KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form S-4
November 24, 2008

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As filed with the Securities and Exchange Commission on November 24, 2008

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-4

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**4899**	**13-3818604**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

**4810 Eastgate Mall
San Diego, CA 92121
(858) 812-7300**
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Eric DeMarco
President and Chief Executive Officer
4810 Eastgate Mall
San Diego, CA 92121
(858) 812-7300**
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

**Scott M. Stanton, Esq.
Jeannette V. Filippone, Esq.
Morrison & Foerster LLP
12531 High Bluff Drive, Suite 100
San Diego, California 92130
(858) 720-5100**

Approximate date of commencement of proposed sale of the securities to the public: As soon as practicable after the effectiveness of this registration statement and the satisfaction or waiver of all other conditions under the merger agreement described herein.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

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

Large accelerated filer o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Share	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, Par Value $0.001	32,900,534	N/A	$38,822,630	$1,525.73

(1) This registration statement relates to common stock, $0.001 par value per share, of the Registrant, expected to be issued in connection with the transaction described herein. The amount of common stock to be registered is based on the estimated number of shares of common stock that are expected to be issued in the merger, assuming an exchange ratio of 1.7933 shares of Registrant's common stock for each outstanding share and for each option and warrant exercisable for shares of Digital Fusion, Inc. common stock.

(2) Estimated solely for purposes of calculation of the registration fee in accordance with Rules 457 (c) and (f) of the Securities Act of 1933, as amended, based upon the product of: (A) 18,346,364, the maximum number of shares of Digital Fusion common stock that may be exchanged in the merger (the sum of (i) 11,745,123 shares of Digital Fusion common stock outstanding as of November 17, 2008, (ii) 6,096,241 shares of Digital Fusion common stock issuable upon the exercise of outstanding options as of November 17, 2008, (iii) 30,000 shares of Digital Fusion common stock issuable upon the exercise of outstanding warrants as of November 17, 2008 and (iv) 475,000 shares of Digital Fusion common stock reserved for issuance under the Digital Fusion deferred compensation plan), multiplied by (B) $1.18, the average of the high and low sale prices for shares of Kratos common stock as reported on the NASDAQ Global Select Market on November 21, 2008.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

The information in this proxy statement/prospectus is not complete and may be changed. Kratos may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This proxy statement/prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer, solicitation or sale is not permitted.

Subject to completion, dated November 24, 2008

PROPOSED MERGER YOUR VOTE IS VERY IMPORTANT

Kratos Defense & Security Solutions, Inc., or Kratos, and Digital Fusion, Inc., or Digital Fusion, have entered into a merger agreement pursuant to which a wholly owned subsidiary of Kratos will merge with and into Digital Fusion, with Digital Fusion continuing as a wholly owned subsidiary of Kratos. Kratos and Digital Fusion believe that the proposed merger will allow Kratos and Digital Fusion to be better positioned to compete in the rapidly evolving defense and security solutions industry.

Immediately prior to the effective time of the merger, each share of Digital Fusion common stock will be converted into the right to receive 1.7933 shares of Kratos common stock. The stockholders of Kratos will continue to own their existing shares, which will not be affected by the merger. Upon completion of the merger, Digital Fusion's former stockholders will own approximately [ ]% of the then outstanding shares of Kratos common stock, based on the number of shares of Kratos and Digital Fusion common stock expected to be outstanding on the closing of the merger. The value of the merger consideration to be received in exchange for each share of Digital Fusion common stock will fluctuate with the market price of Kratos common stock.

Based on the closing sale price for Kratos common stock on November 21, 2008, the last trading day before public announcement of the merger, the 1.7933 exchange ratio represented approximately $2.44 in value for each share of Digital Fusion common stock. Based on the closing sale price for Kratos common stock on [ ], 2008, the latest practicable date before the printing of this joint proxy statement/prospectus, the 1.7933 exchange ratio represented approximately $[ ] in value for each share of Digital Fusion common stock.

The merger cannot be completed unless Kratos stockholders approve the issuance of the shares of Kratos common stock in the merger and Digital Fusion stockholders adopt the merger agreement and approve the merger. A special meeting of the stockholders of Kratos will be held at [ ] on [ ], at [ ] local time, at which the stockholders of Kratos will be asked to consider and vote upon a proposal to approve the issuance of Kratos common stock in connection with the proposed merger. A special meeting of the stockholders of Digital Fusion will be held at [ ] on [ ], at [ ] local time, at which the stockholders of Digital Fusion will be asked to consider and vote upon a proposal to adopt the merger agreement and approve the merger. Holders of approximately 34% of the outstanding shares of Digital Fusion common stock have entered into voting agreements with Kratos, pursuant to which they have agreed to vote their shares in favor of the merger.

Kratos common stock is listed on the Nasdaq Global Select Market under the symbol "KTOS." Digital Fusion common stock trades on the Pink Sheets under the symbol "DIGF.PK." We urge you to obtain current market quotations for the shares of Kratos and Digital Fusion.

After careful consideration, each of the Kratos and Digital Fusion boards of directors has approved the merger agreement and the merger and has determined that it is advisable to enter into the merger. Each of the boards of directors of Kratos and Digital Fusion recommends that its stockholders vote "FOR" the proposals described in the accompanying proxy statement/prospectus.

Your vote is very important. Whether or not you plan to attend your respective company's meeting of stockholders, please submit your proxy as soon as possible to make sure that your shares are represented at that meeting. Information about these meetings, the merger and the other business to be considered by stockholders is contained in this proxy statement/prospectus. We urge you to read this proxy statement/prospectus carefully. You should also carefully consider the risk factors beginning on page 18.

Eric M. DeMarco	Gary Ryan
Chief Executive Officer and President	*Chief Executive Officer and President*
Kratos Defense & Security Solutions, Inc.	Digital Fusion, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities to be issued in connection with the merger or determined if this proxy statement/prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

This proxy statement/prospectus is dated [ ], 200[ ], and is first being mailed to stockholders of Kratos and Digital Fusion on or about [ ], 200[ ].

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS TO BE HELD ON [ ]

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

A special meeting of stockholders of Kratos Defense & Security Solutions, Inc. will be held at [ ] on [ ], 200[ ] at [ ] p.m., local time, for the following purposes:

1. To approve the issuance of [ ] shares of Kratos common stock pursuant to the Agreement and Plan of Merger, dated as of November 21, 2008, by and among Kratos Defense & Security Solutions, Inc., Dakota Merger Sub, Inc., and Digital Fusion, Inc., as the same may be amended from time to time.

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

The accompanying proxy statement/prospectus further describes the matters to be considered at the meeting. A copy of the Agreement and Plan of Merger referenced above has been included as *Annex A* to the proxy statement/prospectus.

The Kratos board of directors has set November 25, 2008 as the record date for the special meeting. Only holders of record of Kratos common stock at the close of business on November 25, 2008 will be entitled to notice of and to vote at the special meeting and any adjournments or postponements thereof. Any stockholder entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote on such stockholder's behalf at the special meeting and any adjournments and postponements thereof. Such proxy need not be a holder of Kratos common stock. **To ensure your representation at the special meeting, please complete and return the enclosed proxy card or submit your proxy by telephone or through the Internet**. Please vote promptly whether or not you expect to attend the special meeting. Submitting a proxy now will not prevent you from being able to vote at the special meeting by attending in person and casting a vote.

The Kratos board of directors unanimously recommends that you vote FOR the proposal to approve the issuance of Kratos common stock in the merger.

By Order of the Kratos Board of Directors,

Eric M. DeMarco
President and Chief Executive Officer
San Diego, CA
[ ], 2008

PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE PROPOSALS OR ABOUT VOTING YOUR SHARES, PLEASE CALL KRATOS' PROXY SOLICITOR, GEORGESON INC., AT [ ].

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS TO BE HELD ON [ ]

To the Stockholders of Digital Fusion, Inc.:

A special meeting of stockholders of Digital Fusion, Inc. will be held at [ ], on [ ] at [ ], local time, for the following purposes:

1. To adopt and approve the Agreement and Plan of Merger, dated as of November 21, 2008, by and among Kratos Defense & Security Solutions, Inc., Dakota Merger Sub, Inc., and Digital Fusion, Inc., as the same may be amended from time to time.

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

The accompanying proxy statement/prospectus further describes the matters to be considered at the special meeting. A copy of the Agreement and Plan of Merger referenced above has been included as *Annex A* to this proxy statement/prospectus.

The Digital Fusion board of directors has set [ ], 2008 as the record date for the special meeting. Only holders of record of shares of Digital Fusion common stock at the close of business on [ ], 2008 will be entitled to notice of and to vote at the special meeting and any adjournments or postponements thereof. **To ensure your representation at the special meeting, please complete and return the enclosed proxy card or submit your proxy by telephone or through the Internet**. Please vote promptly whether or not you expect to attend the special meeting. Submitting a proxy now will not prevent you from being able to vote at the special meeting by attending in person and casting a vote.

The board of directors of Digital Fusion recommends that you vote FOR the proposal to adopt and approve the merger agreement.

By Order of the Digital Fusion Board of Directors,

Gary Ryan
President and Chief Executive Officer
[ ], 2008

PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE PROPOSALS OR ABOUT VOTING YOUR SHARES, PLEASE CALL [ ] AT [ ] (TOLL FREE) OR VIA EMAIL AT [ ].

ADDITIONAL INFORMATION

This joint proxy statement/prospectus incorporates important business and financial information about Kratos Defense & Security Solutions, Inc. that is not included in or being delivered with this joint proxy statement/prospectus. The incorporated information that is not included in or being delivered with this joint proxy statement/prospectus is available to you without charge upon your written or oral request. You can obtain any document that is incorporated by reference in this proxy statement/prospectus, excluding all exhibits that have not been specifically incorporated by reference, on the investor relations page of Kratos' website at *http://www.kratosdefense.com* or by requesting it in writing or by telephone from Kratos at the following address or telephone number:

4810 Eastgate Mall
San Diego, CA 92121
(858) 812-7300
Attn.: Corporate Secretary
Website: *www.kratosdefense.com*

If you would like to request any documents, please do so by [ ], 200[ ] in order to receive them before the special meeting. See "Where You Can Find More Information."

You should rely only on the information contained or incorporated by reference in this joint proxy statement/prospectus and the registration statement of which this joint proxy statement/prospectus is a part to vote on the proposals being presented at the special meetings. No one has been authorized to provide you with information that is different from what is contained in this document or in the incorporated documents.

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QUESTIONS AND ANSWERS ABOUT THE MERGER

The following questions and answers briefly address some commonly asked questions about the Kratos and Digital Fusion meetings. They may not include all the information that is important to holders of stock of Kratos and Digital Fusion. We urge stockholders to read carefully this entire proxy statement/prospectus, including the annexes and the other documents referred to herein.

Q:

Why am I receiving these materials?

A:

We are sending you these materials to help you decide how to vote your shares of Kratos or Digital Fusion common stock with respect to their proposed merger. The merger cannot be completed unless Kratos stockholders approve the issuance of Kratos common stock and Digital Fusion stockholders adopt and approve the merger agreement. Each of Kratos and Digital Fusion is holding its meeting of stockholders to vote on the proposals necessary to complete the merger. Information about these meetings, the merger and the other business to be considered by holders of stock is contained in this proxy statement/prospectus.

We are delivering this document to you as both a joint proxy statement of Kratos and Digital Fusion and a prospectus of Kratos. It is a joint proxy statement because each of our boards of directors is soliciting proxies from its stockholders. It is a prospectus because Kratos will exchange shares of its common stock for shares of Digital Fusion in the merger.

Q:

What will stockholders receive in the merger?

A:

In the proposed merger, holders of Digital Fusion common stock will receive 1.7933 shares of Kratos common stock for each share of Digital Fusion common stock. This exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing.

The stockholders of Kratos will continue to own their existing shares, which will not be affected by the merger.

Q:

When do Kratos and Digital Fusion expect to complete the merger?

A:

Kratos and Digital Fusion expect to complete the merger after all conditions to the merger in the merger agreement are satisfied or waived, including after stockholder approvals are received at their respective stockholder meetings. Kratos and Digital Fusion currently expect to complete the merger during late 2008 or early 2009. However, it is possible that factors outside of either company's control could require Kratos and Digital Fusion to complete the merger at a later time or not to complete it at all.

Q:

How do the boards of directors of Kratos and Digital Fusion recommend that I vote?

A:

The Kratos board of directors unanimously recommends that holders of Kratos common stock vote FOR the proposal to approve the issuance of Kratos common stock in the merger.

The Digital Fusion board of directors unanimously recommends that Digital Fusion stockholders vote FOR the proposal to approve the merger and adopt the merger agreement.

Q:

What do I need to do now?

A:

After carefully reading and considering the information contained in this proxy statement/prospectus, please vote your shares as soon as possible so that your shares will be represented at your respective company's meeting. Please follow the instructions set forth on the proxy card or on the voting instruction form provided by the record holder if your shares are held in the name of your broker or other nominee.

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Q: **How do I vote?**

A: You may vote before your company's meeting in one of the following ways:

- use the toll-free number shown on your proxy card;
- visit the website shown on your proxy card to vote via the Internet;
- complete, sign, date and return the enclosed proxy card in the enclosed postage-paid envelope; or
- cast your vote in person at your company's meeting.

If your shares are held in "street name" through a broker, bank or other nominee, that institution will send you separate instructions describing the procedure for voting your shares. "Street name" stockholders who wish to vote at the meeting will need to obtain a proxy form from the institution that holds their shares.

Q: **When and where are the Kratos and Digital Fusion meetings of stockholders?**

A: The special meeting of Kratos stockholders will be held at [ ] on [ ] at [ ], local time. All stockholders as of the record date, or their duly appointed proxies, may attend the meeting.

The special meeting of Digital Fusion stockholders will be held at [ ], on [ ] at [ ], local time. All stockholders as of the record date, or their duly appointed proxies, may attend the meeting.

Q: **If my shares are held in "street name" by a broker or other nominee, will my broker or nominee vote my shares for me?**

A: Your broker or other nominee does not have authority to vote on the proposals described in this proxy statement/prospectus. Your broker or other nominee will vote your shares held by it in "street name" with respect to these matters ONLY if you provide instructions to it on how to vote. You should follow the directions your broker or other nominee provides.

Q: **What constitutes a quorum?**

Stockholders who hold a majority in voting power of the Kratos common stock issued and outstanding as of the close of business on the record date and who are entitled to vote at the special meeting must be present or represented by proxy in order to constitute a quorum to conduct business at the Kratos special meeting.

Stockholders who hold a majority in voting power of the Digital Fusion common stock issued and outstanding as of the close of business on the record date and who are entitled to vote at the special meeting must be present or represented by proxy in order to constitute a quorum to conduct business at the Digital Fusion special meeting.

Q: **What vote is required to approve each proposal?**

A: For Kratos stockholders, the affirmative vote of a majority of the total votes represented in person or by proxy at the special meeting is required to approve the proposal to approve the issuance of Kratos common stock in the merger.

For Digital Fusion stockholders, the affirmative vote of a majority of the outstanding shares of Digital Fusion common stock entitled to vote at the meeting is required to approve the merger agreement.

Q: **What if I do not vote on the matters relating to the merger?**

A: If you are a Kratos stockholder and you fail to vote or fail to instruct your broker or other nominee how to vote on the proposal to issue shares of common stock in the merger, it will have no effect on the vote for the proposal. If you respond with an "abstain" vote, your proxy will have the same effect as a vote against the proposal. If you submit a proxy but do not indicate how you want to vote on the proposal, your proxy will be counted as a vote in favor of the proposal in accordance with the recommendation of the Kratos board of directors.

If you are a Digital Fusion stockholder and you fail to vote or fail to instruct your broker or other nominee how to vote on the proposal to adopt and approve the merger agreement, it will have the same effect as a vote against the merger. If you respond with an "abstain" vote on the proposal, your proxy will have the same effect as a vote against the proposal. If you respond but do not indicate how you want to vote on the merger, your proxy will be counted as a vote in favor of the merger.

Q: **What if I hold shares in both Kratos and Digital Fusion?**

A. If you are a stockholder of both Kratos and Digital Fusion, you will receive two separate packages of proxy materials. A vote as a Kratos stockholder approving the issuance of Kratos common stock will not constitute a vote as a Digital Fusion stockholder for the merger, or vice versa. Therefore, please sign, date and return all proxy cards that you receive, whether from Kratos or Digital Fusion, or vote as both a Kratos and Digital Fusion stockholder by telephone or via the Internet.

Q: **May I change my vote after I have delivered my proxy or voting instruction card?**

A: Yes. You may change your vote at any time before your proxy is voted at the applicable meeting. You may do this in one of four ways:

- by sending a notice of revocation to the corporate secretary of Kratos or Digital Fusion, as applicable;
- by sending a completed proxy card bearing a later date than your original proxy card;
- by logging onto the Internet website specified on your proxy card in the same manner you would to submit your proxy electronically or by calling the telephone number specified on your proxy card, in each case if you are eligible to do so, and following the instructions on the proxy card; or
- by attending the applicable meeting and voting in person. Your attendance alone will not revoke any proxy.

If you choose any of the first three methods, you must take the described action no later than the beginning of the applicable meeting. If your shares are held in an account at a broker or other nominee, you should contact your broker or other nominee to change your vote.

Q: **What are the material United States federal income tax consequences of the merger?**

A: Kratos and Digital Fusion intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, which we refer to as the Code, for United States federal income tax purposes. Accordingly, a holder of Digital Fusion common stock generally will not recognize any gain or loss for U.S. federal income tax purposes upon the exchange of the holder's shares of Digital Fusion common stock for shares of Kratos common stock pursuant to the merger, except that a Digital Fusion stockholder will recognize a gain or loss with respect to any cash received in lieu of a fractional share of Kratos common stock.

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Q: **Do I have appraisal rights?**

A: The holders of Kratos common stock will not be entitled to exercise any appraisal rights in connection with the merger. Pursuant to Section 262 of the Delaware General Corporation Law, or DGCL, the holders of Digital Fusion common stock are entitled to appraisal rights if they do not vote in favor of the merger and otherwise comply with the requirements of the DGCL. Digital Fusion stockholders who dissent from the merger and exercise their appraisal rights will recognize gain or loss with respect to cash received in exchange for their Digital Fusion common stock.

Q: **Should I send in my stock certificates now?**

A: No. Please do not send your stock certificates with your proxy card.

If you are a holder of Digital Fusion common stock, you will receive written instructions from the exchange agent after the merger is completed on how to exchange your stock certificates for Kratos common stock. Kratos stockholders will not be exchanging their stock certificates in connection with the merger. Accordingly, Kratos stockholders holding stock certificates should keep their stock certificates both now and after the merger is completed.

Q: **What if I hold Digital Fusion and Kratos stock options or warrants?**

A: Kratos stock options and other equity-based awards, including restricted stock units, will remain outstanding and will not be affected by the merger.

Kratos will assume outstanding options and warrants to purchase shares of Digital Fusion common stock in the merger. Each outstanding option and warrant to acquire Digital Fusion common stock will be converted automatically at the effective time of the merger into an option or warrant to acquire Kratos common stock, and will continue to be governed by the terms of the relevant Digital Fusion stock plan and/or related agreements under which it was granted, except that the number of shares of Kratos common stock for which each option or warrant is exercisable and the exercise price of each option or warrant will be adjusted based on the exchange ratio in the merger.

Q: **Who should I contact if I have any questions about the merger, the proxy materials or voting power?**

A: If you have any questions about the merger or if you need assistance in submitting your proxy or voting your shares or need additional copies of the proxy statement/prospectus or the enclosed proxy card, you should contact the company in which you hold shares.

If you are a Kratos stockholder, you should contact Georgeson Inc., the proxy solicitation agent for Kratos, at [ ]. If you are a Digital Fusion stockholder, you should contact Jamie Brabston, Corporate Secretary, at (256) 327-8100 or via email at jbrabston@digitalfusion.com. If your shares are held in a stock brokerage account or by a bank or other nominee, you should call your broker or other nominee for additional information.

SUMMARY

This summary highlights selected information contained in this joint proxy statement/prospectus, referred to as this proxy statement/prospectus, and does not contain all the information that may be important to you. Kratos and Digital Fusion urge you to read carefully this proxy statement/prospectus in its entirety, including the annexes. Unless stated otherwise, all references in this proxy statement/prospectus to Kratos refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, all references to Digital Fusion refer to Digital Fusion, Inc., a Delaware corporation, all references to Merger Sub refer to Dakota Merger Sub, Inc., a Delaware corporation, and all references to the merger agreement refer to the Agreement and Plan of Merger, dated as of November 21, 2008, by and among Kratos, Merger Sub, and Digital Fusion, a copy of which is attached as Annex A to this proxy statement/prospectus.

