management letter issued by the independent auditor, management's response thereto and other material written communications between management and the independent auditor;
- unadjusted audit differences noted by the independent auditor during its audit of our annual financial statements; and
- the potential effects of regulatory and accounting initiatives on our financial statements.

In connection with its review of our annual consolidated financial statements, the Audit Committee also discussed with the independent auditor other matters required to be discussed with the auditors under Statement on Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T (communication with audit committees) and those addressed by Grant Thornton's written disclosures and its letter provided under Independence Standards Board Standard No. 1, as modified or supplemented (independence discussions with audit committees).

The Audit Committee is responsible for the engagement of the independent auditors and has appointed Deloitte to serve in that capacity since June 2013. In connection therewith, the Audit Committee:

- reviewed Deloitte's independence from the Company and management, including Deloitte's written disclosures described above;

- reviewed periodically the level of fees approved for payment to Deloitte and the pre-approved non-audit services it has provided to us to ensure their compatibility with Deloitte's independence; and

- reviewed Deloitte's performance, qualifications and quality control procedures.

Among other matters, the Audit Committee also:

- reviewed the scope of and overall plans for the annual audit and the internal audit program;

- consulted with management and Deloitte with respect to our processes for risk assessment and risk management;

- reviewed the adequacy of certain of our financial policies;

- reviewed and approved our policy with regard to the hiring of former employees of the independent auditors;

- reviewed and approved our policy for the pre-approval of audit and permitted non-audit services by the independent auditors;

- received reports pursuant to our policy for the submission and confidential treatment of communications from employees and others about accounting, internal controls and auditing matters;

- reviewed with management the scope and effectiveness of our disclosure controls and procedures, including for purposes of evaluating the accuracy and fair presentation of our financial statements in connection with certifications made by the Chief Executive Officer and Chief Financial Officer; and

- reviewed significant legal developments and our processes for monitoring compliance with law and Company policies.

Based on the reviews and discussions referred to above, the Audit Committee recommended to the Board, and the Board approved, that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 29, 2013 for filing with the SEC. The Audit Committee also selected Deloitte as our independent auditor for 2014.

Respectfully submitted,

THE AUDIT COMMITTEE OF THE
BOARD OF DIRECTORS

Scott Anderson, *Chairperson*
William Hoglund
Scot Jarvis
Jane Judd

The foregoing Report of the Audit Committee is not "soliciting material," is not deemed "filed" with the SEC, and shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing of ours under the Securities Act of 1933, as amended, or under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") except to the extent we specifically incorporate this report by reference.

EXECUTIVE COMPENSATION

Our Executive Officers

Executive officers are elected by our Board and serve at its discretion. There are no family relationships between any director or executive officer and any other directors or executive officers. Set forth below is information regarding our current executive officers who were also in place as of December 29, 2013.

Name	Position	Age
Eric DeMarco(1)	Chief Executive Officer and President	50
Deanna Lund	Executive Vice President and Chief Financial Officer	46
Deborah Butera	Senior Vice President, General Counsel, Chief Compliance Officer and Secretary	48
Wayne Armstrong	President, Advanced Drones & Target Systems	67
Gerald Beaman	President, Unmanned Combat Aerial Systems	61
Phillip Carrai	President, Technology & Training Solutions	52
David Carter	President, Defense & Rocket Support Services	56
Benjamin Goodwin	President, Public Safety & Security	73
Thomas Mills	President, Modular Systems	54
Richard Poirier	President, Electronic Products	49
Richard Duckworth	Vice President and Corporate Controller	53

(1) The biographical information for Eric DeMarco is provided in the section identifying the Director nominees beginning on page 20.

Each executive officer holds office until his or her respective successor has been appointed, or until his or her earlier death, resignation or dismissal. Historically, our Board has designated our executive officers annually at its first meeting following the annual meeting of stockholders.

Deanna Lund has served as Kratos' Executive Vice President and Chief Financial Officer since April 2004. Prior to joining Kratos, Ms. Lund most recently served as Vice President and Corporate Controller of The Titan Corporation from July 1998 to 2004, then an NYSE-listed corporation, prior to its acquisition by L-3 Communications, and as its Corporate Controller beginning in December 1996. Ms. Lund was also Titan's Corporate Manager of Operations Analysis from 1993 to 1996. Prior to that time, Ms. Lund worked for Arthur Andersen LLP. Ms. Lund received a bachelor's degree in Accounting from San Diego State University, *magna cum laude*, and is a Certified Public Accountant.

