

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form DEF 14A
April 15, 2011

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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

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- 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):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
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 - (2) Form, Schedule or Registration Statement No.:
 - (3) Filing Party:
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April 15, 2011

Dear Stockholder:

You are cordially invited to attend the 2011 Annual Meeting of Kratos Defense & Security Solutions, Inc. ("Kratos"), which will be held at Kratos' headquarters, 4820 Eastgate Mall, San Diego, CA 92121, on Friday, May 27, 2011, 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 Grant Thornton LLP as our independent registered public accounting firm; to approve the adoption of the 2011 Equity Incentive Plan; to approve an amendment to our Employee Stock Purchase Plan to increase the shares available for purchase under the plan; to cast an advisory vote on compensation of our named executive officers; to cast an advisory vote on the frequency of the stockholder 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. This year, we are pleased to take advantage of Securities and Exchange Commission rules that allow companies to furnish their proxy materials over the Internet. As a result, we are mailing to most of our stockholders a Notice of Internet Availability of Proxy Materials (the "Notice") instead of a paper copy of our proxy materials, which include the Notice of Annual Meeting, our proxy statement, our 2010 Annual Report and a proxy card or voting instruction form. The Notice contains instructions on how to access those documents on the Internet and how to cast your vote via the Internet. The Notice also contains instructions on how to request a paper copy of our proxy materials. All stockholders who do not receive the Notice will receive a paper copy of the proxy materials by mail. If you have received a paper copy of our proxy materials 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
SAN DIEGO, CA 92121
(858) 812-7300

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To be held on May 27, 2011

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 Friday, May 27, 2011, at 9:00 a.m. local time at the Company's headquarters, 4820 Eastgate Mall, San Diego, CA 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 Hoggund, Scot Jarvis, Jane Judd, and Samuel Liberatore.
2. To ratify the selection of Grant Thornton LLP as the Company's independent registered public accounting firm for the fiscal year ending December 25, 2011.
3. To approve the adoption of the Company's 2011 Equity Incentive Plan.
4. To approve an amendment to the Company's 1999 Employee Stock Purchase Plan to increase the aggregate number of shares that may be issued under the plan by 250,000 shares.
5. An advisory (non-binding) vote on the compensation of our named executive officers, as presented in the proxy statement accompanying this Notice.
6. An advisory (non-binding) vote on the frequency of the stockholder advisory vote to approve the compensation of our named executive officers, as presented in the proxy statement accompanying this Notice.
7. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this Notice.

The Company's Board of Directors has fixed the close of business on April 4, 2011 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

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

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, PLEASE VOTE ON THE INTERNET AS INSTRUCTED IN THESE MATERIALS, OR, IF YOU REQUESTED AND RECEIVED A PRINTED COPY OF THIS PROXY STATEMENT, COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY, OR VOTE OVER THE PHONE OR INTERNET AS

INSTRUCTED IN THESE MATERIALS AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE MEETING.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

4820 EASTGATE MALL
SAN DIEGO, CA 92121

PROXY STATEMENT

For Annual Meeting of Stockholders to be held on May 27, 2011

General

The enclosed proxy is solicited on behalf of our Board of Directors (the "Board") for use at the Annual Meeting of Stockholders (the "Annual Meeting") of Kratos Defense & Security Solutions, Inc., to be held on May 27, 2011 at 9:00 a.m. local time or 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 Company's headquarters, 4820 Eastgate Mall, San Diego, California 92121.

We intend to mail a Notice Regarding the Availability of Proxy Materials (the "Notice") to all stockholders of record entitled to vote at the Annual Meeting on or about April 15, 2011. The Notice will instruct you as to how you may access and review all of the important information contained in the proxy materials.

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 27, 2011:

Our proxy statement and our 2010 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 2010 Annual Report to Stockholders. 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 proposal. In their discretion, the proxy holders named in the proxy are authorized to vote on any other 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 its use, either:

- (1) by revoking it in person at the Annual Meeting;
- (2) by writing, delivered to our Corporate Secretary at 4820 Eastgate Mall, San Diego, California, 92121 before the proxy is used; or
- (3) by a later dated proxy card delivered to us at the above noted address before the proxy is used.

Your presence at the meeting will not 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, April 4, 2011, 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 April 4, 2011, 23,836,556 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, follow the instructions on the Notice or go to the Internet address stated on your proxy card.