The Parties

Kratos

Kratos Defense & Security Solutions, Inc.
4810 Eastgate Mall
San Diego, CA 92121
(858) 812-7300

Kratos is an innovative provider of mission critical engineering, IT services and warfighter solutions. Kratos performs work primarily for the U.S. government and government agencies, but also performs work for state and local agencies and commercial customers. As a result of its market focus, Kratos is organized into two primary operating segments, the Kratos Government Solutions, or KGS, segment and the Public Safety and Security, or PSS, segment. The principle services of Kratos include, but are not limited to, Command, Control, Communications, Computing, Combat Systems, Intelligence, Surveillance and Reconnaissance, or C5ISR; weapon systems life cycle support and extension; military range operations and technical services; missile, rocket and weapons systems test and evaluation; mission launch services; public safety; security and surveillance systems; advanced network engineering and IT services; and critical infrastructure design and integration services. Kratos offers its customers a range of solutions and technical expertise to support their mission-critical needs by leveraging skills across Kratos' core service areas.

Founded in 1994, Kratos is headquartered in San Diego and has offices in California, Washington D.C. and several other locations in the U.S.

For more information regarding Kratos, visit *www.kratosdefense.com*. The information on Kratos' website is not a part of this proxy statement/prospectus.

Digital Fusion

Digital Fusion, Inc.
5030 Bradford Drive
Building 1, Suite 210
Huntsville, AL 35805
(256) 327-8103

Digital Fusion is an information technology, research and engineering, and acquisition and business support services company that helps its customers make the most of technology to meet their business needs. Digital Fusion's IT Services business unit provides solutions to both government and commercial customers, focused in the following areas: Business Process Automation, Application Development and Data Management, Application Security, Web Portals and Digital Dashboards, System Integration, and IT Support. Digital Fusion's Research and Engineering Services business unit supports a variety of customers with state-of-the-art solutions that include: Systems Development and Engineering; Applied

Aerodynamics/ Computational Fluid Dynamics; Missile Engineering; Thermal-Structural Modeling; Program, Data and Financial Management Support; Modeling and Simulation; Control System Design and Analysis; Mechanical Design and Analysis; Optical Systems Design, Development and Test; Hardware-in-the-Loop Testing; and Test and Evaluation. Digital Fusion's Acquisition and Business Support Services business unit provides solutions focused on the following areas: Budget Integration and Analysis; Accounting Operations; Travel Management; SAP Expertise; Business System Development, Evaluation and Operation; Assessing Best Business Practices and Tools; Contracts Management and Administration; Purchasing Expertise; Procurement Documentation Generation and Evaluation; Price and Cost Analysis; Earned Value Management and Policy Evaluation and Support.

Founded in 1995, Digital Fusion is incorporated in Delaware. Its main office is located in Huntsville, Alabama and it has satellite offices in Texas and Washington, D.C.

For additional information regarding Digital Fusion, visit *www.digitalfusion.com*. The information on Digital Fusion's website is not a part of this proxy statement/prospectus.

Merger Sub

Dakota Merger Sub, Inc., or Merger Sub, a wholly-owned subsidiary of Kratos, is a Delaware corporation formed on November 13, 2008 for the sole purpose of effecting the merger. Upon completion of the merger, Merger Sub will merge with and into Digital Fusion, and Digital Fusion will become a wholly-owned subsidiary of Kratos.

The Merger

Each of the boards of directors of Kratos and Digital Fusion has approved the strategic merger of Kratos and Digital Fusion. Kratos and Digital Fusion have entered into an Agreement and Plan of Merger pursuant to which Digital Fusion will merge with a newly formed, wholly-owned subsidiary of Kratos, with Digital Fusion surviving the merger as a wholly-owned subsidiary of Kratos. In the proposed merger, Digital Fusion stockholders will receive 1.7933 shares of Kratos common stock for each share of Digital Fusion common stock. This exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing. The stockholders of Kratos will continue to own their existing shares, which will not be affected by the merger.

A copy of the merger agreement is attached as *Annex A* to this proxy statement/prospectus. Kratos and Digital Fusion encourage you to read the entire merger agreement carefully because it is the principal document governing the merger. For more information on the merger agreement, see "The Merger Agreement and Related Agreements" beginning on page .

The merger is expected to be completed during late 2008 or early 2009, subject to the satisfaction or waiver of the closing conditions. For a discussion of the timing of the merger, see "The Merger Agreement and Related Agreements Closing and Effective Time of the Merger" beginning on page .

Merger Consideration

Each share of Digital Fusion common stock, par value $0.01 per share, issued and outstanding immediately prior to the completion of the merger, will be converted into the right to receive 1.7933 shares of Kratos common stock, for an aggregate of approximately 21.1 million shares, assuming no exercise or conversion of outstanding options. Kratos will not issue any fractional shares in the merger. Instead, Digital Fusion stockholders will receive cash (without interest) in lieu of such fractional share, after aggregating all fractional shares of Kratos common stock issuable to that holder, determined by multiplying such fraction by the average closing price of Kratos common stock for the five trading days immediately prior to the closing date.

For a more complete description of the merger consideration, see "The Merger Agreement and Related Agreements Terms of the Merger" beginning on page .

Treatment of Stock Options and Warrants

Kratos will assume outstanding options and warrants to purchase shares of Digital Fusion common stock in the merger. Each outstanding option and warrant to acquire Digital Fusion common stock will be converted automatically at the effective time of the merger into an option or warrant to acquire Kratos common stock, and will continue to be governed by the terms of the relevant Digital Fusion stock plan and/or related agreements under which it was granted, except that the number of shares of Kratos common stock for which each option or warrant is exercisable and the exercise price of each option or warrant will be adjusted based on the exchange ratio in the merger. For a more complete discussion of the treatment of Digital Fusion options and other stock-based awards, see "The Merger Agreement and Related Agreements Treatment of Digital Fusion Stock Options" beginning on page and "The Merger Agreement and Related Agreements Treatment of Digital Fusion Warrants" beginning on page .

Directors and Executive Management Following the Merger

The directors and executive management of Kratos will remain unchanged at the effective time of the merger. At the effective time of the merger, the directors and officers of Merger Sub will become the directors and officers of Digital Fusion until each is replaced by his or her successor.

For a more complete discussion of the directors and management of Kratos, see "The Merger Composition of Kratos Board of Directors" beginning on page .

Recommendation of the Kratos Board of Directors

After careful consideration, the Kratos board of directors unanimously recommends that holders of Kratos common stock vote **FOR** the issuance of Kratos common stock in connection with the merger.

For a more complete description of Kratos' reasons for the merger and the recommendations of the Kratos board of directors, see "The Merger The Kratos Board of Directors' Recommendations and Reasons for the Merger" beginning on page .

Recommendation of the Digital Fusion Board of Directors

After careful consideration, the Digital Fusion board of directors unanimously recommends that holders of Digital Fusion common stock vote **FOR** the adoption of the merger agreement and approval of the merger.

For a more complete description of Digital Fusion's reasons for the merger and the recommendation of the Digital Fusion board of directors, see "The Merger The Digital Fusion Board of Directors' Recommendation and Reasons for the Merger" beginning on page .

Opinions of Financial Advisors

Kratos Financial Advisor

In connection with the transaction, Kratos' board of directors received a written opinion from Imperial Capital, LLC, or Imperial Capital, Kratos' financial advisor, as to the fairness, from a financial point of view and as of the date of its opinion, of the exchange ratio in the transaction to Kratos. The full text of Imperial Capital's written opinion, dated November 19, 2008, is attached to this proxy statement as *Annex C*. Holders of Kratos common stock are encouraged to read this opinion carefully in its entirety for a description of the assumptions made, procedures followed, matters considered and limitations on the review undertaken. **Imperial Capital's opinion was provided to Kratos' board of directors in connection with, and for the purposes of, its evaluation of the exchange ratio in the transaction from a financial point of view, does not address the merits of the underlying decision by Kratos to engage in the transaction or the relative merits of any alternatives discussed by Kratos' board of directors, does not constitute an opinion with respect to Kratos' underlying business decision to effect the transaction, any legal, tax or accounting issues concerning the transaction, or any terms of the transaction (other than the exchange ratio) and does not constitute a recommendation as to any action Kratos or any holder of Kratos common stock should take in connection with the transaction or any aspect thereof.**

For a more complete description of Imperial Capital's opinion, see "The Merger Opinion of Financial Advisor to the Kratos Board of Directors" beginning on page . See also *Annex C* to this proxy statement/prospectus.

Digital Fusion Financial Advisor

ISI Partners, LLC, or ISI, delivered an opinion to Digital Fusion's board of directors that, subject to and based upon the assumptions made, procedures followed, matters considered and limitations on its review undertaken, as of November 20, 2008, the exchange ratio in the merger agreement was fair from a financial point of view to Digital Fusion. The full text of ISI's written opinion, dated November 20, 2008, is attached as *Annex D* to this proxy statement/prospectus. Holders of shares of Digital Fusion common stock are urged to read the opinion carefully and in its entirety. ISI's opinion does not and shall not constitute a recommendation to any holders of shares of Digital Fusion common stock as to how they should vote in connection with the merger. This summary of ISI's opinion contained in this proxy statement/prospectus is qualified in its entirety by reference to the full text of the opinion.

For a more complete description of the ISI opinion, see "The Merger Opinion of Financial Advisor to the Digital Fusion Board of Directors" beginning on page . See also *Annex D* to this proxy statement/prospectus.

Interests of Digital Fusion Directors and Executive Officers in the Merger

When you consider the unanimous recommendation of Digital Fusion's board of directors that Digital Fusion stockholders approve the merger agreement and the merger, you should be aware that some Digital Fusion officers and directors may have interests in the transaction that may be different from, or in addition, to their interests as stockholders of Digital Fusion.

For a further discussion of interests of directors and executive officers in the merger, see "The Merger Interests of Digital Fusion Directors and Executive Officers in the Merger" beginning on page .

Material United States Federal Income Tax Consequences of the Merger

Kratos and Digital Fusion intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Code for U.S. federal income tax purposes. Accordingly, Digital Fusion stockholders generally will not recognize gain or loss for U.S. federal income tax purposes upon the receipt of Kratos common stock in the merger, except that a Digital Fusion stockholder will recognize gain or loss with respect to any cash received in lieu of a fractional share of Kratos common stock. Digital Fusion stockholders who exercise their appraisal rights will recognize gain or loss with respect to cash received in exchange for their Digital Fusion common stock.

Tax matters are very complicated and the tax consequences of the merger to you, if you are a Digital Fusion stockholder, will depend upon the facts of your situation. In addition, you may be subject to state, local or foreign tax laws that are not addressed in this proxy statement/prospectus. You are urged to consult with your own tax advisors for a full understanding of the tax consequences of the merger to you.

For a more complete description of the material U.S. federal income tax consequences of the merger, see "The Merger Material United States Federal Income Tax Consequences" beginning on page .

Accounting Treatment of the Merger

The merger will be accounted for as an acquisition by Kratos of Digital Fusion under the purchase method of accounting according to U.S. generally accepted accounting principles.

Regulatory Matters

The parties are not aware of any governmental or regulatory approvals required in order to complete the transaction.

Appraisal Rights

Kratos stockholders have no appraisal rights with respect to the merger under Section 262 of the Delaware General Corporations Law, or DGCL.

Under the DGCL, holders of Digital Fusion common stock who do not vote for the adoption of the merger agreement have the right to seek appraisal and receive cash for the fair value of their shares, but only if they comply with all requirements of the DGCL and at least one stockholder who properly exercised appraisal rights litigates an appraisal proceeding in the Delaware Court of Chancery to obtain the appraisal. See "The Merger Appraisal Rights" on page .

Conditions to Completion of the Merger

Kratos and Digital Fusion expect to complete the merger after all the conditions to the merger in the merger agreement are satisfied or waived, including after the receipt of stockholder approvals at their respective stockholder meetings. In addition to obtaining such stockholder approvals, each of the other closing conditions set forth in the merger agreement must be satisfied. Kratos and Digital Fusion currently expect to complete the merger during late 2008 or early 2009. However, it is possible that factors outside of either company's control could cause the merger to be competed at a later time or not at all.

The merger agreement provides that certain of these conditions may be waived, in whole or in part, by Kratos or Digital Fusion, to the extent legally allowed. Neither Kratos nor Digital Fusion currently expects to waive any material condition to the completion of the merger. If either Kratos or Digital Fusion determines to waive any condition to the merger that would result in a material and adverse change in the terms of the merger to Kratos or Digital Fusion stockholders (including any change in the tax consequences of the transaction to Digital Fusion stockholders), proxies would be resolicited from the Kratos or Digital Fusion stockholders, as applicable.

For a more complete discussion of the conditions to the merger, see "The Merger Agreement and Related Agreements Conditions to Completion of the Merger" beginning on page .

No Solicitation of Other Offers

The merger agreement contains restrictions on the ability of Digital Fusion to solicit or engage in discussions or negotiations with a third party with respect to a proposal to acquire Digital Fusion's equity or assets. Notwithstanding these restrictions, the merger agreement provides that under specified circumstances, if Digital Fusion receives an unsolicited bona fide proposal from a third party to acquire a significant interest in it that its board of directors determines in good faith is reasonably likely to lead to a proposal that is superior to the merger, Digital Fusion may furnish nonpublic information to that third party and engage in negotiations regarding an acquisition proposal with that third party.

For a discussion of the prohibition on solicitation of acquisition proposals from third parties, see "The Merger Agreement and Related Agreements No Solicitation; Changes in Recommendations" beginning on page .

Termination

Kratos and Digital Fusion may mutually agree at any time prior to the completion of the merger (including after stockholder approval) to terminate the merger agreement and abandon the merger. In addition, the agreement may be terminated by either Kratos or Digital Fusion under certain circumstances or upon the occurrence of certain events.

See "The Merger Agreement and Related Agreements Termination" beginning on page .

Termination Fees and Expenses

Digital Fusion is required to pay a termination fee of $1,344,000 to Kratos in the event the merger agreement is terminated by Digital Fusion in connection with the entry into an agreement for a superior proposal. In addition, Digital Fusion is required to pay Kratos the termination fee if Kratos terminates the merger agreement under certain conditions or in the event that Digital Fusion terminates the Merger Agreement and either enters into or consummates a takeover proposal, other than with Kratos, within 12 months of such termination under certain circumstances.

This termination fee could discourage other companies from seeking to acquire or merge with either Digital Fusion or Kratos. See "The Merger Agreement and Related Agreements Termination Fees and Expenses" and " Effect of Termination," beginning on pages and , respectively.

Stockholder Agreements

In order to induce Kratos to enter into the merger agreement, several Digital Fusion stockholders entered into stockholder agreements and irrevocable proxies with Kratos pursuant to which, among other things, each of these stockholders agreed, solely in its capacity as a stockholder, to vote all of its shares of Digital Fusion capital stock and other Digital Fusion securities in favor of the merger and the adoption of the merger agreement, against any action or agreement that would result in a breach of the merger agreement by Digital Fusion, and against any other action which, directly or indirectly, would reasonably be expected to prevent or materially delay the consummation of the merger or the transactions contemplated by the merger agreement. These Digital Fusion stockholders also granted Kratos an irrevocable proxy to their respective Digital Fusion capital stock and securities in accordance with the stockholder agreement.

As of November 21, 2008, the stockholders of Digital Fusion that entered into stockholder agreements owned in the aggregate 3,999,567 shares of Digital Fusion stock, representing approximately 34% of the outstanding Digital Fusion stock.

See "The Merger Agreement and Related Agreements Stockholder Agreements" beginning on page .

Comparison of the Rights of Kratos and Digital Fusion Stockholders

The rights of Digital Fusion stockholders as Kratos stockholders after the merger will be governed by Kratos' certificate of incorporation and bylaws, each as amended, and the laws of the State of

Delaware. Those rights differ from the rights of Digital Fusion stockholders under Digital Fusion's certificate of incorporation and bylaws.

See "Comparison of Rights of Kratos and Digital Fusion Stockholders" beginning on page .

Voting by Digital Fusion Directors and Executive Officers

On [ ], 2008, the record date set by the Digital Fusion board of directors, directors and executive officers of Digital Fusion and their affiliates owned and were entitled to vote [ ] shares of Digital Fusion common stock, or approximately [ ]% of the shares of Digital Fusion common stock outstanding on that date. Stockholders of Digital Fusion holding approximately [ ]% of the shares of Digital Fusion common stock outstanding on that date have executed voting agreements agreeing to vote in favor of the merger.

SELECTED HISTORICAL FINANCIAL DATA OF KRATOS

The selected consolidated financial data below is derived from Kratos' audited consolidated financial statements as of and for each of the five years ended December 31, 2003 through 2007 contained in Kratos' annual reports on Form 10-K for the years ended December 31, 2003, 2004, 2005, 2006 and 2007, except for the financial data as of and for the nine months ended September 28, 2008, which is derived from Kratos' unaudited condensed consolidated financial statements contained in Kratos' quarterly report on Form 10-Q for the period ended September 28, 2008. The information is only a summary and should be read in conjunction with Kratos' consolidated financial statements, accompanying notes, "Certain Information Relating to Kratos Management's Discussion and Analysis of Financial Condition and Results of Operations of Kratos," "Certain Information Relating to Kratos Description of Business," included elsewhere in this proxy statement/prospectus.

	Year ended December 31,					Nine months ended September 28,
	2003	2004	2005	2006	2007	2008
	(in millions, except per share amounts)					
Consolidated Statement of Operations Data:						
Revenues	$ 43.4	$ 116.9	$ 152.3	$ 153.1	$ 193.6	$ 222.0
Operating costs and expenses:						
Costs of revenues	22.2	87.9	115.7	124.2	162.0	178.6
Selling, general and administrative expenses	18.0	28.9	35.5	38.5	39.5	37.7
Research and development						1.0
Stock option investigation and related fees					14.0	(1.0)
Estimated cost for settlement of securities litigation					4.9	
Loss (recovery) of unauthorized issuance of stock options	5.7				(3.4)	(0.6)
Contingent acquisition consideration and restatement fees		13.9	(2.1)	0.1		
Impairment, restructuring fees and adjustments to the liability for unused office space	0.1			21.8	1.2	(0.3)
Total operating costs and expenses	46.0	130.7	149.1	184.6	218.2	215.4
Operating income (loss)	(2.6)	(13.8)	3.2	(31.5)	(24.6)	6.6
Other (income) expense:						
Interest income (expense), net	0.9	0.2	0.1	(0.7)	(1.2)	(7.5)
Impairment of investments in unconsolidated subsidiaries		(2.9)			(1.8)	
Other income and (expense), net	(0.1)	(0.1)	0.2	(0.2)	0.7	0.8
Total other (income) expense	0.8	(2.8)	0.3	(0.9)	(2.3)	(6.7)
Income (loss) from continuing operations before income taxes	(1.8)	(16.6)	3.5	(32.4)	(26.9)	(0.1)
Provision (benefit) for income taxes from continuing operations	(1.0)	(8.4)	(0.1)	13.8	1.3	1.4
Income (loss) from continuing operations	(0.8)	(8.2)	3.6	(46.2)	(28.2)	(1.5)
Income (loss) from discontinued operations	2.7	23.2	(2.0)	(11.7)	(12.6)	0.2
Net income (loss)	$ 1.9	$ 15.0	$ 1.6	$ (57.9)	$ (40.8)	$ (1.3)
Basic earnings (loss) per common share:						
Continuing operations	$ (0.01)	$ (0.12)	$ 0.05	$ (0.63)	$ (0.38)	$ (0.02)
Discontinued operations	0.04	0.34	(0.03)	(0.16)	(0.17)	0.00

Net income (loss)	$ 0.03	$ 0.22	$ 0.02	$ (0.79)	$ (0.55)	$ (0.01)
Diluted earnings (loss) per common share:						
Continuing operations	$ (0.01)	$ (0.12)	$ 0.05	$ (0.63)	$ (0.38)	$ (0.02)
Discontinued operations	0.04	0.34	(0.03)	(0.16)	(0.17)	0.00
Net income (loss)	$ 0.03	$ 0.22	$ 0.02	$ (0.79)	$ (0.55)	$ (0.01)
Weighted average common shares outstanding:						
Basic	68.4	67.7	74.0	73.5	74.0	88.0
Diluted	68.4	67.7	75.0	73.5	74.0	88.0

	December 31,					September 28,
	2003	2004	2005	2006	2007	2008
	(in millions)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 75.8	$ 58.0	$ 7.7	$ 5.4	$ 8.6	$ 2.5
Working capital	132.5	98.6	67.4	(3.8)	23.4	32.2
Goodwill	5.5	57.1	94.4	129.9	194.5	237.3
Other intangible assets	1.9	6.4	7.4	13.4	19.9	25.0
Total assets	279.3	330.7	342.0	337.7	335.3	382.8
Total debt	0.7	1.9	0.7	51.4	76.7	83.8
Stockholders' equity	191.9	219.6	229.7	187.1	167.2	220.0

SELECTED HISTORICAL FINANCIAL DATA OF DIGITAL FUSION

The selected consolidated financial data below is derived from Digital Fusion's audited consolidated financial statements for each of the five years ended December 31, 2003 through 2007, except for financial data for the 38 weeks ended September 18, 2008, which is derived from Digital Fusion's unaudited condensed combined financial statements presented elsewhere in this proxy statement/prospectus. This information is only a summary and should be read in conjunction with Digital Fusion's consolidated financial statements, accompanying notes and "Certain Information Relating to Digital Fusion Management's Discussion and Analysis of Financial Condition and Results of Operations of Digital Fusion" included elsewhere in this proxy statement/prospectus.