Deborah Butera has served as Senior Vice President, General Counsel, Registered In-House Counsel, and Secretary of the Company since September 2010 and was appointed as the Company's Chief Compliance Officer in February 2013. Prior to joining the Company, Ms. Butera represented Kratos as outside counsel since February 2006. Prior to joining Kratos, Ms. Butera was a partner with the law firm of Shapiro Fussell Wedge & Martin, LLP in Atlanta from 2007 through 2010 and was a partner with the international law firm of Yoss, LLP from 2004 through 2007. Ms. Butera has over 19 years of experience counseling clients in legal matters. She has also held various positions of public service in law, including as a member of the board of directors of the Atlanta Bar Association and Chair of the Atlanta Bar Association's Construction Law Section. Ms. Butera received her law degree, with highest honors, from Capital University Law School and received a bachelor's degree in Business Administration from The Ohio State University.

Wayne Armstrong has served as the President of the Company's Advanced Drones & Target Systems Division since August 2013. Mr. Armstrong joined Kratos in March 2011 following the Herley Industries, Inc. merger, where he was Division President of the Herley subsidiary, Micro Systems, Inc. Prior to joining Micro Systems in 2002, Mr. Armstrong served as a Division President for L-3

Communications Corporation, operating a joint venture corporation between L-3 and the Republic of Turkey. He also served as Vice President and Division Director of Metric Systems Corporation, a defense electronics company involved in a wide variety of training and tactical systems, and Mr. Armstrong was an early member of the development team for the U.S. Navy's Aegis Weapon System and Vertical Launching System. He has been involved in target systems, both as a user and as a provider, for 25 years. Mr. Armstrong holds a bachelor's degree in Electrical Engineering from Lamar University and an MBA from Rollins College.

Gerald Beaman has served as the President of the Company's Unmanned Combat Aerial Systems Division since August 2013. Vice Admiral Beaman is an accomplished, proven leader with extensive experience in large-scale operations. Prior to joining Kratos, Mr. Beaman was an officer with the U.S. Navy from December 1977 until his retirement in July 2013 as a Vice Admiral. In the Navy, Mr. Beaman served as the Commander of the U.S. Third Fleet and directed activities for 58,000 personnel responsible for homeland defense, support for civil authorities and for providing relevant training and certification for all West Coast naval forces. In his naval career of 35 years, Mr. Beaman also served as Deputy Chief of Staff Operations Global Force Management, Training and Experimentation, Fleet Forces Command; Deputy Chief of Staff Operations, Joint Forces Command; and Commander, Strike Force Training Pacific. Mr. Beaman holds a master's degree in National Security and Strategic Studies from the Naval War College and a bachelor's degree in Business Administration from Marquette University.

Phillip Carrai has served as President of the Company's Technology & Training Solutions Division since December 2009 and was Executive Vice President of the same division from July 2008 to December 2009. Prior to that, Mr. Carrai served as President of the Information Technology Solutions segment of SYS from October 2006 until SYS's merger with Kratos in June 2008. From 2003 to 2006, Mr. Carrai was the Chief Executive Officer of Ai Metrix, Inc., a telecommunications software company sold to SYS in 2006. He served as Managing Director for the Morino Group and Special Advisor to General Atlantic, Inc. from 2000 to 2003 and was Executive Chairman for Ztango and a board member of Internosis. Mr. Carrai was the Chief Executive Officer of McCabe and Associates, a testing and analysis software company, from 1997 to 2000. From 1989 to 1996, Mr. Carrai held a variety of executive management positions at Legent Corporation, an enterprise software company. Mr. Carrai received his bachelor's degree in Information Science and Accounting from Indiana University of Pennsylvania and his MBA from Carnegie Mellon University.

David Carter has served as President of the Company's Defense & Rocket Support Services Division since December 2009, and he was the Executive Vice President of that division from December 2007 to December 2009. Before its acquisition by Kratos in December 2007, Mr. Carter served as Vice President of Haverstick/DTI Military Services Division since January 2004, where he was responsible for managing the division's technical, financial and business development operations. Mr. Carter has over thirty years of experience both as a member of the U.S. Navy and as a contractor supporting Navy combat weapon systems development, acquisition and life cycle support. Mr. Carter joined Haverstick/DTI in 1989 and for the past twenty-two years has been responsible for building and managing a Department of Defense business sector. Mr. Carter received his associate's degree from Anne Arundel Community College.

Benjamin Goodwin has served as President of the Public Safety & Security segment since joining the Company in June 2008. Prior to that, Mr. Goodwin served as Senior Vice President of Sales and Marketing and President of the Public Safety, Security and Industrial Products Group of SYS from July 2005 until SYS's merger with Kratos in June 2008. Mr. Goodwin has held a variety of executive management positions in his career. From 2004 to 2005, Mr. Goodwin was Chief Operating Officer and Vice President of Sales for Aonix, a developer of software product solutions for the aerospace, telecommunications, and transportation industries. Mr. Goodwin had previously served as Chief Executive Officer of Aonix from 1996 to 2000. From 2000 to 2002, Mr. Goodwin was Executive Vice

President of Sales & Marketing for FinanCenter, a developer of financial decision tools, and Chairman of the Board for Template Graphics Solutions, a provider of 3D graphics tools. From 1976 to 1996, Mr. Goodwin was the President and Chief Operating Officer of Thomson Software Products and President and Chief Executive Officer of SofTech Microsystems. In these capacities, Mr. Goodwin was responsible for the successful completion of an IPO, private placements and a merger in addition to significant revenue growth within the companies. Mr. Goodwin has a bachelor's degree in Psychology from Millsaps College.