To vote by telephone, call the number on your proxy card. If you receive only the Notice, you may follow the procedures outlined in the Notice to request a proxy card.

To vote by mail, if you receive only the Notice, you may follow the procedures outlined in the Notice to request a paper proxy card to submit your vote by mail. If you receive a paper copy of the proxy materials and wish 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 26, 2011. 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 April 4, 2011 your shares of common stock were held, not 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 the Notice 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. In addition, you may request paper copies of our proxy statement and proxy card by following the instructions on the Notice provided by your broker, bank or other nominee.

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 are represented by votes at the Annual Meeting or by proxy. At the close of business on April 4, 2011, the record date for the Annual Meeting, there were 23,836,556 shares of common stock outstanding. Thus, a total of 23,836,568 shares are entitled to vote at the Annual Meeting and holders of common stock representing at least 11,918,279 votes must be represented at the Annual Meeting or by proxy to have a quorum.

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. Votes withheld from a director nominee and abstentions will be counted towards the quorum requirement. Broker non-votes will also be counted towards 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.

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 Auditors	Majority	Yes
3. Adoption of the 2011 Equity Incentive Plan	Majority	No
4. Amendment to the 1999 Employee Stock Purchase Plan	Majority	No
5. Advisory vote on the Compensation of our Named Executive Officers	Majority	No
6. Advisory vote on the Frequency of the Stockholder Advisory Vote on the Compensation of our Named Executive Officers	Plurality	No

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 "plurality" with regard to the advisory vote on the frequency of the stockholder vote on the compensation of our named executive officers means that the option (every one, two or three years)

receiving the greatest number of "for" votes will be considered the frequency recommended by stockholders.

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 votes on Proposals 5 and 6 are non-binding, as provided by law, our Board 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 and the frequency of such advisory votes.

Effect of Withhold Authority Votes, Abstentions and Broker Non-Votes

Withhold Votes: Shares subject to instructions to withhold authority to vote on the election of directors will not be voted. This 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.

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 Auditors; Proposal No. 3 Adoption of the 2011 Equity Incentive Plan; Proposal No. 4 Amendment to the 1999 Employee Stock Purchase Plan; and Proposal No. 5 Advisory Vote on the Compensation of our Named Executive Officers. Because the voting requirement applicable to Proposal No. 6 Advisory Vote on the Frequency of the Stockholder Advisory Vote on the Compensation of our Named Executive Officers is a plurality of the shares voted on the various options, an abstention with regard to this proposal will have no effect on the outcome of the vote.

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, adoption of or 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: Proposal 1 Election of Directors; Proposal No. 3 Adoption of the 2011 Equity Incentive Plan; Proposal No. 4 Amendment to the 1999 Employee Stock Purchase Plan; Proposal No. 5 Advisory Vote on the Compensation of our Named Executive Officers; and Proposal No. 6 Advisory Vote on the Frequency of the Stockholder Advisory Vote on 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, on the adoption of the 2011 Equity Incentive Plan, on the amendment to the 1999 Employee Stock Purchase Plan, and on the two advisory votes related to our 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 Grant Thornton LLP as our independent registered public accounting firm for the fiscal year ending December 25, 2011 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 Notice of Internet Availability of Proxy Materials; Delivery of Proxy Materials

Under rules adopted by the U.S. Securities and Exchange Commission ("SEC"), we may provide access to our proxy materials over the Internet. Accordingly, we are sending a Notice of Internet Availability of Proxy Materials to some of our stockholders of record. If you received a Notice by mail, you will not receive a printed copy of the proxy materials unless you request one. The Notice will tell you how to access and review the proxy materials over the Internet at www.proxyvote.com. The Notice also tells you how to access your proxy card to vote on the Internet. If you received a Notice by mail and would like to receive a printed copy of our proxy materials, please follow the instructions included in the Notice.

If you received more than one Notice or 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 Shareholder 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 or other regular employees. 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, San Diego, California 92121.

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 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.

PROPOSAL NO. 1**ELECTION OF DIRECTORS**

Our Board of Directors currently consists of seven directors, five of whom are currently independent directors within the meaning of the listing standards of The NASDAQ Stock Market, LLC ("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 of Directors 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 2012 Annual Meeting of Stockholders.

