

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
 Form 424B5
 October 07, 2010

Filed pursuant to Rule 424(b)(5)

Registration No. 333-161340

PROSPECTUS SUPPLEMENT
 (to the Prospectus dated August 21, 2009)

2,300,000 Shares of Common Stock

We are offering 2,300,000 shares of our common stock pursuant to this prospectus supplement and the accompanying prospectus. The purchase price for each share is \$10.20. Our common stock is traded on the Nasdaq Global Select Market under the symbol "KTOS." On October 5, 2010, the last reported sale price of our common stock on the Nasdaq Global Select Market was \$10.75 per share.

Investing in our common stock involves a high degree of risk. Before buying any shares, you should review carefully the risks and uncertainties described under the heading "Risk Factors" beginning on page S-6 of this prospectus supplement.

	Per Share	Total
Offering price	\$ 10.20	\$ 23,460,000
Underwriter fees (1)	\$ 0.408	\$ 938,400
Proceeds, before expenses, to Kratos Defense & Security Solutions, Inc.	\$ 9.792	\$ 22,521,600

(1) We have also agreed to reimburse the underwriter for certain out-of-pocket-expenses incurred by it. See "Underwriting" for more information on expense reimbursement.

We have granted the underwriter an option to purchase up to an additional 230,000 shares of our common stock at the public offering price, less underwriting discounts and commissions payable by us, within 30 days of the date of this prospectus to cover over-allotments, if any. If the underwriter exercises its option in full, the total underwriter fees will be \$1,032,240 and our total proceeds, before expenses, will be \$24,773,760.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriter is offering the common stock as set forth under "Underwriting." The underwriter expects to deliver the common stock in book-entry form only, through the facilities of The Depository Trust Company, against payment on

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or about October 12, 2010.

Sole Underwriter

B. Riley & Co., LLC

The date of this prospectus supplement is October 5, 2010

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PROSPECTUS

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ABOUT THIS PROSPECTUS SUPPLEMENT

This prospectus supplement and the accompanying prospectus are part of a registration statement that we filed with the Securities and Exchange Commission (“SEC”) utilizing a “shelf” registration process. This document is in two parts. The first part is the prospectus supplement, including the documents incorporated by reference, which describes the specific terms of this offering. The second part, the accompanying prospectus, including the documents incorporated by reference, provides more general information. Generally, when we refer to this prospectus, we are referring to both parts of this document combined. We urge you to carefully read this prospectus supplement and the accompanying prospectus, and the documents incorporated herein and therein, before buying any of the securities being offered under this prospectus supplement. This prospectus supplement may add or update information contained in the accompanying prospectus and the documents incorporated by reference therein. To the extent that any statement that we make in this prospectus supplement is inconsistent with statements made in the accompanying prospectus or any documents incorporated by reference therein that was filed before the date of this prospectus supplement, the statements made in this prospectus supplement will be deemed to modify or supersede those made in the accompanying prospectus and such documents incorporated by reference therein.

You should rely only on the information contained, or incorporated therein by reference, in this prospectus supplement and contained, or incorporated therein by reference, in the accompanying prospectus. We have not authorized anyone to provide you with different information. No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus supplement and the accompanying prospectus. You should not rely on any unauthorized information or representation. This prospectus supplement is an offer to sell only the securities offered hereby, and only under circumstances and in jurisdictions where it is lawful to do so. You should assume that the information in this prospectus supplement and the accompanying prospectus is accurate only as of the date on the front of the applicable document and that any information we have incorporated by reference is accurate only as of the date of the document incorporated by reference, regardless of the time of delivery of this prospectus supplement or the accompanying prospectus, or any sale of a security.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus to “the Company,” “we,” “us,” “our,” and “Kratos” refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its consolidated subsidiaries.

PROSPECTUS SUPPLEMENT SUMMARY

This summary is not complete and does not contain all of the information that you should consider before investing in the securities offered by this prospectus. You should read this summary together with the entire prospectus supplement and the accompanying prospectus, including our financial statements, the notes to those financial statements and the other documents that are incorporated by reference in this prospectus supplement and the accompanying prospectus, before making an investment decision. See the Risk Factors section of this prospectus supplement beginning on page S-6 for a discussion of the risks involved in investing in our securities.

Kratos Defense & Security Solutions, Inc.

Our Business

Kratos Defense & Security Solutions, Inc. is an innovative provider of mission-critical engineering, information technology services, strategic communications and warfighter products, solutions and services. We work primarily for the U.S. government and federal government agencies, but we also perform work for state and local agencies and commercial customers. Our principal services are related to, but are not limited to, Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance, and Reconnaissance (C5ISR); weapons systems lifecycle support and sustainment; military weapon range operations and technical services; missile, rocket and weapons system test and evaluation; missile and rocket mission launch services; public safety, security and surveillance systems; modeling and simulation; unmanned aerial vehicle systems; and advanced network engineering and information technology services. We offer our customers solutions and expertise to support their mission-critical needs by leveraging our skills across our core service areas.

We derive a substantial portion of our revenue from contracts performed for federal government agencies, including the U.S. Department of Defense (DoD), with the majority of our revenue currently generated from the delivery of mission-critical warfighter solutions, advanced engineering services, system integration and system sustainment services to defense and other non-DoD and civilian government agencies. We believe our diversified and stable client base, strong client relationships, broad array of contract vehicles, considerable employee base possessing government security clearances, extensive list of past performance qualifications, and significant management and operational capabilities position us for continued growth.

Prior to 2008, we were also an independent provider of outsourced engineering and network deployment services, security systems engineering and integration services and other technical services for the wireless communications industry, the U.S. government and enterprise customers. In 2006 and 2007, we undertook a transformation strategy whereby we divested our commercial wireless-related businesses and chose to pursue business with the federal government, primarily the DoD, through strategic acquisitions. On September 12, 2007, we changed our name from Wireless Facilities, Inc. to Kratos Defense & Security Solutions, Inc. Our new name reflects our revised focus as a defense contractor and security systems integrator for the federal government and for state and local agencies. In connection with our name change, we changed our Nasdaq Global Select Market trading symbol to “KTOS.”