Thomas Mills has served as President of Kratos' Modular Systems Division, which includes Gichner Systems Group, based near York, PA, and Charleston Marine Containers ("CMCI"), based in Charleston, SC, since August 2013. With five manufacturing plants, 45 years of experience and approximately 450 employees, Gichner and CMCI are two of the leading suppliers of integrated mobile shelters and container systems to the U.S. military. Prior to joining Gichner in 2004, Mr. Mills held several senior management positions at various publicly traded and privately held companies. Mr. Mills started his career at KPMG and has a bachelor's degree in Accounting from West Chester University.

Richard Poirier has served as President of Kratos' Electronic Products Division since July 2012. Prior to that, Mr. Poirier served as President and General Manager of the Herley Business Unit of Kratos' Weapon Systems Solutions Division beginning in April 2011. Before Herley Industries, Inc.'s ("Herley") acquisition by Kratos in March 2011, Mr. Poirier served as Herley's Chief Executive Officer and President since July 2009, after serving as a Herley Vice President and as General Manager of Herley's New England division since August 2003. Mr. Poirier had been with Herley since 1992 when Herley acquired Micro Dynamics, Inc. ("MDI"). Mr. Poirier joined MDI upon graduation from college in 1987 and has held various management positions over the years. Mr. Poirier holds a bachelor's degree in Electrical Engineering from Marquette University.

Richard Duckworth has served as the Company's Vice President, Corporate Controller, and Principal Accounting Officer since November 2013. Mr. Duckworth brings significant accounting, finance, business, and public company experience and skills to the Company. From March 2008 to November 2013, Mr. Duckworth served as the Vice President of Accounting and Corporate Controller for Novatel Wireless, Inc. Prior to Novatel, Mr. Duckworth was Vice President of Finance and Controller/Accounting Director at Kyocera Wireless Corp. and held various progressive accounting positions at QUALCOMM Inc., including Accounting Director of a QUALCOMM wholly owned subsidiary. Mr. Duckworth began his career with the public accounting firm Coopers & Lybrand (now Pricewaterhouse Coopers) and is a Certified Public Accountant. Mr. Duckworth earned a bachelor's degree in Business Administration with an emphasis on Accounting from San Diego State University.

Compensation Discussion and Analysis

Overview

The following Compensation Discussion and Analysis ("CD&A") describes and analyzes Kratos' compensation program for its named executive officers. Kratos' named executive officers for fiscal year 2013 include its Chief Executive Officer, its Chief Financial Officer, and its three most highly compensated executive officers (other than the Chief Executive Officer and Chief Financial Officer) who were serving as executive officers at the end of fiscal year 2013. The named executive officers during the last completed fiscal year were Eric DeMarco, President and Chief Executive Officer; Deanna Lund, Executive Vice President and Chief Financial Officer; Deborah Butera, Senior Vice President, General Counsel, Registered In-House Counsel, Chief Compliance Officer and Secretary; Phillip Carrai, President of the Technology & Training Solutions Division; and Richard Poirier, President of the Electronic Products Division. In the CD&A, Mr. DeMarco, Ms. Lund and Ms. Butera are sometimes referred to as "corporate named executive officers" and Messrs. Carrai and Poirier are sometimes referred to as "operational named executive officers."

In this CD&A, we first provide an Executive Summary. Next, we cover Kratos' 2013 Say-on-Pay Vote Results, Stockholder Feedback, and Compensation Program Decisions; Compensation Philosophy and Objectives; and 2013 Compensation Program Decisions. We then discuss the process our Compensation Committee follows in setting executive compensation, including Benchmarking Our Program Against Peers, Targeted Pay Mix, and Elements of the Executive Compensation Program. Finally, we engage in a detailed discussion and analysis of the Compensation Committee's specific decisions about the compensation of our named executive officers in 2013 and the changes the Compensation Committee made for fiscal year 2013.

Executive Summary

Kratos' Fiscal 2013 Financial Performance and Executive Compensation

Fiscal Year 2013 was an extremely challenging year for the overall U.S. federal government contracting industry and for the Company. During 2013, there was an extended CRA for the first and final three months of the year, with no overall federal or DoD budget in place. When a CRA is in place, no new contract awards can be made. The initial sequestration cuts from the Budget Control Act were implemented, and the base DoD budget was reduced by approximately $25 billion from 2012 levels, to approximately $505 billion. The DoD budget was cut further, to approximately $497 billion, for Fiscal Year 2014. Approximately 65% of Kratos' revenues are generated from U.S. federal government customers, funding and agencies. As a result, the Company's revenues, Adjusted EBITDA and cash flows were all adversely impacted by this challenging industry environment throughout 2013.