Information Regarding Directors*Nominees for Election to the Board:*

Name	Age	Committees
Scott Anderson	52	Audit Committee (Chair) Nominating and Corporate Governance Committee
Bandel Carano	49	Compensation Committee Nominating and Corporate Governance Committee (Chair)
Eric DeMarco	47	
William Hoglelund, Chairman	57	Audit Committee Compensation Committee Nominating and Corporate Governance Committee
Scot Jarvis	50	Audit Committee Compensation Committee (Chair) Nominating and Corporate Governance Committee
Jane Judd	64	Audit Committee
Samuel Liberatore	72	

Scott Anderson

Scott Anderson has been a director since March 1997. 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. Mr. Anderson has been a director of TC Global, Inc., a public registrant, since July 2010. 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. He currently serves on the board of directors of several private companies, including mInfo, Inc., CosComm International, Inc., Globys, Inc., Alcis Health, Inc., Root Wireless, Inc., and Anvil Corp. Mr. Anderson is a member of the control group of Savary Island Wireless, LLC, a wireless license holder. He holds a B.A. in History from the University of Washington, *magna cum laude*, and a J.D. 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 of Directors 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 of Directors in October 2001. Since 1987, he has been a managing partner of Oak Investment Partners, a multi-stage venture capital firm. Mr. Carano also serves on the Investment Advisory Board of the Stanford Engineering Venture Fund, the board of directors of Airspan Networks, Inc. and NeoPhotonics Corporation, and the board of directors of numerous private companies, including Boston Power, Inc., Good Technologies Inc., MobiTV, Inc., nLight Photonics Corporation, Protean Electric Ltd., Plastic Logic Limited, Solarflare Communications, Inc., Stretch, Inc., and Sundrop Fuels, Inc. Mr. Carano holds a B.S. and an M.S. in Electrical Engineering from Stanford University. Mr. Carano was nominated and elected as one of Kratos' directors pursuant to the terms of a purchase agreement among Kratos and certain of its stockholders in connection with the sale of our Series A Convertible Preferred Stock in October 2001. 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 a director and assumed the role of Chief Executive Officer effective April 1, 2004. Prior to coming to Kratos, 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 holds a B.S. 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 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 of Directors.

William Hogleund

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

Scot Jarvis

Scot Jarvis joined our Board of Directors in 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. He is a member of the control groups of Toba Inlet PCS, LLC and Savary Island Wireless, LLC, both wireless licensees. In addition, Mr. Jarvis was one of the cofounders of Cricket Communications, Inc., the low cost wireless provider owned by Leap Wireless International, Inc. (NASDAQGS: LEAP) and was a member of Leap's board of directors from 1998 to 2002. 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., 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 Good Technologies (since 2003), Airspan Networks (since February 2011), and Slingshot Sports (since 1999). Mr. Jarvis is a venture partner with Oak Investment Partners, a venture capital firm. Mr. Jarvis holds a B.A. in Business Administration from the University of Washington. Mr. Jarvis has extensive experience with mergers and acquisitions transactions, which is of particular significance to the Board of Directors as we continue to pursue growth strategies through mergers and acquisitions.

Jane Judd

Jane Judd joined our Board of Directors in 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. Telisimo International voluntarily filed for Chapter 11 bankruptcy in March 2003 and emerged from the bankruptcy proceedings in September 2003. 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 L3 Communications in 2005. Ms. Judd is a Certified Public Accountant and she received a B.S. from the University of Utah in 1976. Ms. Judd brings financial experience and expertise to the Board of Directors 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 of Directors.

Samuel Liberatore

Samuel Liberatore joined our Board of Directors in 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 revenue 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 weapons system operations, research, development and acquisition before retiring as a Colonel in 1989. He holds a B.S. in Mathematics from Loyola College, Baltimore and an M.S. 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 of Directors 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. Mr. Liberatore provides our Board of Directors with important insight into our key markets and customers, as well as insight into the potential market for any service and product offerings we may contemplate targeting.

**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 Board has selected Grant Thornton LLP ("Grant Thornton") as our independent registered public accounting firm for the fiscal year ending December 25, 2011 and has further directed that management submit the selection of the independent registered public accounting firm for ratification by our stockholders at our Annual Meeting. Grant Thornton has audited our financial statements since July 2005. Representatives of Grant Thornton 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 Grant Thornton 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 Grant Thornton to the stockholders for ratification as a matter of good corporate practice. If the stockholders do not ratify the selection, the Board and the Audit Committee will reconsider whether or not to retain Grant Thornton. Even if the selection is ratified, the Board and the Audit Committee may, in their discretion, direct the appointment of a different independent registered public accounting firm at any time during the year if they determine that such a change would be in our and our stockholders' best interests.

