

KRATOS DEFENSE & SECURITY SOLUTIONS, INC.  
Form DEF 14A  
April 14, 2017

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

**SCHEDULE 14A**

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

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material under §240.14a-12

**Kratos Defense & Security Solutions, Inc.**

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(Name of Registrant as Specified In Its Charter)

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

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April 14, 2017

Dear Stockholder:

You are cordially invited to attend the 2017 Annual Meeting of Kratos Defense & Security Solutions, Inc. ("Kratos"), which will be held at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121, on Wednesday, May 31, 2017, at 9:00 a.m. local time. We hope you will be able to attend the meeting in person.

At our annual meeting, our stockholders will be asked to elect the eight directors named herein to our Board of Directors; to ratify the Board's selection of Deloitte & Touche LLP as our independent registered public accounting firm; to approve an amendment to our 1999 Employee Stock Purchase Plan to increase the number of shares issuable under the plan by 3,000,000 shares; to approve an amendment to our 2014 Equity Incentive Plan to increase the number of shares issuable under the plan by 2,500,000 shares; to cast an advisory vote to approve the compensation of our named executive officers; to cast an advisory vote on the frequency of the stockholder advisory vote to approve the compensation of our named executive officers; and to transact such other business as may properly come before the meeting or any adjournment thereof. Following the formal annual meeting, we will also present a report on our operations and activities, and management will be pleased to answer your questions about us and our business.

Whether or not you plan to attend the annual meeting personally, and regardless of the number of shares of Kratos common stock you own, it is important that your shares be represented at the annual meeting. This year, we are pleased to take advantage of rules enacted by the Securities and Exchange Commission ("SEC") that allow companies to furnish their proxy materials over the Internet. As a result, we are mailing to most of our stockholders a Notice of Internet Availability of Proxy Materials (the "Notice") instead of a paper copy of our proxy materials, which include the Notice of Annual Meeting of Stockholders, our proxy statement, our 2016 Annual Report and a proxy card or voting instruction form. The Notice contains instructions on how to access those documents on the Internet and how to cast your vote via the Internet or by telephone. The Notice also contains instructions on how to request a paper copy of our proxy materials. All stockholders who do not receive the Notice will receive a paper copy of the proxy materials by mail. If you have received a paper copy of our proxy materials you can cast your vote by completing the enclosed proxy card and returning it in the postage-prepaid envelope provided or by utilizing the telephone or Internet voting systems.

Sincerely,

Eric DeMarco  
*President and Chief Executive Officer*

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## KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

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

### NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To be held on May 31, 2017

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

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of Kratos Defense & Security Solutions, Inc. (the "Company") will be held on Wednesday, May 31, 2017, at 9:00 a.m. local time at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121 for the following purposes:

1. To elect the following eight nominees as directors to serve until the next annual meeting, or until their successors are duly elected and qualified: Scott Anderson, Bandel Carano, Eric DeMarco, William Hoggund, Scot Jarvis, Jane Judd, Samuel Liberatore, and Amy Zegart.
2. To ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2017.
3. To approve an amendment to our 1999 Employee Stock Purchase Plan to increase the number of shares issuable under the plan by 3,000,000 shares.
4. To approve an amendment to our 2014 Equity Incentive Plan to increase the number of shares issuable under the plan by 2,500,000 shares.
5. An advisory (non-binding) vote to approve the compensation of our named executive officers, as presented in the proxy statement accompanying this Notice.
6. An advisory (non-binding) vote on the frequency of the stockholder advisory vote to approve the compensation of our named executive officers, as presented in the proxy statement accompanying this Notice.
7. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

Our Board of Directors unanimously recommends a vote "**FOR**" the election of all of the director nominees, "**FOR**" each of proposals 2, 3, 4, and 5, and "**FOR**" holding the advisory vote on executive compensation every "**ONE YEAR**" with respect to proposal 6. The foregoing items of business are more fully described in the proxy statement accompanying this Notice.

Our Board of Directors has fixed the close of business on April 7, 2017 as the record date for the determination of stockholders entitled to notice of and to vote at this annual meeting and at any adjournment or postponement thereof. All stockholders are invited to attend the meeting. You must present your proxy, voter instruction card or meeting notice for admission.

By Order of the Board of Directors,

Eric DeMarco  
*President and Chief Executive Officer*

April 14, 2017

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

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

**Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 31, 2017:** Our Notice of Annual Meeting of Stockholders, proxy statement and 2016 Annual Report on Form 10-K are available at [www.proxyvote.com](http://www.proxyvote.com).

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## 2017 PROXY SUMMARY

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

### Annual Meeting of Stockholders

Time & Date: 9:00 a.m., May 31, 2017

Place: Irvine Amenities Center  
9540 Towne Centre Drive, Suite 175  
San Diego, CA 92121

Record Date: April 7, 2017

Voting: You may vote either in person at the Annual Meeting or by telephone, the Internet or mail. See the section entitled "How to Vote" below for more detailed information regarding how you may vote your shares.

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

**Meeting Agenda and Voting Recommendations**

<b>Proposal</b>	<b>Board of Directors Vote Recommendation</b>	<b>Page References (for more detail)</b>
1. Election of Directors	FOR EACH DIRECTOR NOMINEE	19
2. Ratification of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2017	FOR	23
3. Approval of an amendment to our 1999 Employee Stock Purchase Plan to increase the number of shares issuable under the plan by 3,000,000 shares	FOR	25
4. Approval of an amendment to our 2014 Equity Incentive Plan to increase the number of shares issuable under the plan by 2,500,000 shares	FOR	29
5. Advisory (non-binding) vote to approve the compensation of our named executive officers	FOR	41
6. Advisory (non-binding) vote on the frequency of the stockholder advisory vote on the compensation of our named executive officers	FOR 1 YEAR	46

**Proposal 1: Director Nominees**

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

Name	Age	Director Since	Occupation	Independent	Committees
Scott Anderson	58	1997	President, NE Wireless Networks, LLC	x	Audit (Chair); Nominating & Corporate Governance
Bandel Carano	55	1998	Managing Partner, Oak Investment Partners	x	Compensation
Eric DeMarco	53	2003	President and Chief Executive Officer, Kratos		
William Hogleund (Chairman)	63	2001	Member, Safeboats International, LLP	x	Audit; Compensation; Nominating & Corporate Governance
Scot Jarvis	56	1997	Principal, Cedar Grove Partners, LLC	x	Audit; Compensation (Chair); Nominating & Corporate Governance
Jane Judd	70	2011	Senior Financial Executive (Ret.), Titan Corporation	x	Audit
Samuel Liberatore	80	2009	President (Ret.), Madison Research Division of Kratos	x	Nominating & Corporate Governance
Amy Zegart	50	2014	Senior Fellow, The Hoover Institution, Stanford University and Co-Director, Stanford Center for International Security and Cooperation	x	Nominating & Corporate Governance (Chair)

**Proposal 2: Ratification of Auditors**

As a matter of good corporate governance, we are asking our stockholders to ratify the Audit Committee's selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2017 (please review the complete Proposal No. 2 beginning on page 23 of this proxy statement).

**Proposal 3: Employee Stock Purchase Plan Amendment Proposal**

We are asking the Company's stockholders to approve an amendment to our 1999 Employee Stock Purchase Plan (the "Purchase Plan") to increase the number of shares issuable under the plan by 3,000,000 shares. Such increase would enable us to continue to offer the Purchase Plan to our executive and non-executive employees. We believe key elements of our future success will be broad-based stock ownership by all of our employees and providing them with incentives to become and remain stockholders. The Purchase Plan is a broad-based employee stock purchase plan, which provides eligible



employees, including our non-executive employees, a convenient opportunity to purchase stock and further align their interests with our stockholders' interests.