Despite the adverse federal government budgetary environment and the significant investments the Company made in 2013, management delivered a strong 2013 TSR of 49%. The Company believes that this stock performance was due in part to the important progress Kratos' management team made on a number of strategic initiatives as noted in more detail below, and which include:

- Investing in key defense-related long-term growth opportunities;
- Diversifying away from reliance on defense-related spending; and
- Taking significant cost reduction actions.

Kratos believes that these actions, if successful, could result in significant revenue, EBITDA, and cash flow growth and a related valuation increase for the Company's stockholders.

Despite this federal government budgetary environment in 2013, the Company made significant discretionary investments in certain new growth and large opportunity areas to help position the Company for long-term success, including unmanned systems, electronic warfare and satellite communications. This was due in part to certain new and large program opportunities moving forward, including NGJ, AMDR, and SEWIP. These are all expected to be long term, multi-year national security priority programs. Also in 2013, the Company increased its internal spending on cybersecurity and cyber protection in order to protect the Company's and its customers' intellectual property and sensitive information from significant and increasing cybersecurity threats, especially as related to government contractors. All of these important and required investments had a negative impact on the Company's 2013 EBITDA and cash flow, although they reflect sound strategic choices for enhancing Kratos' long-term success. Through Kratos management's interaction and routine discussions with the Company's stockholders, we believe that these strategic initiatives in the unmanned systems, electronic warfare and satellite communications areas are very important to delivering continued value creation to our equity holders.

Additionally in 2013, the Company continued its successful customer diversification initiative, with Kratos' commercial, international and non U.S. federal government revenues making up approximately 35% of the Company's business. Kratos' management is executing on this customer diversification strategy in response to declining DoD budgets. An important aspect and contributor to our management's diversification strategy is the Company's KPSS business, which represented approximately 22% of our revenues in 2013. KPSS grew 12.7% from 2012 to 2013. Furthermore, Kratos' commercial satellite communications business grew 31.6% in 2013 over 2012. The successful execution of this diversification initiative has helped the Company maintain its overall consolidated revenues at approximately $950 million for 2013, a less than approximate 1% decrease from 2012, in spite of the significantly reduced DoD budget that impacted the entire industry. We believe that the Company's success in maintaining its consolidated revenues in this difficult environment demonstrates that its 2013 performance was among the best in its peer group.

In 2013, our management remained focused on reducing costs and increasing operating efficiencies. For example, Kratos' work force has been reduced by 11.6% from 2012 to 2013, with a total headcount reduction of 502 personnel, from 4,317 to 3,815 employees. In addition, we have significantly reduced the number of leased facilities and overall square footage that we occupy, significantly reducing the Company's cost of facilities and improving efficiencies.

The Company's Board and Compensation Committee take into consideration the performance of our management team and the Company, among other factors, in their consideration of executive compensation. In summary, Kratos' executive management team has successfully:

- Managed the Company through significantly declining U.S. federal government and DoD budgets;
- Significantly diversified the business, whereby approximately 35% of Kratos' revenues are generated from commercial or international customers, and such diversified business is growing organically;
- Made important progress in large new growth and opportunity areas, including unmanned systems, electronic warfare and satellite communications;
- Managed and reduced the Company's overall cost structure, employee headcount and facility requirements, in response to the current, challenging U.S. federal contracting industry environment; and
- Generated real stockholder value through all of the efforts and initiatives noted above, and as represented by the 49% increase in the Company's TSR or stock price from 2012 to 2013.

	Fiscal Year 2013 ($)	Fiscal Year 2012 ($)	Fiscal Year 2011 ($)
Gross Revenues	$ 950.6	$ 969.2	$ 713.9
Cost of Sales	710.6	712.0	522.7
Selling, General and Administrative Expense	193.0	193.1	191.2
Research and Development Expense	21.4	17.8	8.6
Adjusted EBITDA(1)	100.3	115.4	93.0
Operating Cash Flow	22.6	52.3	5.2
Backlog	1,100.0	1,300.0	1,100.0

(1) Earnings before interest, taxes, depreciation, and amortization ("EBITDA") excluding acquisition related items and non-cash items such as impairment of goodwill, intangibles, and stock based compensation expense. Please see our Form 8-K filed with the SEC on March 11, 2014 for information reconciling Adjusted EBITDA to EBITDA.

Our executive management team continues to remain focused on streamlining costs, implementing operating efficiencies, and generating cash flow to continue to de-lever our balance sheet, which we believe will ultimately accrete to the equity value of the Company.

