KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form 10-Q/A
December 07, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

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

For the Quarterly Period Ended June 24, 2012

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

Commission file number 001-34460

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
(Exact name of Registrant as specified in its charter)

Delaware	13-3818604
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4820 Eastgate Mall, Suite 200
San Diego, CA 92121
(858) 812-7300
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

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

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

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

Large accelerated filer o	Accelerated filer ý

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

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

As of November 30, 2012, 56,604,000 shares of the registrant’s common stock were outstanding.

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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form 10-Q/A for the Quarterly Period Ended June 24, 2012

EXPLANATORY NOTE

This amendment (the “Amendment”) to the Quarterly Report on Form 10-Q for the quarterly period ended June 24, 2012 (the “Original Form 10-Q”), of Kratos Defense & Security Solutions, Inc. (the “Company”) which was originally filed with the Securities and Exchange Commission (“SEC”) on August 2, 2012, is being filed for the purpose of adding Note 14 - Condensed Consolidating Financial Statements (the “Guarantor Footnote”) to the consolidated financial statements filed with the Original Form 10-Q in order to conform to the disclosure requirements of Rule 3-10 of Regulation S-X under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The purpose of the Guarantor Footnote is to provide additional supplementary financial information to the holders of the Company's publicly-traded debt instruments. The addition of the footnote does not affect any other portion of the Company's consolidated financial statements, including the Consolidated Balance Sheets, Statements of Operations and Statements of Cash Flows.

As required by Rule 12b-15 under the Exchange Act, new certifications by the Company's principal executive officer and principal financial officer are filed as exhibits to this Amendment under Item 6 of Part II hereof.

This Amendment solely modifies Part I Item 1 and Part II Item 6 of the Original Form 10-Q to reflect the addition of the Guarantor Footnote and does not reflect any events occurring after June 24, 2012 or modify or update the disclosures in the Original Form 10-Q that may have been affected by subsequent events. For the convenience of the reader, this Amendment sets forth the Quarterly Report on Form 10-Q, as amended, in its entirety.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

FORM 10-Q/A

FOR THE QUARTERLY PERIOD ENDED JUNE 24, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par value and number of shares)
(Unaudited)

	December 25, 2011	June 24, 2012
Assets		
Current assets:		
Cash and cash equivalents	$69.6	$145.7
Restricted cash	1.1	0.8
Accounts receivable, net	245.3	256.8
Inventoried costs	76.6	86.4
Prepaid expenses	12.7	12.6
Other current assets	15.7	18.8
Total current assets	421.0	521.1
Property, plant and equipment, net	72.5	72.4
Goodwill	571.6	575.4
Intangible assets, net	124.6	107.2
Other assets	26.3	23.0
Total assets	$1,216.0	$1,299.1
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$48.8	$61.9
Accrued expenses	50.7	52.9
Accrued compensation	39.8	33.8
Accrued interest	5.1	5.1
Billings in excess of costs and earnings on uncompleted contracts	36.2	37.1
Other current liabilities	33.2	32.1
Total current liabilities	213.8	222.9
Long-term debt principal, net of current portion	630.8	630.2
Long-term debt premium	22.8	20.8
Other long-term liabilities	36.0	33.7
Total liabilities	903.4	907.6
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized, $0.001 par value, 0 shares outstanding at December 25, 2011 and June 24, 2012	—	—
Common stock, $0.001 par value, 195,000,000 shares authorized; 32,421,135 and 52,518,189 shares issued and outstanding at December 25, 2011 and June 24, 2012, respectively	—	—
Additional paid-in capital	720.6	819.9
Accumulated other comprehensive loss	(0.2)	(0.4)
Accumulated deficit	(407.8)	(428.0)
Total stockholders' equity	312.6	391.5
Total liabilities and stockholders' equity	$1,216.0	$1,299.1

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

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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(in millions, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 26, 2011	June 24, 2012	June 26, 2011	June 24, 2012
Service revenues	$75.3	$112.1	$155.1	$214.2
Product sales	95.8	107.7	138.8	215.1
Total revenues	171.1	219.8	293.9	429.3
Cost of service revenues	58.0	86.7	118.3	166.5
Cost of product sales	67.7	75.4	102.8	147.7
Total costs	125.7	162.1	221.1	314.2
Gross profit	45.4	57.7	72.8	115.1
Selling, general and administrative expenses	33.7	42.6	53.3	86.4
Merger and acquisition expenses	1.8	1.5	7.6	2.4
Research and development expenses	1.2	4.8	1.8	8.4
Unused office space expense and other	—	1.4	—	1.4
Operating income from continuing operations	8.7	7.4	10.1	16.5
Other income (expense):				
Interest expense, net	(13.1)	(16.2)	(19.8)	(32.3)
Other income, net	—	0.5	0.3	0.9
Total other expense, net	(13.1)	(15.7)	(19.5)	(31.4)
Loss from continuing operations before income taxes	(4.4)	(8.3)	(9.4)	(14.9)
Provision (benefit) for income taxes from continuing operations	0.9	6.6	(0.3)	2.5
Loss from continuing operations	(5.3)	(14.9)	(9.1)	(17.4)
Income (loss) from discontinued operations	0.1	(2.3)	0.4	(2.8)
Net loss	$(5.2)	$(17.2)	$(8.7)	$(20.2)
Basic income (loss) per common share:				
Net loss from continuing operations	$(0.22)	$(0.36)	$(0.40)	$(0.47)
Net income (loss) from discontinued operations	0.00	(0.05)	0.02	(0.07)
Net loss per common share	$(0.22)	$(0.41)	$(0.38)	$(0.54)
Diluted income (loss) per common share:				
Net loss from continuing operations	$(0.22)	$(0.36)	$(0.40)	$(0.47)
Net income (loss) from discontinued operations	0.00	(0.05)	0.02	(0.07)
Net loss per common share	$(0.22)	$(0.41)	$(0.38)	$(0.54)
Weighted average common shares outstanding:				
Basic	23.8	41.7	22.6	37.1
Diluted	23.8	41.7	22.6	37.1
Comprehensive Loss				
Net loss from above	$(5.2)	$(17.2)	$(8.7)	$(20.2)
Other comprehensive income:				
Change in cumulative translation adjustment	—	(0.2)	—	(0.2)
Other comprehensive income, net of tax	—	(0.2)	—	(0.2)
Comprehensive loss	$(5.2)	$(17.4)	$(8.7)	$(20.4)