**Proposal 4: 2014 Equity Incentive Plan Amendment Proposal**

We are asking the Company's stockholders to approve an amendment to our 2014 Equity Incentive Plan (the "2014 Plan") to increase the number of shares issuable under the plan by 2,500,000. Such increase would enable us to have additional shares of common stock available to attract and encourage the continued employment and service of our officers, employees, directors, and other individuals, by offering those persons the opportunity to acquire or increase a direct proprietary interest in our operations and future success and to further align their interests with our stockholders' interests.

**Proposal 5: Advisory Vote to Approve Compensation of Named Executive Officers**

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

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

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

attract, motivate and retain highly qualified executives; and

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

At the 2016 Annual Meeting, our stockholders indicated approval of the compensation of our named executive officers, with 90.19% of the votes cast in favor of the advisory vote. We were very pleased with the voting results in light of the Compensation Committee's and the management's continuing efforts in gathering feedback from key stockholders regarding our executive compensation and developing a compensation structure that more closely aligns pay with performance and aligns the interests of our executives with our stockholders. We continue to regularly solicit feedback from the Company's stockholders regarding our performance, progress on executing the Company's strategic plan and our executive compensation philosophy and programs. As a result, our Compensation Committee took the following actions for 2016 executive compensation:

2016 Executive Pay Highlights: For 2016, the Compensation Committee implemented and/or continued a number of practices that provided more clear alignment between pay and performance, including:

**Base Salary:** In light of the current defense industry contraction and the challenging Department of Defense ("DoD") budgetary environment, the base salaries of all of our corporate named executive officers (the Chief Executive Officer and the Chief Financial Officer) and certain of our business unit executive officers remained frozen at 2014 compensation levels. This was the third base salary freeze since 2013, which reflects the Compensation Committee's emphasis on aligning pay and performance, taking into consideration the continued focus of internal investments in certain growth opportunity technologies and new platforms that the Company has been making and continues to make in its core businesses. The intent of the Compensation Committee was to construct a compensation program that continues to place significant emphasis on performance-based and long-term incentives, while being mindful of the

DoD's current significant budgetary constraints and providing salaries that align with peer compensation data. The Compensation Committee strives for executive compensation to be at or near the median average of peer companies' executive compensation.

**Long-term Equity Incentives:** Since 2013, the Company has issued an approximate 50%/50% mix of performance-based and time-based equity incentives, and the Company followed the same practice in 2016. Similar to 2015, long-term equity incentives granted in 2016 included performance-based restricted stock unit ("RSU") awards that vest 20% for every 10% increase in the closing price of the Company's common stock (above the grant date price of \$4.07) that occurs within 10 years of the grant date, provided that certain other conditions are met. The time-based RSU awards cliff vest 100% at the end of five years, which the Compensation Committee believes provides a strong long-term retention tool and long-term alignment with stockholder interests. Additionally, the Chief Executive Officer's RSU awards granted in 2016 are subject to a five-year holding period under which the common stock underlying such RSUs will not be issued and released until five years from the applicable vesting date. To further align pay and performance, in May 2016 the Compensation Committee decided that for any future RSU grants that vest based on a certain Company common stock closing price being achieved, the specified Company common stock closing price must be sustained for 20 consecutive trading days before a vesting event occurs, subject to the terms of the applicable award agreement; and the Chief Executive Officer agreed to apply such requirement retroactively to the unvested portions of his January 1, 2015 and January 4, 2016 performance-based RSU awards. In addition, the Company awarded 50,000 RSUs (which vest 33.33% on each anniversary of the date of grant) to Gerald Beaman, former President of the Company's Unmanned Systems Division, in August 2016 in recognition of the successful award to the Company of the Low Cost Attributable Strike Demonstrator ("LCASD") contract from the Air Force Research Laboratory, which was targeted as one of the critical strategic opportunities in executing the Company's unmanned combat aerial systems initiative.

**Change in Control Agreements:** Continuing its practice from 2013, the Compensation Committee eliminated excise tax gross-ups in any new change in control agreements or renewals or material amendments of existing change in control agreements.

**Anti-Hedging and Anti-Pledging Policy:** The Company continued its policy that prohibits any hedging and pledging transactions by directors and executive officers.

**Stock Ownership Target Guideline:** The Compensation Committee continued to implement a stock ownership target guideline for our Chief Executive Officer of 1% of our outstanding shares of common stock, including all shares held through options, RSUs, Purchase Plan purchases, open market purchases and 401(k) holdings.

**Clawback Policy:** The Compensation Committee continued its Incentive Compensation Recoupment Policy, under which the Company will seek to recover full or partial portions of cash and equity-based incentive compensation received by executive officers when such incentive compensation either (i) was tied to the achievement of financial results that are subsequently restated to correct an accounting error due to material noncompliance with financial reporting requirements or (ii) would have been lower based upon the subsequently restated financial results.

2017 Executive Pay Highlights: For 2017, the Compensation Committee continued to focus on clear alignment between pay and performance:

**Base Salary:** In light of the continued defense industry contraction and the very challenging DoD budgetary environment, and taking into consideration the continued focus of internal investments in certain growth opportunity technologies and new platforms the Company has

been making and continues to make in its core businesses, the base salaries of most of our named executive officers (including the Chief Executive Officer) remain frozen at 2014 compensation levels. This is the fourth base salary freeze since 2013, which reflects the Compensation Committee's emphasis on aligning pay and performance.

**Long-term Equity Incentives:** The Company continued its practice of issuing an approximate 50%/50% mix of performance-based and time-based equity incentives. Similar to 2016, long-term equity incentives granted in 2017 included performance-based RSU awards that vest 20% for every 10% increase in the Company's common stock (above the grant date price of \$7.51) that occurs within 10 years of the grant date; provided, that such increase in the closing price of the Company's common stock is sustained for 20 consecutive trading days and certain other conditions are met. The time-based RSU awards cliff vest 100% at the end of five years, which the Compensation Committee believes provides a strong long-term retention tool and long-term alignment with stockholder interests. Additionally, the Chief Executive Officer's RSU awards granted in 2017 are subject to a five-year holding period under which the common stock underlying such RSUs will not be issued and released until five years from the applicable vesting date.

Additional information about our compensation philosophy and program, including the compensation actions summarized above, can be found in the "Compensation Discussion and Analysis" section beginning on page 51 of this proxy statement. Our Board of Directors and Compensation Committee believe that the compensation of our named executive officers for fiscal year 2016 was appropriate and reasonable and that our compensation policies and procedures are sound and in the best interests of the Company and its stockholders. Additionally, the Compensation Committee believes that our compensation policies and procedures are effective in achieving the Company's goals of rewarding sustained financial and operating performance and leadership excellence, aligning the executives' long-term interests with those of our stockholders and motivating our executive officers to remain with the Company for long and productive careers.

**Proposal 6: Advisory Vote on the Frequency of the Stockholder Advisory Vote to Approve Compensation of Named Executive Officers**

We are asking our stockholders to provide an advisory vote on whether a non-binding stockholder vote to approve the compensation of our named executive officers should occur every one, two or three years. The Company has engaged some of its stockholders on this issue, and based on their feedback we believe that a majority of our stockholders would prefer an annual vote. Our Board of Directors is therefore recommending that stockholders vote for holding the advisory vote on executive compensation every ONE YEAR.

**Cautionary Statement.** Any statements in this proxy statement that do not describe historical facts may constitute forward-looking statements. These forward-looking statements are based on current expectations but are subject to a number of risks and uncertainties. The factors that could cause our actual future results to differ materially from current expectations are identified and described in more detail in our filings with the Securities and Exchange Commission (the "SEC"), including our Annual Report on Form 10-K for the fiscal year ended December 25, 2016. You should not place undue reliance on these forward-looking statements, which speak only as of the date that they were made. Except as required by applicable law, we do not intend to update any of the forward-looking statements to conform these statements to reflect actual results, later events or circumstances.