Pending Acquisition of Henry Bros. Electronics, Inc.

Overview of the Acquisition

On October 5, 2010 (the “Agreement Date”), we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Hammer Acquisition Inc., a Delaware corporation and our wholly-owned subsidiary (“Merger Sub”), and Henry Bros. Electronics, Inc., a Delaware corporation (“HBE”). Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into HBE, and HBE will continue as the surviving

corporation and as a wholly-owned subsidiary of Kratos (the “Merger”). The boards of directors of Kratos and HBE have approved the Merger Agreement and the transactions contemplated thereby.

At the effective time of the Merger (the “Effective Time”), by virtue of the Merger and without any action on the part of the holders of any shares of the capital stock of HBE, each outstanding share of HBE common stock (other than shares of HBE common stock owned by us, Merger Sub, or HBE stockholders, if any, who have perfected statutory dissenters’ rights under Delaware law) will be converted into the right to receive \$7.00 in cash, without interest. In addition, at the Effective Time all (i) outstanding options to purchase HBE common stock will be assumed by us and converted into options to purchase our common stock (the “Assumed Options”); and (ii) warrants to purchase HBE common stock, whether or not then exercisable or vested, shall be canceled (the “HBE Warrants”). The number of shares of our common stock subject to each Assumed Option and the exercise price of each such option will be appropriately adjusted based on the exchange ratio, which shall be equal to 0.6552.

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Completion of the Merger is subject to various customary conditions, including, among other things: (i) the adoption of the Merger Agreement by stockholders holding at least a majority of the outstanding common stock of HBE; (ii) subject to certain materiality exceptions, the accuracy of the representations and warranties made by each of Kratos and HBE and the compliance by each of Kratos and HBE with their respective obligations under the Merger Agreement; and (iii) the absence of any pending or threatened legal proceedings challenging or seeking to restrain the consummation of the Merger.

The Merger Agreement contains customary representations, warranties and covenants, including covenants obligating HBE to continue to conduct its business and the business of its subsidiaries in the ordinary course, hold a meeting of its stockholders for the purpose of considering the approval and adoption of the Merger Agreement, and cooperate on seeking regulatory approvals and providing access to information regarding HBE and its subsidiaries. The Merger Agreement also contains a “go-shop” provision and a “no-shop” provision.

Under the terms of the “go-shop” provision, during the period beginning on the Agreement Date and continuing until 11:59 p.m. Eastern Time on the 40th calendar day thereafter (the “No-Shop Period Start Date”), HBE and its subsidiaries and their respective representatives shall have the right to:

- initiate, solicit, and facilitate any inquiry or the making, submission or announcement of any proposals or offers that constitute a proposal to:
 - o acquire by merger, issuance or acquisition of securities, business combination or other similar transaction, 15% or more of the outstanding securities of HBE or any of its subsidiaries, or
 - o sell, exchange, transfer or otherwise dispose of any business or assets that account for 15% or more of the consolidated net revenues, net income or assets of HBE and its subsidiaries (any of the foregoing, an “Acquisition Proposal”); and
- engage or enter into, or otherwise participate in any discussions or negotiations with any person with respect to any Acquisition Proposals or otherwise cooperate with or facilitate any such inquiries, proposals, discussions or negotiations to make any Acquisition Proposals.

Under the terms of the “no-shop provision” from the No-Shop Period Start Date until the Effective Time, HBE and its subsidiaries and their respective representatives are not permitted to (i) solicit, initiate or knowingly encourage, or facilitate the making, submission or announcement of any Acquisition Proposal or take any action that would reasonably be expected to lead to an Acquisition Proposal; (ii) furnish any information regarding HBE or any of its subsidiaries to any person in connection with an Acquisition Proposal; (iii) engage in discussions or negotiations with any person with respect to any Acquisition Proposal; (iv) approve or recommend any Acquisition Proposal; or (v) enter into any letter of intent or other agreement relating to an Acquisition Proposal, subject to customary exceptions for HBE to respond to and support a proposal that is more favorable from a financial point of view to HBE’s stockholders than the terms of the Merger and is reasonably capable of being consummated (a “Superior Proposal”) or an Acquisition Proposal that is reasonably likely to lead to a Superior Proposal and to otherwise act in accordance with the exercise of the fiduciary duties of the board of directors.

HBE will be obligated to pay a termination fee of \$1,788,000 to us upon termination of the Merger Agreement:

- by HBE in connection with a Superior Proposal; or

- by us in connection with an HBE triggering event, including, among other things, if the board of directors of HBE changes or otherwise modifies its recommendation that the stockholders of HBE vote in favor of the adoption of the Merger Agreement or HBE or any of its subsidiaries or representatives thereof has materially breached the “no-shop” provision of the Merger Agreement.

In addition, HBE will be obligated to pay the termination fee if the Merger Agreement is terminated because (i) the Merger has not been consummated by February 28, 2011; or (ii) the meeting of the stockholders of HBE to approve the adoption of the Merger Agreement shall have been held and such stockholders did not approve the adoption of the Merger Agreement, and at the time of termination, an Acquisition Proposal with respect to HBE shall have been made or publicly announced and not withdrawn and HBE enters into an acquisition agreement related to an Acquisition Proposal or consummates an Acquisition Proposal within six months following the date the Merger Agreement is terminated.