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

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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(Unaudited)

	Six Months Ended June 26, 2011	Six Months Ended June 24, 2012
Operating activities:		
Net loss	$(8.7)	$(20.2)
Less: Income (loss) from discontinued operations	0.4	(2.8)
Loss from continuing operations	(9.1)	(17.4)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities from continuing operations:		
Depreciation and amortization	16.2	25.9
Deferred income taxes	0.2	1.3
Stock-based compensation	1.4	2.3
Mark to market on swaps	(0.3)	—
Amortization of deferred financing costs	1.3	2.5
Amortization of premium on Senior Secured Notes	—	(2.1)
Provision for doubtful accounts	0.1	0.3
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	1.8	11.6
Inventoried costs	6.4	(9.6)
Prepaid expenses and other assets	3.9	(3.7)
Accounts payable	(9.2)	9.4
Accrued compensation	(2.1)	(6.6)
Accrued expenses	(7.7)	0.3
Billings in excess of costs and earnings on uncompleted contracts	(12.3)	(2.3)
Income tax receivable and payable	0.2	(1.5)
Other liabilities	(0.9)	(0.6)
Net cash provided by (used in) operating activities from continuing operations	(10.1)	9.8
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(249.2)	(21.5)
Decrease in restricted cash	1.2	0.3
Capital expenditures	(2.7)	(6.2)
Net cash used in investing activities from continuing operations	(250.7)	(27.4)
Financing activities:		
Proceeds from the issuance of long-term debt	305.0	—
Proceeds from the issuance of common stock	61.1	97.0
Debt issuance costs	(14.6)	(1.0)
Repayment of debt	(2.2)	(0.5)
Cash paid for contingent acquisition consideration	—	(2.5)
Other	1.0	(0.3)
Net cash provided by financing activities from continuing operations	350.3	92.7
Net cash flows of continuing operations	89.5	75.1
Net operating cash flows of discontinued operations	0.1	1.3
Effect of exchange rate changes on cash and cash equivalents	—	(0.3)
Net increase in cash and cash equivalents	89.6	76.1
Cash and cash equivalents at beginning of period	10.8	69.6

Cash and cash equivalents at end of period	$100.4	$145.7

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

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KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

All references to the “Company” and “Kratos” refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, and its wholly owned subsidiaries.

(a) Basis of Presentation

The information as of June 24, 2012 and for the three and six months ended June 26, 2011 and June 24, 2012 is unaudited. The condensed consolidated balance sheet as of December 25, 2011 was derived from the Company’s audited consolidated financial statements at that date. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of the Company’s financial position, results of operations and cash flows for the interim periods presented. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the U.S. (“GAAP”). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company’s audited annual consolidated financial statements for the fiscal year ended December 25, 2011, included in the Company’s Annual Report on Form 10-K and Form 10-K/A filed with the U.S. Securities and Exchange Commission ("SEC") on March 7, 2012 and December 5, 2012, respectively (collectively the “Form 10-K”). Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

(b) Principles of Consolidation and Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries for which all inter-company transactions have been eliminated in consolidation.

In June 2012, the Company committed to a plan to sell certain lines of business associated with antennas, satellite-cased products and fly-away terminals of the non-core businesses acquired in the Integral acquisition. In accordance with FASB ASC Topic 205, Presentation of Financial Statements ("Topic 205"), these businesses have been classified as held for sale and reported in discontinued operations in the accompanying consolidated financial statements.

(c) Fiscal Year

The Company has a 52/53 week fiscal year ending on the last Sunday of the calendar year, with interim fiscal periods ending on the last Sunday of the last month of each calendar quarter. The six months ended June 26, 2011 and June 24, 2012 consisted of 26 week periods. There were 52 calendar weeks in the fiscal year ended on December 25, 2011 and there are 53 calendar weeks in the fiscal year ending December 30, 2012.

(d) Accounting Policies and Accounting Standards Updates

There have been no changes in the Company's significant accounting policies for the six months ended June 24, 2012 as compared to the significant accounting policies described in the Form 10-K. In addition, there were no new accounting standards updates issued by the Financial Accounting Standards Board during the six months ended June 24, 2012.

(e) Concentrations and Uncertainties

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

Financial instruments, which subject the Company to potential concentrations of credit risk, consist principally of the Company’s billed and unbilled accounts receivable. The Company’s accounts receivable result from sales to customers within

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the federal government, state and local agencies and commercial customers in various industries. The Company performs ongoing credit evaluations of its commercial customers. Credit is extended based on evaluation of the customer’s financial condition, and collateral is not required. Accounts receivable are recorded at the invoiced amount and do not bear interest. See Note 12 for a discussion of the Company’s significant customers.

The Company has outstanding 10% Senior Secured Notes due 2017 ("the Notes") with an aggregate principal amount of $625.0 million outstanding as of June 24, 2012. The Notes are due on June 1, 2017 and the Company pays interest at the rate of 10% per annum semi-annually, in arrears, on June 1 and December 1 of each year. In addition, the Company has $85.0 million available under its existing revolving credit agreement. See Note 9 for a complete description of the Company’s debt.