## **KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**

**4820 EASTGATE MALL, SUITE 200**

**SAN DIEGO, CA 92121**

### **PROXY STATEMENT**

**FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON MAY 31, 2017**

#### **General**

The enclosed proxy is solicited on behalf of our Board of Directors (the "Board") for use at the 2017 Annual Meeting of Stockholders (the "Annual Meeting") of Kratos Defense & Security Solutions, Inc., to be held on May 31, 2017 at 9:00 a.m. local time and at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting of Stockholders. The Annual Meeting will be held at the Irvine Amenities Center located at 9540 Towne Centre Drive, Suite 175, San Diego, California 92121.

We intend to mail a Notice Regarding the Availability of Proxy Materials (the "Notice") or our proxy materials to all stockholders of record entitled to vote at the Annual Meeting on or about April 14, 2017. The Notice will instruct you as to how you may access and review all of the important information contained in the proxy materials.

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

#### **Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 31, 2017:**

**Our Notice of Annual Meeting of Stockholders, proxy statement and 2016 Annual Report on Form 10-K are available at [www.proxyvote.com](http://www.proxyvote.com).** You are encouraged to access and review all of the important information contained in the proxy materials before voting.

#### **Solicitation and Revocation of Proxy**

Our Board is soliciting the accompanying proxy. In accordance with unanimous recommendations of our Board, the individuals named in the proxy will vote all shares represented by proxies in the manner designated, or, if no designation is made, they will vote the proxies FOR the election of all of the director nominees, FOR each of proposals 2, 3, 4, and 5, and FOR annual say-on-pay vote frequency for proposal 6. In their discretion, the proxy holders named in the proxy are authorized to vote on any matters that may properly come before the Annual Meeting and at any continuation, postponement or adjournment of the Annual Meeting. As of the date of this proxy statement, our Board does not know of any other items of business that will be presented for consideration at the Annual Meeting other than those described in this proxy statement. The individuals acting as proxies will not vote on a particular matter if the proxy card representing those shares instructs them to abstain from voting on that matter or to the extent a proxy card is marked to show that some of the shares represented by the proxy card are not to be voted.

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

- (1) by revoking it in person at the Annual Meeting;
- (2) by sending a written notice that you are revoking your proxy to our Corporate Secretary at 4820 Eastgate Mall, Suite 200, San Diego, California, 92121; or

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

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

### **Shares Outstanding and Voting Rights**

Only stockholders of record as of the record date, April 7, 2017, will be entitled to notice of and to vote at the Annual Meeting or at any continuation, postponement or adjournment of the original meeting. On the record date, our only class of voting stock outstanding was common stock. On April 7, 2017, 86,446,084 shares of common stock were issued and outstanding. Each outstanding share of common stock entitles the holder to one vote on all matters to be voted upon at the Annual Meeting.

### **How to Vote**

#### ***Stockholder of Record: Shares Registered in Your Name***

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

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

To vote via the Internet, go to the Internet address stated on your proxy card.

To vote by telephone, call the number stated on your proxy card.

To vote by mail, simply mark your proxy card, date and sign it and return it in the postage-prepaid envelope.

Votes submitted via the Internet or by telephone must be received by 11:59 P.M. Eastern Time on May 30, 2017. Submitting your proxy via the Internet or by telephone will not affect your right to vote in person should you decide to attend the Annual Meeting. If voting by mail, the proxy card must be received prior to the Annual Meeting. Even if you plan to attend the Annual Meeting, we encourage you to submit your proxy to vote your shares in advance of the Annual Meeting.

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

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

If at the close of business on April 7, 2017 your shares of common stock were not held in your name, but rather in an account at a brokerage firm, bank, dealer or other similar organization, then you are the beneficial owner of shares held in "street name," and you will receive a proxy card and voting instructions from that organization. Your broker, bank or other nominee will allow you to deliver your voting instructions via the Internet and may also permit you to submit your voting instructions by telephone.

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

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

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

**Counting of Votes; Quorum**

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

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if at least a majority of our outstanding shares of common stock entitled to vote are represented by votes at the Annual Meeting or by proxy. At the close of business on April 7, 2017, the record date for the Annual Meeting, there were 86,446,084 shares of common stock outstanding and entitled to vote at the Annual Meeting.

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

**Required Vote**

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

Proposal	Vote Required	Discretionary Voting Allowed?
1. Election of Directors	Plurality	No
2. Ratification of Auditor	Majority	Yes
3. Approval of the amendment to the 1999 Employee Stock Purchase Plan	Majority	No
4. Approval of the amendment to the 2014 Equity Incentive Plan	Majority	No
5. Advisory Vote to Approve the Compensation of Our Named Executive Officers	Majority	No
6. Advisory Vote on the Frequency of the Stockholder Advisory Vote on the Compensation of our Named Executive Officers	Plurality	No

Our Board unanimously recommends a vote "**FOR**" the election of all of the director nominees, "**FOR**" each of proposals 2, 3, 4, and 5, and "**FOR**" holding the advisory vote on executive compensation every "**ONE YEAR**" with respect to proposal 6.

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

compensation of our named executive officers means that the option (every one, two or three years) receiving the greatest number of "for" votes will be considered the frequency recommended by stockholders.

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

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

Although the advisory votes on Proposals No. 5 and 6 are non-binding, as provided by law, our Board and Compensation Committee will review the results of the votes and, consistent with our record of stockholder engagement, will take the results into account in making a determination concerning executive compensation and the frequency of such advisory votes.

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

*Withhold Votes:* Shares subject to instructions to withhold authority to vote on the election of directors will not be voted. This will have no effect on the election of directors because, under plurality voting rules, the eight director nominees receiving the highest number of "for" votes will be elected. However, if any nominee for director receives a greater number of votes "withheld" than votes "for" his or her election, our corporate governance policies require that such person must promptly tender his or her resignation to the Board following certification of the vote. Any such resignation will be reviewed by our Nominating and Corporate Governance Committee and, within 90 days after the election, the Board will determine whether to accept, reject or take other appropriate action with respect to the resignation. "Withhold" votes and broker non-votes are not considered votes cast and will have no effect on the election of the nominees.

*Abstentions:* Under Delaware law (under which Kratos is incorporated), abstentions are counted as shares present and entitled to vote at the Annual Meeting. Therefore, abstentions will have the same effect as a vote "against": Proposal No. 2 Ratification of Auditor; Proposal No. 3 Approval of the amendment to the 1999 Employee Stock Purchase Plan; Proposal No. 4 Approval of the amendment to the 2014 Equity Incentive Plan; and Proposal No. 5 Advisory Vote to Approve the Compensation of our Named Executive Officers. Because the voting requirement applicable to Proposal No. 6 Advisory Vote on the Frequency of the Stockholder Advisory Vote on the Compensation of our Named Executive Officers is a plurality of the shares voted on the various options, an abstention with regard to this proposal will have no effect on the outcome of the vote.

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

Banks, brokers, and other such record holders are not permitted to vote the uninstructed shares of their customers on a discretionary basis in the election of directors, amendments to equity plans or on executive compensation matters. Because broker non-votes are not considered under Delaware law to be entitled to vote at the Annual Meeting, they will have no effect on the outcome of the votes on: Proposal No. 1 Election of Directors; Proposal No. 3 Approval of the amendment to the 1999 Employee Stock Purchase Plan; Proposal No. 4 Approval of the amendment to the 2014 Equity Incentive Plan; Proposal No. 5 Advisory Vote to Approve the Compensation of our Named Executive Officers; and Proposal No. 6 Advisory Vote on the Frequency of the Stockholder Advisory Vote on the Compensation of our Named Executive Officers. As a result, if you hold your shares in street name and you do not instruct your bank, broker, or other such holder how to vote your shares in the election of directors, on the approval of the amendment to the 1999 Employee Stock Purchase Plan, on the approval of the amendment to the 2014 Equity Incentive Plan, and on the two advisory votes related to the compensation of our named executive officers, no votes will be cast on your behalf on these proposals. **Therefore, it is critical that you indicate your vote on these proposals if you want your vote to be counted.** The proposal to ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2017 should be considered a routine matter. Therefore, your broker will be able to vote on this proposal even if it does not receive instructions from you, so long as it holds your shares in its name.