Concurrently with the execution and delivery of the Merger Agreement, certain stockholders of HBE holding approximately 60% of the voting power of HBE (collectively, the “HBE Stockholders”) entered into voting agreements in favor of the Company (collectively, the “Voting Agreements”). Pursuant to such Voting Agreements, the HBE Stockholders granted the board of directors of the Company irrevocable proxies to vote all shares of HBE common stock beneficially owned by them in favor of the Merger. The Voting Agreements terminate if the Merger Agreement is terminated in accordance with its terms.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, a copy of which is attached hereto as Annex A.

Overview of HBE’s Business

HBE is an established leader in the electronic physical security industry providing technology-based integrated electronic security systems, services and emergency preparedness consultation to commercial enterprises and government agencies.

HBE’s operations are divided into two business segments – Security System Integration and Specialty Products and Services. The Security System Integration segment provides cradle to grave services for a wide variety of security, communications and control systems. HBE specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. Through the Specialty Products and Services segment HBE provides emergency preparedness programs, and specialized radio frequency communication equipment and integration. Each of HBE’s segments markets its products and services nationwide with an emphasis in Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia. HBE’s customers are primarily medium and large businesses and governmental agencies and HBE derives a majority of its revenues from project installations and to a smaller extent, maintenance service revenue.

Strategic Rationale

We believe that the proposed acquisition will provide long-term strategic and financial benefits to our stockholders, including long-term growth in revenues, earnings, and returns on equity, and will offer other important benefits including:

- Providing us with significant opportunities for operating synergies and improved profitability. In particular, we believe that the combined entity will be able to pursue larger programs, will experience improved gross margins and will be able to take advantage of improved leverage on selling, general and administrative costs.

- Positioning our Public Safety and Security business segment to benefit from a growing trend toward state-of-the-art security and communications systems. We believe the Merger will provide us with comprehensive services, systems and communications capabilities, allowing the combined entity to successfully respond to increasingly stringent customer security, emergency preparedness and communications requirements.

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- Providing us with significant opportunities to cross sell our NeuralStar and dopplerVUE situational awareness, security network management and cyber security software products into HBE's large and established customer base.

Our Corporate Information

We were initially incorporated in the state of New York in 1994, commenced operations in 1995 and were reincorporated in Delaware in 1998. On September 12, 2007, we changed our name from Wireless Facilities, Inc. to Kratos Defense & Security Solutions, Inc. On September 10, 2009, we effected a 1-for-10 reverse split of our common stock. The closing price of our common stock on such date was \$0.84 per share, or an adjusted closing price of \$8.40 per share. Our executive offices are located at 4820 Eastgate Mall, San Diego, California 92121, and our telephone number is (858) 812-7300. We maintain an Internet website at www.kratosdefense.com. Information contained in or accessible through our website does not constitute part of this prospectus supplement or the accompanying prospectus.

The Offering

Common stock offered by us pursuant to this prospectus supplement	2,300,000 shares of common stock (or 2,530,000 shares of common stock if the underwriter exercises its option to purchase additional shares in full).
Common stock to be outstanding after this offering	18,325,661 shares of common stock (or 18,555,661 shares of common stock if the underwriter exercises its option to purchase additional shares in full).(1)
Over-allotment option	230,000 shares of common stock
Use of proceeds	We estimate that the net proceeds of this offering will be approximately \$22.4 million (or \$24.6 million if the underwriter exercises its option to purchase additional shares in full). We intend to use the net proceeds from the sale of common stock under this prospectus supplement for general corporate purposes, including acquisition transactions generally. Specifically, we may use the proceeds to fund the cash consideration payable to the stockholders of HBE in connection with our proposed acquisition thereof. In the event that the HBE acquisition is not consummated, we intend to use the net proceeds from the sale of common stock under this prospectus supplement for the acquisition of or investment in other businesses, services and technologies that are complementary to our own and other general corporate expenses. Pending such uses, we intend to invest the net proceeds in short-term, investment-grade securities. See “Use of Proceeds” on page S-23 of this prospectus supplement.
Nasdaq Global Select Market symbol	“KTOS”
Risk factors	This investment involves a high degree of risk. See “Risk Factors” beginning on page S-6 of this prospectus supplement for a discussion of factors you should carefully consider before deciding to invest in our common stock.

(1) The number of shares of our common stock to be outstanding immediately after the closing of this offering is based on 16,025,661 shares of common stock outstanding as of September 26, 2010 and excludes, as of that date:

- 1,214,314 shares of common stock issuable upon the exercise of outstanding stock options at a weighted average exercise price of \$28.14 per share;
- 1,706,529 shares of common stock available for future grant under our 1999 Employee Stock Purchase Plan and 2005 Equity Incentive Plan (the “Plans”);
 - 744,807 shares of common stock issuable upon the vesting and settlement of restricted stock units;
- 100,000 shares of common stock which may be issued upon conversion of 10,000 shares of Series B Preferred Shares; and
 - any shares issuable upon the exercise of Assumed Options.

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RISK FACTORS

An investment in our common stock involves a substantial risk of loss. You should carefully consider these risk factors, together with all of the other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus, as modified and superseded pursuant to Rule 412 under the Securities Act of 1933, as amended, or the Securities Act, before you decide to invest in our common stock. The occurrence of any of the following risks could harm our business. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our operations. You should also refer to the other information contained in this prospectus supplement and the accompanying prospectus or incorporated by reference, including our financial statements and the notes to those statements and the information set forth under the heading “Cautionary Note Regarding Forward-Looking Statements.”

Risks Related to the Proposed Acquisition of HBE

The proposed acquisition of HBE may not be completed within the expected timeframe, or at all, and the failure to complete such acquisition could adversely affect our stock price and our future business and financial results.

On October 5, 2010, we entered into the Merger Agreement with HBE. The Merger Agreement is an executory contract subject to numerous closing conditions beyond our control, and there is no guarantee that these conditions will be satisfied in a timely manner or at all. If any of the conditions to the proposed Merger are not satisfied (or waived by the other party), we may not complete the Merger or realize the anticipated benefits thereof. Disputes regarding interpretations of the agreement could also delay or prevent the closing. In addition, the market price of our common stock may reflect various market assumptions as to whether and when the proposed Merger will occur. Consequently, the failure to complete the Merger within the expected timeframe, or at all, could result in a significant change in the market price of our common stock.