	Year Ended December 31,					Nine months ended September 19, 2008
	2003	2004	2005	2006	2007	
	(All amounts except per share data in millions)					
Consolidated Statements of Operations Data:						
Revenues	$ 6.4	$ 6.8	$20.9	$34.4	$47.5	$ 44.7
Gross profit	1.5	0.8	3.5	5.1	7.1	6.3
Selling, general and administrative	1.7	1.7	2.7	4.9	6.2	4.5
Operating income (loss)	(0.2)	(0.9)	0.8	0.0	0.9	1.8
Provision (benefit) for income taxes	(0.0)	0.0	0.0	2.5	0.9	0.3
Net income (loss)	$ (0.4)	$ (1.0)	$ 0.0	$ 1.3	$ 1.6	$ 1.4
Net income (loss) per common share:						
Basic	$0.06	$(0.13)	$0.00	$0.11	$0.14	$ 0.12
Diluted	$0.06	$(0.13)	$0.00	$0.09	$0.12	$ 0.10
Weighted average shares:						
Basic	7.2	8.0	10.9	11.4	11.6	11.7
Diluted	7.2	8.0	13.0	14.0	13.6	13.6

	As of December 31,					Nine months ended September 19, 2008
	2003	2004	2005	2006	2007	
	(All amounts in millions)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$0.4	$ 0.3	$ 0.0	$ 0.0	$ 0.0	$ 1.0
Working capital	0.5	(0.3)	(0.2)	1.0	3.1	6.0
Total assets	4.6	5.4	13.7	17.0	21.0	23.3
Short-term debt	0.1	0.6	3.0	2.7	1.8	
Long-term debt	1.3	0.1	1.7	1.5	0.0	
Total stockholders' equity	2.3	3.4	5.7	8.6	12.3	14.9

Certain amounts in the selected consolidated financial data above have been reclassified to conform to the 2007 presentation. See Note 1 of Notes to Consolidated Financial Statements of Digital Fusion.

SELECTED UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL DATA

The following summary unaudited pro forma condensed combined financial information is designed to show how the merger of Kratos and Digital Fusion might have affected historical financial statements if the merger had been completed at an earlier time and was prepared based on the historical financial results reported by Kratos, including Haverstick Consulting, Inc., SYS Technologies, and Digital Fusion. The unaudited pro forma condensed combined balance sheet gives effect to the merger as if it had occurred on September 28, 2008. The unaudited pro forma condensed combined income statements for the nine months ended September 28, 2008 and the year ended December 31, 2007, give effect to the merger as if the merger had become effective at January 1, 2007. The unaudited pro forma condensed combined financial statements assume the merger is completed on or before December 28, 2008. The merger will be accounted for under the purchase method of accounting in accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" with Kratos treated as the acquiring entity.

If the merger is consummated on or after December 29, 2008, the merger will be accounted for under Statement of Financial Accounting Standards (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R would require that the purchase price be determined based on Kratos's closing stock price on the date the merger is consummated, and that contingent assets and liabilities be recorded at fair value. Further, SFAS 141R would require that merger-related transaction costs and exit and termination costs be recorded to expense as incurred rather than capitalized as part of goodwill.

The following should be read in connection with "Unaudited Pro Forma Condensed Combined Financial Statements" beginning on page 150 and the Kratos, Haverstick and Digital Fusion audited consolidated financial statements beginning on pages FI-1, FII-1, and FIII-1, respectively. The pro forma condensed combined financial data is presented for illustrative purposes only and is not necessarily indicative of the financial condition or results of operations of future periods or the financial condition or results of operations that actually would have been realized had the entities been a single company during these periods.

	Year ended December 31, 2007	Period ended September 28, 2008
	(In millions, except per share amounts)	
Statements of Operations Data:		
Revenues	$ 414.3	$ 303.2
Operating income (loss)	(20.7)	7.7
Loss from continuing operations	(34.7)	(1.1)
Loss per common share from continuing operations:		
Basic	$ (0.27)	$ (0.01)
Diluted	$ (0.27)	$ (0.01)
Weighted average common shares outstanding:		
Basic	130.0	130.1
Diluted	130.0	130.1

	As of September 28, 2008
Balance Sheet Data:	
Cash and cash equivalents	$ 1.2
Property and equipment, net	8.1
Goodwill	266.2
Intangible assets, net	33.3
Total assets	430.8
Long-term debt, net of current portion	76.4
Accumulated deficit	(281.3)
Total stockholders' equity	256.4

EQUIVALENT AND COMPARATIVE PER SHARE INFORMATION

The tables below reflect:

- the historical net loss from continuing operations, book value per share and cash dividends per share of Kratos common stock and the historical net income from continuing operations, book value per share and cash dividends per share of Digital Fusion common stock;

- the unaudited pro forma combined Kratos, including Haverstick Consulting, Inc. and SYS Technologies, and Digital Fusion net loss from continuing operations after giving effect to the merger on a purchase basis if the merger had been consummated on January 1, 2007; book value per share, and cash dividends after giving effect to the merger on a purchase basis if the merger had been consummated on September 28, 2008; and

- the unaudited pro forma combined per Digital Fusion equivalent share data net loss from continuing operations, book value per share and cash dividends per share calculated by multiplying the unaudited pro forma combined data by the exchange ratio of 1.7933, which is the Kratos share which would be received for each share of Digital Fusion common stock pursuant to the merger agreement.

The following tables should be read in conjunction with the historical audited consolidated financial statements and accompanying notes of each of Kratos, Digital Fusion and Haverstick which are included elsewhere in this proxy statement/prospectus.

The unaudited pro forma data are presented for illustrative purposes only and are not necessarily indicative of actual or future financial position or results of operation that would have been realized if the proposed mergers had been completed as of the date indicated or will be realized upon completion of the proposed mergers. See the section entitled "Unaudited Pro Forma Condensed Combined Financial Information" beginning on page 150 of this proxy statement/prospectus.

	As of and for the year ended December 31, 2007	As of and for the nine month period ended September 28, 2008
Kratos Historical		
Basic loss per share	$ (0.38)	$ (0.02)
Diluted loss per share	(0.38)	(0.02)
Book value per share	2.26	2.50
Cash dividends per share		
Digital Fusion Historical		
Basic income per share	$ 0.14	$ 0.12
Diluted income per share	0.12	0.10
Book value per share	0.90	1.10
Cash dividends per share		
Unaudited Pro Forma Combined		
Basic loss per share	$ (0.27)	$ (0.01)
Diluted loss per share	(0.27)	(0.01)
Book value per common share		1.97
Cash dividends per share		
Unaudited Pro Forma Combined Digital Fusion Equivalents		
Basic loss per share	$ (0.48)	$ (0.02)
Diluted loss per share	(0.48)	(0.02)
Book value per common share		3.52

Cash dividends per share

The above tables show only historical comparisons. Because the market prices of Kratos and Digital Fusion common stock will likely fluctuate prior to the merge, these comparisons may not provide meaningful information to Kratos stockholders in determining whether to approve the issuance of shares of Kratos common stock in the merger or to Digital Fusion stockholders in determining whether to adopt the merger agreement and approve the merger. Kratos and Digital Fusion stockholders are encouraged to obtain current market quotations for Kratos and Digital Fusion common stock and to review carefully the other information contained in this joint proxy statement/prospectus in considering whether to approve the respective proposals before them.

The following table presents:

- the last reported sale price of a share of Kratos common stock, as reported on The NASDAQ Global Select Market;

- the last reported sale price of a share of Digital Fusion common stock, as reported on the Pink Sheets; and

- the pro forma equivalent per share value of Digital Fusion common stock based on the exchange ratio (i.e. 1.7933 shares of Kratos common stock for each outstanding share of Digital Fusion common stock) and the closing price of Kratos common stock;

in each case, on November 21, 2008, the last full trading day prior to the public announcement of the proposed merger, and on , 2008, the last practicable trading day prior to the date of this joint proxy statement/prospectus.

Date	Kratos Common Stock	Digital Fusion Common Stock	Equivalent Price per Share
November 21, 2008	$ 1.36	$ 1.65	$ 2.44
, 2008			

No cash dividends have been paid on either Kratos or Digital Fusion common stock during the two most recent financial years, and neither company intends to pay cash dividends on its common stock in the immediate future.

RISK FACTORS

In addition to the other information contained in this joint proxy statement/prospectus, you should carefully consider the following risk factors in deciding how to vote on the merger. In addition, you should read and consider the risks associated with each of the businesses of Kratos and Digital Fusion because these risks will also relate to Kratos following completion of the merger.

Risks Related to the Merger

The failure to successfully integrate Digital Fusion's business and operations in the expected time frame may adversely affect the combined company's future results.

Kratos believes that the merger with Digital Fusion will result in certain benefits including cost synergies and operational efficiencies. To realize the anticipated benefits, Kratos will be required to devote significant management attention and resources to integrating the two companies. The merger involves the integration of two companies that have previously operated independently with principal offices in two distinct locations. Due to legal restrictions, at present Kratos and Digital Fusion are able to conduct only limited planning regarding the integration of the two companies. The actual integration may result in additional and unforeseen expenses or delays. If Kratos is not able to successfully integrate Digital Fusion's business and operations, or if there are delays in combining the businesses, the anticipated benefits of the merger may not be realized fully or at all or may take longer to realize than expected. In addition, certain small business contracts could be at risk due to the merger as a result of recent changes to the rules governing the treatment of small business contracts after an acquisition. Failure to realize the full benefits of the merger could adversely affect Kratos' business, financial results, financial condition and stock price following the merger.

Because the market price of Kratos common stock will fluctuate, Digital Fusion stockholders cannot be sure of the market value of the Kratos common stock that they will receive.

When we complete the merger, each share of Digital Fusion common stock will be converted into the right to receive 1.7933 shares of Kratos common stock. The exchange ratio is fixed and will not be adjusted for changes in the market price of either Kratos common stock or Digital Fusion common stock. The merger agreement does not provide for any price-based termination right for either party. Accordingly, the market value of the shares of Kratos common stock that Kratos issues and Digital Fusion stockholders will be entitled to receive when the parties complete the merger will depend on the market value of shares of Kratos common stock at the time that the parties complete the merger and could vary significantly from the market value on the date of this proxy statement/prospectus or the date of the Kratos special meeting and the Digital Fusion special meeting. The market value of Kratos common stock will continue to fluctuate after the completion of the merger. For example, during the third calendar quarter of 2008, the sales price of Kratos common stock ranged from a low of $1.33 to a high of $2.14, as reported on the Nasdaq Global Select Market. See "Market Price of and Dividends on Kratos' Common Equity and Related Stockholder Matters" on page .

These variations could result from changes in the business, operations or prospects of Kratos or Digital Fusion prior to or following the merger, market assessments as to whether and when the merger will be consummated, regulatory considerations, general market and economic conditions and other factors both within and beyond the control of Kratos or Digital Fusion.

The issuance of shares of Kratos common stock to Digital Fusion stockholders in the merger will substantially dilute the interest in Kratos held by Kratos stockholders prior to the merger.

If the merger is completed, Kratos will issue up to approximately 32.9 million shares of Kratos common stock in connection with the merger, including common stock issuable pursuant to outstanding Digital Fusion options and warrants assumed by Kratos. Based on the number of shares of Kratos and Digital Fusion common stock outstanding on the Kratos and Digital Fusion record dates, Digital Fusion stockholders before the merger will own, in the aggregate, approximately [ ]% of the shares of Kratos common stock outstanding immediately after the merger on a fully diluted basis. The issuance of shares of Kratos common stock to Digital Fusion stockholders in the merger will cause a significant reduction in the relative percentage interest of current Kratos stockholders in the earnings, voting rights, liquidation value and book and market value of Kratos.

Uncertainty about the merger and diversion of management could harm Kratos and Digital Fusion, whether or not the merger is completed.

In response to the announcement of the merger, existing or prospective customers of Kratos or Digital Fusion may delay or defer their procurement or other decisions concerning Kratos or Digital Fusion, or they may seek to change their existing business relationship. In addition, as a result of the merger, current and prospective employees could experience uncertainty about their future with Kratos or Digital Fusion, and either organization could lose key employees as a result. In addition to retention, these uncertainties may also impair each company's ability to recruit or motivate key personnel. Completion of the merger will also require a significant amount of time and attention from management. The diversion of management attention away from ongoing operations could adversely affect ongoing operations and business relationships.

Failure to complete the merger could adversely affect Kratos' and Digital Fusion's stock prices and their future business and financial results.

Completion of the merger is conditioned upon, among other things, the receipt of approval of the Kratos and Digital Fusion stockholders. There is no assurance that the parties will receive the necessary approvals or satisfy the other conditions to the completion of the merger. Failure to complete the proposed merger would prevent Kratos and Digital Fusion from realizing the anticipated benefits of the merger. Each company will also remain liable for significant transaction costs, including legal, accounting and financial advisory fees. In addition, the market price of each company's common stock may reflect various market assumptions as to whether the merger will occur. Consequently, the failure to complete the merger could result in a significant change in the market price of the common stock of Kratos and Digital Fusion.

The combined company will incur significant transaction and merger-related costs in connection with the merger.

Kratos and Digital Fusion expect to incur significant costs associated with completing the merger and combining the operations of the two companies. The exact magnitude of these costs is not yet known. In addition, there may be unanticipated costs associated with the integration. Although Kratos and Digital Fusion expect that the elimination of duplicative costs and other efficiencies may offset incremental transaction and merger-related costs over time, these benefits may not be achieved in the near term or at all.

Because Digital Fusion's executive officers have interests in seeing the merger completed that are different than those of Digital Fusion's other stockholders, these persons may have conflicts of interest in recommending that Digital Fusion stockholders vote to adopt and approve the merger agreement.

Certain of Digital Fusion's directors and executive officers have interests in the merger that are different from, or are in addition to, the interests of Digital Fusion stockholders generally. This difference of interests stems from the equity and equity-linked securities held by such persons, the retention agreements covering Digital Fusion's executive officers under which such officers are entitled to severance payments and other benefits if their employment is terminated following the merger, and the Kratos obligation under the merger agreement to indemnify Digital Fusion's directors and officers following the merger. These and other material interests of the directors and executive officers of

Digital Fusion in the merger that are different than those of the other Digital Fusion stockholders are described under "The Merger Interests of Digital Fusion Directors and Executive Officers" beginning on page .

The merger agreement contains provisions that could discourage a potential alternative acquirer that might be willing to pay more to acquire Digital Fusion.

The merger agreement contains "no shop" provisions that restrict Digital Fusion's ability to solicit or facilitate proposals regarding a merger or similar transaction with another party. Further, there are only limited exceptions to Digital Fusion's agreement that its board of directors will not withdraw or adversely qualify its recommendation regarding the merger agreement. Under certain circumstances, Digital Fusion's board of directors is permitted to terminate the merger agreement in response to an unsolicited third party proposal to acquire Digital Fusion, which Digital Fusion's board of directors determines to be more favorable than the merger with Kratos. However, if Digital Fusion or Kratos terminates the merger agreement because Digital Fusion has received an acquisition proposal that is deemed more favorable by its board of directors, Kratos will be entitled to collect a $1,344,000 termination fee from Digital Fusion. We describe these provisions under "The Merger Agreement and Related Agreements Termination" beginning on page and " Termination Fees and Expenses" beginning on page .

These provisions could discourage a potential third party acquirer from considering or proposing an alternative acquisition, even if it were prepared to pay consideration with a higher value than that proposed to be paid in the merger, or might result in a potential third party acquirer proposing to pay a lower per share price than it might otherwise have proposed to pay because of the added expense of the termination fee.

Resales of shares of Kratos common stock following the merger and additional obligations to issue shares of Kratos common stock may cause the market price of Kratos common stock to decrease.

As of November 21, 2008, Kratos had 105,292,730 shares of common stock outstanding and approximately 8,452,378 shares of common stock subject to outstanding options and other rights to purchase or acquire its shares. Kratos currently expects that it will issue up to approximately 32.9 million shares of common stock in connection with the merger, including common stock issuable in connection with assumed options and warrants. The issuance of these new shares of Kratos common stock and the sale of additional shares of Kratos common stock that may become eligible for sale in the public market from time to time upon exercise of options and other equity-linked securities could have the effect of depressing the market price for shares of Kratos common stock.

Future results of the combined company may differ materially from the unaudited pro forma financial statements presented in this proxy statement/prospectus.

The future results of Kratos may be materially different from those shown in the unaudited pro forma financial statements presented in this proxy statement/prospectus which show only a combination of the historical results of Kratos and Digital Fusion. Kratos expects to incur significant costs associated with completing the merger and combining the operations of the two companies and the exact magnitude of these costs is not yet known. Furthermore, these costs may decrease the capital that Kratos could use for income-earning investments in the future.

The trading price of shares of Kratos common stock after the merger may be affected by factors different from those affecting the price of shares of Kratos common stock or shares of Digital Fusion common stock before the merger.

When the merger is completed, holders of Digital Fusion common stock will become holders of Kratos common stock. The results of operations of Kratos and the trading price of Kratos common stock after the merger may be affected by factors different from those currently affecting Kratos' or Digital Fusion's results of operations and trading prices.

Risks Related to Kratos

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

Kratos derives a significant portion of its revenue from contracts with the U.S. federal government and government agencies and subcontracts under federal government prime contracts, and the success of Kratos' business and growth of its business will continue to depend on its successful procurement of government contracts either directly or through prime contractors. Accordingly, changes in government contracting policies or government budgetary constraints could directly affect Kratos' financial performance. Among the factors that could adversely affect Kratos' 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;
- 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 invoices by government payment offices.

These and other factors could cause governments and government agencies, or prime contractors that use Kratos 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 Kratos' business, financial condition and results of operations. Many of Kratos' 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.

Kratos derives a substantial amount of its revenues from the sale of its 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 Kratos' 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 Kratos' existing contracts;
- reduce potential future income from existing contracts;

modify some of the terms and conditions in existing contracts;

- suspend or permanently prohibit Kratos from doing business with the federal government or with any specific government agency;
- impose fines and penalties;
- subject Kratos 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 Kratos.

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 Kratos. 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. Kratos may not be awarded contracts for which it bid, and substantial delays or cancellation of purchases may follow its successful bids as a result of such protests.

Certain of Kratos' government contracts also contain "organizational conflict of interest" clauses that could limit its ability to compete for certain related follow-on contracts. For example, when Kratos works on the design of a particular solution, it may be precluded from competing for the contract to install that solution. While Kratos actively monitors its contracts to avoid these conflicts, it may not be able to avoid all organizational conflict of interest issues.

Kratos faces intense competition from many competitors that have greater resources than it does, which could result in price reductions, reduced profitability or loss of market share.

Kratos operates in highly competitive markets and generally encounters 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 its 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 Kratos does. These competitors could, among other things:

- divert sales from Kratos 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 Kratos to charge lower prices; or
- adversely affect Kratos' relationships with current clients, including its ability to continue to win competitively awarded engagements in which it is the incumbent.

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

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

Kratos has completed several acquisitions of complementary businesses in recent years, including its December 2007 acquisition of Haverstick Consulting, Inc. and June 2008 acquisition of SYS. The success of these acquisitions will depend in part on the success in integrating the operations, technologies and personnel of Haverstick and SYS into Kratos. The failure to successfully integrate the operations of the two companies or otherwise to realize any of the anticipated benefits of the acquisition could seriously harm Kratos' results of operations.

Kratos continually evaluates opportunities to acquire new businesses as part of its ongoing strategy and may in the future acquire additional companies that it believes could complement or expand its business or increase its customer base. As more fully described elsewhere in this proxy statement/prospectus, on November 21, 2008, Kratos entered into a merger agreement with Digital Fusion. Acquisitions, including the proposed acquisition of Digital Fusion, 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 Kratos to enter into government novation agreements, a potentially time-consuming process;
- notifying and obtaining approval from agencies from which import and export licenses have been issued; and
- inability to generate sufficient revenue to offset acquisition costs.