#### **Delivery of Notice of Internet Availability of Proxy Materials; Delivery of Multiple Proxy Materials**

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

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

#### **Cost and Method of Solicitation**

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

#### **Stockholder List**

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



**Admission to the Annual Meeting**

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

If you need directions to the Annual Meeting so that you may attend or vote in person, please contact Kratos Defense & Security Solutions, Inc., Attention: Investor Relations, 4820 Eastgate Mall, Suite 200, San Diego, California 92121, telephone (858) 812-7300.

**Voting Results**

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

## CORPORATE GOVERNANCE

### Overview

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

### Corporate Governance Guidelines

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

### Director Independence

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

### Nominations for Directors

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

In addition, our Bylaws set forth a process for stockholders to nominate individuals for election to the Board. See "Stockholder Proposals" below for additional information regarding the content and timing of the information that must be received by our Corporate Secretary for a director nominee to be considered for election at our 2018 Annual Meeting. A printed copy of our Bylaws may be obtained by any stockholder upon request to our Corporate Secretary at Kratos Defense & Security Solutions, Inc., 4820 Eastgate Mall, Suite 200, San Diego, California 92121.

The goal of the Nominating and Corporate Governance Committee is to assemble a board of directors that brings a variety of perspectives and skills derived from high quality business and

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

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

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

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

#### **Stockholder Communications with Directors**

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

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communication to: Chairman of the Board or Board of Directors, c/o Corporate Secretary, Kratos Defense & Security Solutions, Inc., 4820 Eastgate Mall, Suite 200, San Diego, California 92121.

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

### **Code of Ethics**

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

### **Meetings and Committees of the Board**

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

### **Meeting Attendance**

Our Board normally meets quarterly but may hold additional meetings as required. During fiscal year 2016, the Board held four regularly scheduled meetings, one special meeting and acted by unanimous written consent one time. Each of our directors attended at least 75% of the aggregate of the total number of Board meetings and the total number of meetings of each Committee on which he or she was serving. All eight of our directors attended last year's annual meeting of stockholders.

Our Board has adopted a "Board Member Attendance at Annual Meetings Policy," which strongly encourages all directors to attend the Company's annual meetings of stockholders. The full policy is available for review on our website at [www.kratosdefense.com/about-kratos/governance](http://www.kratosdefense.com/about-kratos/governance).

### **Executive Sessions**

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

## **Committees of the Board**

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

### ***Audit Committee***

Our Audit Committee consists of Messrs. Anderson (Chairperson), Hoglund and Jarvis and Ms. Judd. Our Board has affirmatively determined that each member of the Audit Committee is independent under NASDAQ Marketplace Rule 5605(a)(2) and meets the independence and all other qualifications under NASDAQ Marketplace Rule 5605(c), the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and applicable rules of the SEC. Our Board has also affirmatively determined that Ms. Judd qualifies as an "audit committee financial expert" as such term is defined in Regulation S-K under the Securities Act of 1933, as amended. During 2016, the Audit Committee met six times.

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

### ***Compensation Committee***

Our Compensation Committee consists of Messrs. Carano, Hoglund and Jarvis (Chairperson). Our Board has affirmatively determined that each member of the Compensation Committee is independent as such term is defined under NASDAQ Marketplace Rule 5605(a)(2) and meets the independence and all other qualifications under NASDAQ Marketplace Rule 5605(d). During 2016, the Compensation Committee met four times. Our Board has adopted a charter for the Compensation Committee, which is available for review on our website at [www.kratosdefense.com/about-kratos/governance](http://www.kratosdefense.com/about-kratos/governance). The Compensation Committee reviews and makes recommendations to our Board concerning the compensation and benefits of our executive officers (including the Chief Executive Officer) and directors, oversees the administration of our stock option and employee benefits plans, and reviews general policies relating to compensation and benefits. In accordance with NASDAQ Marketplace Rule 5605(d), the Compensation Committee evaluates the independence of each compensation consultant, outside counsel and advisor retained by or providing advice to the Compensation Committee. The Compensation Discussion and Analysis section below provides additional information regarding the Compensation Committee's processes and procedures for considering and determining executive compensation.

### ***Nominating and Corporate Governance Committee***

Our Nominating and Corporate Governance Committee consists of Ms. Zegart (Chairperson) and Messrs. Anderson, Hoglund, Jarvis and Liberatore. Our Board has affirmatively determined that each member of the Nominating and Corporate Governance Committee is independent as such term is defined under NASDAQ Marketplace Rule 5605(a)(2). The Nominating and Corporate Governance Committee evaluates and recommends to the Board nominees for each election of directors. The Nominating and Corporate Governance Committee met four times in 2016. Our Board has adopted a charter for the Nominating and Corporate Governance Committee, which is available for review on our website at [www.kratosdefense.com/about-kratos/governance](http://www.kratosdefense.com/about-kratos/governance). The responsibilities of the Nominating and

Corporate Governance Committee include making recommendations to the Board with respect to the nominations or elections of directors and providing oversight of our corporate governance policies and practices.

### **Board and Committee Effectiveness**

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

### **Board Leadership Structure**

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

The Board believes that the current structure of a separate Chairman of the Board and Chief Executive Officer is the optimum structure for the Company at this time, taking into consideration Mr. DeMarco's active role in pursuing the Company's business and strategic plans.

### **Board Role in Risk Management**

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

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

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

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

### **Compensation Committee Interlocks and Insider Participation**

During fiscal year 2016, no members of our Compensation Committee were officers or employees of Kratos or any of our subsidiaries or had any relationship otherwise requiring disclosure hereunder. In addition, none of our executive officers serves on the board of directors or compensation committee of a company that has an executive officer that serves on our Board or our Compensation Committee.

**Certain Relationships and Related Party Transactions**

None of our directors are a party to any agreement or arrangement relating to compensation provided by a third party in connection with their service on the Board that would be required to be disclosed pursuant to NASDAQ Rule 5250(b)(3).

During fiscal year 2016, the Company paid \$1,948,078 to one of its suppliers, 5-D Systems, Inc. ("5-D") for engineering services rendered to its Unmanned Systems business unit. Steve Fendley, who was promoted in January 2017 to President of our Unmanned Systems Division, is a cofounder and owned 33.3% of 5-D as of December 31, 2016. Mr. Fendley was not a related party during fiscal year 2016.

**Procedures for Approval of Related Party Transactions**

Under its charter, the Audit Committee is charged with reviewing all potential related party transactions. Our policy has been that the Audit Committee, which is comprised solely of independent, disinterested directors, is responsible for reviewing and approving related party transactions. All such related party transactions are then reported where required under applicable SEC rules. With respect to related party transactions with 5-D, the Audit Committee has (1) approved transactions for the first quarter of 2017 and (2) delegated authority going forward to the Chief Executive Officer to review and approve transactions, subject to management presenting approved transactions to the Audit Committee on at least a quarterly basis for further review and ratification by the Audit Committee. Aside from this policy and procedure, we have not adopted additional procedures for review of, or standards for approval of, related party transactions but instead review such transactions on a case-by-case basis.

## PROPOSAL NO. 1

## ELECTION OF DIRECTORS

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

Our Board has designated the persons named below as nominees for election of directors. All nominees are currently serving as directors of the Company. If elected at the Annual Meeting, each of the nominees will serve until our 2018 Annual Meeting of Stockholders, or until their successors are duly elected and qualified.

## Information Regarding Directors

*Nominees for Election to the Board:*

Name	Age	Committees
Scott Anderson	58	Audit Committee (Chair) Nominating and Corporate Governance Committee
Bandel Carano	55	Compensation Committee
Eric DeMarco	53	
William Høglund, Chairman	63	Audit Committee Compensation Committee Nominating and Corporate Governance Committee
Scot Jarvis	56	Audit Committee Compensation Committee (Chair) Nominating and Corporate Governance Committee
Jane Judd	70	Audit Committee & Designated Financial Expert
Samuel Liberatore	80	Nominating and Corporate Governance Committee
Amy Zegart	50	Nominating and Corporate Governance Committee (Chair)
<b>Scott Anderson</b>		

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



public company boards and audit committees provide important resources in his service on our Board and in his capacity as the chairman of our Audit Committee. Mr. Anderson holds a Top Secret National Security Clearance.