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

Note 2. Acquisitions

(a) Summary of Recent Acquisitions

Asset Purchase

On December 30, 2011, the Company acquired selected assets of a critical infrastructure security and public safety system integration business (the “Critical Infrastructure Business”) for approximately $20.0 million. The asset purchase agreement provides that the purchase price will be (i) increased on a dollar-for-dollar basis if the working capital on the closing date (as defined in the asset purchase agreement) exceeds $17.0 million or (ii) decreased on a dollar-for-dollar basis if the working capital is less than $17.0 million. In accordance with the terms of the asset purchase agreement, the Company submitted its computation of the closing working capital to the Seller on April 27, 2012, which reflected a deficiency to the minimum required working capital. The Seller had 60 days to object to the Company's computation of the closing working capital. Recently, both parties have mutually agreed to extend the time to discuss the Company's closing working capital computations and the Seller's objections to August 30, 2012. As the Seller and the Company have not yet agreed on the working capital adjustment, the Company has not reflected an adjustment to the purchase price.

The Critical Infrastructure Business designs, engineers, deploys, manages and maintains specialty security systems at some of the most strategic asset and critical infrastructure locations in the U.S. Additionally, these security systems are typically integrated into command and control system infrastructure or command centers. Approximately 15% of the revenues of the Critical Infrastructure Business are recurring in nature due to the operation, maintenance or sustainment of the security systems once deployed. The Critical Infrastructure Business is part of the Company's Public Safety & Security (“PSS”) segment.

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

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

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Accounts receivable	$23.4
Other assets	0.5
Intangible assets	2.0
Goodwill	3.8
Total assets	29.7
Current liabilities	(9.7)
Net assets acquired	$20.0

The goodwill recorded in this transaction is tax deductible.

As of December 30, 2011, the expected fair value of accounts receivable approximated historical cost. The gross accounts receivable was $24.4 million, of which approximately $1.0 million is not expected to be collectible.

The amounts of revenue and operating income (loss) of the Critical Infrastructure Business included in the Company's Condensed Consolidated Statement of Operations and Comprehensive Income for the three and six months ended June 24, 2012 are $16.6 million and $30.4 million, and $0.1 million and $(0.5) million, respectively.

SecureInfo Corporation

On November 15, 2011, the Company acquired SecureInfo Corporation ("SecureInfo") for $20.3 million in cash, which includes a $1.5 million earn-out that was paid in March 2012. Upon completion of the SecureInfo transaction, the Company deposited $1.8 million of the purchase price ("the holdback") into an escrow account as security for SecureInfo's indemnification obligations as set forth in the SecureInfo purchase agreement. In addition, the SecureInfo purchase agreement provided that the purchase price would be (i) increased on a dollar for dollar basis if the working capital on the closing date (as defined in the SecureInfo purchase agreement) exceeded $2.2 million or (ii) decreased on a dollar for dollar basis if the working capital was less than $2.2 million. The SecureInfo working capital was $2.1 million and the Company and SecureInfo agreed to a working capital adjustment of $0.1 million.

Based in northern Virginia, SecureInfo is a cybersecurity company specializing in assisting defense, intelligence, civilian government and commercial customers to identify, understand, document, manage, mitigate and protect against cybersecurity risks while reducing information security costs and achieving compliance with applicable regulations, standards and guidance. SecureInfo offers strategic advisory, operational cybersecurity and cybersecurity risk management services and is a recognized leader in the rapidly evolving fields of cloud security, continuous monitoring and cybersecurity training. Customers include the Department of Defense, the Department of Homeland Security ("DHS") and large commercial customers, including market leading cloud computing service providers. SecureInfo is part of the Kratos Government Solutions ("KGS") segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by SecureInfo's nationally recognized expertise in operational cybersecurity, cybersecurity risk management as well as cybersecurity training programs.

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

Cash	$1.4
Other assets	3.0

Property and equipment	0.1
Intangible assets	4.5
Goodwill	12.2
Total assets	21.2
Current liabilities	(0.9)
Net assets acquired	$20.3

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The goodwill recorded in this transaction is not tax deductible.

As of November 15, 2011, the expected fair value of accounts receivable approximated historical cost. The gross accounts receivable was $2.9 million, of which $0.0 million is not expected to be collectible.

The amounts of revenue and operating income of SecureInfo included in the Company's Condensed Consolidated Statement of Operations and Comprehensive Income for the three and six months ended June 24, 2012 are $4.0 million and $7.7 million, and $0.1 million and $0.3 million, respectively.
Integral Systems, Inc.

On July 27, 2011, the Company acquired Integral, in a cash and stock transaction valued at $241.1 million. Upon completion of the acquisition, the Company paid an aggregate of $131.4 million in cash, issued approximately 10.4 million shares of the Company's common stock valued at $108.7 million and issued replacement stock options with a fair value of $1.0 million.

To fund the cash portion of the acquisition, on July 27, 2011, the Company issued $115.0 million aggregate principal amount of 10% Senior Secured Notes due 2017 (the “Notes”). The Notes were issued at a premium of 105% for an effective interest rate of approximately 8.9%. The gross proceeds of approximately $120.8 million, which includes an approximate $5.8 million issuance premium and excludes accrued interest received of $1.8 million, were used to finance, in part, the cash portion of the purchase price for the acquisition of Integral, to refinance existing indebtedness of Integral and its subsidiaries, to pay certain severance payments in connection with the acquisition and to pay related fees and expenses. See Note 9 for a complete description of the Company's debt.