The offering of common stock pursuant to this prospectus supplement is not conditioned on the completion of the proposed Merger.

The offering of common stock pursuant to this prospectus supplement is not conditioned on completion of the proposed Merger. Although certain information contained in this prospectus supplement generally assumes the completion of the Merger, we cannot assure you that the Merger will be consummated on the terms described in this prospectus supplement or at all. If we do not complete the proposed Merger, we will retain broad discretion to use the net proceeds from this offering of common stock for the acquisition of or investment in other businesses, services and technologies that are complementary to our own and other general corporate expenses.

We may experience difficulties in integrating HBE’s business and realizing the expected benefits of the proposed Merger.

Our ability to achieve the benefits we anticipate from the proposed Merger will depend in large part upon whether we are able to integrate HBE’s business into our business in an efficient and effective manner. Because the businesses of HBE and Kratos differ, we may not be able to integrate HBE’s business smoothly or successfully and the process may take longer than expected. The integration of certain operations and the differences in operational culture following the Merger will require the dedication of significant management resources, which may distract management’s attention from day-to-day business operations. If we are unable to successfully integrate the operations of HBE’s business into our business, we may be unable to realize the revenue growth and other anticipated benefits we expect to achieve as a result of the proposed Merger and our business and results of operations could be adversely affected.

The announcement and pendency of the proposed Merger may cause disruptions in our and/or HBE's business, which could have an adverse effect on our business, financial condition or results of operations.

The announcement and pendency of the proposed Merger could cause disruptions in the business of HBE. Specifically:

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- current and prospective employees of HBE may experience uncertainty about their future roles with Kratos, which might adversely affect the ability of HBE to retain key personnel and attract new personnel;
- current and prospective customers of HBE may experience uncertainty about the ability of HBE to meet their needs, which might cause customers to seek other suppliers for the products and services provided by HBE; and
- management's attention has been focused on the Merger, which may divert management's attention from the core business of HBE and other opportunities that could have been beneficial to HBE.

This could have an adverse effect on the business, financial condition or results of operations of HBE prior to the completion of the Merger and on us following consummation of the Merger. These disruptions to HBE's business could be exacerbated by a delay in the completion of the Merger.

We have not included historical financial statements of HBE or any pro forma financial statements in this prospectus supplement, which may limit your ability to evaluate an investment in shares of our common stock.

Although our planned acquisition of HBE is considered to be probable, we have determined that it is not significant enough under applicable SEC rules to require the inclusion of any historical financial statements of HBE or any financial statements reflecting the pro forma impact of the proposed acquisition in this prospectus supplement. Your decision to invest must be based solely on the information set forth herein and specifically incorporated herein by reference. See the section entitled "Incorporation of Certain Documents by Reference" beginning on page S-27.

Risks Related to Our Business

Our business could be adversely affected by changes in the contracting or fiscal policies of the federal government and governmental entities.

We derive a significant portion of our revenue from contracts with the U.S. federal government and government agencies and subcontracts under federal government prime contracts, and the success of our business and growth of our business will continue to depend on our successful procurement of government contracts either directly or through prime contractors. Accordingly, changes in government contracting policies or government budgetary constraints could directly affect our financial performance. Among the factors that could adversely affect our business are:

- changes in fiscal policies or decreases in available government funding, including budgetary constraints affecting federal government spending generally, or specific departments or agencies in particular;
 - the adoption of new laws or regulations or changes to existing laws or regulations;
 - changes in political or social attitudes with respect to security and defense issues;
- changes in federal government programs or requirements, including the increased use of small business providers;
 - increases in the federal government initiatives related to in-sourcing;
- changes in or delays related to government restrictions on the export of defense articles and services;
 - potential delays or changes in the government appropriations process; and
 - delays in the payment of our invoices by government payment offices.

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These and other factors could cause governments and government agencies, or prime contractors that use us as a subcontractor, to reduce their purchases under existing contracts, to exercise their rights to terminate contracts at-will or to abstain from exercising options to renew contracts, any of which could have an adverse effect on our business, financial condition and results of operations. Many of our government customers are subject to stringent budgetary constraints. The award of additional contracts from government agencies could be adversely affected by spending reductions or budget cutbacks at these agencies.

Our new credit facility contains restrictive covenants that could limit our ability to operate our business and, if not satisfied, could result in the acceleration of any amounts then due under the credit facility.

The agreement governing our credit facility subjects us to various financial and other covenants with which we must comply. These covenants require that we maintain a minimum fixed charge coverage ratio and include restrictions on our ability to:

- incur additional debt;
- create or incur liens;
- bid on or perform work due to limits on the amount of performance bonds that may be secured by letters of credit;
 - pay dividends or make other equity distributions to our stockholders;
 - make investments and effect certain acquisitions;
 - sell assets;
 - issue or become liable on a guarantee;
 - create or acquire new subsidiaries; and
 - effect a merger or consolidation of, or sell all or substantially all of our assets.

Upon the occurrence of any event of default under our credit agreement, our lenders could elect to declare all amounts then outstanding on our credit facility, together with accrued interest, to be immediately due and payable. If our lenders were to accelerate payment of these amounts, we may not have sufficient assets to repay them in full. In addition, if we fail to comply with these financial and other covenants, or are otherwise unable to make scheduled debt payments or comply with the other provisions of our debt instruments, our lenders may be permitted under certain circumstances to deny future access to liquidity, seize control of substantially all of our assets and exercise other remedies provided for in those agreements and under applicable law.