2013 Say-on-Pay Vote Results, Stockholder Feedback, and Compensation Program Decisions

Beginning in 2011, we gave our stockholders the opportunity to provide feedback on our executive compensation program and related proxy disclosure through an advisory vote at our annual stockholders meeting. Stockholders were asked to approve, on an advisory basis, the compensation paid to the named executive officers. Stockholders also indicated a strong preference to hold the advisory vote annually. At our annual meeting in 2012, our stockholders approved, on an advisory basis, the "say-on-pay" resolution for the compensation of our named executive officers in fiscal year 2011, with 55% of the votes cast in favor of the proposal. Despite the majority support and approval of the named executive officers' compensation, we were disappointed in the May 2012 voting results and recognized the need to better understand our stockholders' opinions. As a result, we initiated a review to gain further feedback from key stockholders on their perspectives of our executive compensation program. Our Compensation Committee took actions in 2012 and 2013 to provide clearer alignment between pay and performance.

As a result of the actions our Compensation Committee took in 2012 and 2013, an overwhelming majority of stockholders indicated their approval in 2013, with 96.48% of the advisory votes cast in favor of approving the compensation of our named executive officers. Our Compensation Committee has continued to employ the same principles in determining the compensation program for 2014. A summary of the actions that were taken in 2012 and 2013 in response to stockholder feedback that remain in effect are as follows:

Aspect of Compensation Program	Stockholder Feedback	Compensation Program Changes for 2013 in Response to Stockholder Feedback
Change in Control Agreements	Recent stockholder opposition to the practice of excise tax gross-ups has led many companies to eliminate the provision.	Any new change in control agreements or any renewals or material amendments of existing change in control agreements will eliminate excise tax gross ups. In addition, equity awards have a "double-trigger," such that they will not accelerate in the event of a change in control unless also accompanied by a qualifying termination of employment.
Long-Term Equity Incentives	Some stockholders believe that long-term equity incentives should be earned or vested based upon the achievement of specific performance goals aligned with stock performance.	The Compensation Committee made the decision to grant equity to align the Company's stock performance with the vesting of long-term equity incentives. For instance, stock options were granted in January 2013 with 50% of the equity award vesting upon the achievement of a Company market price per share of $15.00 (a 201% increase above the option strike price of $4.98). The remaining 50% of the equity award cliff vests 100% at the end of 5 years. In the event of a change in control, accelerated vesting will only occur if the market price per share is at least in excess of 15% of the option strike price. In addition, the RSUs granted in January 2014 included 50% of the equity award vesting upon the achievement of a Company market price of $12.15 (or a 50% increase above the market price at grant date of $8.10 per share). The vesting schedule of the performance-based RSUs vest 20% for every 10% increase in market share price above the market price at grant date of $8.10, with full vesting occurring upon the achievement of a Company market price of $12.15. The remaining 50% of the equity award cliff vests 100% at the end of 5 years. In the event of a change in control, accelerated vesting will only occur if the market price per share is at least in excess of 15% of the market price on the date of grant of $8.10, or at least $9.32 per share. The Company also increased the component of long-term equity incentive compensation as a percentage of total compensation to provide a greater emphasis on compensation that is directly linked with the creation of long-term stockholder value.
Hedging and Pledging Policy	Stockholders generally oppose share hedging transactions or pledging transactions by directors and executive officers that diminish the alignment with shareholder interests.	Beginning in March 2013, the Company has implemented a policy that prohibits hedging and pledging transactions by directors and executive officers.
Stock Ownership Target Guidelines	Some stockholders believe that the Company should have stock ownership guidelines.	The Company implemented a stock ownership target guideline of 1% of the outstanding shares of common stock for our Chief Executive Officer, including all shares held through options, restricted stock units, Employee Stock Purchase Plan purchases, open market purchases and 401(k) holdings. Over the past four quarters, the Chief Executive Officer has purchased shares of Kratos common stock on the open market. Additionally, other executive officers have purchased shares of Kratos common stock on the open market during the past few quarterly open trading windows.

Compensation Philosophy and Objectives

The following chart highlights important considerations in the development, review and approval of the compensation of our named executive officers. We include additional detail for each of these highlights in the following pages of this CD&A.

Compensation Philosophy and Objectives	
Objectives of Executive Compensation Program	Our executive compensation program is designed to: Build long-term stockholder value Deliver strong business and financial results Attract, motivate and retain a highly qualified and effective management team to lead our business
Philosophy of Executive Compensation Program	Our executive compensation philosophy is built on five principles: Align compensation with stockholders' interests and avoid excessive risk taking Pay for performance Emphasize long-term focus Align compensation to market Provide appropriate degrees of at-risk and performance-based compensation
Methods to Achieving the Executive Compensation Program Objectives	Tie annual and long-term cash and stock incentives to achievement of measurable corporate and individual performance objectives

Reward individual performance and reinforce business strategies and objectives for enhanced stockholder value

Evaluate employee performance and compensation to ensure we can attract and retain employees in a competitive manner