As consideration for the acquisition of Integral, each Integral stockholder received (i) $5.00 in cash, without interest, and (ii) 0.588 shares of the Company's common stock for each share of Integral common stock. In addition, upon completion of the acquisition (i) each outstanding Integral stock option with an exercise price less than $13.00 per share was, if the holder thereof had so elected in writing, canceled in exchange for an amount in cash equal to the product of the total number of shares of Integral common stock subject to such in-the-money option, multiplied by the aggregate value of the excess, if any, of $13.00 over the exercise price per share applicable to such option, less the amount of any tax withholding, (ii) each outstanding Integral stock option with an exercise price equal to or greater than $13.00 per share and each Integral in-the-money option the holder of which had not made the election described in (i) above was converted into an option to purchase Company common stock, with the number of shares subject to such option adjusted to equal the number of shares of Integral common stock subject to such out-of-the-money option multiplied by 0.9559, rounded up to the nearest whole share, and the per share exercise price under each such option adjusted by dividing the per share exercise price applicable to such option by 0.9559, rounded up to the nearest whole cent, and (iii) each outstanding share of restricted stock granted under an Integral equity plan or otherwise, whether vested or unvested, was canceled and converted into the right to receive $13.00, less the amount of any tax withholding.

Integral is a global provider of products, systems and services for satellite command and control, telemetry and digital signal processing, data communications, enterprise network management and communications information assurance. Integral specializes in developing, managing and operating secure communications networks, both satellite and terrestrial, as well as systems and services to detect, characterize and geolocate sources of radio frequency or RF interference. Integral’s customers include U.S. and foreign commercial, government, military and intelligence organizations. For almost 30 years, customers have relied on Integral to design and deliver innovative commercial-based products, solutions and services that are cost-effective and reduce delivery schedules and risk. Integral is part of the Company’s KGS segment.

The excess of the purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition was allocated to goodwill. The value of the goodwill represents the value the Company expects to be created by Integral's significant expertise with satellite operations, ground systems, signal processing and other areas of satellite command and control, as well as advanced technologies for Unmanned Aerial Vehicles, situational awareness, remote management and numerous established electronic attack and electronic warfare platforms, tactical missile systems, and strategic deterrence systems. The Integral transaction has been accounted for using the acquisition method of accounting which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the merger date. The following table summarizes the preliminary estimated fair values of major assets acquired and liabilities assumed (in millions):

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Cash	$6.8
Accounts receivable	68.4
Inventoried costs	15.8
Deferred tax assets	36.4
Other assets	3.5
Property and equipment	12.9
Intangible assets	32.0
Goodwill	187.8
Total assets	363.6
Current liabilities	(84.5)
Deferred tax liabilities	(19.5)
Long-term liabilities	(18.5)
Net assets acquired	$241.1

The goodwill recorded in this transaction is not tax deductible.

As of July 27, 2011, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $68.5 million, of which $0.1 million is not expected to be collectible. There was no contingent purchase consideration associated with the acquisition of Integral.

The amounts of revenue and operating income of Integral included in the Company's Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 24, 2012 were $50.9 million and $94.9 million, and $0.4 million and $2.2 million, respectively.

Herley Industries, Inc.

On March 25, 2011, the Company acquired approximately 13.2 million shares of Herley Industries, Inc. ("Herley")common stock, representing approximately 94% of the total outstanding shares of Herley common stock, in a tender offer to purchase all of the outstanding shares of Herley common stock. The fair value of the non-controlling interest related to Herley as of March 25, 2011 was $16.9 million, which represents the market trading price of $19.00 per share multiplied by the approximately 0.9 million shares that were not tendered as of March 25, 2011. On March 30, 2011, following the purchase of the non-controlling interest in a subsequent offering period, Herley became a wholly owned subsidiary of the Company. The shares of Herley common stock were purchased at a price of $19.00 per share. Accordingly, the Company paid approximately $245.5 million in cash consideration as of March 27, 2011, and as of April 15, 2011 the Company had paid aggregate cash consideration of $270.7 million for the shares of Herley common stock and certain in-the-money options, which were exercised upon the change in control. In addition, upon completion of the subsequent short-form merger, all unexercised options to purchase Herley common stock were assumed by the Company and converted into options to purchase Kratos common stock, entitling the holders thereof to receive 1.3495 shares of Kratos common stock for each share of Herley common stock underlying the options ("Herley Options"). The Company assumed each Herley Option in accordance with the terms (as in effect as of the date of the Herley Merger Agreement) of the applicable Herley equity plan and the option agreement pursuant to which such Herley Option was granted. The Herley Options are exercisable for an aggregate of approximately 0.8 million shares of the Company's common stock. All Herley Options were fully vested upon the change in control and the fair value of the Herley Options assumed was $1.9 million. The total aggregate consideration for the purchase of Herley was $272.5 million. In addition, the Company assumed change in control obligations of $4.0 million related to the transaction and incurred combined transaction expenses of $11.1 million.

To fund the acquisition of Herley, on February 11, 2011, Kratos sold approximately 4.9 million shares of its common stock at a purchase price of $13.25 per share in an underwritten public offering. Kratos received gross proceeds of approximately $64.8 million and net proceeds of approximately $61.1 million after deducting underwriting fees and other offering expenses. Kratos used the net proceeds from this offering to fund a portion of the purchase price for the acquisition of Herley. To fund the remaining purchase price, Kratos issued $285.0 million in aggregate principal amount of Notes at a premium of 107% through its wholly owned subsidiary, Acquisition Co. Lanza Parent ("Lanza"), on March 25, 2011, in an unregistered offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. On April 4, 2011, after the acquisition of Herley was complete, Lanza was merged with and into Kratos and all assets and liabilities of Lanza became assets and liabilities of Kratos. See Note 9 for a complete description of the Company’s debt.