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 26, 2010 by Grant Thornton is compatible with maintaining their independence.

The following table sets forth the aggregate fees for services provided to us by Grant Thornton for the fiscal years ended December 27, 2009 and December 26, 2010:

	Fiscal 2009	Fiscal 2010
Audit Fees(1)	\$ 815,286	\$ 1,095,796
Audit-Related Fees(2)		46,860
Tax Fees(3)		45,000
All Other Fees(4)	3,950	4,150
TOTAL	\$ 819,236	\$ 1,191,806

(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. In 2009, the amount includes \$50,000 for Registration Statement Form S-3 and \$7,000 for work performed in connection with the Company's SEC comment letter responses. The amount in 2010 includes \$137,188 for an

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Offering Memorandum in connection with the sale of Senior Secured Notes, \$38,841 associated with the filing of Registration Statements on Form S-4 and S-8, and \$4,500 for work performed with respect to the Company's response to an SEC letter.

- (2) *Audit-Related Fees* consist of fees billed by Grant Thornton for services rendered in connection with litigation of \$8,310 and \$38,550 associated with the audits of the Company's 401-K plans.
- (3) *Tax Fees* consist of fees billed for professional services rendered for the preparation of the Company's federal and state income tax return and the preparation of stub income tax returns for Gichner.
- (4) *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 July 2005, each new engagement of Grant Thornton has been approved in advance by the Audit Committee.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR
THE RATIFICATION OF SELECTION OF GRANT THORNTON LLP AS THE COMPANY'S
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
FOR THE FISCAL YEAR ENDED DECEMBER 25, 2011.**

PROPOSAL NO. 3

APPROVAL OF THE ADOPTION OF THE KRATOS DEFENSE & SECURITY SOLUTIONS, INC. 2011 EQUITY INCENTIVE PLAN

At the Annual Meeting, our stockholders will be asked to approve the Kratos Defense & Security Systems, Inc. 2011 Equity Incentive Plan (the "2011 Plan") and to approve 2,000,000 shares of common stock for issuance under the 2011 Plan (subject to adjustment upon certain changes in the capital structure). Our stockholders have previously authorized us to issue up to 1,900,000 shares of common stock under the Kratos Defense & Security Systems, Inc. 2005 Equity Incentive Plan, as amended (the "2005 Plan") (subject to adjustment upon certain changes in the capital structure). A copy of the 2011 Plan is attached as Appendix A to this Proxy Statement.

We are asking our stockholders to approve the 2011 Plan so that we will have additional shares of common stock available to attract and encourage the continued employment and service of, and maximum efforts by, officers, employees and other individuals by offering those persons an opportunity to acquire or increase a direct proprietary interest in our operations and future success. Since January 2007, we have pursued this goal primarily through the grant of restricted stock units and the adoption of the 2011 Plan will enable us to continue this practice. We believe that in our human-capital intensive business, restricted stock units and other forms of equity awards are an important factor in hiring and retaining talented personnel.

The Compensation Committee and the Board of Directors believe that in order to successfully attract and retain the best possible candidates for positions of responsibility, we must continue to offer a competitive equity incentive program. The only other plan under which we are making equity awards is the 2005 Plan, which has been approved by our stockholders. As of March 31, 2011, 694,922 shares remained available for the future grant of stock awards, including restricted stock unit awards, under the 2005 Plan. The adoption of the 2011 Plan will not impact our ability to continue making equity awards under the 2005 Plan.

The Board of Directors and the Compensation Committee believe that additional shares must be made available as our ability to offer equity compensation to our existing and new employees impacts our ability to hire and retain employees. The Compensation Committee uses restricted stock units as its principal form of long-term equity compensation, and the Compensation Committee views this form of award as critical to achieving its compensation objectives for executives and the broader employee population. Accordingly, on March 10, 2011, the Board unanimously adopted, subject to stockholder approval, the 2011 Plan with a maximum of 2,000,000 shares of common stock issuable under the 2011 Plan (subject to adjustment upon certain changes in the capital structure of the company).