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

We currently anticipate that our available capital resources, including our credit facility and operating cash flows, will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, such resources may not be sufficient to fund the long-term growth of our business. If we determine that it is necessary to raise additional funds, either through an expansion or refinancing of our credit facility or through

public or private debt or equity financings, additional financing may not be available on terms favorable to us, or at all. Disruptions in the capital and credit markets may continue indefinitely or intensify, which could adversely affect our ability to access these markets. Limitations on our borrowing base contained in our credit facility may limit our access to capital, and we could fall out of compliance with financial and other covenants contained in our credit facility which, if not waived, would restrict our access to capital and could require us to pay down our existing debt under the credit facility. Our lenders may not agree to extend additional or continuing credit under our credit facility or waive restrictions on our access to capital. If we were to conduct a public or private offering of securities, any new offering would be likely to dilute our stockholders' equity ownership. If adequate funds are not available or are not available on acceptable terms, we may not be able to take advantage of available opportunities, develop new products or otherwise respond to competitive pressures and our business, operating results or financial condition could be materially adversely affected.

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

Federal and state income tax laws impose restrictions on the utilization of net operating loss (“NOL”) and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code of 1986, as amended. In general, an ownership change occurs when shareholders owning 5% or more of a “loss corporation” (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation’s value at the time of the ownership change times the greater of the long-term tax-exempt rate determined by the IRS in the month of the ownership change or the two preceding months. We believe that an “ownership change” may have occurred which could limit the utilization of the loss carryforwards. We are currently evaluating the extent of the limitation on our annual utilization of the NOL carryforwards. Any potential limitation would not impact the income tax provision for the quarter ended June 27, 2010. In addition, future equity offerings or acquisitions that have equity as a component of the purchase price could result in an “ownership change”. If and when an “ownership change” occurs, utilization of the NOL or other tax attributes may be further limited.

We derive a substantial amount of our revenues from the sale of our solutions either directly or indirectly to U.S. government entities pursuant to government contracts, which differ materially from standard commercial contracts, involve competitive bidding and may be subject to cancellation or delay without penalty, any of which may produce volatility in our revenues and earnings.

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

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

In addition, government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted and typically impose provisions that permit cancellation in the event that necessary funds are unavailable to the public agency. Competitive procurements impose substantial costs and managerial time and effort in order to prepare bids and proposals for contracts that may not be awarded to us. In many cases, unsuccessful bidders for government agency contracts are provided the opportunity to formally protest certain

contract awards through various agencies, administrative and judicial channels. The protest process may substantially delay a successful bidder's contract performance, result in cancellation of the contract award entirely and distract management. We may not be awarded contracts for which we bid, and substantial delays or cancellation of purchases may follow our successful bids as a result of such protests.

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

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

As of June 27, 2010, our backlog was approximately \$680 million, of which \$252 million was funded. Funded backlog is estimated future revenue under government contracts and task orders for which funding has been appropriated by Congress and authorized for expenditure by the applicable agency, plus our estimate of the future revenue we expect to realize from our commercial contracts that are under firm orders. Although funded backlog represents only business which is considered to be firm, cancellations or scope adjustments may still occur. The remaining \$428 million is unfunded. Unfunded backlog reflects our estimate of future revenue under awarded government contracts and task orders for which either funding has not yet been appropriated or expenditure has not yet been authorized. Unfunded backlog does not include estimates of revenue from government wide acquisition contracts (GWAC) or General Services Administration (GSA) schedules beyond awarded or funded task orders, but does include estimates of revenue beyond awarded or funded task orders for other types of indefinite quantity contracts. The amount of unfunded backlog is not exact or guaranteed and is based upon, among other things, management’s experience under such contracts and similar contracts, the particular clients, the type of work and budgetary expectations. Our management may not accurately assess these factors or estimate the revenue we will realize from these contracts, and our unfunded and total backlog may not reflect the actual revenue ultimately received from these contracts.

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

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

We operate in highly competitive markets and generally encounter intense competition to win contracts from many other firms, including mid-tier federal contractors with specialized capabilities and large defense and IT services providers. Competition in our markets may increase as a result of a number of factors, such as the entrance of new or larger competitors, including those formed through alliances or consolidation. These competitors may have greater financial, technical, marketing and public relations resources, larger client bases and greater brand or name recognition than we do. These competitors could, among other things:

- divert sales from us by winning very large-scale government contracts, a risk that is enhanced by the recent trend in government procurement practices to bundle services into larger contracts;
- force us to charge lower prices; or

- adversely affect our relationships with current clients, including our ability to continue to win competitively awarded engagements in which we are the incumbent.

If we lose business to our competitors or are forced to lower our prices, our revenue and our operating profits could decline. In addition, we may face competition from our subcontractors who, from time-to-time, seek to obtain prime contractor status on contracts for which they currently serve as a subcontractor to us. If one or more of our current subcontractors are awarded prime contractor status on such contracts in the future, it could divert sales from us or could force us to charge lower prices, which could cause our margins to suffer.

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

We continually evaluate opportunities to acquire new businesses as part of our ongoing strategy and we may in the future acquire additional companies that we believe could complement or expand our business or increase our customer base. Acquisitions involve numerous risks, including:

- difficulties in integrating operations, technologies, accounting and personnel;
- difficulties in supporting and transitioning customers of acquired companies;
- difficulties or delays in transitioning federal government contracts pursuant to federal acquisition regulations;
- diversion of financial and management resources from existing operations;
- potential loss of key employees;
- federal acquisition regulations may require us to enter into government novation agreements, a potentially time-consuming process; and
 - inability to generate sufficient revenue to offset acquisition costs.

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

Our financial results may vary significantly from quarter to quarter.

We expect our revenue and operating results to vary from quarter to quarter. Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of our expenses are fixed in the short-term. We may incur significant operating expenses during the start-up and early stages of large contracts and

may not be able to recognize corresponding revenue in that same quarter. We may also incur additional expenses when contracts expire, are terminated or are not renewed.