***Bandel Carano***

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

***Eric DeMarco***

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

***William Høglund***

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

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served on various independent committees of the Board, has taken an active leadership role, and is well qualified to serve as the Chairman of the Board. Mr. Hoglund holds a Top Secret National Security Clearance.

### *Scot Jarvis*

Scot Jarvis has served as a director since February 1997. Mr. Jarvis co-founded Cedar Grove Partners, LLC in 1997, an investment and consulting/advisory partnership with a focus on wireless communications investments. Prior to co-founding Cedar Grove, Mr. Jarvis served as a senior executive of Eagle River, Inc., an investment firm owned by Craig McCaw. While at Eagle River he founded Nextlink Communications on behalf of McCaw and served on its board of directors. He has also served on the board of directors of Nextel Communications, NextG Networks, Inc., Leap Wireless, and Rootmetrics, Inc. From 1985 to 1994, Mr. Jarvis served in several executive capacities at McCaw Cellular Communications until it was sold to AT&T. Mr. Jarvis served on the board of directors of Vitesse Semiconductor from 2012 until its acquisition by Microsemi Corporation in April 2015. Mr. Jarvis currently serves on the board of directors of Airspan Networks (since 2011), MobiTV (since 2013), and Slingshot Sports (since 1999). Mr. Jarvis is a venture partner with Oak Investment Partners, a multi-stage venture capital firm. Mr. Jarvis holds a bachelor's degree in Business Administration from the University of Washington. Mr. Jarvis has extensive experience with mergers and acquisitions transactions, which has been of particular significance to the Board during the Company's pursuit of growth strategies through mergers and acquisitions. Mr. Jarvis holds a Top Secret National Security Clearance.

### *Jane Judd*

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

### *Samuel Liberatore*

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

the Board prior experience as a military officer, extensive experience and expertise working in the missile defense industry, and recent experience working in the defense contracting industry. Mr. Liberatore holds a Top Secret National Security Clearance.

*Amy Zegart*

Amy Zegart has served as a director since September 2014. Ms. Zegart is a Davies Family Senior Fellow at the Hoover Institution, a professor of political science (by courtesy) at Stanford University, and co-director of Stanford's Center for International Security and Cooperation. Until 2011, she served as professor of public policy at UCLA's Luskin School of Public Affairs. An award-winning author, Ms. Zegart's research examines the organizational challenges of American national security agencies. She served on the Clinton administration's National Security Council staff and as a foreign policy adviser to the Bush-Cheney 2000 presidential campaign. She has testified before the Senate Intelligence Committee, provided training to the U.S. Marine Corps, and advised officials on intelligence and homeland security matters. From 2009 to 2011, she served on the National Academies of Science Panel to Improve Intelligence Analysis. She has served on the FBI Intelligence Analysts Association National Advisory Board, the Los Angeles Police Department's Counter-Terrorism and Community Police Advisory Board, and the Secretary of Energy Advisory Board Task Force on Nuclear Nonproliferation. She is a lifetime member of the Council on Foreign Relations. Prior to her academic career, she was a management consultant at McKinsey & Company. A former Fulbright scholar, Ms. Zegart received an A.B. in East Asian studies magna cum laude from Harvard University and an M.A. and Ph.D. in political science from Stanford University. Ms. Zegart brings significant knowledge on national and international security issues to the Board. Ms. Zegart holds an interim Top Secret National Security Clearance.

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

**PROPOSAL NO. 2****RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Our Audit Committee has selected Deloitte & Touche LLP ("Deloitte") as our independent registered public accounting firm for the fiscal year ending December 31, 2017. Deloitte was appointed as our independent registered public accounting firm in June 2013. Representatives of Deloitte are expected to be present at the Annual Meeting, will have an opportunity to make a statement if they so desire, and will be available to respond to appropriate questions.

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

**Audit and Other Fees**

As part of its duties, the Audit Committee considers whether the provision of services, other than audit services, during the fiscal year ended December 25, 2016 by the Company's independent registered public accounting firm is compatible with maintaining their independence.

The following table sets forth the aggregate fees for services provided to us by Deloitte for the fiscal years ended December 27, 2015 and December 25, 2016. All fees described below were approved by the Audit Committee.

	<b>Fiscal 2015</b>	<b>Fiscal 2016</b>
Audit Fees(1)	\$ 2,586,474	\$ 2,024,042
Audit-Related Fees(2)	57,041	141,986
Tax Fees(3)	45,782	14,516
All Other Fees		
<b>TOTAL</b>	<b>\$ 2,689,297</b>	<b>\$ 2,180,544</b>

(1)

*Audit Fees* consist of fees billed and expected to be billed for professional services rendered for the integrated audit of Kratos' consolidated annual financial statements and review of the interim consolidated financial statements included in quarterly reports, services related to compliance with the provisions of the Sarbanes-Oxley Act, Section 404, and services that are normally provided by Deloitte in connection with statutory and regulatory filings or engagements.

(2)

*Audit-Related Fees* consist of fees billed and expected to be billed for professional services rendered by Deloitte that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported above as Audit Fees. The 2015 amount includes \$22,500 for professional services rendered for the filing of a Form S-8, \$18,831 for professional services rendered related to the disposition of a portion of a reporting unit classified as discontinued operations, and \$15,710 for professional services rendered for reviewing the Company's responses to a comment letter from the SEC. The 2016 amount includes \$141,986 for professional fees rendered related to the filing of a Form S-3 related to our equity offering in November 2016.

- (3) *Tax Fees* in 2015 include non-recurring charges related to the disposition of the Company's U.S. and U.K. Electronic Products business and tax structuring for business operations in Saudi Arabia.

**Audit Committee Pre-Approval Policy**

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by our independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services. The Audit Committee has delegated pre-approval authority to the Audit Committee Chairperson. The independent auditor and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditor in accordance with this pre-approval. Since June 2013, each new engagement of Deloitte has been approved in advance by the Audit Committee. All of the services of Deloitte for 2016 and 2015 described above were approved in advance by the Audit Committee.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE *FOR* THE RATIFICATION OF SELECTION OF DELOITTE & TOUCHE LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 31, 2017.**

**PROPOSAL NO. 3**

**APPROVAL OF AN AMENDMENT TO THE KRATOS DEFENSE & SECURITY SOLUTIONS, INC.  
1999 EMPLOYEE STOCK PURCHASE PLAN TO INCREASE THE AGGREGATE NUMBER OF SHARES THAT MAY BE  
ISSUED UNDER THE PLAN BY 3,000,000 SHARES**

At the Annual Meeting, our stockholders will be asked to approve an amendment to the Kratos Defense & Security Solutions, Inc. 1999 Employee Stock Purchase Plan to increase the maximum number of shares of common stock that may be issued under the Purchase Plan by 3,000,000 shares. This increase would enable us to continue to offer the Purchase Plan to our employees, which we otherwise anticipate would be depleted by the end of 2017 if current market conditions and employee participation rates continue. Our stockholders previously approved the reservation of 5,210,000 shares of our common stock for purchase by employees under the Purchase Plan. The amount of shares purchased under the Purchase Plan for the second subscription period of 2016, ending December 31, 2016, was approximately 392,000 shares.

As of April 7, 2017, a total of 693,422 shares remain available for future purchases under the Purchase Plan, without giving effect to the proposed amendment. The number of shares to be purchased for the January 1, 2017 to June 30, 2017 subscription period is estimated at approximately 217,000 shares, based upon the current employee participation in the Purchase Plan, payroll deductions, and the current Company common stock price. Assuming we maintain our current participation levels in the Purchase Plan, and market conditions remain unchanged, we will not have a sufficient number of shares available for issuance under the Purchase Plan to satisfy the first subscription period of 2018. Specifically, we project that, based upon the current employee participation rate, payroll deductions, and the current Company common stock price, that if stockholders approve the proposed amendment, we would have sufficient shares to satisfy our current employee participation levels in the Purchase Plan through 2023. However, the number of shares issued under the Purchase Plan in any given subscription period is dependent on the Company's common stock price on the applicable Purchase Date (as defined below) and we may, even if the amendment is approved, run out of shares prior to 2023 if the Company's common stock price decreases from current levels.