Acquired companies may have liabilities or adverse operating issues that Kratos fails 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, Kratos, 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 impairments in the future that could harm Kratos' financial results. In addition, if Kratos finances acquisitions by issuing convertible debt or equity securities its existing stockholders may be diluted, which could affect the market price of its stock. If Kratos fails to properly evaluate acquisitions or investments, it may not achieve the anticipated benefits of any such acquisitions and may incur costs in excess of what it anticipates.

Kratos has agreed to indemnify acquirers of its divested operations against specified losses in connection with the sale of these operations, and any demands for indemnification may result in expenses it does not anticipate and distract the attention of its management from its continuing businesses.

Kratos agreed to indemnify acquirers of its divested operations against specified losses in connection with their sale and generally retain responsibility for various legal liabilities that accrued prior to closing. Kratos also made representations and warranties to these acquirers about the condition of the divested businesses and agreed to working capital adjustment provisions that could obligate it to

make substantial payments to some of these acquirers. If any acquirer makes an indemnification claim because it has suffered a loss or a third party has commenced an action against the divested business, or if Kratos is required to make payments in settlement of working capital adjustments, Kratos may incur substantial expenses resolving such claims or defending against the third party action, which would harm its operating results. Kratos' ability to defend itself may be impaired because its former employees are now employees of the acquirer or other companies. These indemnity claims may require management to devote a substantial amount of time to resolving the claim and may divert management attention from responsibilities related to the daily ongoing concerns of the business. In addition, Kratos may be required to expend substantial resources trying to determine which party has responsibility for the claim, even if it is ultimately found to be not responsible.

Kratos' financial results may vary significantly from quarter to quarter.

Kratos expects its 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 its expenses are fixed in the short-term. It 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. It may also incur additional expenses when contracts expire, are terminated or are not renewed.

In addition, payments due to Kratos 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, Kratos' clients may have to suspend engagements that Kratos is working on until a budget has been approved. Any such suspensions may reduce Kratos' 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 Kratos receives as a result of the federal government's fiscal year end would serve to increase its third or fourth quarter revenue, but will generally decrease profit margins for that quarter, as these activities generally are not as profitable as Kratos' typical offerings.

Additional factors that may cause Kratos' 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 its 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 the GSA Schedule 70 Contracts, government wide acquisition 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 ongoing government inquiries;
- strategic decisions by it or its competitors, such as acquisitions, divestitures, spin-offs and joint ventures;
- strategic investments or changes in business strategy;

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- changes in the extent to which it uses subcontractors;
- seasonal fluctuations in its staff utilization rates;
- changes in its effective tax rate, including changes in its judgment as to the necessity of the valuation allowance recorded against its deferred tax assets; and
- the length of sales cycles.

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

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

To develop new business opportunities, Kratos primarily relies on establishing and maintaining relationships with various government entities and agencies. It may be unable to successfully maintain its relationships with government entities and agencies, and any failure to do so could materially adversely affect its ability to compete successfully for new business. In addition, it often acts as a subcontractor or in "teaming" arrangements in which it and other contractors bid together on particular contracts or programs for the federal government or government agencies. As a subcontractor or team member, it often lacks control over fulfillment of a contract, and poor performance on the contract could tarnish its reputation, even when it performs as required. Kratos expects to continue to depend on relationships with other contractors for a portion of its revenue in the foreseeable future. Moreover, its 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 it provides or if any prime contractor or teammate teams with other companies to independently provide those services.

Kratos derives a significant portion of its revenues from a limited number of customers.

Kratos has derived, and believes that it will continue to derive, a significant portion of its revenues from a limited number of customers. To the extent that any significant customer uses less of Kratos' services or terminates its relationship with Kratos, Kratos' revenues could decline significantly. As a result, the loss of any significant client could seriously harm Kratos' business. For the nine month period ended September 28, 2008, two customers comprised approximately 66.5% and 50.4% of Kratos' federal business revenues and total revenues, respectively, and Kratos' five largest customers accounted for approximately 81.8% and 62.0% of its total federal business revenues and total revenues, respectively. None of Kratos' customers are obligated to purchase additional services from it. As a result, the volume of work that Kratos performs for a specific customer is likely to vary from period to period, and a significant client in one period may not use its services in a subsequent period.

Kratos' margins and operating results may suffer if it experiences unfavorable changes in the proportion of cost-plus-fee or fixed-price contracts in its 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 Kratos enters into, fixed-price contracts typically provide higher profit opportunities because Kratos 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 Kratos' contract types. Kratos' federal government customers typically determine what type of contract it enters into. Cost-plus-fee and fixed-price contracts in its federal business accounted for approximately 39.5% and 35.3%, respectively, of its federal business revenues for the period ended

September 28, 2008. To the extent that Kratos enters into more cost-plus-fee or less fixed-price contracts in proportion to its total contract mix in the future, its margins and operating results may suffer.

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

Kratos provides various professional services and sometimes procures equipment and materials on behalf of its federal government customers under various contractual arrangements. From time to time, in order to ensure that it satisfies its customers' delivery requirements and schedules, it may elect to initiate procurement in advance of receiving final authorization from the government customer or a prime contractor. If a government or prime contractor customers' requirements should change, if the government or the prime contractor should direct the anticipated procurement to a contractor other than Kratos, or if the equipment or materials become obsolete or require modification before Kratos is under contract for the procurement, Kratos' investment in the equipment or materials might be at risk. This could reduce anticipated earnings or result in a loss, negatively affecting Kratos' cash flow and profitability.

Loss of Kratos' GSA contracts or GWAC schedule contracts would impair its ability to attract new business.

Kratos is a prime contractor under several GSA contracts and GWAC schedule contracts. Kratos believes that its ability to provide services under these contracts will continue to be important to its business because of the multiple opportunities for new engagements each contract provides. If it were to lose its position as prime contractor on one or more of these contracts, it could lose substantial revenues and its 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. Kratos' government clients may not continue to exercise the options remaining on its current contracts and its future clients may not exercise options on any future contracts.

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

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

The loss of any member of Kratos' senior management team could impair its relationships with federal government clients and disrupt the management of its business.

Kratos believes that the success of its business and its ability to operate profitably depends on the continued contributions of the members of its senior management team. Kratos relies on its senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of its senior management team have established and maintain with federal government personnel contribute to its ability to maintain strong client relationships and to identify new business opportunities. The loss of any member of its senior management team could impair its ability to identify and secure new contracts, to maintain good client relations and to otherwise manage its business.

If Kratos fails to attract and retain skilled employees or employees with the necessary security clearances, it may not be able to perform under its contracts or win new business.

The growth of Kratos' business and revenue depends in large part upon its 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 Kratos and some of its 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 Kratos' contracts contain provisions requiring it to staff an engagement with personnel that the client considers key to Kratos' successful performance under the contract. In the event Kratos is unable to provide these key personnel or acceptable substitutions, the client may terminate the contract and Kratos may lose revenue.

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

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

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

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

Kratos' failure to comply with complex procurement laws and regulations could cause it to lose business and subject it to a variety of penalties.

Kratos must comply with laws and regulations relating to the formation, administration and performance of federal government contracts, which affect how it does business with its clients and may impose added costs on it. In addition, the federal government, including the Defense Contract Audit

Agency (DCAA), audits and reviews a contractor's performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. The DCAA also reviews a contractor's internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems, and the contractor's compliance with such policies. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. Adverse findings in a DCAA audit could materially affect Kratos' competitive position and result in a substantial adjustment to its revenue and profit.

The commercial business arena in which Kratos operates 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 Kratos' commercial business, the barriers to entry in this area are relatively low. Kratos does not have any intellectual property rights in this segment of its business to protect its methods and business start-up costs do not pose a significant barrier to entry. The success of Kratos' commercial business is dependent on its employees, customer relations and the successful performance of its services. If Kratos faces increased competition as a result of new entrants in its markets, it could experience reduced operating margins and loss of market share and brand recognition.

If Kratos' commercial customers do not invest in security systems and other new in-building technologies such as wireless local area networks and/or IP-based networks, its business will suffer.

Kratos intends to devote significant resources to developing its enterprise-based wireless local area networks (WLAN), but it may not achieve widespread market acceptance amongst the enterprises it identifies as potential customers. It is possible that some enterprises will determine that capital constraints and other factors outweigh their need for WLAN systems. A significant delay in the adoption of WLAN by enterprises could harm Kratos' business.

If Kratos experiences systems or service failure, its reputation could be harmed and its clients could assert claims against it for damages or refunds.

Kratos creates, implements and maintains IT solutions that are often critical to its clients' operations. Kratos has experienced, and may in the future experience, some systems and service failures, schedule or delivery delays and other problems in connection with its work. If it experiences these problems, it 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 its reputation and adversely affect its 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 Kratos' contracts limit its liability for consequential damages that may arise from negligence in rendering services to its clients, these contractual provisions may not be legally sufficient to protect Kratos if it is sued. In addition, its 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 Kratos could seriously harm its business. Even if not successful, these claims could result in significant legal and other costs, may be a distraction to Kratos' management and may harm its reputation.

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

Many of the systems Kratos develops, installs and maintains 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 Kratos' business, damage its reputation and prevent it from being eligible for further work on sensitive or classified systems for federal government clients. It could incur losses from such a security breach that could exceed the policy limits under its errors and omissions and product liability insurance. Damage to Kratos' reputation or limitations on its eligibility for additional work resulting from a security breach in one of the systems it develops, installs and maintains could materially reduce its revenue.

Kratos' employees may engage in misconduct or other improper activities, which could cause it to lose contracts.

Kratos is 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 Kratos' clients' sensitive or classified information, which could result in regulatory sanctions against Kratos and serious harm to its 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 Kratos takes to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could cause it to lose contracts or lead to a reduction in revenues.

Kratos' business is dependent upon its ability to keep pace with the latest technological changes.

The market for Kratos' 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 Kratos' business and operating results. Kratos has derived, and expects to continue to derive, a substantial portion of its 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, its success will depend, in part, on its ability to develop and market service offerings that respond in a timely manner to the technological advances of its customers, evolving industry standards and changing client preferences.

If Kratos is unable to manage its growth, its business could be adversely affected.

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

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

Kratos may become subject to claims from its employees or third parties who assert that software and other forms of intellectual property that it uses in delivering services and solutions to its clients infringe upon intellectual property rights of such employees or third parties. Kratos' employees develop some of the software and other forms of intellectual property that Kratos' uses to provide its services and solutions to its clients, but it also licenses technology from other vendors. If its employees, vendors, or other third parties assert claims that it or its clients are infringing on their intellectual property rights, Kratos could incur substantial costs to defend those claims. If any of these infringement claims are ultimately successful, it 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 its employees, vendors, or other third parties, or redesign its products and services that rely on the challenged software or technology.

Kratos attempts to protect its trade secrets by entering into confidentiality and intellectual property assignment agreements with third parties, its employees and consultants. However, these agreements can be breached and, if they are, there may not be an adequate remedy available. In addition, others may independently discover Kratos' trade secrets and proprietary information and in such cases Kratos could not assert any trade secret rights against such party. Enforcing a claim that a party illegally obtained and is using trade secret is difficult, expensive and time consuming, and the outcome is unpredictable. If Kratos is unable to protect its intellectual property, its competitors could market services or products similar to its services and products, which could reduce demand for its offerings. Any litigation to enforce Kratos' intellectual property rights, protect its 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.

The matters relating to Kratos' internal review of its stock option granting practices and the restatement of its financial statements have exposed it to civil litigation claims, regulatory proceedings and government proceedings that could have a material adverse effect on it.

In the summer of 2006, Kratos' current executive management team, which has been in place since 2004, initiated an investigation of Kratos' past stock option granting practices, which is referred to as the Equity Award Review, in reaction to media reports regarding stock option granting practices of public companies. The Equity Award Review was conducted with oversight from the Kratos board of directors and assistance from Kratos' outside counsel. In February 2007, the board of directors appointed a Special Committee of the board to review the adequacy of the Equity Award Review and the recommendations of management regarding historical option granting practices, and to make recommendations and findings regarding those practices and individual conduct. The Special Committee was not charged with making, and did not make, any evaluation of the accounting determinations or tax adjustments. The Special Committee was comprised of a non-employee director who had not served on the Compensation Committee before 2005.

The Equity Award Review encompassed all grants of options to purchase shares of Kratos' common stock and other equity awards made from two months prior to Kratos' IPO in November 1999 through December 2006. Kratos also reviewed all option grants that were entered into its stock option database, Equity Edge, after its IPO with a grant date before November 1999, as well as other substantial grants issued prior to its IPO, consisting of more than 14,000 grants. Kratos further reviewed all option grants with a grant date that preceded an employee's date of hire. As part of the review, interviews of 18 current and former officers, directors, employees and attorneys were conducted, and more than 40 million pages of electronic and hard copy documents were searched for relevant information. The Special Committee also conducted its own separate review of the option granting practices during the tenure of current executive management team through additional interviews and document collection and review with the assistance of its own separate counsel and FTI Consulting.

The Equity Award Review established the absence of contemporaneous evidence supporting a substantial number of the previously-recorded option grants, substantially all of which were made in the period from 1998 through late 2003. During this period of time, in some instances, documents, data and interviews suggest that option grants were prepared or finalized days or, in some cases, weeks or months after the option grant date recorded in Kratos' books. The affected grants include options issued to certain newly-hired employees but dated prior to their employment start dates and options issued to non-employees, including advisors to the board of directors erroneously designated as employees. The Special Committee also concluded that certain former employees and former officers participated in making improper option grants, including the selection of grant dates with the benefit of hindsight and in the deferral of the recording of otherwise approved option grants.

In light of the Equity Award Review, the Audit Committee of Kratos' board of directors concluded that Kratos' prior financial statements for periods from 1998 through the interim financial statements for the period ended September 30, 2006, could no longer be relied upon and must be restated. Kratos' management determined that, from fiscal year 1998 through fiscal year 2005, Kratos had unrecorded non-cash equity-based compensation charges associated with its equity incentive plans. These charges are material to Kratos' financial statements for the years ended December 31, 1998 through 2005, the periods to which such charges would have related. Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q affected by the restatements have not been and will not be amended and should not be relied upon. Kratos' Annual Report on Form 10-K filed on September 11, 2007 superseded and replaced in their entirety all of Kratos' previously issued financial statements and related reports filed with the Securities and Exchange Commission.

Kratos' past stock option granting practices and the restatement of its prior financial statements have exposed and may continue to expose it to greater risks associated with litigation, regulatory proceedings and government inquiries and enforcement actions. As described in "Certain Information About Kratos Legal Proceedings" on page , several derivative complaints have been filed in state and federal courts against Kratos' current directors, some of its former directors and some of its current and former executive officers pertaining to allegations relating to stock option grants. The SEC initiated an inquiry into Kratos' historical stock option granting practices and Kratos received a subpoena from the U.S. Attorney's Office for the Southern District of California for the production of documents relating to its historical stock option granting practices. On April 1, 2008, the SEC notified Kratos that it had completed its investigation and that it did not intend to recommend any enforcement action by the SEC against Kratos. Kratos is cooperating with the U.S. Attorney's Office for the Southern District of California, and expects to continue to do so.

The period of time necessary to resolve the U.S. Attorney's Office inquiry is uncertain, and Kratos cannot predict the outcome of the inquiry or whether it will face additional government inquiries, investigations or other actions related to its historical stock option grant practices. Subject to certain limitations, it is obligated to indemnify its current and former directors, officers and employees in connection with the investigation of its historical stock option practices, the pending DOJ and concluded SEC inquiries and any future government inquiries, investigations or actions. These inquiries could require Kratos to expend significant management time and incur significant legal and other expenses, and could result in civil and criminal actions seeking, among other things, injunctions against Kratos and the payment of significant fines and penalties by it, which could have a material adverse effect on its financial condition, business, results of operations and cash flow.

If a federal government investigation uncovers improper or illegal activities, including any potential improper or illegal activities related to Kratos' stock option review or related matters, Kratos may be subject to 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, it could suffer serious harm to its reputation and competitive position if allegations of impropriety were made against it, whether or not true. If its reputation or relationship with federal government agencies was impaired, or if the federal government otherwise ceased doing business with it or significantly decreased the amount of business it does with Kratos, Kratos' revenues and operating profit would decline.

If Kratos fails to maintain an effective system of internal controls, it may not be able to accurately report its financial results or prevent fraud.

Effective internal controls are necessary for Kratos to provide reliable financial reports. If it cannot provide reliable financial reports, its operating results could be misstated, its reputation may be harmed and the trading price of its stock could be negatively affected. Kratos' management has concluded that its disclosure controls and procedures were effective at the reasonable assurance level as of September 28, 2008. However, there can be no assurance that Kratos' controls over financial processes and reporting will be effective in the future or that additional material weaknesses or significant deficiencies in its 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 Kratos' operating results, cause it to fail to meet its reporting obligations or result in material misstatements in its financial statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in its reported financial information, which could have a negative effect on the trading price of Kratos stock. In addition, from time to time Kratos acquires businesses which could have limited infrastructure and systems of internal controls. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is costly and requires considerable management attention, particularly in the case of newly acquired entities.

Kratos may need additional capital in the future to fund the growth of its business and financing may not be available.

Kratos currently anticipates that its available capital resources, including its credit facility and operating cash flows, will be sufficient to meet its 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 its business or the expenses associated with the ongoing litigation, litigation settlements and government inquiries. In particular, Kratos may experience a negative operating cash flow due to billing milestones and project timelines in certain of its contracts.

Kratos may raise additional funds through public or private debt or equity financings if such financings become available on favorable terms or it may expand its credit facility to fund future acquisitions and for general corporate purposes. However, Kratos' lender may not agree to extend additional or continuing credit under that facility, particularly in light of the current challenges in the lending markets. Kratos could fall out of compliance with financial and other covenants contained in its credit facility which, if not waived, would restrict its access to capital and could require it to pay down its existing debt under the credit facility. Any new financing or offerings would likely dilute its stockholders' equity ownership. In addition, additional financing may not be available on terms favorable to Kratos, or at all. If adequate funds are not available or are not available on acceptable terms, Kratos may not be able to take advantage of unanticipated opportunities, develop new products or otherwise respond to competitive pressures. In any such case, Kratos' business, operating results or financial condition could be materially adversely affected.

Kratos' ability to make payments on its debt will be contingent on its future operating performance, which will depend on a number of factors that are outside of its control.

Kratos' debt service obligations are estimated to be approximately $11 million to $13 million in 2008, including approximately $2.6 million of principal repayments. This debt service may have an adverse impact on Kratos' earnings and cash flow, which could in turn negatively impact its stock price. It is also subject to interest rate risk due to its indebtedness at variable interest rates, based on a base rate or LIBOR plus an applicable margin. As a result, shifts in interest rates could have a material adverse effect on it.

Kratos' ability to make principal and interest payments on its debt is contingent on its future operating performance, which will depend on a number of factors, many of which are outside of its control. In addition, the degree to which it is leveraged could have other important negative consequences on Kratos, including the following:

- Kratos must dedicate a substantial portion of its cash flows from operations to the payment of its indebtedness, reducing the funds available for future working capital requirements, capital expenditures, acquisitions or other general corporate requirements;
- a significant portion of its borrowings are, and will continue to be, at variable rates of interest, which may result in higher interest expense in the event of increases in interest rates;
- it may be more vulnerable to a downturn in the industries in which it operates or a downturn in the economy in general;
- it may be limited in its flexibility to plan for, or react to, changes in its businesses and the industries in which it operates;
- it may be placed at a competitive disadvantage compared to its competitors that have less debt;
- it may determine that it is necessary to dispose of certain assets or one or more of its businesses to reduce its debt; and
- its ability to borrow additional funds in excess of its current financing may be limited.

Kratos may not generate sufficient cash flow from operations and future borrowings may not be available in amounts sufficient to enable it to pay its indebtedness or to fund its other liquidity needs. Moreover, it may need to refinance all or a portion of its indebtedness on or before maturity. In such a case, Kratos may not be able to refinance any of its indebtedness on commercially reasonable terms or at all. If it is unable to make scheduled debt payments or comply with the other provisions of its debt instruments, its various lenders may be permitted under certain circumstances to accelerate the maturity of the indebtedness owed to them and exercise other remedies provided for in those instruments and under applicable law.

Kratos is subject to restrictive debt covenants pursuant to its indebtedness, which may restrict its ability to finance its business and the violation of which could result in its lenders foreclosing on substantially all of its assets.