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

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

- the terms of customer contracts that affect the timing of revenue recognition;
 - variability in demand for our services and solutions;
- commencement, completion or termination of contracts during any particular quarter;
 - timing of award or performance incentive fee notices;
 - timing of significant bid and proposal costs;
- variable purchasing patterns under GSA Schedule 70 contracts, GWACs, blanket purchase agreements and other indefinite delivery/indefinite quantity contracts;
 - restrictions on and delays related to the export of defense articles and services;
 - costs related to government inquiries;
 - strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs and joint ventures;
 - strategic investments or changes in business strategy;
 - changes in the extent to which we use subcontractors;
 - seasonal fluctuations in our staff utilization rates;
- changes in our effective tax rate including changes in our judgment as to the necessity of the valuation allowance recorded against our deferred tax assets; and
 - the length of sales cycles.

Significant fluctuations in our operating results for a particular quarter could cause us to fall out of compliance with the financial covenants contained in our credit facility, which if not waived by the lender, could restrict our access to capital and cause us to take extreme measures to pay down our debt under the credit facility. In addition, fluctuations in our financial results could cause our stock price to decline.

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

To develop new business opportunities, we primarily rely on establishing and maintaining relationships with various government entities and agencies. We may be unable to successfully maintain our relationships with government entities and agencies, and any failure to do so could materially adversely affect our ability to compete successfully for new business. In addition, we often act as a subcontractor or in “teaming” arrangements in which we and other contractors bid together on particular contracts or programs for the federal government or government agencies. As a subcontractor or team member, we often lack control over fulfillment of a contract, and poor performance on the contract could tarnish our reputation, even when we perform as required. We expect to continue to depend on relationships with other contractors for a portion of our revenue in the foreseeable future. Moreover, our revenue and operating results could be materially adversely affected if any prime contractor or teammate chooses to offer a client services of the type that we provide or if any prime contractor or teammate teams with other companies to independently provide those services.

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We derive a significant portion of our revenues from a limited number of customers.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of customers. To the extent that any significant customer uses less of our services or terminates its relationship with us, our revenues could decline significantly. As a result, the loss of any significant client could seriously harm our business. For the three and six months ended June 27, 2010, two customers comprised approximately 34% and 38% of our total revenues, respectively, and our five largest customers accounted for approximately 58% and 34% of our total revenues, respectively. None of our customers are obligated to purchase additional services from us. As a result, the volume of work that we perform for a specific customer is likely to vary from period to period, and a significant client in one period may not use our services in a subsequent period.

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

Although fixed-price contracts entail a greater risk of a reduced profit or financial loss on a contract compared to other types of contracts we enter into, fixed-price contracts typically provide higher profit opportunities because we may be able to benefit from cost savings. In contrast, cost-plus-fee contracts are subject to statutory limits on profit margins, and generally are the least profitable of our contract types. Our federal government customers typically determine what type of contract we enter into. Cost-plus-fee and fixed-price contracts in our federal business accounted for approximately 28% and 48%, respectively, of our federal business revenues for the three months ended June 27, 2010 and approximately 30% and 40%, respectively, of our federal business revenues for the six months ended June 27, 2010. To the extent that we enter into more cost-plus-fee or less fixed-price contracts in proportion to our total contract mix in the future, our margins and operating results may suffer.

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

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

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

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

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

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

The loss of any member of our senior management could impair our relationships with federal government clients and disrupt the management of our business.

We believe that the success of our business and our ability to operate profitably depends on the continued contributions of the members of our senior management. We rely on our senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of our senior management team have established and maintain with federal government personnel contribute to our ability to maintain strong client relationships and to identify new business opportunities. We do not have any employment agreements providing for a specific term of employment with any member of our senior management. The loss of any member of our senior management could impair our ability to identify and secure new contracts, to maintain good client relations and to otherwise manage our business.

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

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

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

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

As a prime contractor, we often rely upon other companies to perform work we are obligated to perform for our clients as subcontractors. As we secure more work under our GWAC vehicles, we expect to require an increasing level of support from subcontractors that provide complementary and supplementary services to our offerings. Depending on labor market conditions, we may not be able to identify, hire and retain sufficient numbers of qualified employees to perform the task orders we expect to win. In such cases, we will need to rely on subcontracts with unrelated companies. Moreover, even in favorable labor market conditions, we anticipate entering into more subcontracts in the future as we expand our work under our GWACs. We are responsible for the work performed by our subcontractors, even though in some cases we have limited involvement in that work.

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If one or more of our subcontractors fail to satisfactorily perform the agreed-upon services on a timely basis or violate federal government contracting policies, laws or regulations, our ability to perform our obligations as a prime contractor or meet our clients' expectations may be compromised. In extreme cases, performance or other deficiencies on the part of our subcontractors could result in a client terminating our contract for default. A termination for default could expose us to liability, including liability for the agency's costs of procurement, could damage our reputation and could hurt our ability to compete for future contracts.

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

Federal government agencies, including the Defense Contract Audit Agency (DCAA), routinely audit and investigate government contracts and government contractors' administrative processes and systems. These agencies review our performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. They also review the adequacy of our compliance with government standards for its accounting and management of internal control systems, including: control environment and overall accounting system, general information technology system, budget and planning system, purchasing system, material management and accounting system, compensation system, labor system, indirect and other direct costs system, billing system and estimating system used for pricing on government contracts. Both contractors and the U.S. government agencies conducting these audits and reviews have come under increased scrutiny. The current audits and reviews have become more rigorous and the standards to which contractors are being held are being more strictly interpreted, increasing the likelihood of an audit or review resulting in an adverse outcome.

While we have submitted all applicable incurred cost claims, the actual indirect cost audits by the DCAA have not been completed for fiscal 2005 and subsequent fiscal years. Although we have recorded contract revenues subsequent to fiscal 2004 based upon costs that we believe will be approved upon final audit or review, we do not know the outcome of any ongoing or future audits or reviews and, if future adjustments exceed our estimates, our profitability would be adversely affected.