Our option overhang is relatively low and substantially all of the outstanding options to acquire our common stock have exercise prices that are materially higher than the current trading prices of our common stock. In 2010 and 2011, we issued a substantial number of shares of common stock in public offerings that materially increased our outstanding share count by 7.2 million shares, or a 45 percent increase in our outstanding shares of 15.9 million at March 5, 2010. Our acquisitions of DEI Services Corporation, SCT Acquisition, LLC, Henry Bros. Electronics, Inc., and Herley Industries, Inc. in the second half of 2010 and beginning of 2011 also added an aggregate 1,397 additional employees, representing approximately 36.2% of our total current workforce and an increase of approximately 56.7% of our workforce as it existed immediately prior to the first of those acquisitions. We typically do not award a number of restricted stock units in a fiscal year that is more than approximately 2% of the Company's outstanding share count. For example, 333,000 restricted stock unit awards have been made in 2011, which is less than 2% (or 476,695 shares of common stock) of the number of shares of common stock issued and outstanding on March 31, 2011 (23,834,763 shares). This general policy is subject to adjustment for acquisition-related initial grants for the employees joining the Company as a result of the acquisition.

Approval of the 2011 Plan requires the affirmative vote of the holders of a majority of the shares of common stock present or represented and entitled to vote at the Annual Meeting.

Summary of the 2011 Plan

A summary of the 2011 Plan is set forth below. This summary is qualified in its entirety by the specific language of the 2011 Plan, a copy of which is available to any stockholder upon request and is attached as Appendix A to this Proxy.

Types of Awards

The 2011 Plan permits us to grant a wide-variety of awards to meet our compensation needs, such as restricted stock units, restricted stock, stock appreciation rights, stock options, and deferred stock units.

Administration

The 2011 Plan is administered by the Compensation Committee. Subject to the terms of the 2011 Plan, the Compensation Committee may select participants to receive awards, determine the terms and conditions of awards, and interpret provisions of the 2011 Plan. The Compensation Committee determines at what time or times each award may be settled and whether any such award will vest on

unusual circumstances when the Compensation Committee believes such acceleration to be in the best interest of the company, a Change in Control, or a Participant's death. Awards shall become vested at a rate no faster than pro rata over a period of at least four years following the grant date (or, in the case of vesting with respect to awards subject to performance-based or event-based vesting, no portion of such award shall vest prior to one year following the grant date). Awards may only be subject to accelerated vesting in connection with unusual circumstances to the extent that the Administrator believes such acceleration to be in the best interest of the Company, a Change in Control, certain involuntary employment terminations in connection with a Change in Control or a change in control of the Board, a Participant's death or as otherwise set forth in an enforceable agreement with a participant. The 2011 Plan forbids, without stockholder approval, the repricing of any outstanding stock option or stock appreciation right by an amendment that lowers the exercise price of such awards. The Board of Directors may take any action that the Compensation Committee could take under the 2011 Plan.

The 2011 Plan provides that the Company and its affiliates will, to the extent permitted by law, indemnify members of the Compensation Committee and their delegates against any claims, liabilities or costs arising from the good faith performance of their duties under the 2011 Plan. The 2011 Plan releases these individuals from liability for good faith actions associated with the administration of the 2011 Plan.

Common Stock Reserved for Issuance

The common stock to be issued under the 2011 Plan consists of authorized but unissued shares and treasury shares. If any shares covered by an award are not purchased or are forfeited, or if an award otherwise terminates without delivery of any common stock, then the number of shares of common stock counted against the aggregate number of shares available under the 2011 Plan with respect to the award will, to the extent of any such forfeiture or termination, again be available for making awards under the 2011 Plan. To the extent an award is settled in cash, the award will not count against the number of shares available for issuance under the 2011 Plan.

Eligibility

Awards may be made under the 2011 Plan to our current or prospective (to the extent eventually employed) employees, directors and consultants, or the employees, directors and consultants of any present or future parent or subsidiary corporation. As of the end of January 2011, approximately 2,800 employees, six non-employee directors and no consultants would have been eligible to participate in the 2011 Plan had it been in effect.

Recoupment of Awards. Unless otherwise provided in an award agreement, and to the extent permitted by applicable law, the Compensation Committee may in its sole and absolute discretion, without obtaining approval, require that a participant reimburse the Company for all or any portion of any awards granted under the 2011 Plan or may require the termination or rescission of, or the recapture of any award or the proceeds thereof under certain situations including to the extent (i) the granting, vesting or payment of the award was predicated on the achievement of certain financial results that were subsequently the subject of a material financial restatement, (ii) the participant either benefited from a calculation that later proves to be materially inaccurate or the participant engaged in fraud or misconduct that caused the need for a material financial restatement, and (iii) a lower granting, vesting, or payment of such award otherwise would have occurred.