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

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

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

Cash	$21.8
Accounts receivable	39.1
Inventoried costs	42.8
Deferred tax assets	17.3
Other assets	7.2
Property and equipment	34.2
Intangible assets	37.0
Goodwill	146.4
Total assets	345.8
Current liabilities	(40.8)
Deferred tax liabilities	(16.8)
Debt	(9.5)
Long-term liabilities	(6.2)
Net assets acquired	$272.5

The goodwill recorded in this transaction is not tax deductible.

As of March 25, 2011, the expected fair value of accounts receivable approximated the historical cost. The gross accounts receivable was $39.3 million, of which $0.2 million is not expected to be collectible. There were no contingent liabilities associated with the acquisition of Herley. The Company initially recorded $47.9 million of inventory and $30.4 million in property and equipment. The Company decreased the value of acquired inventory to $42.8 million and increased the value of acquired property and equipment to $34.2 million based on its updated valuations.

The amounts of revenue and operating income of Herley included in the Company's Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 24, 2012 are $48.6 million and $95.9 million, and $8.0 million and $14.2 million, respectively.

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805, Business Combinations ("Topic 805"), the allocation of the purchase price for the Company's acquisitions of

SecureInfo and the Critical Infrastructure Business are subject to adjustment during the measurement period after the respective closing dates when additional information on asset and liability valuations become available. The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the respective acquisition dates to estimate the fair value of assets acquired and liabilities assumed. Measurement period adjustments reflect new information obtained about facts and circumstances that existed as of the respective acquisition dates. The Company believes that such information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed but the Company is waiting for additional information necessary to finalize those fair values. The Company has not

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finalized its valuation of certain assets and liabilities recorded in connection with these transactions, including intangible assets, inventory, property and equipment and deferred taxes. Thus, the provisional measurements recorded are subject to change. Any changes will be recorded as adjustments to the fair value of those assets and liabilities, and residual amounts will be allocated to goodwill. The final valuation adjustments may also require adjustment to the consolidated statements of operations.

Pro Forma Financial Information

The following tables summarize the supplemental Condensed Consolidated Statements of Operations and Comprehensive Income information on an unaudited pro forma basis as if the acquisitions of SecureInfo, Integral, Herley, and the Critical Infrastructure Business occurred on December 27, 2010, and include adjustments that were directly attributable to the foregoing transactions or were not expected to have a continuing impact on the Company. All acquisitions, except the acquisition of the Critical Infrastructure Business, which was acquired on December 30, 2011, were included in the Company's results of operations for the full six months ended June 24, 2012. There are no material, nonrecurring pro forma adjustments directly attributable to the business combinations included in the reported pro forma revenue and earnings for 2011. The pro forma results are for illustrative purposes only for the applicable period and do not purport to be indicative of the actual results that would have occurred had the transactions been completed as of the beginning of the period, nor are they indicative of results of operations that may occur in the future (all amounts, except per share amounts are in millions):

	For the Three Months Ended June 26, 2011		For the Six Months Ended June 26, 2011	
Pro forma revenues	$241.8		$484.6	
Pro forma net loss before tax	(5.8	)	(38.8	)
Pro forma net loss	(6.6	)	(38.6	)
Net income (loss) attributable to the registrant	(5.3	)	(9.1	)
Basic and diluted pro forma loss per share	$(0.19	)	$(1.13	)

The pro forma results for the three and six month periods ended June 26, 2011 include $1.8 million and $7.6 million of acquisition related expenses, respectively. The pro forma financial information also reflects pro forma adjustments for the additional amortization associated with finite-lived intangible assets acquired, additional incremental interest expense, deferred financing costs related to the financing undertaken for the Integral and Herley transactions, the change in stock compensation expense as a result of the exercise of stock options and restricted stock immediately prior to closing of the Integral and Herley transactions, and the tax effect of the increased interest expense and intangible amortization. The weighted average common shares also reflect the issuance of 4.9 million shares in February 2011 for the Herley acquisitions and 10.4 million shares in July 2011 for the Integral acquisition. These adjustments are as follows (in millions except per share data):

	For the Three Months Ended June 26, 2011		For the Six Months Ended June 26, 2011	
Intangible amortization	$4.2		$14.0	
Net change in stock compensation expense	(0.6	)	(3.6	)
Net change in interest expense	3.0		12.9	
Net change in income tax benefit (expense)	0.1		(0.1	)
Increase in weighted average common shares outstanding for shares issued and not already included in the weighted average common shares outstanding	10.4		11.6	

Contingent Acquisition Consideration

In connection with some of its acquisitions, the Company agreed to make additional future payments to the seller contingent upon achievement of specific performance-based milestones by the acquired entities. Pursuant to the provisions of Topic 805, the Company will re-measure these liabilities each reporting period and record changes in the fair value in its Condensed Consolidated Statement of Operations and Comprehensive Income. Increases or decreases in the fair value of the contingent consideration liability which is measured as the present value of expected future cash flows, a Level 3 measurement in the fair value hierarchy, can result from changes in discount periods and rates, as well as changes in the estimates on the achievement of the performance-based milestones.

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Contingent acquisition consideration as of December 25, 2011 and June 24, 2012 is summarized in the following table (in millions):

Balance as of December 25, 2011	$7.6	
Cash payments	(4.0	)
Balance as of June 24, 2012	$3.6	

As of June 24, 2012, $2.5 million is reflected in other current liabilities and $1.1 million is reflected in other long-term liabilities in the condensed consolidated balance sheet. Other than the cash payments noted above, there were no changes in the fair value of contingent consideration for the three and six month periods ended June 24, 2012.