Ensure total compensation paid to executive officers is fair, reasonable and competitive, considering accomplishments of the individual executive officers and the Company as a whole

Principal Elements of the Executive Compensation Program

Base salary

Annual performance-based incentive cash bonus awards

Long-term equity incentives in the form of restricted stock units and stock options and other equity awards

Other benefits and perquisites, such as life and health insurance benefits and a qualified 401(k) savings plan offered to all employees

Post-termination severance and accelerated vesting of previously granted equity awards upon termination and/or a change of control

The Compensation Committee views these components of compensation as related but distinct. Although the Compensation Committee does review total compensation, we do not believe that compensation derived from one component of compensation should negate or offset the compensation incentives provided by the other components. The Compensation Committee determines the appropriate level for each compensation component based in part, but not exclusively, on the Company's strategic plan, aligning the Company's strategic objectives and executive compensation with stockholder expectations for long-term value creation, compensation for similar positions at peer companies, internal equity and consistency, and other considerations it deems relevant, such as rewarding extraordinary performance.

2013 Compensation Program Decisions

The table below summarizes the compensation decisions that our Compensation Committee made in November 2012 effective for the start of fiscal year 2013 relative to our named executive officers and the implications of the Company's performance during the fiscal year on incentive award payouts.

2013 Compensation Program Decisions and Actions

Decisions Effective on the Start of Fiscal Year 2013 (made in November 2012)	The Compensation Committee froze the base salaries of all corporate named executive officers at 2012 compensation levels to construct a compensation program with additional emphasis on performance-based and long-term incentives. The Compensation Committee increased the operational (non-corporate) named executive officer base salaries between 2.2% and 12.9% to align with the market median levels of similar positions in Kratos' Compensation Peer Group, with additional emphasis and consideration on individual performance, individual accomplishments, and evaluation of other considerations such as achievements and performance of the Company, execution of the Company's business plan and execution of the Company's strategic plan. Consideration was also made to better align compensation levels relative to other positions with similar responsibilities within the Company.
	The annual operating plan ("AOP") was based on aggressive targets of revenue, Adjusted EBITDA, and operating cash flow targets, which is the basis for our targets for fiscal year 2013 incentive compensation purposes. Our Board reviews and approves our annual consolidated AOP, as well as each division's AOP. These targets were set in October 2012, amidst industry uncertainty in the DoD budgets, with the impact of Sequestration and prolonged Continuing Resolutions unknown at that time.
	The fiscal year 2013 AOP included revenues of $975 million, Adjusted EBITDA of $120 million, and operating cash flow of $52.6 million. All of the fiscal year 2013 AOP financial targets excluded any impact from acquisitions and assumed a stable DoD budgetary environment, since the effects of Sequestration, the lack of a DoD budget and the resulting impact of operating in such an environment were not known when the targets were established.
	The Compensation Committee granted stock options in January 2013. It did not grant any other stock awards to the named executive officers during fiscal year 2013. Beginning in 2013, the Compensation Committee began issuing a 50%/50% mix of performance-based and time-based equity awards. The Compensation Committee believes that granting equity with vesting tied to performance measures incentivizes the Company's executive officers to build long-term equity value and closely aligns the interests of our executive officers with our stockholder's interests. For instance, the performance-based options granted in 2013 vest upon the Company's common stock reaching $15.00 per share, thereby requiring an approximate 201% increase in equity value above the grant date market price of $4.98. In addition, the performance-based RSUs granted in January 2014 vest 20% for each 10% increase in the fair market value of the Company's common stock above the grant date market price of $8.10, until fully vested. The performance-based RSUs do not fully vest until the Company's common stock reaches $12.15 per share, or a 50% increase in equity value above the grant date market price of $8.10.

2013 Compensation Program Decisions and Actions

Incentive Plan Outcomes for Performance During Fiscal Year 2013

In 2013, the Company fell short of its AOP budget objectives for Revenues, Adjusted EBITDA, and Operating Cash Flows, as established in October 2012. This shortfall was due to the various challenges faced from several months of a CRA under which no new contract awards can be made and the impact of reduced spending from sequestration (as explained in more detail above), and due to the investments the Company made in several areas that are anticipated to be strong long-term strategic growth opportunities. In the face of these business challenges, the Company's management team defined and executed on key objectives of identifying and pursuing large new program opportunities, diversifying the Company away from defense-related projects and reducing costs. In 2013, stockholders rewarded the Company's financial performance and definition of future strategies in the face of this challenging environment with total shareholder returns of 49%. Based upon a similar perspective on management's performance in light of the macro-economic headwinds, the Compensation Committee determined that the 2013 annual incentive awards should be paid at a target level for the Company's corporate named executive officers and at certain payout levels for the operational named executive officers, both of which are above the result that would be determined according to the direct financial performance delivered. Based on the overall Company results delivered, the Compensation Committee determined the following annual incentive awards to be appropriate for 2013:

Named Executive Officer	Actual Payout Multiplier (% of target bonus payable)
Eric DeMarco	100%
Deanna Lund	100%
Deborah Butera	100%
Phillip Carrai	47%
Richard Poirier	23%

The Compensation Committee considered the following performance measures for fiscal year 2013: Revenues, Adjusted EBITDA and Operating Cash Flow(1). After taking into consideration all of the factors noted above, the Compensation Committee made the decision to pay amounts in excess of the computed payout multiplier, at or below the target bonus payable.