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

We must comply with laws and regulations relating to the formation, administration and performance of federal government contracts, which affect how we do business with our clients, prime contractors, subcontractors and vendors and may impose added costs on us. Our role as a contractor to agencies and departments of the U.S. Government results in our being routinely subject to investigations and reviews relating to compliance with various laws and regulations, including those associated with organizational conflicts of interest. These investigations may be conducted without our knowledge. Adverse findings in these investigations or reviews can lead to criminal, civil or administrative proceedings and we could face civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with federal government agencies. In addition, we could suffer serious harm to our reputation and competitive position if allegations of impropriety were made against us, whether or not true. If our reputation or relationship with federal government agencies were impaired, or if the federal government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating profit would decline.

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

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

- lose revenue due to adverse client reaction;
- be required to provide additional services to a client at no charge;
- receive negative publicity, which could damage our reputation and adversely affect our ability to attract or retain clients; and
- suffer claims for substantial damages.

In addition to any costs resulting from product or service warranties, contract performance or required corrective action, these failures may result in increased costs or loss of revenue if clients postpone subsequently scheduled work or cancel, or fail to renew, contracts.

While many of our contracts limit our liability for consequential damages that may arise from negligence in rendering services to our clients, we cannot ensure that these contractual provisions will be legally sufficient to protect us if we are sued. In addition, our errors and omissions and product liability insurance coverage may not be adequate, may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or the insurer may disclaim coverage as to some types of future claims. The successful assertion of any large claim against us could seriously harm our business. Even if not successful, these claims could result in significant legal and other costs, may be a distraction to our management and may harm our reputation.

Security breaches in sensitive federal government systems could result in the loss of clients and negative publicity.

Many of the systems we develop, install and maintain involve managing and protecting information involved in intelligence, national security and other sensitive or classified federal government functions. A security breach in one of these systems could cause serious harm to our business, damage our reputation and prevent us from being eligible for further work on sensitive or classified systems for federal government clients. We could incur losses from such a security breach that could exceed the policy limits under our errors and omissions and product liability insurance. Damage to our reputation or limitations on our eligibility for additional work resulting from a security breach in one of the systems we develop, install and maintain could materially reduce our revenue.

Our employees may engage in misconduct or other improper activities, which could cause us to lose contracts.

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

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

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

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If we are unable to manage our growth, our business could be adversely affected.

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

We may be harmed by intellectual property infringement claims and our failure to protect our intellectual property could enable competitors to market products and services with similar features.

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

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

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

Effective internal controls are necessary for us to provide reliable financial reports. If we cannot provide reliable financial reports, our operating results could be misstated, our reputation may be harmed and the trading price of our stock could be negatively affected. Our management has concluded that there are no material weaknesses in our internal controls over financial reporting as of December 27, 2009. However, there can be no assurance that our controls over financial processes and reporting will be effective in the future or that additional material weaknesses or significant deficiencies in our internal controls will not be discovered in the future. Any failure to remediate any future material weaknesses or implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results, cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock. In addition, from time to time we acquire businesses which could have limited infrastructure and systems of internal controls.

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

A significant portion of our net assets come from goodwill and other intangible assets. In accordance with Financial Accounting Standards Board Accounting Standards Code Topic 350 Intangibles—Goodwill and Other (“Topic 350”) we periodically review the carrying values of our goodwill to determine whether such carrying values exceed the fair market value. Our acquired companies are subject to annual review for goodwill impairment. If impairment testing indicates that the carrying value of a reporting unit exceeds its fair value, the goodwill of the reporting unit is deemed impaired. Accordingly, an impairment charge would be recognized for that reporting unit in the period identified.

In 2008, as a result of our annual review, we recorded a goodwill impairment charge of \$105.8 million related to our Kratos Government Solutions (KGS) segment, to reflect the declining market and economic conditions through December 28, 2008. In the beginning of 2009, we performed another impairment test for goodwill in accordance with Topic 350 as of February 28, 2009. The test indicated that the book value for the KGS segment exceeded the fair values of the businesses and resulted in our recording a charge totaling \$41.3 million in that segment for the impairment of goodwill. The impairment charge was primarily driven by adverse equity market conditions that caused a decrease in current market multiples and our average stock price as of February 28, 2009, compared with the test performed as of December 28, 2008. Future reviews could result in further impairment charges, which could have a significant effect on our financial results.

The commercial business arena in which we operate has relatively low barriers to entry and increased competition could result in margin erosion, which would make profitability even more difficult to sustain.

Other than the technical skills required in our commercial business, the barriers to entry in this area are relatively low. We do not have any intellectual property rights in this segment of our business to protect our methods, and business start-up costs do not pose a significant barrier to entry. The success of our commercial business is dependent on our employees, customer relations and the successful performance of our services. If we face increased competition as a result of new entrants in our markets, we could experience reduced operating margins and loss of market share and brand recognition.

Risks Related to Investments in our Securities

We may allocate the net proceeds from this offering in ways that you and other stockholders may not approve.

We intend to use the net proceeds from this offering for general corporate purposes, including acquisition transactions generally. Specifically, we may use the proceeds to fund the cash consideration payable to the stockholders of HBE in connection with our proposed acquisition thereof. In the event that the Merger is not consummated, we intend to use the net proceeds from the sale of common stock under this prospectus supplement for general corporate purposes, including the acquisition of or investment in other businesses, services and technologies that are complementary to our own. In general, our management will have broad discretion in the application of the net proceeds from this offering and could spend the proceeds in ways that do not necessarily improve our operating results or enhance the value of our common stock.

Our stock price may be volatile, which may result in lawsuits against us and our officers and directors.