Pursuant to the terms of the agreement and plan of merger with DEI Services Corporation ("DEI") entered into on August 9, 2010 (“the DEI Agreement”), upon achievement of certain cash receipts, revenue, EBITDA and backlog amounts in 2010, 2011 and 2012, the Company will be obligated to pay certain additional contingent consideration (the “DEI Contingent Consideration”). The Company has paid $2.9 million related to the DEI Contingent Consideration of which $2.5 million was paid in April 2012. As of June 24, 2012, the potential undiscounted amount of future DEI Contingent Consideration that may be payable by the Company under the DEI Agreement is between $2.0 million and $4.5 million, subject to potential reductions if certain cash receipts are not collected. The DEI Contingent Consideration, which includes contingent consideration already paid and potential future contingent consideration, may be reduced in the event certain anticipated cash receipts are not collected within agreed upon time period, and could reduce the prior and future contingent consideration by approximately $6.0 million.

Note 3. Goodwill and Intangible Assets

(a) Goodwill

The Company performs its annual impairment test for goodwill in accordance with ASC Topic 350, Intangibles-Goodwill and Other (“Topic 350”) as of the last day of each fiscal year or when evidence of potential impairment exists.

The Company assesses goodwill for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment, referred to as a component. The Company determines its reporting units by first identifying its operating segments, and then assessing whether any components of these segments constitute a business for which discrete financial information is available and where segment management regularly reviews the operating results of that component. The Company aggregates components within an operating segment that have similar economic characteristics. For the annual and, if necessary, interim impairment assessment, the Company identified its reporting units to be its KGS and PSS operating segments.

In order to test for potential impairment, the Company estimates the fair value of each of its reporting units based on a comparison and weighting of the income approach, specifically the discounted cash flow method and the market approach, which estimates the fair value of the Company's reporting units based upon comparable market prices and recent transactions and also validates the reasonableness of the implied multiples from the income approach. The Company reconciles the fair value of its reporting units to its market capitalization by calculating its market capitalization based upon an average of its stock price prior to and subsequent to the date the Company performs its analysis and assuming a control premium. The Company uses these methodologies to determine the fair value of its reporting units for comparison to their corresponding book values because there are no observable inputs available (Level 3 hierarchy as defined by ASC Topic 820, Fair Value Measurements and Disclosures (“Topic 820”)). If the book value exceeds the estimated fair value for a reporting unit a potential impairment is indicated, and Topic 350 prescribes the approach for determining the impairment amount, if any.

In accordance with Topic 350, as a result of the Company's decision in June 2012 to dispose of certain non-core businesses acquired in the Integral Systems acquisition, the Company allocated $1.5 million of goodwill to discontinued operations which resulted in an impairment charge (see Note 8). The Company then tested the goodwill remaining in the KGS reporting unit. The fair value of the KGS reporting unit exceeded its carrying value by 7.4% Considering the relatively small excess of fair value over carrying value for the KGS reporting unit and given the current market conditions and continued economic uncertainty in the U.S. defense industry as a result of the Budget Control Act of 2011 (the "Budget Control Act"), the fair value of the KGS reporting unit may deteriorate, resulting in an impairment of the goodwill in that unit. Due to continual changes in market and general business conditions, the Company cannot predict whether, and to what extent, its goodwill and

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long-lived intangible assets may be impaired in future periods. Any resulting impairment loss could harm the Company's profitability and financial condition.

The changes in the carrying amount of goodwill for the six months ended June 24, 2012 are as follows (in millions):

	Public Safety & Security	Kratos Government Solutions	Total
Balance as of December 25, 2011	$33.0	$539.0	$572.0
Retrospective adjustments	—	(0.4)	(0.4)
Balance as of December 25, 2011 after retrospective adjustments	33.0	538.6	571.6
Additions due to business combinations	3.8	—	3.8
Balance as of June 24, 2012	$36.8	$538.6	$575.4

The accumulated impairment losses as of December 25, 2011 and June 24, 2012 were $165.4 million; $147.1 million associated with the KGS segment and $18.3 million associated with the PSS segment.

(b) Purchased Intangible Assets

The following table sets forth information for finite-lived intangible assets subject to amortization (in millions):

	As of December 25, 2011			As of June 24, 2012		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Acquired finite-lived intangible assets:						
Customer relationships	$78.1	$(19.8)	$58.3	$79.2	$(27.2)	$52.0
Contracts and backlog	60.1	(39.6)	20.5	61.0	(50.3)	10.7
Developed technology and technical know-how	22.1	(4.1)	18.0	22.1	(5.2)	16.9
Trade names	2.6	(0.8)	1.8	2.6	(1.0)	1.6
Favorable operating lease	1.8	(0.3)	1.5	1.8	(0.3)	1.5
Total	$164.7	$(64.6)	$100.1	$166.7	$(84.0)	$82.7

In addition to the finite-lived intangible assets listed in the table above, the Company has $24.5 million of indefinite-lived intangible assets consisting of trade names at both December 25, 2011 and June 24, 2012.

Consolidated amortization expense related to intangible assets subject to amortization was $9.2 million and $8.9 million for the three months ended June 26, 2011 and June 24, 2012, respectively, and $12.6 million and $19.4 million for the six months ended June 26, 2011 and June 24, 2012, respectively.

The estimated future amortization expense of purchased intangible assets with finite lives as of June 24, 2012 is as follows (in millions):

Fiscal Year	Amount
2012 (remaining six months)	$16.4
2013	18.5
2014	16.8
2015	11.0

2016	6.3
Thereafter	13.7
Total	$82.7

Note 4. Inventoried Costs

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Inventoried costs are stated at the lower of cost or market. Cost is determined using the average cost or first-in, first-out method and is applied consistently within an operating entity. Inventoried costs primarily relate to work in process under fixed-price contracts using costs as the basis of the percentage-of-completion calculation under the units produced method of revenue recognition. These costs represent accumulated contract costs less the portion of such costs allocated to delivered items. Accumulated contract costs include direct production costs, factory and engineering overhead and production tooling costs. Pursuant to contract provisions of U.S. Government contracts, such customers may have title to, or a security interest in, inventories related to such contracts as a result of advances, performance-based payments, and progress payments. The Company reflects those advances and payments as an offset against the related inventory balances.