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(1) These performance measures contain non-GAAP financial measures, including Adjusted EBITDA (which excludes the impairment of goodwill and intangible assets, changes in the accrual for unused office space, estimated contract design retrofit costs, restructuring and acquisition related items, losses from discontinued operations, transaction and other acquisition related items, contract and legal settlements, stock compensation expense and income from SWAP instruments, and the associated margin rates). Kratos believes this information is useful to investors because it provides a basis for measuring the Company's available capital resources, the actual and forecasted operating performance of the Company's business and the Company's cash flow, excluding extraordinary items and non-cash items that would normally be included in the most directly comparable measures calculated and presented in accordance with generally accepted accounting principles. The Company's management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating the Company's actual and forecasted operating performance, capital resources and cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and investors should carefully evaluate the Company's financial results calculated in accordance with GAAP and reconciliations to those financial statements. In addition, non-GAAP financial measures as reported by the Company may not be comparable to similarly titled amounts reported by other companies.

Benchmarking Our Program Against Peers

To gauge marketplace compensation levels and practices, the Compensation Committee works with the Vice President of Human Resources to conduct a marketplace analysis of our executive compensation practices and pay levels against a group of publicly traded companies that we refer to as the "Compensation Peer Group," and Mercer, an independent executive compensation consultant, provides guidance on the peer group selection and the overall competitive pay methodology. Mercer was selected by the Compensation Committee based on recommendations from other companies and outside counsel, and the compensation consultant assisted with the review of the Company's Compensation Peer Group. The Compensation Peer Group, which the Compensation Committee annually reviews and updates, consists of a group of companies that:

- we compete against for talent,
- are in our industry or a similar industry, or
- have broadly similar revenues and employee population.

We rely upon the compensation data gathered from the Compensation Peer Group to represent the competitive market for executive talent for Kratos executives. Based on the most recent available data for fiscal year 2013, the average and median annual revenue for the Compensation Peer Group are approximately $1.45 billion and $860 million, respectively. The average and median number of employees for the Compensation Peer Group are 4,600 and 2,770, respectively. Kratos is within an acceptable range of the companies in its Compensation Peer Group for both annual revenue, at $950 million, and number of employees, at 3,815.

Compensation Peer Group for 2013

AAR Corp.	DigitalGlobe Inc.	Microsemi Corporation
AeroVironment, Inc.	Ducommun Incorporated	Moog Inc.
Anaren, Inc.(1)	FLIR Systems, Inc.	Orbital Sciences Corporation
American Science & Engineering, Inc.	Harris Corporation	Sparton Corporation
Alliant Techsystems Inc.	iRobot Corporation	ViaSat, Inc.
CACI International Inc.	Mantech International Corporation	VSE Corporation
Comtech Telecommunications Corp.	Mercury Systems, Inc.	

(1) Fiscal year 2013 data was not available for Anaren, Inc. as a result of its acquisition.

Targeted Pay Mix

Consistent with the pay philosophy approved by the Compensation Committee, our pay mix at target (shown below for our Chief Executive Officer and other named executive officers) involves a compensation mix (at target) that is largely incentive based. The charts below include fiscal year 2013 base salary, target annual incentive, target long-term incentive cash, and target values for equity incentives granted in fiscal year 2013. The charts below illustrate how the mix of total direct compensation for our named executive officers emphasizes variable compensation with a significant focus on long-term incentives tied to our long-term share value.

2013 Chief Executive Officer Target Compensation Mix

2013 Other Named Executive Officer Target Compensation Mix

Elements of the Executive Compensation Program

There are four principal elements of our Executive Compensation Program. Collectively, our Compensation Committee believes that these elements deliver an executive compensation package that achieves the program's three objectives: build long-term stockholder value; drive sustained, strong business and financial results; and attract, motivate and retain a highly qualified and effective management team to drive our financial and operational performance. The changes the Compensation Committee implemented for fiscal year 2013 reflect a continued shift toward simple, transparent, and performance-based compensation that takes into account stockholder feedback gained through our stockholder engagement efforts over the past two years.