The covenants contained in Kratos' current credit agreements and any credit agreement governing future debt may significantly restrict its future operations. Furthermore, upon the occurrence of any event of default, its lenders could elect to declare all amounts outstanding under such agreements, together with accrued interest, to be immediately due and payable. If those lenders were to accelerate the payment of those amounts, Kratos' assets may not be sufficient to repay those amounts in full. Kratos' indebtedness contains covenants that, among other things, significantly restricts and, in some cases, effectively eliminates its ability and the ability of its subsidiaries to:

- incur additional debt;

- create or incur liens;
- secure performance bonds by letters of credit, thereby limiting the amount of work it may bid on or perform;
- pay dividends or make other equity distributions to its stockholders;
- make investments;
- sell assets;
- issue or become liable on a guarantee;
- create or acquire new subsidiaries;
- effect a merger or consolidation, or sell all or substantially all of its assets; and
- raise capital via equity securities.

In addition, Kratos must comply with certain financial covenants. In the event it fails to meet any of such covenants and is unable to cure such breach or otherwise renegotiate such covenants, its lenders would have significant rights to deny future access to liquidity and/or seize control of substantially all of its assets. The material financial covenants with which it must comply include a maximum first lien leverage ratio, a maximum total leverage ratio, a minimum liquidity ratio, a minimum fixed charge coverage ratio, and a minimum consolidated EBITDA.

Kratos may be required to prepay its indebtedness prior to its stated maturity, which may limit its ability to pursue business opportunities.

Pursuant to the terms of certain of Kratos' indebtedness, in certain instances Kratos is required to prepay outstanding indebtedness prior to its stated maturity date. Specifically, certain non-recurring cash inflows such as proceeds from asset sales, insurance recoveries, and equity offerings may have to be used to pay down indebtedness and may not be reborrowed. These prepayment provisions may limit Kratos' ability to utilize this cash flow to pursue business opportunities.

Kratos' stock price may be volatile, which may result in lawsuits against it and its 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 Kratos' 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 Kratos' common stock include, but are not limited to, the following:

- quarterly variations in operating results;
- announcements of new services by Kratos or its competitors;
- the gain or loss of significant customers;
- changes in analysts' earnings estimates;

rumors or dissemination of false information;

pricing pressures;

short selling of its common stock;

impact of litigation and ongoing 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 it.

Companies that have experienced volatility in the market price of their stock have frequently been the subjects of securities class action litigation. Kratos and certain of its 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 Kratos may be involved could result in substantial costs to Kratos and a diversion of its management's attention and resources, which could materially harm its financial condition and results of operations.

Kratos' charter documents and Delaware law may deter potential acquirers and may depress its stock price.

Certain provisions of Kratos' charter documents and Delaware law, as well as certain agreements Kratos has with its executives, could make it substantially more difficult for a third party to acquire control of Kratos. These provisions include those:

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 Kratos' board of directors or for proposing matters that can be acted on by stockholders at meetings of its stockholders; and.

Section 203 of the Delaware General Corporation Law, which prohibits Kratos from engaging in a business combination with an interested stockholder unless specific conditions are met; and

entitling certain of Kratos' executives to receive payments in certain circumstances following a change in control.

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

Kratos may incur goodwill impairment charges in its reporting entities which could harm its profitability.

A significant portion of Kratos' net assets come from goodwill and other intangible assets. In accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, "Goodwill and Other Intangible Assets," Kratos periodically reviews the carrying values of its goodwill to determine whether such carrying values exceed the fair market value. Its 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, which could reduce Kratos' profitability.

Risks Related to Digital Fusion

Revenues would decline if Digital Fusion's relationships with agencies of the federal government Digital were harmed.

Digital Fusion's largest customers are agencies of the federal government. If the federal government in general, or any significant government agency, uses less of its services or terminates its relationship with Digital Fusion, its revenues would decline substantially, and its business would be

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seriously harmed. During 2007, contracts with the federal government and contracts with prime contractors of the federal government accounted for approximately 98% of Digital Fusion's revenues. Digital Fusion believes that federal government contracts are likely to account for a greater portion of its revenues for the foreseeable future. The volume of work that it performs for a specific customer, however, is likely to vary from year to year, and a significant customer in one year may not use its services as extensively, or at all, in a subsequent year.

Digital Fusion's government contracts may be terminated prior to their completion, and if Digital Fusion does not replace them, its operating results may be harmed.

Digital Fusion derives some of its revenues from government contracts that typically are awarded through competitive processes and span a one year base period and one or more option years. The unexpected termination or non-renewal of one or more of Digital Fusion's significant contracts could result in significant revenue shortfalls. Digital Fusion's customers generally have the right not to exercise the option periods. In addition, its contracts typically contain provisions permitting an agency to terminate the contract on short notice, with or without cause.

Following termination, if the customer requires further services of the type provided in the contract, there is frequently a competitive re-bidding process. Digital Fusion may not win any particular re-bid or be able to successfully bid on new contracts to replace those that have been terminated. Even if Digital Fusion does win the re-bid, Digital Fusion may experience revenue shortfalls in periods where Digital Fusion anticipated revenues from the contract rather than its termination and subsequent re-bidding. These revenue shortfalls could harm operating results for those periods.

Digital Fusion's lack of long-term contracts with customers and its relatively fixed operating expenses expose it to greater risk of incurring losses.

Many customers retain Digital Fusion on an engagement-by-engagement basis, rather than under long-term contracts. Digital Fusion incurs costs based on its expectations of future revenues. Digital Fusion operating expenses are relatively fixed and cannot be reduced on short notice to compensate for unanticipated variations in the number or size of engagements in progress. These factors make it difficult for Digital Fusion to predict its revenues and operating results. If Digital Fusion fails to predict its revenues accurately, it may seriously harm its financial condition and results of operation.

A reduction in or the termination of Digital Fusion's services could lead to underutilization of its employees and could harm its operating results.

Digital Fusion's employee compensation expenses are relatively fixed. Therefore, if a customer defers, modifies or cancels an engagement or chooses not to retain Digital Fusion for additional phases of a project, its operating results will be harmed unless Digital Fusion can rapidly re-deploy its employees to other engagements in order to minimize underutilization.

Failing to maintain strong relationships with prime contractors could result in a decline in Digital Fusion's revenues.

Digital Fusion derived approximately 33% of its revenues during 2007 through its relationships with prime contractors, which, in turn, have contractual relationships with end-customers. Digital Fusion expects to continue to depend on these relationships for a material portion of its revenues in the foreseeable future. If any of these prime contractors eliminate or reduce their engagements with Digital Fusion, or have their engagements eliminated or reduced by their end-customers, Digital Fusion will lose a source of revenues, which, if not replaced, will adversely affect its operating results.

The loss of a key executive could impair Digital Fusion's relationships with government customers and disrupt the management of its business.

Digital Fusion believes that its success depends on the continued contributions of the members of its senior management. Digital Fusion relies on senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of its senior management team have established and maintain with government personnel contribute to its ability to maintain good customer relations and to identify new business opportunities. The loss of any member of its senior management could impair its ability to identify and secure new contracts, to maintain good customer relations, and otherwise to manage its business.

Digital Fusion may lose money on fixed-price contracts if Digital Fusion miscalculates the resources Digital Fusion need to complete the contract.

Unlike time and materials contracts, for which Digital Fusion are reimbursed based on its actual expenditures of resources, fixed-price contracts require Digital Fusion to price its contracts by predicting its expenditures in advance. If Digital Fusion miscalculates the resources it needs to complete fixed-price engagements, its operating results could be seriously harmed because Digital Fusion is not compensated for the higher costs.

Digital Fusion could lose revenues and customers and have exposure to liability if it fails to meet its customer expectations.

Digital Fusion creates, implements and maintains technology solutions that are often critical to its customers' operations. If Digital Fusion's technology solutions or other applications have significant defects or errors or fail to meet its customers' expectations, Digital Fusion may:

- lose revenues due to adverse customer reaction;
- be required to provide additional remediation services to a customer at no charge;
- receive negative publicity, which could damage its reputation and adversely affect its ability to attract or retain customers; or
- suffer claims for substantial damages against Digital Fusion, regardless of its responsibility for the failure.

While many of Digital Fusion's contracts limit its liability for damages that may arise from negligent acts, errors, mistakes or omissions in rendering services to its customers, Digital Fusion cannot be sure that these contractual provisions will protect it from liability for damages if Digital Fusion is sued. Furthermore, its general liability insurance coverage 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 any future claim. The successful assertion of any large claim against it could seriously harm its business. Even if not successful, such claims could result in significant legal and other costs and may be a distraction to management.

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

Many of the systems Digital Fusion develops involve managing and protecting information involved in sensitive government functions. A security breach in one of these systems could cause serious harm to Digital Fusion's business, could result in negative publicity, and could prevent it from having further access to such critically sensitive systems or other similarly sensitive areas for other governmental customers. Losses that Digital Fusion could incur from such a security breach could exceed the policy limits that it has for "errors and omissions" or product liability insurance.

If Digital Fusion cannot obtain the necessary security clearances, Digital Fusion may not be able to perform classified work for the government and its revenues may suffer.

Government contracts require Digital Fusion, and some of its employees, to maintain security clearances. If Digital Fusion loses or is unable to obtain security clearances, the customer can terminate the contract or decide not to renew it upon its expiration. As a result, to the extent Digital Fusion cannot obtain the required security clearances for its employees working on a particular engagement, Digital Fusion may not derive the revenue anticipated from the engagement, which, if not replaced with revenue from other engagements, could seriously harm its operating results.

Audits of Digital Fusion's government contracts may result in a reduction in revenues Digital Fusion receives from those contracts or may result in civil or criminal penalties that could harm its reputation.

Federal government agencies routinely audit government contracts. These agencies review a contractor's performance on its contract, pricing practices, cost structure, and compliance with applicable laws, regulations and standards. An audit could result in a substantial adjustment to Digital Fusion's revenues because any costs found to be improperly allocated to a specific contract will not be reimbursed, while improper costs already reimbursed must be refunded. If a government audit uncovers improper or illegal activities, Digital Fusion may be subject to 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, Digital Fusion could suffer serious reputational harm if allegations of impropriety were made against it.

Digital Fusion may be liable for penalties under a variety of procurement rules and regulations, and changes in government regulations could slow its growth or reduce its profitability.

Digital Fusion must comply with and is affected by federal government regulations relating to the formation, administration, and performance of government contracts. These regulations affect how Digital Fusion does business with its customers and may impose added costs on its business. Any failure to comply with applicable laws and regulations could result in contract termination, price or fee reductions, or suspension or debarment from contracting with the federal government. Further, the federal government may reform its procurement practices or adopt new contracting methods relating to the GSA schedule or other government-wide contract vehicles. If Digital Fusion is unable to successfully adapt to those changes, its business could be seriously harmed.

Digital Fusion's failure to adequately protect its confidential information and proprietary rights may harm its competitive position.

While Digital Fusion's employees execute confidentiality agreements, it cannot guarantee that this will be adequate to deter misappropriation of its confidential information. In addition, Digital Fusion may not be able to detect unauthorized use of its intellectual property in order to take appropriate steps to enforce its rights. If third parties infringe or misappropriate its copyrights, trademarks, or other proprietary information, Digital Fusion's competitive position could be seriously harmed. In addition, other parties may assert infringement claims against Digital Fusion or claim that it has violated its intellectual property rights. Such claims, even if not true, could result in significant legal and other costs and may be a distraction to management.

Changes to federal government procurement rules and regulations could impact revenues.

While the government procurement changes of the mid-1990s generally benefited companies servicing the federal government (such as government agencies being able to award outsourcing contracts based on "best value" over lowest price), any future changes that sought to limit or reduce government outsourcing, perhaps, for example, bringing more technology systems work "in-house," could have a negative impact on Digital Fusion's revenues.

Continued involvement in Iraq, or other nations, could impact federal government spending on Digital Fusion's civilian and defense programs.

Although Digital Fusion's work focuses primarily on its customers' mission-critical programs, continued involvement in Iraq, or a war in another country, could change the federal government's spending priorities for domestic and military programs. Spending on its customers' programs could also be negatively impacted by Congress' unwillingness to pass the necessary appropriation bills required to pay for a war effort.

Digital Fusion's quarterly operating results may fluctuate significantly as a result of factors outside of Digital Fusion's control, which could cause the market price of its stock to decline.

Digital Fusion's revenue and operating results could vary significantly from quarter to quarter. In addition, Digital Fusion cannot predict with certainty its future revenue or results of operations. As a consequence, its operating results may fall below the expectations of securities analysts and investors, which could cause the price of its stock to decline. Factors that may affect its operating results include, but are not limited to:

- fluctuations in revenue earned on contracts;
- commencement, completion, or termination of contracts during any particular quarter;
- variable purchasing patterns under GSA schedule contracts, GWACs, and agency-specific indefinite delivery/indefinite quantity contracts;
- providing services under a share-in-savings or performance-based contract;
- additions and departures of key personnel;
- strategic decisions by Digital Fusion or its competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments, or changes in business strategy;
- changes in policy or budgetary measures that adversely affect government contracts in general; and
- the seasonality of its business.

Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of its expenses are fixed in the short-term. Digital Fusion may incur significant operating expenses during the start-up and early stages of large contracts and may not receive corresponding payments or revenue in that same quarter. Digital Fusion may also incur significant or unanticipated expenses when contracts expire or are terminated and not renewed. In addition, payments due to Digital Fusion from government agencies may be delayed due to billing cycles or as a result of failures of governmental budgets to gain Congressional and administration approval in a timely manner.

Digital Fusion's employees may engage in misconduct or other improper activities, which could harm its business.

Digital Fusion is 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, seeking reimbursement for improper expenses, or falsifying time records. Employee misconduct could also involve the improper use of its customers' sensitive or classified information, which could result in regulatory sanctions against it and serious harm to its reputation. It is not always possible to deter employee misconduct, and the precautions Digital Fusion takes to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could harm its business.

Digital Fusion has a limited operating history, which makes it difficult to evaluate its business.

Digital Fusion has been in operation since 1995 and many of its services have only been offered since 1997 or later. In 1999 and 2000, Digital Fusion acquired multiple companies. In 2000 and 2001, it sold off multiple divisions and under went significant restructurings. In 2001, 2004, and 2005, there was a significant change in management. As a result of the change in management and business units, prior operating history may not be representative of current operations, which makes it difficult to evaluate Digital Fusion and forecast future results.

Digital Fusion has experienced significant operating losses in the past. If it does not generate sufficient cash flow from operations or is unable to raise capital in sufficient amounts, it may be unable to continue to operate.

Historically, Digital Fusion has experienced significant losses in its operations; however, 2007 and 2006 were profitable years and losses are not expected in the foreseeable future. For the year ended December 28, 2007 and 2006, income from continuing operations was $1,592,000 and $1,257,000, respectively. Its expenses may increase as it seeks to grow its business and as business grows. Even though Digital Fusion has been profitable for two consecutive years, it may be unable to sustain profitability. It may not generate sufficient cash flow from operations or be able to raise capital in sufficient amounts to enable it to continue to operate. An inability to sustain profitability may also result in an impairment loss in the value of long-lived assets, such as goodwill, property and equipment, and other tangible and intangible assets. If it is unable to generate sufficient cash flow from operations or raise capital in sufficient amounts, Digital Fusion may be unable to continue as a going concern.

A loss of a significant customer could substantially decrease revenues.

Digital Fusion has several large customers and a termination by a major customer could substantially decrease revenues.

If revenues do not meet forecasted revenue, it may have an adverse effect on Digital Fusion's financial condition, and could cause material losses.

A large portion of the revenues derived from the consulting business is generally non-recurring in nature. There can be no assurance that Digital Fusion will obtain additional contracts for projects similar in scope to those previously obtained from any of its customers, that it will be able to retain existing customers or attract new customers, or that it will not remain largely dependent on a limited customer base, which may continue to account for a substantial portion of revenues. In addition, Digital Fusion is generally subject to delays in customer funding, lengthy customer review processes for awarding contracts, non-renewal, delay, termination, reduction or modification of contracts in the event of changes in customer policies or as a result of budgetary constraints, and increased or unexpected costs resulting in losses in the event of "fixed-price" contracts.

Digital Fusion may increase its operating expenses to increase the number of its sales, marketing and technical personnel to sell, provide, and support its products and services. It may not be able to adjust spending quickly enough to offset any unexpected revenue shortfall. It may have significant accounts receivable balances with customers that expose it to credit risks if such customers are unable to settle such obligations. If there is an unexpected shortfall in revenues in relation to expenses, or significant bad debt expense, there could be a material adverse effect on Digital Fusion's financial condition, and it could suffer material losses.

If Digital Fusion fails to adequately keep up with the rapidly changing, evolving information technology market, it may not be able to attain profitability.

The markets for some of Digital Fusion's services are rapidly changing and evolving, and therefore the ultimate level of demand for its services is subject to a high degree of uncertainty. Any significant decline in demand for programming and applications development and IT support and integration consulting services could materially adversely affect its business and prospects and it may not be able to attain profitability.

Digital Fusion's success is dependent on its ability to continually attract and retain new customers as well as to replace customers that do not renew their contracts. Achieving significant market acceptance will require substantial efforts and expenditures to create awareness of its services.

Digital Fusion may not have the resources to compete effectively with larger competitors, which could result in lost market share and decreased pricing.

Competition for the services that Digital Fusion provides is significant, and Digital Fusion expects that competition will continue to intensify due to the ease of entering that market. It may not have the financial resources, technical expertise, sales and marketing, or support capabilities to successfully meet this competition. If it is unable to compete successfully against such competitors, it will lose its market share. It competes against numerous large companies that have substantially greater market presence, longer operating histories, more significant customer bases, and greater financial, technical, facilities, marketing, capital, and other resources.

Digital Fusion's competitors may respond more quickly than Digital Fusion can to new or emerging technologies and changes in customer requirements. The competitors may also devote greater resources to the development, promotion, and sale of their products and services. They may develop services that are superior to or have greater market acceptance than Digital Fusion's. Competitors may also engage in more extensive research and development, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, and make more attractive offers to existing and potential employees and strategic partners.

New competitors, including large computer software, professional services, and other technology and telecommunications companies, may enter Digital Fusion's markets and rapidly acquire significant market share. As a result of increased competition and vertical and horizontal integration in the industry, Digital Fusion could encounter significant pricing pressures. These pricing pressures could result in significantly lower average selling prices for its services. It may not be able to offset the effects of any price reductions with an increase in the number of customers, higher revenue from services, cost reductions or otherwise. In addition, professional services businesses are likely to encounter consolidation in the near future, which could result in decreased pricing and other competition.

If Digital Fusion is unable to maintain efficient and uninterrupted operation of its computer systems, it could cause the loss of certain customers.

Some of Digital Fusion's business depends on the efficient and uninterrupted operation of its computer and communications hardware systems and infrastructure. Currently, most of its computer systems are located and maintained in its corporate headquarters in Huntsville, Alabama. While precautions have been taken against systems failure, interruptions could result from natural disasters, as well as power loss, telecommunications failure, and similar events. A disaster recovery plan is being implemented to avoid any major interruptions. Digital Fusion also leases telecommunications lines from local and regional carriers, whose service may be interrupted. Any damage or failure that interrupts or delays network operations could result in an unacceptable level of service to customers and their possible loss.

If Digital Fusion is unable to maintain the security integrity of its systems, it may result in a liability to Digital Fusion or a loss of customers.

Although measures have been taken to protect the integrity of Digital Fusion's infrastructure and the privacy of confidential information, it is potentially vulnerable to physical or electronic intrusions, computer viruses, or similar issues. If the security measures are circumvented the security of confidential information stored on the system could be jeopardized, proprietary information misappropriated, or operations interrupted. Digital Fusion may be required to make significant additional investments and take efforts to protect against or remedy security breaches. Security breaches that result in access to confidential information could damage its reputation and expose it to a risk of loss or liability.

The security services that are offered in connection with customers' use of the networks cannot guarantee complete protection from computer viruses, break-ins, and other disruptive problems. Although an attempt is made to limit contractually the liability in such instances, the occurrence of these problems may result in claims against Digital Fusion or liability on its part. These claims, regardless of their ultimate outcome, could result in costly litigation and could have a material adverse effect on its financial position and reputation and on its ability to attract and retain customers.

If Digital Fusion is unable to retain the services of key personnel, business operations may be disrupted.

The loss of existing personnel or the failure to recruit additional qualified technical, managerial, and sales personnel could disrupt business operations as well as increase expenses in connection with hiring replacement personnel. Digital Fusion depends on the performance of its executive officers and key employees, some of whom have not entered into employment agreements. The loss of these executives or key employees could disrupt business operations.

Digital Fusion may need additional capital and not be able to attain it, which could affect its ability to continue as a going concern.