Income Tax Withholding. As a condition for the issuance of shares pursuant to awards, the 2011 Plan requires satisfaction of any applicable federal, state, local, or foreign withholding tax obligations that may arise in connection with the award or the issuance of shares.

Transferability. Awards under the 2011 Plan generally may not be sold, pledged, assigned, hypothecated, transferred, assigned or disposed of other than by will or the laws of descent and distribution, except to the extent permitted by the Compensation Committee.

Restricted Stock Units

The Compensation Committee may grant restricted stock units under the 2011 Plan, which represent a right to receive shares of common stock at a future date determined in accordance with the participant's award agreement. No monetary payment is normally required for receipt of restricted stock units or the shares issued in settlement of the award, the consideration for which is furnished in the form of the participant's services to us. The Compensation Committee may grant restricted stock unit awards subject to conditions and the attainment of performance goals over such periods as the Compensation Committee determines in writing and sets forth in a written agreement between us and the participant, or may make the awards subject to vesting conditions based on such service or performance criteria as the Compensation Committee specifies. Unless otherwise provided by the Compensation Committee, or as set forth in an enforceable agreement with a participant, a participant will forfeit any restricted stock units as to which the restrictions have not lapsed prior to the participant's termination of service. Participants have no voting rights or rights to receive cash dividends with respect to restricted stock unit awards until shares of common stock are issued in settlement of such awards.

Restricted Stock Awards

The Compensation Committee may grant restricted stock awards under the 2011 Plan. Restricted stock awards may be subject to vesting conditions based on such service or performance criteria as the Compensation Committee specifies, and the shares acquired generally may not be transferred by the participant until vested. Unless otherwise provided by the Compensation Committee, or as set forth in an enforceable agreement with a participant, a participant will forfeit any shares of restricted stock as to which the restrictions have not lapsed prior to the participant's termination of service. Participants holding restricted stock will have the right to vote the shares, but not to receive any dividends paid.

Stock Options

The 2011 Plan permits the granting of options to purchase shares of common stock intended to qualify as incentive stock options under the Internal Revenue Code and stock options that do not qualify as incentive stock options. The exercise price of each stock option may not be less than 100% of the fair market value of our common stock on the date of grant. In the case of certain 10% stockholders who receive incentive stock options, the exercise price may not be less than 110% of the fair market value of our common stock on the date of grant. An exception to these requirements is made for options that we grant in substitution for options held by employees of companies that we acquire. In such a case the exercise price is adjusted to preserve the economic value of the employee's stock option from his or her former employer. The exercise price of each indexed stock option (an option with an exercise price that either increases by a fixed percentage over time or changes by reference to a published index), and the terms and adjustments which may be made to such an option, will be determined by the Compensation Committee in its sole discretion at the time of grant. On March 31, 2011, the closing price of our common stock on the NASDAQ Global Select Market was \$14.22 per share.

The 2011 Plan provides that the option exercise price may be paid in cash, by check, or in cash equivalent, by the assignment of the proceeds of a sale with respect to some or all of the shares being acquired upon the exercise of the option, to the extent legally permitted, by tender of shares of common stock owned by the optionee having a fair market value not less than the exercise price, by a net exercise procedure, or such other lawful consideration as approved by the Compensation Committee, or by any combination of these. Nevertheless, the Compensation Committee may restrict the forms of payment permitted in connection with any option grant. No option may be exercised unless the optionee has made adequate provision for federal, state, local and foreign taxes, if any, relating to the exercise of the option, including, if permitted or required by us, through the optionee's surrender of a portion of the option shares to us.

Options will become vested and exercisable at such times or upon such events and subject to such terms, conditions, performance criteria or restrictions as specified by the Compensation Committee. The maximum term of any option granted under the 2011 Plan is ten years, provided that an incentive stock option granted to a 10% stockholder must have a term not exceeding five years. The Compensation Committee will specify in each written option agreement, and solely in its discretion, the period of post-termination exercise applicable to each option.

Generally, stock options are exercisable during the optionee's lifetime only by the optionee.