Our Board believes that the Purchase Plan benefits us and our stockholders by providing our employees with an opportunity to purchase shares of common stock at a discount through payroll deductions, which helps to attract, retain and motivate valued employees. We also believe that this aligns our employees' interests with the long-term objectives of our stockholders. We believe that this is a valuable long-term incentive plan for all employees, especially since approximately 98% of the number of shares purchased under the Purchase Plan since inception were purchased by non-executive employees. To provide a reasonable reserve of shares to permit us to continue offering this opportunity to our employees, the Board has adopted, subject to stockholder approval, an amendment to increase the number of shares of common stock that may be issued under the Purchase Plan by 3,000,000 shares, which represents 3.5% of our total current outstanding shares.

Employees who actively participate in the Purchase Plan may have up to 15% of their earnings for the relevant offering period withheld pursuant to the Purchase Plan. The price paid for common stock at each such purchase date equals the lower of 85% of the fair market value of the common stock at the commencement date of that offering period or 85% of the fair market value of the common stock on the relevant purchase date. Employees may end their participation in the offering at any time during the offering period, and participation ends automatically upon termination of employment. We may purchase shares of our common stock on the open market in order to satisfy our obligation at the end of each subscription period to issue shares to employees participating in the Purchase Plan. In the event we have not purchased a sufficient number of shares to meet such obligations, we can issue additional shares.

## Summary of the Purchase Plan

The following summary is qualified in its entirety by the complete text of the Purchase Plan, as proposed to be amended, a copy of which has been included as Appendix A to the electronic version of this proxy statement filed with the SEC. Stockholders are urged to read the actual text of the Purchase Plan in its entirety.

**General.** At the beginning of each offering under the Purchase Plan (each, an "Offering"), each participant in the Purchase Plan is granted the right to purchase, through accumulated payroll deductions, up to a number of shares of our common stock determined on the first day of the Offering (a "Purchase Right"). The Purchase Right is automatically exercised on each purchase date during the Offering (a "Purchase Date") unless the participant has withdrawn from participation in the Purchase Plan prior to such date. The Purchase Plan is intended to qualify as an "employee stock purchase plan" under section 423 of the Internal Revenue Code of 1986, as amended (the "Code").

**Authorized Shares.** Currently, a maximum of 693,422 authorized but unissued or reacquired shares of common stock remain available for issuance under the Purchase Plan, subject to appropriate adjustment in the event of any stock dividend, stock split, reverse stock split, recapitalization or similar change in our capital structure, or in the event of any merger, sale of assets or other reorganization. If any Purchase Right expires or terminates, the shares subject to the unexercised portion of such Purchase Right will again be available for issuance under the Purchase Plan.

**Administration.** The Purchase Plan is administered by the Board of Directors or a committee of the Board. (For purposes of this discussion, the term "Board" refers to either the Board of Directors or such committee.) Subject to the provisions of the Purchase Plan, the Board determines the terms and conditions of Purchase Rights granted under the plan. The Board has the authority to interpret the Purchase Plan and Purchase Rights granted thereunder, and any such interpretation of the Board will be binding.

**Eligibility.** Any employee of the Company or any parent or subsidiary of the Company designated by the Board for inclusion in the Purchase Plan is eligible to participate in an Offering under the plan so long as the employee is customarily employed for at least 20 hours per week and more than five months in any calendar year. As of April 7, 2017, approximately 2,900 employees, including all executive officers, were eligible to participate in the Purchase Plan.

**Offerings.** Generally, each Offering under the Purchase Plan extends for a period of six months (the "Offering Period"). New Offering Periods begin every six months (an "Offering Date") and do not overlap. Offering Periods generally commence on January 1 and July 1 of each year. Shares are purchased on the last day of each purchase period. The Board may establish a different term for any Offering (not to exceed 27 months) or purchase period or different commencement or ending dates for an Offering or a purchase period.

**Participation and Purchase of Shares.** Participation in an Offering under the Purchase Plan is limited to eligible employees who authorize payroll deductions prior to the first day of an Offering Period. Payroll deductions may not exceed 15% of an employee's earnings on any payday during the Offering Period, provided that the Board may establish a different limit from time to time. An employee who becomes a participant in the Purchase Plan will automatically participate in each Offering beginning immediately after the last day of the Offering Period in which he or she is a participant until the employee withdraws from the Purchase Plan, becomes ineligible to participate, or terminates employment.

Subject to any uniform limitations or notice requirements imposed by the Company, a participant may increase or decrease his or her rate of payroll deductions or withdraw from the Purchase Plan at any time during an Offering. Upon withdrawal, the Company will refund without interest the

participant's accumulated payroll deductions not previously applied to the purchase of shares. Once a participant withdraws from an Offering, that participant may not again participate in the same Offering at any later time. If the fair market value of a share of common stock on the Offering Date of the current Offering in which employees are participating is greater than such fair market value on the Offering Date of a new Offering, then, unless a participant elects otherwise, each participant will be automatically withdrawn from the current Offering after purchasing shares and enrolled in the new Offering.

On each Purchase Date, we issue to each participant in the Offering the number of shares of our common stock equal to the amount of payroll deductions accumulated for the participant during the Purchase Period divided by the purchase price, limited in any case by the number of shares subject to the participant's Purchase Right for that Offering. The price at which shares are sold under the Purchase Plan is established by the Board but may not be less than 85% of the lesser of the fair market value per share of common stock on the Offering Date or on the Purchase Date. The fair market value of the common stock on any relevant date generally will be the closing price per share as reported on the NASDAQ Global Select Market. On April 7, 2017, the closing price of our common stock as reported on the NASDAQ Global Select Market was \$7.84 per share. Any payroll deductions under the Purchase Plan not applied to the purchase of shares will be returned to the participant without interest, unless the amount remaining is less than the amount necessary to purchase a whole share of common stock, in which case the remaining amount may be applied to the next Purchase Period.

**Termination or Amendment.** The Purchase Plan will continue until terminated by the Board or until all of the shares reserved for issuance under the plan have been issued. The Board may amend or terminate the Purchase Plan at any time, except that the approval of our stockholders is required within 12 months of the adoption of any amendment increasing the number of shares authorized for issuance under the Purchase Plan, or changing the categories of corporations that may be designated by the Board as corporations whose employees may participate in the Purchase Plan.

### Plan Benefits

The table below sets forth the aggregate numbers of shares of common stock purchased by our named executive officers; all of our current executive officers as a group; and all employees, including all current officers who are not executive officers, as a group under the Purchase Plan from its inception through April 7, 2017:

Named Executive Officer and Position	Shares of Common Stock Purchased under Purchase Plan
Eric DeMarco, President and Chief Executive Officer	29,302
Deanna Lund, Executive Vice President and Chief Financial Officer	16,626
Jonah Adelman, President, Microwave Electronics	
Gerald Beaman, President, Unmanned Systems(1)	9,334
Phillip Carrai, President, Technology & Training Solutions	17,074
All current executive officers as a group	86,653
All employees, including all current officers who are not executive officers, as a group	4,428,100

(1) Mr. Beaman retired from the Company in January 2017.

None of our directors who are not also executive officers are eligible to participate in the Purchase Plan. Since its inception, no shares have been issued under the Purchase Plan to any other nominee for election as a director, or any associate of any such director, nominee or executive officer, and no other



person has been issued five percent or more of the total amount of shares issued under the Purchase Plan.