Future capital uses and requirements will depend on numerous factors, including:

- extent to which solutions and services gain market acceptance;
- level of revenues from present and future solutions and services;
- expansion of operations;
- costs and timing of product and service developments, and sales and marketing activities;
- costs related to acquisitions of technology or businesses;
- competitive developments;
- costs related to downsizing and discontinuation or sale of business units;
- need for working capital;
- timing of accounts receivable collections; and
- timing of debt payments.

In order to continue to increase sales and marketing efforts, and continue to expand and enhance the solutions and services offered to present and future customers, Digital Fusion may require additional capital that may not be available on acceptable terms, or at all. In addition, if unforeseen difficulties arise in the course of these or other aspects of business, it may be required to spend funds that are greater than originally anticipated. Therefore, it will be required to raise additional capital through public or private equity or debt financings, collaborative relationships, bank facilities, or other arrangements. There can be no assurances that such additional capital will be available on acceptable terms, or at all. Any additional equity financing is expected to be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants and increased interest costs. Operations have been financed to date primarily through private sales of equity securities, proceeds from the initial public offering in May 1998, debt facilities, and cash flow from operations.

There can be no assurance that additional funding will be available to finance ongoing operations when needed or that adequate funds for operations, whether from financial markets, collaborative or other arrangements with corporate partners, or other sources, will be available when needed, or on acceptable terms. The inability to obtain sufficient funds may require Digital Fusion to delay, reduce, or eliminate some or all of its expansion programs, to limit the marketing of its products, or to license to third parties the rights to commercialize products or technologies that it would otherwise seek to develop and market.

The unpredictability of quarterly operating results may cause the price of Digital Fusion's common stock to fluctuate.

Revenues and operating results vary significantly from quarter-to-quarter due to a number of factors, many of which are beyond Digital Fusion's control. Investors should not rely on quarter-to-quarter comparisons of results of operations as an indication of future performance. It is possible that in some future periods, results of operations may be below the expectations of public market analysts and investors. In that event, the market price of its common stock may fall.

Factors that could cause quarterly results to fluctuate include:

- change in customer demand for products and services;
- timing of the expansion of operations;
- seasonality in revenues, principally during the summer and year-end holidays;
- the mix of products and services revenues from operating divisions;
- changes in pricing by competitors or Digital Fusion;
- introduction of new products or services by competitors or Digital Fusion;
- costs related to acquisitions of technology or businesses;
- recession or slow-down in economy; and
- termination of customer contracts.

Digital Fusion has limited intellectual property protection and may not be able to successfully protect proprietary information, which could result in lost sales and lost competitive advantage.

Digital Fusion relies on a combination of copyright and trademark laws, trade secrets laws, and license and nondisclosure agreements to protect its proprietary information, particularly the computer software applications that it has developed. It currently has one registered copyright and one patent application pending. It may be possible for unauthorized third parties to copy aspects of, or otherwise obtain and use, proprietary information without authorization. The majority of current contracts with customers contain provisions granting to the customer intellectual property rights to certain of Digital Fusion's work product, including the customized programming that is created for such customer. It is anticipated that contracts with future customers will contain similar provisions. Other existing agreements and future agreements may be silent as to the ownership of such rights. To the extent that the ownership of such intellectual property rights is expressly granted to a customer or is ambiguous, the ability to reuse or resell such rights may be limited.

Digital Fusion's policy is to execute confidentiality agreements with its employees and consultants upon the commencement of an employment or consulting relationship. These agreements generally require that all confidential information developed or made known to the individual during the course of the individual's relationship with Digital Fusion be kept confidential and not disclosed to third parties. These agreements also generally provide that inventions conceived by the individual in the course of rendering services to Digital Fusion shall be Digital Fusion's exclusive property. There can be no assurance that such agreements will not be breached, that there would be adequate remedies for any breach, or that trade secrets will not otherwise become known to or be independently developed by competitors, which may result in lost sales and lost competitive advantage.

If Digital Fusion fails to perform to customers' expectations it could result in claims against it which could reduce its earnings.

Digital Fusion's services involve development, implementation, and maintenance of computer systems and computer software that are critical to the operations of its customers' businesses. Failure or inability to meet a customer's expectations in the performance of its services could harm its business reputation or result in a claim for substantial damages, regardless of its responsibility for such failure or inability. In addition, in the course of performing services, Digital Fusion's personnel often gain access to technologies and content that includes confidential or proprietary customer information. Although policies have been implemented to prevent such customer information from being disclosed to unauthorized parties or used inappropriately, any such unauthorized disclosure or use could result in a claim for substantial damages. Digital Fusion attempts to limit contractually any damages that could arise from negligent acts, errors, mistakes, or omissions in rendering services and, although general liability insurance coverage is maintained, including coverage for errors and omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims. The successful assertion of one or more large claims against Digital Fusion that are uninsured, exceed available insurance coverage, or result in changes to corporate insurance policies, including premium increases or the imposition of a large deductible or co-insurance requirements, would have a material adverse effect on the financial condition of Digital Fusion.

Large quantities of common stock sales by Digital Fusion's stockholders could cause its common stock price to decrease due to the lack of a liquid market for its common stock.

The market price of Digital Fusion's common stock could decline as a result of sales of a large number of shares of its common stock in the market or the perception that these sales may occur. These sales also might make it more difficult for it to sell equity securities in the future at a time and at a price that it deems appropriate.

Digital Fusion has holders of options and warrants that if exercised, could also have an adverse effect on the market price of its common stock.

Anti-Takeover Provisions

Provisions of Digital Fusion's Restated Certificate of Incorporation, its Amended and Restated By-laws, and Delaware law, could make it difficult for a third party to acquire it, even if doing so would be beneficial to its stockholders.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This proxy statement/prospectus includes forward-looking statements. These forward-looking statements relate to outlooks or expectations for earnings, revenues, expenses, asset quality or other future financial or business performance, strategies or expectations, or the impact of legal, regulatory or supervisory matters on business, results of operations or financial condition. Specifically, forward looking statements may include:

- statements relating to the benefits of the merger, including anticipated synergies and cost savings estimated to result from the merger;
- statements relating to future business prospects, revenue, income and financial condition; and
- statements preceded by, followed by or that include the words "estimate," "plan," "project," "forecast," "intend," "expect," "anticipate," "believe," "seek," "target" or similar expressions.

These statements reflect management judgments based on currently available information and involve a number of risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. However, actual results may differ materially from those in the forward-looking statements. Some factors that could cause actual results to differ include:

- either or both of the companies' respective stockholders may not approve the merger;
- the merger not close when expected or at all;
- the businesses may not be integrated successfully;
- expected cost savings from the merger may not be fully realized within the expected time frames or at all;
- revenues following the merger may be lower than expected;
- the effects of vigorous competition in the markets in which Kratos and Digital Fusion operate;
- the possibility of one or more of the markets in which Kratos and Digital Fusion compete being impacted by changes in political or other factors such as monetary policy, legal and regulatory changes or other external factors over which they have no control;
- changes in general economic and market conditions; and
- other risks referenced from time to time in filings with the SEC and those factors listed in this joint proxy statement/prospectus under "Risk Factors" beginning on page .

You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this proxy statement/prospectus, or in the case of any other document, as of the date of that document. Except as required by law, neither Kratos nor Digital Fusion undertakes any obligation to publicly update or release any revisions to these forward-looking statements to reflect any events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Additional factors that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed in this proxy statement/prospectus, including the section of this proxy statement/prospectus entitled "Risk Factors."

THE SPECIAL MEETING OF KRATOS STOCKHOLDERS

Date, Time and Place of the Special Meeting

These proxy materials are delivered in connection with the solicitation by the Kratos board of directors of proxies to be voted at the Kratos special meeting, which is to be held at [ ], at [ ], local time, on [ ]. On or about [ ], Kratos commenced mailing this proxy statement/prospectus and the enclosed form of proxy to its stockholders entitled to vote at the meeting.

Purpose of the Kratos Special Meeting

Kratos stockholders will be asked to vote on the following proposals:

1. To approve the issuance of Kratos common stock, par value $0.001 per share, pursuant to the Agreement and Plan of Merger, dated as of November 21, 2008, by and among Kratos Defense & Security Solutions, Inc., Dakota Merger Sub, Inc., and Digital Fusion, Inc., as the same may be amended from time to time.

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

It is a condition to completion of the merger that Kratos stockholders approve the issuance of shares of Kratos common stock in the merger. When the merger becomes effective, each share of Digital Fusion common stock outstanding immediately before the merger will be converted into the right to receive 1.7933 shares of Kratos common stock. Under Marketplace Rule 4350(i) promulgated by the Nasdaq Stock Market, a company listed on the Nasdaq Stock Market is required to obtain stockholder approval in connection with a merger with another company if the number of shares of common stock or securities convertible into common stock to be issued is in excess of 20% of the number of shares of common stock then outstanding. If the merger is completed, Kratos will issue up to approximately 32.9 million shares of Kratos common stock in connection with the merger, including common stock issuable pursuant to outstanding options, warrants and grants under the Digital Fusion deferred compensation plan, which will be assumed by Kratos. On an as converted basis, the aggregate number of shares of Kratos common stock to be issued and issuable in connection with the merger will exceed 20% of the shares of Kratos common stock outstanding on the record date for the Kratos special meeting, and for this reason Kratos must obtain the approval of Kratos stockholders for the issuance of these securities to Digital Fusion stockholders in the merger.

Board of Directors Recommendation

The Kratos board of directors has unanimously recommended that the Kratos stockholders vote "**FOR**" the proposal to approve the issuance of shares of Kratos common stock pursuant to the merger agreement. The approval of this proposal is required for completion of the merger.

Record Date and Voting Power

Only stockholders of record as of the close of business on November 25, 2008 (the official record date) will be entitled to notice of and to vote at the special meeting or at any subsequent meeting due to an adjournment of the original meeting. **Kratos is mailing this proxy statement and the accompanying proxy card on or about** [ ] **to all stockholders of record as of November 25, 2008.**

On the record date, Kratos had two classes of voting stock, common stock and preferred stock, of which [ ] shares of common stock were issued and outstanding and 10,000 shares of Series B Convertible Preferred Stock were issued and outstanding. Each outstanding share of common stock entitles the holder to one vote and each outstanding share of Series B Convertible Preferred Stock entitles the holder to one hundred votes on all matters to be voted upon at the special meeting.

A complete list of stockholders entitled to vote at the Kratos special meeting will be available for examination by any Kratos stockholder at Kratos' headquarters, for purposes pertaining to the Kratos special meeting, during normal business hours for a period of ten days before the Kratos special meeting, and at the time and place of the Kratos special meeting.

Quorum and Votes Required

In order to carry on the business of the meeting, Kratos must have a quorum. A quorum requires the presence, in person or by proxy, of the holders of a majority of the votes entitled to be cast at the meeting.

The affirmative vote of a majority of the shares of Kratos common stock represented at a meeting in person or by proxy and entitled to vote at a meeting at which a quorum is present is required to approve the issuance of the Kratos common stock in the merger.

Abstentions, Broker Non-Votes and Incomplete Proxies

Brokers who hold shares of Kratos common stock in "street name" for a beneficial owner of those shares typically have the authority to vote in their discretion on routine proposals when they have not received instructions from beneficial owners. However, under the rules that govern brokers, brokers are not allowed to exercise their voting discretion with respect to the approval of matters that are "non-routine," such as approval of the issuance of shares of Kratos common stock pursuant to the merger agreement, without specific instructions from the beneficial owner. These non-voted shares are referred to as "broker non-votes." If your broker holds your Kratos common stock in "street name," your broker will vote your shares only if you provide instructions on how to vote by filling out the voter instruction form sent to you by your broker with this joint proxy statement/prospectus.

If you return a proxy card but fail to indicate your vote with respect to a proposal, an incomplete proxy, your shares will be voted in favor of the proposal in accordance with the recommendation of the board of directors.

Abstentions, incomplete proxies and "broker non-votes" will be counted as present and entitled to vote for purposes of determining whether a quorum is present at the meeting. Abstentions will have the same effect as a vote against and broker non-votes will have no effect on the outcome of the proposal for approval of the issuance of shares of Kratos common stock pursuant to the merger agreement.

Voting of Proxies

Giving a proxy means that a Kratos stockholder authorizes the persons named in the enclosed proxy card to vote its shares at the Kratos special meeting and any adjournment or postponement thereof in the manner it directs. A Kratos stockholder may vote by proxy or in person at the meeting. To vote by proxy, a Kratos stockholder may use one of the following methods if it is a registered holder (that is, it holds its stock in its own name):

Telephone voting, by dialing the toll-free number and following the instructions on the proxy card;

Via the Internet, by going to the web address *www.proxyvote.com* and following the instructions on the proxy card; or

Mail, by completing and returning the proxy card in the enclosed envelope. The envelope requires no additional postage if mailed in the United States.

Kratos requests that its stockholders complete and sign the accompanying proxy and return it to Kratos as soon as possible in the enclosed postage-paid envelope. When the accompanying proxy is returned properly executed, the shares of Kratos stock represented by it will be voted at the Kratos special meeting in accordance with the instructions contained on the proxy card.

If any proxy is returned without indication as to how to vote, the Kratos stock represented by the proxy will be considered a vote in favor of all matters for consideration at the Kratos special meeting or at any adjournment or postponement thereof. Unless a stockholder checks the box on its proxy card to withhold discretionary authority, the proxy holders may use their discretion to vote on other matters relating to the Kratos special meeting.

If a Kratos stockholder's shares are held in "street name" by a broker or other nominee, the stockholder should check the voting form used by that firm to determine whether it may vote by telephone or the Internet.

Every stockholder's vote is important. Accordingly, each Kratos stockholder should sign, date and return the enclosed proxy card, or vote via the Internet or by telephone, whether or not it plans to attend the Kratos special meeting in person.

Revocability of Proxies and Changes to a Kratos Stockholder's Vote

A Kratos stockholder has the power to change its vote at any time before its shares are voted at the special meeting by:

- notifying Kratos' Corporate Secretary, Laura L. Siegal, in writing at 4810 Eastgate Mall, San Diego, CA 92121 that you are revoking your proxy;
- executing and delivering a later dated proxy card or submitting a later dated vote by telephone or in the internet; or
- voting in person at the special meeting.

However, if a Kratos stockholder has shares held through a brokerage firm, bank or other custodian, it may revoke its instructions only by informing the custodian in accordance with any procedures it has established.

Solicitation of Proxies

The solicitation of proxies from Kratos stockholders is made on behalf of the Kratos board of directors. Kratos and Digital Fusion will generally share equally the cost and expenses of printing and mailing this proxy statement/prospectus and all fees paid to the SEC. Kratos will pay the costs of soliciting and obtaining these proxies, including the cost of reimbursing brokers, banks and other financial institutions for forwarding proxy materials to their customers. Proxies may be solicited, without extra compensation, by Kratos officers and employees by mail, telephone, fax, personal interviews or other methods of communication. Kratos has engaged the firm of Georgeson Inc. to assist Kratos in the distribution and solicitation of proxies from Kratos stockholders and will pay Georgeson an estimated fee of $8,500 plus out-of-pocket expenses for its services. Digital Fusion will pay the costs of soliciting and obtaining its proxies and all other expenses related to the Digital Fusion special meeting.

Householding of Proxy Materials

As permitted by the Exchange Act, only one copy of this proxy statement/prospectus is being delivered to stockholders residing at the same address, unless Kratos stockholders have notified Kratos of their desire to receive multiple copies of the proxy statement/prospectus. Kratos will promptly deliver, upon oral or written request, a separate copy of this proxy statement/prospectus to any stockholder residing at an address to which only one copy was mailed. Requests for additional copies for this year or future years should be directed to: Kratos Defense & Security Solutions, Inc., Attention: Corporate Secretary, 4810 Eastgate Mall, San Diego, CA 92121.

All Kratos stockholders may view this proxy statement/prospectus on the internet at *www.kratosdefense.com*.

Attending the Meeting

Subject to space availability, all stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Since seating is limited, admission to the meeting will be on a first-come, first-served basis. Registration and seating will begin at [   ], local time.

If you are a registered stockholder (that is, if you hold your stock in certificate form), an admission ticket is enclosed with your proxy card. If you wish to attend the special meeting, please vote your proxy but keep the admission ticket and bring it with you to the special meeting.

If your shares are held in "street name" (that is, through a bank, broker or other holder of record) and you wish to attend the special meeting, you must bring a copy of a bank or brokerage statement reflecting your stock ownership as of the Kratos record date to the special meeting.

THE SPECIAL MEETING OF DIGITAL FUSION STOCKHOLDERS

Date, Time and Place of the Special Meeting

These proxy materials are delivered in connection with the solicitation by the Digital Fusion board of directors of proxies to be voted at the Digital Fusion special meeting, which is to be held at [ ], at [ ], local time, on [ ]. On or about [ ], Digital Fusion commenced mailing this proxy statement/prospectus and the enclosed form of proxy to its stockholders entitled to vote at the meeting.

Purpose of the Digital Fusion Special Meeting

Digital Fusion stockholders will be asked to vote on the following proposals:

1. To adopt and approve the Agreement and Plan of Merger, dated November 21, 2008, by and among Kratos Defense Security Solutions, Inc., Dakota Merger Sub, Inc. and Digital Fusion.

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

Record Date and Voting Power

Only stockholders of record as of the close of business on [ ] (the official record date) will be entitled to notice of and to vote at the special meeting or at any subsequent meeting due to an adjournment of the original meeting. **Digital Fusion is mailing this proxy statement and the accompanying proxy card on or about** [ ] **to all stockholders of record as of [ ].**

On the record date, [ ], Digital Fusion had one class of voting stock outstanding. On that date, [ ] shares of Digital Fusion 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 special meeting.

A complete list of stockholders entitled to vote at the Digital Fusion special meeting will be available for examination by any Digital Fusion stockholder at Digital Fusion's headquarters, for purposes pertaining to the Digital Fusion special meeting, during normal business hours for a period of ten days before the Digital Fusion special meeting, and at the time and place of the Digital Fusion special meeting.

Quorum and Votes Required

In order to carry on the business of the meeting, Digital Fusion must have a quorum. A quorum requires the presence, in person or by proxy, of the holders of a majority of the votes entitled to be cast at the meeting. The affirmative vote of a majority of the outstanding shares of Digital Fusion common stock is required to adopt and approve the merger agreement.

Abstentions, Broker Non-Votes and Incomplete Proxies

If you are a Digital Fusion stockholder and you fail to vote or fail to instruct your broker or other nominee how to vote on the merger agreement, your failure to vote or instruct your broker or other nominee how to vote will have the effect of a negative vote on the merger proposal. Similarly, if you "abstain" from voting, the shares represented by your proxy will be counted as present for purposes of determining whether a quorum exists, and your abstention will have the effect of a negative vote on the merger proposal. If you submit a proxy but do not indicate how you want your shares to be voted on the merger proposal, your proxy will be counted as present for purposes of determining whether a quorum exists and will be counted as voting in favor of the merger proposal.

Voting by Digital Fusion Directors and Executive Officers

On the Digital Fusion record date, directors and executive officers of Digital Fusion and their affiliates owned and were entitled to vote [ ] shares of Digital Fusion common stock, or approximately [ ]% of the total voting power of the shares of Digital Fusion common stock outstanding on that date. All of Digital Fusion's directors and executive officers have executed voting agreements pursuant to which each has agreed to vote their shares of common stock in favor of the merger. In addition, Madison Run, an investor affiliated with one of Digital Fusion's directors, holds 22.3% of the total voting power of the shares of Digital Fusion, and it has agreed to vote its shares in favor of the merger.

Voting of Proxies

Giving a proxy means that a Digital Fusion stockholder authorizes the persons named in the enclosed proxy card to vote its shares at the Digital Fusion special meeting and any adjournment or postponement thereof in the manner it directs. A Digital Fusion stockholder may vote by proxy or in person at the meeting. To vote by proxy, a Digital Fusion stockholder may use one of the following methods if it is a registered holder (that is, it holds its stock in its own name):

- **Telephone voting,** by dialing the toll-free number 1-866-626-4508 and following the instructions on the proxy card;

- **Via the Internet,** by going to the web address *www.votestock.com* and following the instructions on the proxy card; or

- **Mail,** by completing and returning the proxy card in the enclosed envelope. The envelope requires no additional postage if mailed in the United States.

Digital Fusion requests that its stockholders complete and sign the accompanying proxy and return it to Digital Fusion as soon as possible in the enclosed postage-paid envelope. When the accompanying proxy is returned properly executed, the shares of Digital Fusion stock represented by it will be voted at the special meeting and any adjournment or postponement thereof in accordance with the instructions contained on the proxy card.