The Company regularly reviews inventory quantities on hand, future purchase commitments with its suppliers, and the estimated utility of its inventory. If the Company’s review indicates a reduction in utility below carrying value, it reduces its inventory to a new cost basis.

Inventoried costs consisted of the following components (in millions):

	December 25, 2011	June 24, 2012
Raw materials	$43.3	$45.8
Work in process	25.7	30.8
Finished goods	6.9	9.2
Supplies and other	4.0	0.9
Subtotal inventoried costs	79.9	86.7
Less customer advances and progress payments	(3.3)	(0.3)
Total inventoried costs	$76.6	$86.4

Note 5. Stockholders’ Equity

On May 14, 2012, the Company sold 20.0 million shares of its common stock at a purchase price of $5.00 per share in an underwritten public offering. The Company received gross proceeds of $100.0 million. After deducting underwriting and other offering expenses, the Company received approximately $97.0 million in net proceeds. The Company used the net proceeds from this offering to fund a portion of the cash consideration paid to the stockholders of Composite Engineering, Inc. ("CEI") in connection with the Company's acquisition thereof on July 2, 2012.

On February 11, 2011, the Company sold approximately 4.9 million shares of its common stock at a purchase price of $13.25 per share in an underwritten public offering. The Company received gross proceeds of approximately $64.8 million. After deducting underwriting and other offering expenses, the Company received approximately $61.1 million in net proceeds.

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A summary of the changes in stockholders' equity is provided below (in millions):

	Six Months Ended June 26, 2011	Six Months Ended June 24, 2012
Stockholders' equity at beginning of period	$169.9	$312.6
Comprehensive income:		
Net loss	(8.7)	(20.2)
Foreign currency translation	—	(0.2)
Total comprehensive loss	(8.7)	(20.4)
Additional paid-in-capital from the issuance of common stock for cash	61.1	97.0
Stock-based compensation	1.4	2.3
Employee stock purchase plan and restricted stock units settled in cash	0.3	—
Exercise of stock options and warrants	1.1	—
Fair value of stock options assumed in acquisitions	1.9	—
Stockholders' equity at end of period	$227.0	$391.5

In prior reporting periods, the Company had two classes of outstanding stock, Series B Convertible Preferred Stock and common stock. On March 8, 2011, all of the 10,000 shares of the previously issued and outstanding shares of Series B Convertible Preferred Stock were redeemed for 100,000 shares of common stock. Common stock issued by the Company for the six months ended June 26, 2011 and June 24, 2012 was as follows (in millions):

	Six Months Ended June 26, 2011	Six Months Ended June 24, 2012
Shares outstanding at beginning of the period	18.6	32.4
Stock issued for employee stock purchase plan, stock options and restricted stock units exercised	0.3	0.1
Redemption of Series B Convertible Preferred Stock	0.1	—
Common stock issued for cash	4.9	20.0
Shares outstanding at end of the period	23.9	52.5

Note 6. Net Income (Loss) Per Common Share

The Company calculates net income (loss) per share in accordance with ASC Topic 260, Earnings Per Share ("Topic 260"). Under Topic 260, basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. Diluted net income (loss) per common share reflects the effects of potentially dilutive securities.

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(In millions, except earnings per share)	For the Three Months Ended June 26, 2011	For the Three Months Ended June 24, 2012	For the Six Months Ended June 26, 2011	For the Six Months Ended June 24, 2012
Loss from continuing operations available for common shareholders (A)	$(5.3)	(14.9)	$(9.1)	(17.4)
Weighted average outstanding shares of common stock (B)	23.8	41.7	22.6	37.1
Dilutive effect of employee stock options and awards	—	—	—	—
Common stock and common stock equivalents (C)	23.8	41.7	22.6	37.1
Loss per share:				
Basic (A/B)	$(0.22)	(0.36)	$(0.40)	(0.47)
Diluted (A/C)	$(0.22)	(0.36)	$(0.40)	(0.47)

The following shares were excluded from the calculation of diluted loss per share because their inclusion would have been anti-dilutive.

(In millions)	For the Three Months Ended June 26, 2011	For the Three Months Ended June 24, 2012	For the Six Months Ended June 26, 2011	For the Six Months Ended June 24, 2012
Shares from stock options and awards	2.2	3.1	1.7	2.6

Note 7. Income Taxes

As of December 25, 2011, the Company had $10.2 million of unrecognized tax benefits that, if recognized, would affect the effective tax rate, subject to possible offset by an increase in the valuation allowance. During the six months ended June 24, 2012, this amount was reduced by $0.1 million relating to the expiration of statutes of limitations. This reduction in unrecognized tax benefits was recorded as a tax benefit from discontinued operations. Additionally, the unrecognized tax benefit amount was reduced by $0.3 million as a result of the completion of an Internal Revenue Service (“IRS”) audit. This reduction in unrecognized tax benefits was recorded as a benefit from continuing operations.

During the six months ended June 24, 2012, the Company decreased the unrecognized tax benefits of Integral by $0.2 million, which was recorded as an adjustment to goodwill. Integral's unrecognized tax benefits are related to various federal tax issues.