Stock Appreciation Rights

A stock appreciation right gives a participant the right to receive the appreciation in the fair market value of our common stock between the date of grant of the award and the date of its exercise. The stock appreciation right will be settled through either shares of common stock or in cash or a combination thereof, as determined by the Compensation Committee. The Compensation Committee may grant stock appreciation rights under the 2011 Plan in tandem with a related stock option or as a freestanding award. A tandem stock appreciation right is exercisable only at the time and to the same extent that the related option is exercisable, and its exercise causes the related option to be canceled. Freestanding stock appreciation rights vest and become exercisable at the times and on the terms established by the Compensation Committee. The maximum term of any stock appreciation right granted under the 2011 Plan is ten years. Stock appreciation rights generally are exercisable during the participant's lifetime only by the participant.

Deferred Stock Awards

The 2011 Plan provides that certain participants who are executives or members of a select group of highly compensated employees may elect to receive, in lieu of payment in cash or stock of all or any portion of such participant's cash and/or stock compensation, an award of deferred stock units. A participant electing to receive deferred stock units will be granted automatically, on the effective date of such deferral election, an award for a number of stock units equal to the amount of the deferred compensation divided by an amount equal to the fair market value of a share of our common stock on the date of grant. A stock unit is an unfunded bookkeeping entry representing a right to receive one share of our common stock in accordance with the terms and conditions of the deferred stock unit award. Participants are not required to pay any additional cash consideration in connection with the settlement of a deferred stock unit award. A participant's compensation not paid in the form of a deferred stock unit award will be paid in cash in accordance with our normal payment procedures.

Each deferred stock unit award will be evidenced by a written agreement between us and the participant specifying the number of stock units subject to the award and the other terms and conditions of the deferred stock unit award, consistent with the requirements of the 2011 Plan. Deferred stock unit awards are fully vested upon the vesting of the underlying award being deferred (if any) and stand-alone deferred stock unit awards will vest as determined by the Compensation

Committee. Deferred stock unit awards will be settled by distribution to the participant of a number of whole shares of common stock equal to the number of stock units subject to the award on a date or dates set forth in the participant's written agreement in accordance with the terms of the 2011 Plan at the time of his or her election to receive the deferred stock unit award. A holder of stock unit has no voting rights or other rights as a stockholder until shares of common stock are issued to the participant in settlement of the stock unit.

Change in Control

The 2011 Plan defines a "Change in Control" as any of the following events upon which our stockholders immediately before the event do not retain immediately after the event, in substantially the same proportions as their ownership of shares of the company's voting stock immediately before the event, direct or indirect beneficial ownership of a majority of the total combined voting power of the voting securities of the company, its successor or the corporation to which the assets of the company were transferred: (i) a sale or exchange by the stockholders in a single or series of related transactions of more than 50% of the company's voting stock; (ii) a merger or consolidation in which the company is a party; (iii) the sale, exchange or transfer of all or substantially all of the assets of the company; or (iv) a liquidation or dissolution of the company. If a Change in Control occurs, the surviving, continuing, successor or purchasing corporation or parent corporation thereof may either assume all outstanding awards or substitute new awards having an equivalent value.

In the event of a Change in Control in connection with which the outstanding awards are not assumed or replaced, then the Compensation Committee may, subject to any enforceable agreement with a participant: (a) accelerate the vesting of all or a portion of awards and provide for the lapse of any of our repurchase rights with respect to shares issued pursuant to an award; (b) provide for the payment of cash or other consideration to participants in exchange for the cancellation of all or some of their outstanding awards (based on the fair market value, on the date of the Change in Control, of the award being cancelled); (c) terminate all or some of the outstanding awards on the consummation of the Change in Control, provided that the Compensation Committee may provide for vesting of awards or portions thereof as of a date immediately prior to consummation of the Change in Control; and (d) make such other modifications, adjustments or amendments to outstanding awards or the 2011 Plan as the Compensation Committee deems necessary or appropriate, subject however to the terms set forth above. Awards that are not settled or cancelled prior to consummation of a Change in Control transaction in which the award is not being assumed or substituted shall terminate.

Any award not assumed, replaced or exercised prior to the Change in Control generally will terminate. The 2011 Plan authorizes the Compensation Committee, in its discretion, to provide for different treatment of any award, as may be specified in such award's written agreement, which may provide for acceleration of the vesting or settlement of any award on a Change in Control.

Adjustments for Stock Dividends and Similar Events

The Compensation Committee will make appropriate adjustments in outstanding awards and the number of shares available for issuance under the 2011 Plan, including the individual limitations on awards, to reflect common stock dividends, stock splits and other similar events.