If any proxy is returned without indication as to how to vote, the Digital Fusion stock represented by the proxy will be considered a vote in favor of the adoption and approval of the merger agreement. Unless a Digital Fusion stockholder checks the box on its proxy card to withhold discretionary authority, the proxy holders may use their discretion to vote on other matters relating to the special meeting.

If a Digital Fusion stockholder's shares are held in "street name" by a broker or other nominee, the stockholder should check the voting form used by that firm to determine whether it may vote by telephone or the Internet.

Every stockholder's vote is important. Accordingly, each Digital Fusion stockholder should sign, date and return the enclosed proxy card, or vote via the Internet or by telephone, whether or not it plans to attend the Digital Fusion special meeting in person.

Revocability of Proxies and Changes to an Digital Fusion Stockholder's Vote

A Digital Fusion stockholder has the power to change its vote at any time before its shares are voted at the special meeting by:

- notifying Digital Fusion's Corporate Secretary, in writing at 5030 Bradford Drive, Building 1, Suite 210, Huntsville, Alabama 35805, that you are revoking your proxy;

- executing and delivering a later dated proxy card or submitting a later dated vote by telephone or through the internet; or

- voting in person at the special meeting.

However, if a Digital Fusion stockholder has shares held through a brokerage firm, bank or other custodian, it may revoke its instructions only by informing the custodian in accordance with any procedures it has established.

Solicitation of Proxies

The solicitation of proxies from Digital Fusion stockholders is made on behalf of the Digital Fusion board of directors. Kratos and Digital Fusion will generally share equally the cost and expenses of printing and mailing this proxy statement/prospectus and all fees paid to the SEC. Digital Fusion will pay the costs of soliciting and obtaining these proxies, including the cost of reimbursing brokers, banks and other financial institutions for forwarding proxy materials to their customers. Proxies may be solicited, without extra compensation, by Digital Fusion officers and employees by mail, telephone, fax, personal interviews or other methods of communication.

Attending the Meeting

Subject to space availability, all stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Since seating is limited, admission to the meeting will be on a first-come, first-served basis. Registration and seating will begin at [ ], local time.

If you are a registered stockholder (that is, if you hold your stock in certificate form), an admission ticket is enclosed with your proxy card. If you wish to attend the special meeting, please vote your proxy but keep the admission ticket and bring it with you to the special meeting.

If your shares are held in "street name" (that is, through a bank, broker or other holder of record) and you wish to attend the special meeting, you need to bring a copy of a bank or brokerage statement to the special meeting reflecting your stock ownership as of the Digital Fusion record date.

THE MERGER

The following is a discussion of the merger and the material terms of the merger agreement between Kratos and Digital Fusion. You are urged to read carefully the merger agreement in its entirety, a copy of which is attached as Annex A to this proxy statement/prospectus and incorporated by reference herein.

Background of the Merger

Digital Fusion received inquiries into its possible sale beginning in 2006. The Digital Fusion board of directors began discussing the need to engage an investment banking firm in April of 2006. The purpose of engaging an investment banking firm was to provide the Digital Fusion board of directors with an analysis of potential strategies and also to assist in determining the value of the company. In July of 2006, the Digital Fusion board of directors engaged the investment banker, ISI Partners, LLC, or ISI, and requested that ISI provide recommendations as to the financial structure and strategic future of Digital Fusion. ISI made a presentation to the Digital Fusion board on July 26, 2006, in which it evaluated several potential courses of action for the company. After an extensive and detailed review of Digital Fusion's strategy and financial projections, ISI recommended that Digital Fusion should deregister its stock under the Exchange Act and focus on building company value.

On August 29, 2006, the Digital Fusion board of directors again met with ISI and its legal counsel, Lanier, Ford, Shaver & Payne P.C., or LFSP, to discuss deregistration. Following an extensive review of ISI's recommendation and the advice of legal counsel, the Digital Fusion board approved the filing of a Form 15 with the SEC in order to deregister its stock.

Digital Fusion deregistered its stock by filing a Form 15 with the SEC on September 11, 2006. In October of 2006, the Digital Fusion board of directors formed a strategy committee, which would be responsible for shaping the future strategy of Digital Fusion.

On November 1, 2006, the President of Digital Fusion responded to an inquiry from a well-established government contractor regarding a possible sale of Digital Fusion. The Digital Fusion board of directors determined that a sale of the business at that time was premature, and the President informed the company that there was no interest in selling the company at that time.

On December 19, 2006, Digital Fusion's President asked ISI to respond to an unsolicited inquiry from an investment bank regarding the Digital Fusion board of directors' interest in selling Digital Fusion. ISI corresponded with the investment bank; however, it never replied.

In August of 2007, ISI received an inquiry from another interested party, regarding its interest in purchasing Digital Fusion. On August 28, 2007, Digital Fusion and the interested party executed a Non-Disclosure Agreement.

On September 17, 2007, Digital Fusion received a non-binding letter of intent from Kratos. The letter of intent was an offer to purchase Digital Fusion for consideration comprised of a mix of cash and stock. The Digital Fusion board of directors met and thoroughly reviewed the letter of intent from Kratos. They voted to reject the offer at that time because the terms and conditions were deemed unfavorable to Digital Fusion's stockholders and due to uncertainty related to the restatement of Kratos' financial statements and late SEC filings.

Negotiations between the financial advisors of both Digital Fusion and Kratos continued informally through the rest of September and October. On November 28, 2007, Kratos delivered a second non-binding letter of intent to Digital Fusion for $55,000,000 in cash. The Digital Fusion board of directors met on December 3, 2007, and thoroughly reviewed the offer. After discussion between the Digital Fusion board of directors, its financial advisor, and legal counsel, the Digital Fusion board of directors voted to approve the letter of intent, subject to certain changes. Kratos did not accept the counteroffer.

Despite the rejection of Digital Fusion's counteroffer, in February 2008, Digital Fusion's financial advisor contacted Kratos' chief executive officer to discuss Kratos' renewed interest in acquiring Digital Fusion once it had completed its acquisition of SYS. The two parties continued their discussions informally from May 2008 through July 2008.

On August 11, 2008, Digital Fusion's strategy committee met and discussed a third non-binding letter of intent from Kratos. The committee agreed to continue negotiations with Kratos on some of the terms of the letter of intent. The committee resolved that ISI, LFSP and Mr. Chris Brunhoeber, Chief Financial Officer, should continue negotiations.

On August 13, 2008, Digital Fusion's board of directors met and heard a presentation from ISI regarding the history of negotiations between Digital Fusion and Kratos and the industry and overall market dynamics. After a thorough review and discussion of the letter of intent, and discussions with LFSP, including a review of the board's fiduciary duties to the Digital Fusion stockholders, the board of directors voted unanimously to approve the non-binding letter of intent, including the provisions binding Digital Fusion to negotiate exclusively with Kratos until November 11, 2008. The board of directors also stated there were certain matters remaining to be negotiated, and thus the signed letter of intent was returned to Kratos with a cover letter from its President, which stated that resolution of five specific items was of prime importance.

On August 19, 2008, a teleconference was held between representatives of Kratos and Digital Fusion to discuss due diligence. Representatives of Kratos travelled to Huntsville, Alabama on August 26 to 27 to continue on-site due diligence, as well as to review Digital Fusion's capabilities. At that time, discussions related to transition and integration planning also began.

On September 3 to 5, certain of Digital Fusion's officers and directors traveled to San Diego, California to Kratos' corporate office to continue negotiations for a definitive agreement. At this time, Kratos executives presented capabilities briefings on each of their divisions, and answered some of Digital Fusion's due diligence questions. During these meetings, it became apparent that there were several transaction terms that would have to be amended to reach a satisfactory conclusion.

Negotiations over Digital Fusion's financials, waterfall analysis and its business opportunities continued throughout September. On September 24, 2008, Digital Fusion's board met to discuss the status of the transaction with Kratos. The Digital Fusion board of directors agreed that the strategy committee should meet and review the status of the transaction and make a recommendation to the board within 10 days of how to proceed.

On October 3, 2008, Digital Fusion received a revised letter of intent from Kratos. The revised letter of intent provided for an aggregate merger consideration of approximately 27.5 million shares of Kratos stock. The letter of intent provided for a stock-for-stock transaction that would have a fixed exchange ratio and a working capital adjustment. Digital Fusion's board met and voted unanimously to approve the non-binding letter of intent, including the provisions binding Digital Fusion to negotiate exclusively with Kratos until January 1, 2009.

On October 14-17, the President of Digital Fusion, its financial advisor and chief financial officer returned to San Diego to continue due diligence. Discussions were held with regard to Kratos' financial statements and forecasts, and other legal and due diligence issues.

On or about October 15, 2008, Kratos' counsel, Morrison & Foerster LLP, delivered to LFSP an initial draft of the merger agreement. From October 15, 2008 until the execution of the merger agreement, Kratos and Digital Fusion and representatives exchanged drafts of the merger agreement and held extensive negotiations relating to its terms and conditions.

The Chairman of the Digital Fusion board of directors traveled to Huntsville October 22 to 24 to work on due diligence issues with management.

On Tuesday, October 28, 2008, a conference call was held between, management of Digital Fusion and Kratos to discuss outstanding diligence issues as well as treatment of Digital Fusion's options, employee retention and lock-up and bleed-out guidelines.

On October 29, 2008, briefing slides were sent to members of the Digital Fusion board in preparation for a conference call the next day. ISI also sent the board of directors its valuation analysis on the small cap defense contractors.

On October 30-31, 2008, the Digital Fusion board of directors met along with LFSP and ISI to discuss the terms and conditions of the merger agreement, the recent activity of the stock markets, small and microcap markets, and the negative impact upon both the stock price of Digital Fusion and Kratos, and to discuss other due diligence items including Digital Fusion's financial forecast for 2009 and 2010. The discussions ended with an agreement that discussions would continue, and that Mr. DeMarco would personally come to Huntsville to address certain concerns.

On November 7, 2008, Digital Fusion received Kratos' proposed non-competition, stockholder and retention agreements. In the days that followed, further discussion of the exchange ratio, deal valuation and Kratos stock price occurred. As of November 7, 2008 Kratos' offer was a fixed exchange ratio of between 1.77 - 1.76 shares of Kratos stock for each share of Digital Fusion stock.

On November 10, 2008, Digital Fusion's board of directors met to discuss the Kratos transaction, including integration of the two companies, employee retention, and the fairness of the transaction with respect to Digital Fusion's stockholders. The Digital Fusion board of directors discussed the various issues that needed to be resolved before and during Kratos Chief Executive Officer Eric DeMarco's upcoming trip to Huntsville.

On November 19, 2008, Kratos' board of directors held a board meeting to consider approval of the merger agreement and the strategic acquisition of Digital Fusion. Also at such meeting, Imperial Capital reviewed with Kratos' board of directors Imperial Capital's financial analyses and delivered to Kratos' board of directors an oral opinion, which opinion was confirmed by delivery of a written opinion, dated November 19, 2008, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the exchange ratio in the transaction was fair, from a financial point of view, to Kratos. The full text of the written opinion of Imperial Capital, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with such opinion, is attached hereto as *Annex C*. Following discussion, the Kratos board of directors approved the merger agreement and the transactions contemplated by the merger agreement and resolved to recommend that the Kratos stockholders vote to approve the issuance of Kratos common stock in the merger.

On November 20, 2008, Digital Fusion's board of directors held a board meeting to consider approval of the merger agreement and the merger. Also at such meeting, ISI reviewed with Digital Fusion's board of directors its financial analyses and delivered to the board of directors an oral opinion, which opinion was confirmed by delivery of a written opinion, dated November 20, 2008, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the exchange ratio in the transaction was fair, from a financial point of view, to the stockholders of Digital Fusion. The full text of the written opinion of ISI, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with such opinion, is attached hereto as *Annex D*. Following discussion, the Digital Fusion board of directors approved the merger agreement and the transactions contemplated by the merger agreement and resolved to recommend that the Digital Fusion stockholders vote to approve and adopt the merger agreement and the merger. All directors were present for the meeting and voted to approve the transaction unanimously.

The Kratos Board of Directors' Recommendations and Reasons for the Merger

At a special meeting of the Kratos board of directors held on November 19, 2008, the Kratos board of directors:

- determined that the merger is advisable, fair to and in the best interests of Kratos and its stockholders;
- approved the merger agreement;
- directed that approval of the issuance of Kratos common stock pursuant to the merger agreement be submitted for consideration by Kratos stockholders at a Kratos special meeting; and
- resolved to recommend that the Kratos stockholders vote "FOR" approval of the proposal to issue Kratos common stock in the merger pursuant to the merger agreement.

In reaching its decision, the Kratos board of directors consulted with Kratos' management, as well as Kratos' financial advisor and outside legal counsel, and considered the short-term and long-term interests of Kratos and its stockholders. The Kratos board of directors considered that the merger could enhance stockholder value through, among other things, enabling Kratos, following the merger, to capitalize on the following strategic advantages and opportunities:

- The government market is an attractive market for continued expansion due to relative stability and steady cash flow generation;
- The merger would allow Kratos to access new customers, obtain additional contract vehicles and further grow its operations in Huntsville, Alabama to take advantage of BRAC realignment opportunities;
- The combined company, with greater scale, size, more past performance qualifications and a larger number of employees, especially those with security clearances, will be able to bid on larger and more contracts in the prime contract role;
- The merger will broaden the capabilities that Kratos can offer to its customers;
- The merger will allow Kratos to add approximately 300 hard-to-find employees with skill sets that are very marketable and in high demand; and
- The merger will assist Kratos in achieving its growth objectives and profitability targets.

The Kratos board of directors also considered a variety of other factors and risks concerning the merger, including the following:

- The information concerning the respective historic businesses of Kratos and Digital Fusion, financial results and prospects, including the result of Kratos due diligence review of Digital Fusion;
- The assessments of Kratos that Digital Fusion's business can effectively and efficiently be integrated;
- The financial presentation of Imperial Capital and its opinion dated November 19, 2008, to Kratos' board of directors as to the fairness, from a financial point of view and as of that date, of the exchange ratio in the transaction to Kratos, as more fully described below under " Opinion of Kratos' Financial Advisor" beginning on page and in the written opinion of

Imperial Capital attached as *Annex C* to this proxy statement/prospectus;

- The exchange ratio and the fact that the exchange ratio is fixed and will not fluctuate based upon changes in the Kratos stock price between signing and closing, reflecting the strategic purpose of the merger and consistent with market practices for a merger of this type;

- The expectation that Digital Fusion stockholders and option holders, immediately after completion of the merger, would hold approximately 20% of the outstanding shares of common stock of Kratos, on a fully diluted basis;

- The challenges and costs of combining the two businesses and the risks of completing the integration, which could harm the combined company's operating results and preclude the realization of anticipated synergies or benefits from the merger;

- The potential for diversion of management and employee attention from other strategic priorities and for increased employee attrition both before and after the closing of the merger agreement, and the potential effect on the business and relations of Kratos with customers and suppliers;

- The fees and expenses associated with completing the merger; and

- The risk that anticipated cost savings will not be achieved.

The foregoing discussion of the factors considered by the Kratos board of directors is not intended to be exhaustive but summarizes the material factors and risks considered by Kratos' board of directors in making its recommendation. In view of the wide variety of factors considered in connection with its evaluation of the merger and the complexity of these matters, the Kratos board of directors did not find it useful to, and did not attempt to, quantify, rank or otherwise assign relative weights to these factors. In considering the factors described above, individual members of the Kratos board of directors may have given different weight to different factors.

In addition, the Kratos board of directors did not undertake to make any specific determination as to whether any particular factor, or any aspect of any particular factor, was favorable or unfavorable to its ultimate determination, but rather conducted an overall analysis of the factors described above, including discussions with the Kratos management team and the Kratos outside legal and financial advisors. Based on the totality of the information presented, the Kratos board of directors determined that Kratos should proceed with the merger and the merger agreement, and recommends that the Kratos stockholders approve the Share Issuance.

The Digital Fusion Board of Directors' Recommendations and Reasons for the Merger

At a regular meeting of the Digital Fusion board of directors held on November 20, 2008, the board of directors voted unanimously to approve the merger agreement, the merger, and the other transactions contemplated by the merger agreement, to direct that the merger agreement and the merger be submitted to a vote of Digital Fusion's stockholders and to recommend that Digital Fusion's stockholders vote to adopt and approve the merger agreement and the merger. In reaching its decision to enter into the merger agreement, the Digital Fusion board of directors consulted with: senior management; outside legal counsel; its audit firm Anglin Reichman Snellgrove & Armstrong, P.C.; and its financial advisor ISI. Digital Fusion's board of directors also reviewed a significant amount of information and considered a number of factors, the most relevant of which include the following:

- That by combining complementary operations, the combined company would have better opportunities for future growth;

- The opportunity for Digital Fusion's stockholders to participate in a larger, more diversified organization and to benefit from the potential appreciation in the value of Kratos' common stock;

- Information concerning the business, earnings, operations, competitive position and prospects of Digital Fusion and Kratos both individually and on a combined basis;
- The trading volume and market liquidity of Kratos stock;
- The opportunity for Digital Fusion stockholders to receive a significant premium over the existing market price for shares of Digital Fusion's common stock prior to the announcement of the merger;
- Discussions with Digital Fusion senior management and legal and financial advisor regarding certain business, financial, legal and accounting aspects of the merger, the results of the legal and financial due diligence and a review of the terms and conditions of the merger;
- The opinion of ISI that, as of November 20, 2008, and subject to the assumptions and limitations set forth in the fairness opinion, the exchange ratio in the merger was fair, from a financial point of view, to the holders of Digital Fusion's common stock;
- The possibility, as alternatives to the merger, of seeking to raise additional equity or debt capital, or seeking to engage in a business combination with an organization other than Kratos;
- The likely impact of the merger on Digital Fusion's employees and customers;
- The interests that certain executive officers and directors of Digital Fusion have with respect to the merger, in addition to their interests as stockholders of Digital Fusion generally, as described in "The Merger Interests of Digital Fusion Directors and Executive Officers in the Merger," starting on page ;
- The fact that the parties intend for the merger to qualify as a tax-free transaction for U.S. federal income tax purposes which would permit Digital Fusion's stockholders to receive Kratos common stock in a tax-free exchange; and
- The history of contacts with other potential strategic partners and the judgment of Digital Fusion's board of directors and management that it was unlikely that any other party would be a more attractive strategic partner or make a proposal more favorable to Digital Fusion and its stockholders than Kratos.

Digital Fusion's board of directors also considered a number of potentially negative factors in its deliberation concerning the merger. The negative factors considered by the board of directors included:

- The risk that the merger would not be completed in a timely manner or at all;
- The possible negative effects of the public announcement of the merger on Digital Fusion's relationships with customers, suppliers, and employees; and operating results;
- The fact that the Digital Fusion stockholders will not receive the full benefit of any future growth in the value of their equity that Digital Fusion may have achieved as an independent company, and the potential disadvantage of Digital Fusion stockholders in the event that Kratos does not perform as well in the future as Digital Fusion may have performed as an independent company;

The substantial management time, effort and expense that will be required to consummate the merger and integrate the operations of the two companies;

The possibility that certain provisions of the merger agreement, including, among others, the no solicitation and termination fee payment provisions of the merger agreement and the fact that certain officers of Digital Fusion executed stockholder voting agreements, would likely have the effect of discouraging other persons potentially interested in merging with or acquiring Digital Fusion from pursuing such an opportunity;

- The impact of unfavorable credit market on Kratos' ability to raise additional capital; and

- The other risks and uncertainties discussed above under "Risk Factors," beginning on page of this proxy statement/prospectus including the various outstanding stockholder and stock option litigation matters involving Kratos, and the potential future impacts of those matters on the merger consideration being issued to the Digital Fusion stockholders.

The foregoing discussion of the information and factors considered by the board of directors of Digital Fusion is not intended to be exhaustive. In view of the wide variety of the material factors considered in connection with the evaluation of the merger and the complexity of these matters, the board of directors did not find it practicable to, and did not, quantify or otherwise attempt to assign any relative weight to the various factors considered. In addition, the board of directors did not undertake to make any specific determination as to whether any particular factor, or any aspect of any particular factor, was favorable or unfavorable to the ultimate determination of the Digital Fusion board of directors, but rather, the Digital Fusion board of directors conducted an overall analysis of the factors described above, including discussions with and questioning of Digital Fusion's senior management, and legal and financial advisors. In considering the factors described above, individual members of the board of directors of Digital Fusion board of directors may have given different weight to different factors.

Opinion of Financial Advisor to the Kratos Board of Directors

On November 19, 2008, at a meeting of Kratos' board of directors held to evaluate the proposed transaction, Imperial Capital delivered to Kratos' board of directors an oral opinion, confirmed by delivery of a written opinion, dated November 19, 2008, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the exchange ratio in the transaction was fair, from a financial point of view, to Kratos.