The stock market in general and the stock prices of government services companies in particular, have experienced volatility that has often been unrelated to or disproportionate to the operating performance of those companies. The market price of our common stock has fluctuated in the past and is likely to fluctuate in the future. Factors which could have a significant impact on the market price of our common stock include, but are not limited to, the following:

- quarterly variations in operating results;
- announcements of new services by us or our competitors;

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- the gain or loss of significant customers;
- changes in analysts' earnings estimates;
- rumors or dissemination of false information;
 - pricing pressures;
 - short selling of our common stock;
- impact of litigation and government inquiries;
 - general conditions in the market;
- political and/or military events associated with current worldwide conflicts; and
 - events affecting other companies that investors deem comparable to us.

Companies that have experienced volatility in the market price of their stock have frequently been the subject of securities class action litigation. We and certain of our current and former officers and directors have been named defendants in class action and derivative lawsuits. These matters and any other securities class action litigation and derivative lawsuits in which we may be involved could result in substantial costs to us and a diversion of our management's attention and resources, which could materially harm our financial condition and results of operations.

Our charter documents and Delaware law may deter potential acquirers and may depress our stock price.

Certain provisions of our charter documents and Delaware law, as well as certain agreements we have with our executives, could make it substantially more difficult for a third party to acquire control of us. These provisions include:

- authorizing the board of directors to issue preferred stock;
- prohibiting cumulative voting in the election of directors;
- prohibiting stockholder action by written consent;
- establishing advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by stockholders at meetings of our stockholders;
- Section 203 of the Delaware General Corporation Law, which prohibits us from engaging in a business combination with an interested stockholder unless specific conditions are met; and
- a number of our executives have agreements with us that entitle them to payments in certain circumstances following a change in control.

We also have a stockholder rights plan which may discourage certain types of transactions involving an actual or potential change in control and may limit our stockholders' ability to approve transactions that they deem to be in their best interests. As a result, these provisions may depress our stock price.

Risks Related to Our Recent Acquisition of Gichner Holdings, Inc.

We may not realize the anticipated benefits of our recent acquisition of Gichner because of integration difficulties.

On May 19, 2010, we acquired 100% of the voting equity interests of Gichner Holdings, Inc. (“Gichner”) headquartered in Dallastown, Pennsylvania, pursuant to the Stock Purchase Agreement, dated as of April 12, 2010, by and between the Company and the stockholders of Gichner. Integrating the operations of the businesses of Gichner successfully or otherwise realizing any of the anticipated benefits of the acquisition of Gichner, including anticipated cost savings and additional revenue opportunities, involves a number of potential challenges. The failure to meet these integration challenges could seriously harm our financial condition and results of operations. Realizing the benefits of the acquisition will depend in part on the integration of information technology (“IT”) operations and personnel. These integration activities are complex and time-consuming and we may encounter unexpected difficulties or incur unexpected costs, including:

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

We may not successfully integrate the operations of the businesses of Gichner in a timely manner, and we may not realize the anticipated benefits and synergies of the acquisition of Gichner to the extent, or in the time frame, anticipated.

We significantly increased our leverage in connection with our financing of our acquisition of Gichner.

We incurred approximately \$225.0 million of indebtedness in the form of 10% Senior Secured Notes (the “Original Notes”) in connection with our financing of our acquisition of Gichner. As a result of this indebtedness, our interest payment obligations have increased. The degree to which we will be leveraged could have adverse effects on our business, including the following:

- it may make it difficult for us to satisfy our obligations under the Original Notes or certain notes issued in exchange therefor (the “Exchange Notes”), and our other indebtedness and contractual and commercial commitments;
- it may require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
-

it may limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;

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- it may restrict us from making strategic acquisitions or exploiting business opportunities;
- it may place us at a competitive disadvantage compared to our competitors that have less debt;
 - it may limit our ability to borrow additional funds;
- it may prevent us from raising the funds necessary to repurchase the Original Notes or the Exchange Notes tendered to us if there is a change of control, which would constitute a default under the indentures governing the Original Notes and the Exchange Notes and under our credit facility; and
- it may decrease our ability to compete effectively or operate successfully under adverse economic and industry conditions.

If new debt is incurred, these risks may intensify. Our ability to meet our debt service obligations will depend upon our future performance, which may be subject to the financial, business and other factors affecting our operations, many of which are beyond our control.

Any increase in our debt service obligations may adversely affect our cash flow.

A higher level of indebtedness increases the risk that we may default on our debt obligations. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. If we are unable to generate sufficient cash flow to pay the interest on our debt, we may have to delay or curtail our operations.

Our ability to generate cash flows from operations and to make scheduled payments on our indebtedness will depend on our future financial performance. Our future financial performance will be affected by a range of economic, competitive and business factors that we cannot control. A significant reduction in operating cash flows resulting from changes in economic conditions, increased competition or other events beyond our control could increase the need for additional or alternative sources of liquidity and could have a material adverse effect on our business, financial condition, results of operations, prospects and our ability to service our debt and other obligations. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as reducing capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. We cannot assure that any of these alternative strategies could be effected on satisfactory terms, if at all, or that they would yield sufficient funds to make required payments on the Original Notes and the Exchange Notes and our other indebtedness.

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

If we are unable to manage our growth profitably on a combined basis, our business and financial results could suffer.

Our future financial results will depend in part on our ability to profitably manage our growth on a combined basis with Gichner. Management will need to maintain existing customers and attract new customers, recruit, retain and effectively manage employees, as well as expand operations and integrate customer support and financial control systems. If the integration-related expenses and capital expenditure requirements are greater than anticipated or if we

are unable to manage our growth profitably after the acquisition, our financial condition and results of operations may suffer.

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

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

In addition, under environmental laws, ordinances or regulations, a current or previous owner or operator of property may be liable for the costs of removal or remediation of some kinds of hazardous substances or petroleum products on, under, or in its property, adjacent or nearby property, or o