The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes. There was no material expense recorded during the six months ended June 26, 2011. During the six months ended June 24, 2012, a $0.3 million expense was recorded related to interest and penalties. The Company recorded a benefit for interest and penalties related to the reversal of prior positions of $0.7 million and $0.1 million for the six months ended June 26, 2011 and June 24, 2012, respectively. The Company believes that it is reasonably possible that as much as $1.5 million of the liabilities for uncertain tax positions will expire within 12 months of June 24, 2012 due to the expiration of various applicable statutes of limitations.

The Company is subject to taxation in the U.S., various state tax jurisdictions and various foreign tax jurisdictions. The Company's tax years for 2000 and later are subject to examination by the U.S. and state tax authorities due to the existence of net operating loss (“NOL”) carryforwards. Generally, the Company's tax years for 2002 and later are subject to examination by various foreign tax authorities.

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In assessing the Company's ability to realize deferred tax assets, management considers, on a periodic basis, whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. As such, management has determined that it is appropriate to maintain a full valuation allowance against the Company's deferred tax assets, with the exception of an amount equal to its deferred tax liabilities, which can be expected to reverse over a definite life. Management will continue to evaluate the necessity to maintain a valuation allowance against the Company's net deferred tax assets. A reconciliation of the total income tax provision to the amount computed by applying the statutory federal income tax rate of 35% to loss from continuing operations before income tax provision for the three and six months ended June 26, 2011 and June 24, 2012 is as follows (in millions):

	For the Three Months Ended		For the Six Months Ended	
	June 26, 2011	June 24, 2012	June 26, 2011	June 24, 2012
Income tax benefit at federal statutory rate	$(1.6)	$(2.8)	$(3.4)	$(5.4)
State and foreign taxes, net of federal tax benefit and valuation allowance	1.1	6.6	1.6	2.5
Nondeductible expenses and other	0.6	0.3	1.5	0.8
Impact of indefinite lived deferred tax liabilities and state law changes	—	—	0.3	—
Settlement with IRS	—	—	(2.1)	—
Increase/(decrease) in reserves for uncertain tax positions		—		(0.1)
Increase/(decrease) in federal valuation allowance	0.8	2.5	1.8	4.7
Total	$0.9	$6.6	$(0.3)	$2.5

Federal and state income tax laws impose restrictions on the utilization of NOL and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 (“Section 382”) of the Internal Revenue Code of 1986, as amended (the “Code”). In general, an ownership change occurs when shareholders owning 5% or more of a “loss corporation” (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any 3-year period. The annual base Section 382 limitation is calculated by multiplying the loss corporation's value (which may be modified for certain recent increases to capital) at the time of the ownership change times the greater of the long-term tax-exempt rate determined by the Internal Revenue Service (“IRS”) in the month of the ownership change or the two preceding months. In March 2010, an “ownership change” occurred that will limit the utilization of the loss carryforwards. Additionally, in May 2012, another “ownership change” was triggered. As a result of this change in May, the Company's federal annual utilization of NOL carryforwards will be limited to $28.1 million a year for the five years succeeding the initial ownership change and $11.6 million per year thereafter. If the entire limitation amount is not utilized in a year, the excess can be carried forward and utilized in future years. For the six months ended June 24, 2012, there was no impact of such limitations on the income tax provision since the amount of taxable income did not exceed the annual limitation amount. In addition, future equity offerings or acquisitions that have equity as a component of the purchase price could also result in an “ownership change”. If and when any other “ownership change” occurs, utilization of the NOL or other tax attributes may be further limited. As discussed elsewhere, deferred tax assets relating to the NOL and credit carryforwards are offset by a full valuation allowance. In addition, utilization of state tax loss carryforwards is dependent upon sufficient taxable income apportioned to the states.

Note 8. Discontinued Operations

In June of 2012, consistent with the Company's plans to complete its assessment and evaluation of the non-core businesses acquired in the Integral acquisition, the Company committed to a plan to sell certain lines of business associated with antennas, satellite-cased products and fly-away terminals. These operations were previously reported in the KGS segment, and in accordance with Topic 205 Presentation of Financial Statements ("Topic 205"), these businesses have been classified as held for sale and reported in discontinued operations in the accompanying condensed consolidated financial statements. The Company recorded a $1.5 million impairment charge associated with the portion of goodwill that was allocated to the discontinued businesses based on management's estimate of the fair value of the business.

On August 2, 2010, the Company divested the southeast division of its PSS segment for approximately $0.1 million cash consideration and the assumption of certain liabilities.

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The following table presents the results of discontinued operations (in millions):

	For the Three Months Ended		For the Six Months Ended	
	June 26, 2011	June 24, 2012	June 26, 2011	June 24, 2012
Revenue	$—	$1.8	$—	$7.4
Net income (loss) before taxes	0.1	(2.3)	0.1	(2.9)
Benefit for income taxes	—	—	(0.3)	(0.1)
Net income (loss) after taxes	$0.1	$(2.3)	$0.4	$(2.8)

The benefit for income taxes for the six months ended June 26, 2011 and June 24, 2012 was primarily due to the expiration of the statute of limitations for certain foreign tax contingencies related to the Company's discontinued wireless services business.

The following is a summary of the assets and liabilities of discontinued operations which are in other current assets, other current liabilities and other long-term liabilities in the accompanying condensed consolidated balance sheets as of December 25, 2011 and June 24, 2012 (in millions):

	December 25, 2011	June 24, 2012
Accounts receivable, net	$5.3	$2.2
Inventoried costs	4.0	4.4
Other current assets	0.4	0.7
Current assets of discontinued operations	$9.7	$7.3
Property and equipment, net	$0.6	$0.5
Goodwill	$1.5	$—
Other non-current assets	$0.3	$0.4
Non-current assets of discontinued operations	$2.4	$0.9
Accounts payable	$3.0	$4.5
Accrued expenses	1.5	1.7