The full text of Imperial Capital's opinion describes the assumptions made, procedures followed, matters considered and limitations on the review undertaken by Imperial Capital. This opinion is attached as *Annex C* and is incorporated into this proxy statement by reference. **Imperial Capital's opinion is directed only to the fairness, from a financial point of view, of the exchange ratio in the transaction to Kratos. The opinion does not address the merits of the underlying decision by Kratos to engage in the transaction or the relative merits of any alternatives discussed by Kratos' board of directors and does not constitute an opinion with respect to Kratos' underlying business decision to effect the transaction, any legal, tax or accounting issues concerning the transaction, or any terms of the transaction (other than the exchange ratio). The opinion does not constitute a recommendation as to any action Kratos or any holder of Kratos common stock should take in connection with the transaction or any aspect thereof. Holders of Kratos common stock are encouraged to read the opinion carefully in its entirety. The summary of Imperial Capital's opinion described below is qualified in its entirety by reference to the full text of its opinion.**

In arriving at its opinion, Imperial Capital, among other things:

- Analyzed certain publicly available information of Kratos that it believed to be relevant to its analysis, including Kratos' annual report on Form 10-K for the fiscal year ending December 31, 2007 and quarterly reports on Form 10-Q for the quarters ending June 29, 2008 and September 28, 2008;

- Analyzed certain publicly available information of Digital Fusion that it believed to be relevant to its analysis, including Digital Fusion's annual reports for the fiscal years ending December 30, 2006 and December 28, 2007 and quarterly earnings releases for the quarters ending June 27, 2008 and September 19, 2008 (Draft);

Reviewed certain internal financial forecasts and budgets prepared and provided by Kratos' and Digital Fusion's managements;

Met with and held discussions with certain members of Kratos' and Digital Fusion's managements to discuss their respective operations and future prospects;

Reviewed industry reports and publications;

Reviewed public information with respect to certain other public companies with business lines and financial profiles which it deemed to be relevant;

Reviewed the implied financial multiples and premiums paid in merger and acquisition transactions which it deemed to be relevant;

Reviewed current and historical market prices of Kratos common stock and Digital Fusion common stock, as well as the trading volume and public float of such common stock;

Reviewed a draft of the Merger Agreement, including material schedules and exhibits, dated November 17, 2008; and

Conducted such other financial studies, analyses and investigations and took into account such other matters as it deemed necessary, including its assessment of general economic and monetary conditions.

In giving its opinion, Imperial Capital relied upon the accuracy and completeness of the foregoing financial and other information and did not assume any responsibility for independent verification of such information or conduct or receive any independent valuation or appraisal of any assets of Kratos or Digital Fusion or any appraisal or estimate of liabilities of Kratos or Digital Fusion. With the consent of Kratos' board of directors, Imperial Capital assumed that all financial forecasts had been reasonably prepared on bases reflecting the best currently available estimates and judgments of management of Kratos and Digital Fusion as to the future financial performance of the companies. Imperial Capital also relied upon the assurances of management of both companies that they were unaware of any facts that would make the information or financial forecasts provided to it incomplete or misleading. It assumed no responsibility for, and expressed no view as to, such financial forecasts or the assumptions on which they are based. Imperial Capital's opinion was based upon financial, economic, market and other conditions as they existed and could be evaluated on the date of its opinion and did not address the fairness of the exchange ratio as of any other date. These conditions were and remain subject to extraordinary levels of volatility and uncertainty, and Imperial Capital expressed no view as to the impact of such volatility and uncertainty on Kratos, Digital Fusion or the contemplated benefits of the transaction.

At the direction of Kratos' board of directors, Imperial Capital was not asked to, and it did not, offer any opinion as to the terms, other than the exchange ratio to the extent expressly specified in Imperial Capital's opinion, of the Merger Agreement or any related documents or the form of the transaction or any related transaction. Imperial Capital expressed no opinion as to what the value of Kratos common stock would be when issued pursuant to the transaction or the prices at which Kratos common stock or Digital Fusion common stock will trade at any time. Imperial Capital expressed no opinion as to the fairness of the amount or nature of any compensation to be received by any officers, directors or employees of any parties to the transaction or any class of such persons. Imperial Capital assumed, with the consent of Kratos' board of directors that (i) the final executed form of the Merger Agreement would not differ in any material respect from the draft that Imperial Capital examined, (ii) the parties to the Merger Agreement would comply with all the material terms of the Merger Agreement, and (iii) the transaction would be consummated in accordance with the terms of the Merger Agreement without any adverse waiver or amendment of any material term or condition thereof. Imperial Capital also assumed that all governmental, regulatory or other consents and approvals necessary for the consummation of the transaction would be obtained without any material adverse effect on Digital Fusion, Kratos or the transaction. Except as described above, Kratos' board of directors imposed no other instructions or limitations on Imperial Capital with respect to the investigations made or the procedures followed by Imperial Capital in rendering its opinion. The issuance of Imperial Capital's opinion was approved by an authorized committee of Imperial Capital.

In connection with rendering its opinion to Kratos' board of directors, Imperial Capital performed a variety of financial and comparative analyses that are summarized below. The following summary is not a complete description of all analyses performed and factors considered by Imperial Capital in connection with its opinion. The preparation of a financial opinion is a complex process involving subjective judgments and is not necessarily susceptible to partial analysis or summary description. With respect to the selected public companies analysis and the selected transactions analysis summarized below, no company or transaction used as a comparison was either identical or directly comparable to Kratos, Digital Fusion or the proposed transaction. These analyses necessarily involve complex considerations and judgments concerning financial and operating characteristics and other factors that could affect the public trading or acquisition values of the companies concerned.

Imperial Capital believes that its analyses and the summary below must be considered as a whole and that selecting portions of its analyses and factors or focusing on information presented in tabular format, without considering all analyses and factors or the narrative description of the analyses, could create a misleading or incomplete view of the processes underlying Imperial Capital's analyses and opinion. Imperial Capital did not draw, in isolation, conclusions from or with regard to any one factor or method of analysis for purposes of its opinion, but rather arrived at its ultimate opinion based on the results of all analyses undertaken by it and assessed as a whole.

The estimates of the future performance of Kratos and Digital Fusion provided by management of Kratos and Digital Fusion in or underlying Imperial Capital's analyses are not necessarily indicative of future results or values, which may be significantly more or less favorable than those estimates. In performing its analyses, Imperial Capital considered industry performance, general business and economic conditions and other matters, many of which are beyond the control of Kratos and Digital Fusion. Estimates of the financial value of companies do not purport to be appraisals or necessarily reflect the prices at which companies actually may be sold.

The exchange ratio in the transaction was determined through negotiation between Kratos and Digital Fusion, and the decision by Kratos' board of directors to enter into the transaction was solely that of Kratos' board of directors. Imperial Capital's opinion and financial analyses were only one of many factors considered by Kratos' board of directors in its evaluation of the transaction and should not be viewed as determinative of the views of Kratos' board of directors or management with respect to the transaction or the exchange ratio.

The following is a brief summary of the material financial analyses performed by Imperial Capital and reviewed with Kratos' board of directors in connection with Imperial Capital's opinion relating to the proposed transaction. **The financial analyses summarized below include information presented in tabular format. In order to fully understand Imperial Capital's financial analyses, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Considering the data below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of Imperial Capital's financial analyses.**

Contribution Analysis

Imperial Capital reviewed and compared each party's relative financial contribution to the pro forma combined entity. For each party, Imperial Capital considered the (i) pro forma equity ownership contemplated in the proposed transaction, (ii) pre-transaction market capitalization (computed using closing stock prices as of November 18, 2008), (iii) pre-transaction enterprise value, (iv) revenue for the latest twelve-month period ended September 2008, (v) gross profit for the latest twelve-month period ended September 2008, (vi) earnings before interest, taxes, depreciation and amortization, commonly referred to as "EBITDA," for the latest twelve-month period ended September 2008, (vii) estimated revenue for the 2008 fiscal year, (viii) estimated EBITDA for the 2008 fiscal year, (ix) estimated revenue for the 2009 fiscal year and (x) estimated EBITDA for the 2009 fiscal year. Financial data for Kratos and Digital Fusion were based on the most recent available filings with the Securities and Exchange Commission and on projections provided by Kratos' and Digital Fusion's managements. This analysis indicated the following relative financial contribution of each party to the pro forma combined entity:

	Digital Fusion	**Kratos**
Pro Forma Equity Ownership per Proposed Transaction	19.6%	80.4%
Pre-Transaction Market Capitalization	11.5%	88.5%
Pre-Transaction Enterprise Value	7.4%	92.6%
Latest Twelve-Month Period Ended September 2008 Revenue(1)	14.6%	85.4%
Latest Twelve-Month Period Ended September 2008 Gross Profit(1)	10.8%	89.2%
Latest Twelve-Month Period Ended September 2008 EBITDA(1)	22.9%	77.1%
2008 Estimated Revenue	15.1%	84.9%
2008 Estimated EBITDA	20.2%	79.8%
2009 Estimated Revenue	12.9%	87.1%
2009 Estimated EBITDA	16.5%	83.5%

(1) Kratos' and Digital Fusion's Latest Twelve-Month Period Ended September 28, 2008 and September 19, 2008, respectively.

Selected Companies Analysis

Imperial Capital reviewed and compared selected financial information for Kratos and Digital Fusion with corresponding financial information and multiples for the following companies Imperial Capital considered relevant to Kratos and Digital Fusion:

Medium Capitalizations ($200 million - $1 billion Enterprise Value)	**Small Capitalizations (< $200 million Enterprise Value)**
ICF International, Inc.	ATS Corporation
MAXIMUS, Inc.	Dynamics Research Corp.
NCI, Inc.	Paradigm Holdings Inc.
SRA International, Inc.	TechTeam Global, Inc.
Stanley, Inc.	VSE Corp.

In its review of the selected companies, Imperial Capital considered, among other things, (i) market capitalization (computed using closing stock prices as of November 18, 2008), (ii) enterprise values, (iii) enterprise values as a multiple of revenue for the latest twelve-month period ended September 30, 2008 (with the exception of MAXIMUS, Inc., for which revenue for the twelve-month period ended June 30, 2008 was used), estimated revenue for the 2008 calendar year and estimated revenue for the 2009 calendar year and (iv) enterprise values as a multiple of EBITDA for the latest twelve-month period ended September 30, 2008 (with the exception of MAXIMUS, Inc., for which EBITDA for the twelve-month period ended June 30, 2008 was used), estimated EBITDA for the 2008 calendar year and estimated EBITDA for the 2009 calendar year. Financial data for the selected companies were based on the most recent available filings with the Securities and Exchange Commission and on the Institutional Brokers' Estimate System's and First Call estimates. Financial data for Kratos and Digital Fusion were based on the most recent available filings with the Securities and Exchange Commission and on forecasts provided by Kratos' and Digital Fusion's managements. This analysis indicated the following implied equity value per share ranges of Digital Fusion based on selected small capitalization company trading multiples applied to Digital Fusion's (a) revenue for the latest twelve-month period ended September 19, 2008, estimated revenue for the 2008 fiscal year and estimated revenue for the 2009 fiscal year and (b) EBITDA for the latest twelve-month period ended September 19, 2008, estimated EBITDA for the 2008 fiscal year and estimated EBITDA for the 2009 fiscal year:

	Implied Equity Value per Share		
Based on	**Low**	**Mid**	**High**
Latest Twelve-Month Period Ended September 19, 2008 Revenue	$1.13	$1.54	$1.92
2008 Estimated Revenue	$1.15	$1.57	$1.96
2009 Estimated Revenue	$0.96	$1.35	$1.72
Latest Twelve-Month Period Ended September 19, 2008 EBITDA	$2.03	$2.19	$2.36
2008 Estimated EBITDA	$1.61	$1.77	$1.92
2009 Estimated EBITDA	$1.20	$1.38	$1.54

This analysis also indicated the following implied equity value per share ranges of Digital Fusion based on selected medium capitalization company trading multiples applied to Digital Fusion's (i) revenue for the latest twelve-month period ended September 19, 2008, estimated revenue for the 2008 fiscal year and estimated revenue for the 2009 fiscal year and (ii) EBITDA for the latest twelve-month period ended September 19, 2008, estimated EBITDA for the 2008 fiscal year and estimated EBITDA for the 2009 fiscal year:

	Implied Equity Value per Share		
Based on	**Low**	**Mid**	**High**
Latest Twelve-Month Period Ended September 19, 2008 Revenue	$2.87	$3.21	$3.55
2008 Estimated Revenue	$2.86	$3.20	$3.54
2009 Estimated Revenue	$2.47	$2.80	$3.12
Latest Twelve-Month Period Ended September 19, 2008 EBITDA	$2.66	$2.82	$2.97
2008 Estimated EBITDA	$2.52	$2.67	$2.82
2009 Estimated EBITDA	$2.44	$2.59	$2.74

This analysis also indicated the following implied equity value per share ranges of Kratos based on selected medium capitalization company trading multiples applied to Kratos' pro forma (including Haverstick and SYS) (i) revenue for the latest twelve-month period ended September 28, 2008, estimated revenue for the 2008 fiscal year and estimated revenue for the 2009 fiscal year and (ii) EBITDA for the latest twelve-month period ended September 28, 2008, estimated EBITDA for the 2008 fiscal year and estimated EBITDA for the 2009 fiscal year:

	Implied Equity Value per Share		
Based on	**Low**	**Mid**	**High**
Latest Twelve-Month Period Ended September 28, 2008 Revenue	$1.54	$1.87	$2.20
2008 Estimated Revenue	$1.43	$1.76	$2.08
2009 Estimated Revenue	$1.47	$1.83	$2.18
Latest Twelve-Month Period Ended September 28, 2008 EBITDA	$0.45	$0.54	$0.62
2008 Estimated EBITDA	$0.58	$0.67	$0.76
2009 Estimated EBITDA	$0.89	$1.01	$1.13

Selected Transactions Analysis

Imperial Capital reviewed and compared selected financial information for Kratos and Digital Fusion with corresponding financial information for the following selected transactions involving companies Imperial Capital considered relevant to Kratos and Digital Fusion that were announced in the last two years:

Date Announced	**Target**	**Buyer**
October 2008	SM&A	Odyssey Investment Partners LLC
September 2008	MAXIMUS, Inc., Certain Assets	Constellation Software, Inc.
August 2008	SI International, Inc.	Serco, Inc.
August 2008	Emerging Technologies Group, Inc.	ManTech International Corp.
August 2008	Base One Technologies, Ltd.	Apptis, Inc.
July 2008	Oberon Associates, Inc.	Stanley, Inc.
July 2008	Kadix Systems LLC	Dynamics Research Corp.
June 2008	Digital Solutions, Inc.	Bart & Associates
June 2008	Project Performance Corporation	AEA Technology PLC
May 2008	Pomeroy IT Solutions, Inc.	Comvest Investment Partners
April 2008	G&B Solutions, Inc.	VSE Corp.
February 2008	SYS	Kratos Defense & Security Solutions, Inc.
January 2008	Jones & Stokes Associates, Inc.	ICF International, Inc.
January 2008	Sparta, Inc.	Cobham PLC
January 2008	iSYS LLC	WidePoint Corp.
December 2007	MTC Technologies, Inc.	BAE Systems, Inc.
December 2007	Integrated Combat Systems, Inc.	Orbit International
December 2007	RS Information Systems	Wyle, Inc.
November 2007	McDonald Bradley, Inc.	ManTech International Corp.
November 2007	Haverstick Consulting, Inc.	Kratos Defense & Security Solutions, Inc.
October 2007	PAC, Inc.	Quintegra Solutions, Ltd.
October 2007	Number Six Software, Inc.	ATS Corp.
October 2007	Dragon Development Corporation	CACI International
August 2007	Potomac Management Group	ATS Corp.
June 2007	Z-Tech Corp.	ICF International, Inc.
June 2007	Karta Technologies, Inc.	NCI, Inc.
June 2007	3H Technology LLC	Apogen Technologies, Inc.
June 2007	Constella Group LLC (Wachovia/Wakefield Group)	SRA International, Inc.
June 2007	D3 Technologies, Inc.	LMI Aerospace, Inc.
May 2007	Multimax, Inc.	Harris Corp.
May 2007	Wexford	CACI International
May 2007	New Vectors LLC	TechTeam Government Solutions, Inc.
May 2007	Logtec, Inc.	SI International, Inc.
May 2007	Dimensions International, Inc.	Honeywell International, Inc.
May 2007	Advanced Concepts, Inc.	L-1 Identity Solutions, Inc.
April 2007	SRS Technologies, Inc.	ManTech International Corp.
April 2007	Techrizon LLC	Stanley, Inc.
March 2007	ITS Corp.	QinetiQ Group PLC
January 2007	Analex Corp.	QinetiQ Group PLC
December 2006	QSS Group, Inc.	Perot Systems Corporation

In its review of the selected transactions, Imperial Capital considered, among other things, the enterprise value implied in each of the selected transactions as a multiple of revenue and EBITDA for the latest twelve-month period as of the date of announcement of the respective transaction. To the extent such data was not publicly available but the acquiring company disclosed forecasted revenue or EBITDA, Imperial Capital considered the enterprise value implied in the transaction as a multiple of such forecasted data. Imperial Capital then compared the multiples derived from the selected transactions with the corresponding multiples implied in the proposed transaction for Digital Fusion based on the exchange ratio. Multiples for the selected transactions were based on information from Securities and Exchange Commission filings, Capital IQ and company press releases. This analysis indicated the following implied equity value per share range of Digital Fusion based on selected merger and acquisition transaction multiples applied to Digital Fusion's revenue and EBITDA for the latest twelve-month period ended September 19, 2008:

	Implied Equity Value per Share		
Based on	**Low**	**Mid**	**High**
Latest Twelve-Month Period Ended September 19, 2008 Revenue	$ 3.68	$ 4.00	$ 4.33
Latest Twelve-Month Period Ended September 19, 2008 EBITDA	$ 2.83	$ 2.98	$ 3.13

This analysis indicated the following implied equity value per share range of Kratos based on selected transaction multiples applied to Kratos' pro forma (including Haverstick and SYS) revenue and EBITDA for the latest twelve-month period ended September 28, 2008:

	Implied Equity Value per Share		
Based on	**Low**	**Mid**	**High**
Latest Twelve-Month Period Ended September 30, 2008 Revenue	$ 2.33	$ 2.66	$ 2.99
Latest Twelve-Month Period Ended September 30, 2008 EBITDA	$ 0.54	$ 0.63	$ 0.71

Discounted Cash Flow Analysis

Imperial Capital performed a discounted cash flow analysis of Digital Fusion using forecasts for the period ranging from the beginning of fiscal year 2009 through the end of fiscal year 2012 (the "forecast period") provided by Kratos' management. Imperial Capital calculated the implied present values of free cash flows for Digital Fusion for the forecast period using discount rates ranging from 15.0% to 18.0%. Imperial Capital calculated the terminal values for Digital Fusion based on multiples of 6.0x to 10.0x applied to the 2012 free cash flow. The estimated terminal values were then discounted to implied present values using discount rates ranging from 15.0% to 18.0%. For range of discount rate and terminal value multiples, Imperial Capital added the implied present value of free cash flows to the implied present value of the terminal value to arrive at implied enterprise value for Digital Fusion. Imperial Capital then calculated the implied equity value of Digital Fusion as the implied enterprise value plus the $500,000 cash required as of closing. Implied equity value per share of Digital Fusion common stock was calculated using fully-diluted shares outstanding of Digital Fusion, as provided by the management of Digital Fusion. This analysis resulted in a range of implied equity values per share of Digital Fusion common stock of approximately $1.98 to $2.92.

Exchange Ratio Comparison

Imperial Capital calculated the average equity valuation per share of Kratos and Digital Fusion based on an equal weighting of the various valuation methodologies. The following represent the ranges calculated for Digital Fusion:

Method	Low	High
Selected Companies Analysis (Small Capitalization) Latest Twelve-Month Period Ended September 19, 2008 Revenue	$1.13	$1.92
Selected Companies Analysis (Small Capitalization) Latest Twelve-Month Period Ended September 19, 2008 EBITDA	$2.03	$2.36
Selected Companies Analysis (Small Capitalization) Estimated 2008 Revenue	$1.15	$1.96
Selected Companies Analysis (Small Capitalization) Estimated 2008 EBITDA	$1.61	$1.92
Selected Companies Analysis (Small Capitalization) Estimated 2009 Revenue	$0.96	$1.72
Selected Companies Analysis (Small Capitalization) Estimated 2009 EBITDA	$1.20	$1.54