	Link to Program Objectives	**Type of Compensation**	**Key Features**
Base Salary	Compensation Committee considers base salaries paid by companies in the Compensation Peer Group and survey data and uses the 50th percentile as a guideline.	Cash	Provides a stable source of income and is a standard compensation element in executive compensation packages.
Annual Incentive Performance Plan	A cash-based award that encourages named executive officers to focus on the business and financial objectives for each fiscal year. Target incentive opportunity is set as a percentage of base salary.	Cash	Payout is based on profitability, growth and operational performance during the fiscal year and occurs only if minimum performance levels are met.
Long Term Equity Awards	Links compensation of named executive officer to the building of long-term stockholder value. Keeps the program competitive and helps retain talent.	Long-Term Equity	Aligns executive officers' compensation with the creation of stockholder value.
	Changes Made in 2013 and Thereafter The long-term incentive pay mix shifts emphasis to long-term equity incentives utilizing stock options with specific market performance milestones (market price of over 200% of grant price) in order to achieve vesting on 50% of equity awards granted in 2013. In order to achieve vesting on 50% of equity awards granted in 2014, specific market performance of a 10% increase in the share price compared to the grant date share price is required to achieve each 20% of vesting, or a total of specific market performance of a 50% increase in the share price compared to the grant date share price to achieve full vesting of the performance-based equity.		
Employment and Change of Control Agreements	Ensures named executive officers remain focused on creating sustainable performance.	Benefit	Agreements protect the Company and the named executive officers from risks by providing: Economic stability Death or disability payments

Payments and benefits in the event of a change in control

Changes Made in 2013 and Thereafter

We have eliminated excise tax gross-ups in the event of a change of control for any new employment agreements or renewed or materially amended existing employment agreements. In addition, under any new equity awards, equity vesting in the event of a change of control will be double-trigger equity vesting for participants receiving equity rather than single-trigger.

Base Salary

Base salary is the only fixed element of our executive officers' target total direct compensation and is based on historic base salary levels and base salaries paid to executives in comparable positions at the Compensation Peer Group companies. In the fall of each year, the Compensation Committee reviews the base salary for each of our executive officers and determines whether any adjustments are necessary based on an executive officer's level of responsibility, changes in duties, individual performance and achievements, success in contributing to our short-term and long-term objectives, as well as any unique challenges faced by the Company, internal pay equity, changes in the competitive marketplace and taking into account the compensation practices of the Compensation Peer Group companies. The factors that the Company's Chief Executive Officer takes into consideration in reaching his recommendation for compensation for each of the named executive officers (other than the Chief Executive Officer) include the size of the organization (revenues, operating income, and headcount, etc.) the named executive officer manages and the accomplishments of the named executive officer during the most recent period, including contract awards, bid and proposal pipeline, integration of acquisitions, margin improvement, cost containment, strategic positioning for future growth opportunities, etc. The Chief Executive Officer also reviews the size of peer companies and the size of similar and related peer companies' organizations as related to the named executive officers of the organization. The base salary of our Chief Executive Officer is reviewed and recommended by the Compensation Committee acting in consultation with the other independent members of our Board.

In November 2012, the Compensation Committee applied the above principles as well as the feedback from key stockholders on our executive compensation. Specifically, the Compensation Committee decided to make changes to the executive compensation program with more focus on pay for performance and to increase the performance-based long-term equity incentives to more clearly align executive compensation with Company stock performance. Effective for 2013, the base compensation for all corporate named executive officers was frozen at 2012 compensation levels, with no increase in base salary to constructively provide additional emphasis on long-term incentives, specifically from a long-term basis, tied directly to long-term stockholder value. For the base compensation for the operational named executive officers, the Compensation Committee decided to adjust certain of the executive officers' salaries commensurate with their various roles and responsibilities and applied the above principles in connection with their review of peer companies' executive compensation policies, taking into consideration the size and organizational structure of those peer companies.

Similarly, in November 2013, the Compensation Committee reviewed the base salaries of all named executive officers. Despite the extremely challenging business environment in 2013, the Company's stock price increased 49% from its fiscal year end 2012 to 2013. The Compensation Committee and the Company's management believe recognition by the capital markets and equity investors of the growth potential in the new programs and strategic focus investment areas has been positively reflected in the Company's trading stock price in 2013. Accordingly, the Compensation Committee decided to increase corporate executive base salaries for 2014 in order to achieve a total compensation package mix with more emphasis on long-term equity and incentive based compensation. The base salary increases provided to our named executive officers for 2013 ranged from 0% to 12.9% and ranged from 0% to 10% for 2014. Our named executive officers' annual base salaries in 2013 (effective from January 7, 2013) and 2014 (effective from December 30, 2013) and the percentage of target total direct compensation represented by the base salaries are as follows:

Named Executive Officer	2013 Base Salary ($)	Percent Change from 2012	Percent of Total Target Direct Compensation	2014 Base Salary ($)	Percent Change from 2013
Eric DeMarco	695,000	0.0%	27.6%	760,000	9.4%
Deanna Lund	425,000	0.0%	34.8%	460,000	8.2%
Deborah Butera	344,000	0.0%	47.3%	364,000	5.8%