### **New Plan Benefits**

Participation in the Purchase Plan is voluntary, and each eligible employee will make his or her own decision whether and to what extent to participate in the Purchase Plan. It is therefore not possible to determine the benefits or amounts that will be received in the future by individual employees or groups of employees under the Purchase Plan.

### **Summary of U.S. Federal Income Tax Consequences**

The following is a brief summary of certain of the U.S. federal income tax consequences of participation in the Purchase Plan. It does not attempt to describe all possible federal tax consequences, nor does it describe any state, local, or foreign tax consequences, of such participation or tax consequences based on a participant's particular circumstances. The information below is based upon current federal income tax rules and therefore is subject to change. Each participant should consult his or her tax adviser regarding the federal, state, local, and other tax consequences of participation in the Purchase Plan.

Generally, there are no tax consequences to an employee of either becoming a participant in the Purchase Plan or purchasing shares under the Purchase Plan. The tax consequences of a disposition of shares vary depending on the period such stock is held before its disposition. If a participant disposes of shares within two years after the Offering Date or within one year after the Purchase Date on which the shares are acquired (such disposition being referred to as a "disqualifying disposition"), the participant recognizes ordinary income in the year of disposition in an amount equal to the difference between the fair market value of the shares on the Purchase Date and the purchase price, regardless of whether there is any gain upon such disposition. Such income may be subject to tax withholding by the employer. Any additional gain or any loss recognized by the participant resulting from the disposition of the shares is a capital gain or loss. If the participant disposes of shares at least two years after the Offering Date and at least one year after the Purchase Date on which the shares are acquired (a "qualifying disposition"), the participant recognizes ordinary income in the year of disposition in an amount equal to the lesser of (i) the difference between the fair market value of the shares on the date of disposition and the purchase price or (ii) the difference between the fair market value of the shares on the Offering Date and the purchase price (determined as if the Purchase Right were exercised on the Offering Date). Any additional gain recognized by the participant on the disposition of the shares is a capital gain. If the fair market value of the shares on the date of disposition is less than the purchase price, there is no ordinary income, and the loss recognized is a capital loss. If the participant still owns the shares at the time of his or her death, the lesser of (i) the difference between the fair market value of the shares on the date of death and the purchase price or (ii) the difference between the fair market value of the shares on the Offering Date and the purchase price (determined as if the Purchase Right were exercised on the Offering Date) is recognized as ordinary income in the year of the participant's death.

If the participant disposes of the shares in a disqualifying disposition, we should be entitled to a deduction equal to the amount of ordinary income recognized by the participant as a result of the disposition, except to the extent such deduction is limited by applicable provisions of the Code. We will not receive a deduction for qualifying dispositions.

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE *FOR*  
THE AMENDMENT TO THE 1999 EMPLOYEE STOCK PURCHASE PLAN TO INCREASE  
THE AGGREGATE NUMBER OF SHARES THAT MAY BE ISSUED UNDER  
THE PLAN BY 3,000,000 SHARES.**

**PROPOSAL NO. 4**  
**APPROVAL OF AN AMENDMENT TO THE KRATOS DEFENSE & SECURITY SOLUTIONS, INC.**  
**2014 EQUITY INCENTIVE PLAN TO INCREASE THE AGGREGATE NUMBER OF**  
**SHARES THAT MAY BE ISSUED UNDER THE PLAN BY 2,500,000 SHARES**

At the Annual Meeting, our stockholders will be asked to approve an amendment to the Kratos Defense & Security Systems, Inc. 2014 Equity Incentive Plan to increase the maximum number of shares of common stock that may be issued under the 2014 Plan by 2,500,000 shares.

We currently maintain the 2014 Plan to grant restricted stock units and other stock awards in order to provide long term incentives to our employees, directors, and consultants. Our stockholders approved the 2014 Plan at the 2014 Annual Meeting as the successor to the Kratos Defense & Security Solutions, Inc. 2011 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. Amended and Restated 2005 Equity Incentive Plan, the Kratos Defense & Security Solutions, Inc. 2000 Nonstatutory Stock Option Plan, the Kratos Defense & Security Solutions, Inc. 1999 Equity Incentive Plan, the Amended and Restated Integral Systems, Inc. 2008 Stock Incentive Plan, the Amended and Restated Herley Industries, Inc. 2010 Stock Plan, the Herley Industries, Inc. 2003 Stock Option Plan, the Henry Bros. Electronics, Inc. 2007 Stock Option Plan, the Henry Bros. Electronics, Inc. 2006 Stock Option Plan, the Amended and Restated 2005 Digital Fusion, Inc. Equity Incentive Plan, the 2000 Digital Fusion, Inc. Stock Option Plan, the 1999 Digital Fusion, Inc. Stock Option Plan, and the 1998 Digital Fusion, Inc. Stock Option Plan (collectively, the "Prior Plans").

Any shares subject to outstanding stock awards granted under the Prior Plans or granted outside of a Prior Plan that, at any time after March 27, 2014, (i) expire or terminate for any reason prior to exercise or settlement; (ii) are forfeited, cancelled or otherwise returned to the Company because of the failure to meet a contingency or condition required to vest such shares; or (iii) are reacquired, withheld (or not issued) to satisfy a tax withholding obligation in connection with an award or to satisfy the purchase price or exercise price of a stock award (collectively, the "Returning Shares") are immediately added to the share reserve of the 2014 Plan and become available for issuance pursuant to stock awards granted under the 2014 Plan.

Our stockholders previously authorized us to issue up to 1,550,000 shares plus the number of Returning Shares under the 2014 Plan (subject to adjustment upon certain changes in the capital structure). As of April 7, 2017, 1,493,426 shares remain available for grant under the 2014 Plan, plus potential Returning Shares. If our stockholders approve this proposal, we will have approximately 3,993,426 shares (plus potential Returning Shares) available to grant under the 2014 Plan, which we anticipate will cover equity grants for the next three years, based on the current headcount of the Company, our Compensation Committee's compensation philosophy, the Company's anticipated burn rate, and industry standards.

We are asking our stockholders to approve the increase to the 2014 Plan so that we can continue to use the 2014 Plan to attract and encourage the continued employment and service of, and maximum efforts by, officers, employees and other individuals by offering those persons an opportunity to acquire or increase a direct proprietary interest in our operations and future success. Since 2007, we have pursued this goal primarily through the grant of RSUs. We believe that in our heavily human-capital intensive business, RSUs are an important factor in hiring and retaining talented personnel. The Company's equity awards provide long-term incentives that align the interests of our employees, directors and consultants with the interests of our stockholders. If our stockholders do not approve the 2014 Plan, the Company strongly believes that it will be unable to successfully use equity as part of its compensation program, as most of its competitors in the industry do, putting the Company at a significant disadvantage and compromising its ability to enhance stockholder value. Therefore, we believe the approval of this request is in the best interest of our stockholders and our Company.

Approval of the 2014 Plan requires the affirmative vote of the holders of a majority of the shares of common stock present or represented and entitled to vote at the Annual Meeting.

### **Description of the 2014 Plan**

The material features of the 2014 Plan are outlined below. This summary is qualified in its entirety by reference to the complete text of the 2014 Plan, as proposed to be amended, a copy of which has been included as Appendix B to the electronic version of this proxy statement filed with the SEC. Stockholders are urged to read the actual text of the 2014 Plan in its entirety.

#### *Types of Awards*

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

#### *Shares Available for Awards*

If this proposal is approved, the aggregate number of shares of our common stock that may be issued pursuant to stock awards under the 2014 Plan will not exceed 4,050,000 shares plus the number of Returning Shares, which could potentially include up to 1,971,338 shares previously awarded under the Prior Plans.

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

As of April 7, 2017, stock options to purchase approximately 945,412 shares were outstanding and awards other than stock options covering an aggregate of 3,155,650 shares were outstanding. The weighted-average exercise price of all stock options outstanding as of April 7, 2017 was \$7.88, and the weighted-average remaining term of such stock options was 5.03 years. As of April 7, 2017, the closing price of our common stock as reported on the NASDAQ Global Market was \$7.84 per share and a total of 86,446,084 shares of our common stock were outstanding.