Section 162(m) of the Internal Revenue Code

Section 162(m) of the Internal Revenue Code, which we refer to as the Code, limits publicly held companies to an annual deduction for federal income tax purposes of \$1,000,000 for compensation paid to its chief executive officer and the three most highly compensated executive officers (other than the chief executive officer and the chief financial officer) determined at the end of each year (the "covered employees"). However, performance-based compensation is excluded from this limitation. The 2011

Plan is designed to permit the Compensation Committee to grant awards that qualify as performance-based for purposes of satisfying the conditions of Section 162(m). To qualify as performance-based:

the compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals;

the performance goal under which compensation is paid must be established by a Compensation Committee comprising two or more directors who qualify as outside directors for purposes of the exception;

the material terms under which the compensation is to be paid must be disclosed to and subsequently approved by stockholders of the corporation before payment is made in a separate vote; and

the Compensation Committee must certify in writing before payment of the compensation that the performance goals and any other material terms were in fact satisfied.

In the case of compensation attributable to stock options and stock appreciation rights, the performance goal requirement (summarized above) is deemed satisfied, and the certification requirement (summarized above) is inapplicable, if the grant or award is made by the Compensation Committee; the plan under which the option or stock appreciation right is granted states the maximum number of shares with respect to which options and stock appreciation rights may be granted during a specified period to an employee; and under the terms of the option or stock appreciation rights, the amount of compensation is based solely on an increase in the value of the stock after the date of grant.

One or more of the following business criteria, on a consolidated basis, and/or with respect to specified subsidiaries or business units (except with respect to the total stockholder return and earnings per share criteria), will be used by the Compensation Committee in establishing performance goals:

revenue;

gross margin;

operating margin;

operating income;

pre-tax profit;

earnings before interest, taxes, depreciation and amortization ("EBITDA");

net income;

cash flow;

expenses;

the market price of the shares;

earnings per share;

return on stockholder equity;

return on capital;

return on net assets;

economic value added;

number of customers;

market share;

return on investment;

profit after tax;

customer satisfaction;

growth of earnings before interest and taxes;

days sales outstanding ("DSOs");

adjusted EBITDA;

EBITDA margin; and

adjusted EBITDA margin.

Under Section 162(m) of the Code, a director is an "outside director" if he or she is not a current employee of the corporation; is not a former employee who receives compensation for prior services (other than under a qualified retirement plan); has not been an officer of the corporation; and does not receive, directly or indirectly (including amounts paid to an entity that employs the director or in which the director has at least a five percent ownership interest), remuneration from the corporation in any capacity other than as a director.

In order to comply with Section 162(m) of the Code and ensure compensation attributable to awards under the 2011 Plan are performance based compensation, the maximum number of shares subject to stock options, restricted stock units, restricted stock or stock appreciation rights that can be awarded under the 2011 Plan to any person is 125,000 per year and 500,000 total, for all years.

Term of 2011 Plan; Amendment and Termination of the 2011 Plan

Unless sooner terminated by the Board, the 2011 Plan will terminate 10 years after approval by our stockholders. The Board may terminate or amend the 2011 Plan at any time and for any reason. However, amendments will be submitted for stockholder approval to the extent required by the Internal Revenue Code or other applicable laws.

Federal Income Tax Consequences of Awards

Restricted Stock Units

There are no immediate tax consequences of receiving an award of restricted stock units under the 2011 Plan. A participant who is awarded restricted stock units will be required to recognize ordinary income in an amount equal to the fair market value of shares issued to such participant at the end of the restriction period or, if later, the payment date. If we comply with the restrictions of Section 162(m) of the Code, we will be entitled to a deduction for compensation paid in the same amount treated as compensation income to the participant in the year the participant is taxed on the income.

Restricted Stock

A grantee who is awarded restricted stock will not recognize any taxable income for federal income tax purposes in the year of the award, provided that the shares of common stock are subject to restrictions (that is, the restricted stock is nontransferable and subject to a substantial risk of forfeiture). However, the grantee may elect under Section 83(b) of the Code to recognize compensation income in the year of the award in an amount equal to the fair market value of the common stock on the date of the award, determined without regard to the restrictions. If the grantee does not make such a Section 83(b) election, the fair market value of the common stock on the date the restrictions lapse will be treated as compensation income to the grantee and will be taxable in the year the restrictions