#### *Eligibility*

All of our employees, non-employee directors and consultants are eligible to participate in the 2014 Plan and may receive all types of awards, provided that incentive stock options may be granted under the 2014 Plan only to our employees (including officers) and employees of our affiliates. As of April 7, 2017, we have approximately 2,900 employees and seven non-employee directors.

#### *Grant Limits*

Under the 2014 Plan, a maximum of 2,000,000 shares of our common stock may be granted to any one participant during any one calendar year pursuant to stock options, stock appreciation rights and other stock awards whose value is determined by reference to an increase over an exercise price or

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

#### *Administration*

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

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

#### *Repricing; Cancellation and Re-Grant of Stock Awards*

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

#### *Stock Options*

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

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

The term of stock options granted under the 2014 Plan may not exceed 10 years. Except as explicitly provided otherwise in an optionholder's stock option agreement, stock options granted under the 2014 Plan generally terminate three months after termination of the optionholder's service unless (i) termination is due to the optionholder's disability, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the termination of service) at any time

within 12 months following termination; (ii) the optionholder dies before the optionholder's service has terminated, or within the period (if any) specified in the stock option agreement after termination of service for a reason other than death, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the optionholder's death) within 18 months following the optionholder's death by the person or persons to whom the rights to such stock option have passed; (iii) the optionholder is terminated for cause, in which case the stock option will cease to be exercisable immediately upon the optionholder's termination, or (iv) the stock option by its terms specifically provides otherwise. A stock option term may be extended in the event that exercise of the stock option following termination of service is prohibited by applicable securities laws or if the sale of stock received upon exercise of a stock option would violate our insider trading policy. In no event may a stock option be exercised after its original expiration date.

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

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

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

#### *Limitations on Incentive Stock Options*

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

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

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

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

#### *Restricted Stock Awards*

Restricted stock awards may be granted under the 2014 Plan pursuant to restricted stock award agreements. A restricted stock award may be granted in consideration for cash, check, bank draft or money order payable to us, the recipient's services performed for us or an affiliate of ours, or any other form of legal consideration acceptable to the Plan Administrator. Shares of our common stock acquired under a restricted stock award may be subject to forfeiture to us in accordance with a vesting schedule

to be determined by the Plan Administrator. Rights to acquire shares of our common stock under a restricted stock award may be transferred only upon such terms and conditions as are set forth in the restricted stock award agreement. Except as otherwise provided in the applicable restricted stock award agreement, restricted stock awards that have not vested will be forfeited upon the participant's termination of continuous service for any reason.

#### *Restricted Stock Unit Awards*

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

#### *Stock Appreciation Rights*

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

#### *Performance Awards*

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

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

practicable following the end of the performance period, the Compensation Committee will certify (in writing) whether the performance goals have been satisfied.

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

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

#### *Other Stock Awards*

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

#### *Transferability of Stock Awards*

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

*Clawback/Recovery*

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

*Changes to Capital Structure*

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

*Corporate Transactions; Change in Control*

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

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

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

For purposes of the 2014 Plan, a change in control generally means (i) the acquisition by a person or entity of more than 50% of our combined voting power other than by merger, consolidation or similar transaction; (ii) a consummated merger, consolidation or similar transaction immediately after



which our stockholders cease to own more than 50% of the combined voting power of the surviving entity; (iii) a consummated sale, lease or exclusive license or other disposition of all or substantially all of our consolidated assets; or (iv) when a majority of our board becomes comprised of individuals whose nomination, appointment, or election was not approved by a majority of the board or their approved successors.

*Plan Amendments and Termination*

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

**U.S. Federal Income Tax Consequences**

The information set forth below is a brief summary of certain of the U.S. federal income tax consequences to a recipient under the 2014 Plan. It does not purport to be a complete discussion of all federal tax consequences, nor does it address any state, local or foreign tax considerations. The information is based upon current federal income tax rules and therefore is subject to change. Because the tax consequences to any recipient may depend on his or her particular situation, each recipient should consult his or her tax adviser regarding the federal, state, local, and other tax consequences of the grant or exercise of an award or the disposition of stock acquired as a result of an award. The 2014 Plan is not qualified under the provisions of Section 401(a) of the Code and is not subject to any of the provisions of the Employee Retirement Income Security Act of 1974. Our ability to realize the benefit of any tax deductions described below depends on our generation of taxable income as well as the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligations.

*Nonstatutory Stock Options*

Generally, there is no taxation upon the grant of an NSO if the stock option is granted with an exercise price equal to the fair market value of the underlying stock on the grant date. On exercise, an optionholder will recognize ordinary income equal to the excess, if any, of the fair market value of the stock on the date of exercise over the exercise price. If the optionholder is employed by us or one of our affiliates, that income will be subject to withholding taxes. The optionholder's tax basis in the acquired shares will be equal to their fair market value on the date of exercise of the stock option, and the optionholder's capital gain holding period for those shares will begin on that date. On a disposition of the acquired shares, any additional gain or loss generally will be taxed to the optionholder as either short-term or long-term capital gain or loss depending on how long the shares were held.

Subject to certain requirements under the Code, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the optionholder.

*Incentive Stock Options*

The 2014 Plan provides for the grant of stock options that qualify as "incentive stock options," as defined in Section 422 of the Code. Under the Code, an optionholder generally is not subject to ordinary income tax upon the grant or exercise of an ISO. If the optionholder holds a share received on exercise of an ISO for more than two years from the date the stock option was granted and more than one year from the date the stock option was exercised, which is referred to as the required

holding period, the difference, if any, between the amount realized on a sale or other taxable disposition of that share and the holder's tax basis in that share will be long-term capital gain or loss.

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

We are not allowed an income tax deduction with respect to the grant or exercise of an ISO or the disposition of a share acquired on exercise of an ISO after the required holding period. If there is a disqualifying disposition of a share, however, we are allowed a deduction in an amount equal to the ordinary income includible in income by the optionholder, subject to certain requirements under the Code.

#### *Restricted Stock Awards*

A recipient of restricted stock normally will recognize ordinary income when the restrictions on the restricted stock lapse (*i.e.*, at the time the restricted shares are no longer subject to a substantial risk of forfeiture or become transferable, whichever occurs first), which will be equal to the excess, if any, of the fair market value of the stock on such date over any amount paid by the recipient in exchange for the stock. A recipient may, however, file an election with the Internal Revenue Service, within 30 days following his or her receipt of the stock award, to recognize ordinary income, as of the date the recipient receives the award, equal to the excess, if any, of the fair market value of the stock on the date the award is granted over any amount paid by the recipient for the stock.

The recipient's basis for the determination of gain or loss upon the subsequent disposition of shares acquired from stock awards will be the amount paid for such shares plus any ordinary income recognized either when the stock is received or when the stock becomes vested. On a disposition of the acquired shares, any additional gain or loss should be eligible for short-term or long-term capital gain or loss tax treatment depending on how long the shares were held after the ordinary income was recognized.

Subject to certain requirements under the Code, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

#### *Restricted Stock Unit Awards*

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

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

Subject to certain requirements under the Code, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

#### *Stock Appreciation Rights*

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

In general, no taxable income is reportable when a stock appreciation right is granted to a recipient. Upon exercise, the recipient generally will recognize ordinary income in an amount equal to the fair market value of any shares received. Any additional gain or loss recognized upon any later disposition of such shares would be capital gain or loss. Subject to certain requirements under the Code, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock appreciation right.

#### **Plan Benefits**

The table below sets forth the aggregate numbers of shares of common stock subject to all stock awards, including options, that have been granted (even if not currently outstanding) to our named executive officers; all of our current executive officers as a group; and all employees, including all

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current officers who are not executive officers, as a group under the 2014 Plan from its inception through April 7, 2017:

Named and Position	Number of Shares Subject to Stock Awards
Eric DeMarco, President and Chief Executive Officer	715,000
Deanna Lund, Executive Vice President and Chief Financial Officer	300,000