KRATOS DEFENSE & SECURITY SOLUTIONS, INC.
Form S-4
April 10, 2008

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**As filed with the Securities and Exchange Commission on April 9, 2008**

**Registration No.**

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form S-4

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

# KRATOS DEFENSE & SECURITY SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

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

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

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

**Copies to:**
**WITH A COPY TO**

| | |
|---|---|
| **Marty B. Lorenzo**<br>**Sagar M. Brahmbhatt**<br>DLA Piper US LLP<br>4365 Executive Drive, Suite 1100<br>San Diego, CA 92121<br>(858) 677-1400<br>(858) 677-1401 (facsimile) | **Otto E. Sorensen**<br>Luce, Forward, Hamilton & Scripps LLP<br>600 West Broadway, Suite 2600<br>San Diego, California 92101<br>(619) 699-2534<br>(619) 645-5324 (facsimile) |

**Approximate date of commencement of proposed sale of the securities to the public:**
**As soon as practicable after this registration statement becomes effective and all other conditions to the proposed merger described herein have been satisfied or waived.**

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

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

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

| Title of Each Class of Securities to be Registered | Amount to be Registered | Proposed Maximum Offering Price Per Share | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee |
|---|---|---|---|---|
| Common Stock, par value $0.001 per share | 32,500,000(1) | N/A | $69,550,000(2) | $2,733.32 |

(1) The number of shares of common stock of the registrant being registered is based upon (x) an estimate of the maximum number of shares of common stock, no par value, of SYS, a California corporation ("SYS") presently outstanding or issuable or expected to be issued multiplied by (y) the exchange ratio of 1.2582 shares of common stock, par value $0.001 per share, of the registrant, for each such share of common stock of SYS.

(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(f) under the Securities Act of 1933, as amended. The proposed maximum aggregate offering price for the common stock is the product of (x) $2.14, the average of the high and low sales prices of SYS common stock, as quoted on the American Stock Exchange, on April 7, 2008, and (y) 32,500,000, the estimated maximum number of shares of SYS common stock that may be exchanged for the shares of common stock of the registrant being registered.

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

**The information in this joint proxy statement/prospectus is not complete and may be changed. We may not sell the securities offered by this joint proxy statement/prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This joint proxy statement/prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction where an offer, solicitation or sale is not permitted.**

**PRELIMINARY SUBJECT TO COMPLETION DATED APRIL 9, 2008**

**PROPOSED MERGER YOUR VOTE IS VERY IMPORTANT**

Each of the boards of directors of Kratos Defense & Security Solutions, Inc., a Delaware corporation ("***Kratos***") and SYS, a California corporation ("***SYS***"), has approved a strategic merger, combining Kratos and SYS. We believe that the proposed merger will allow Kratos and SYS to be better positioned to compete in the rapidly evolving defense and security solutions industry.

Kratos and SYS have entered into an Agreement and Plan of Merger and Reorganization pursuant to which SYS will merge with a newly formed, wholly-owned subsidiary of Kratos, with SYS surviving the merger as a wholly-owned subsidiary of Kratos.

In the proposed merger, SYS shareholders will receive 1.2582 shares of Kratos common stock for each share of SYS common stock. This exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing. The stockholders of Kratos will continue to own their existing shares, which will not be affected by the merger. Upon completion of the merger, SYS's former shareholders will own approximately 24% of the then outstanding shares of Kratos common stock, based on the number of shares of Kratos and SYS common stock expected to be outstanding on the closing of the merger. The value of the merger consideration to be received in exchange for each share of SYS common stock will fluctuate with the market price of Kratos common stock.

Based on the closing sale price for Kratos common stock on February 20, 2008, the last trading day before public announcement of the merger, the 1.2582 exchange ratio represented approximately $2.65 in value for each share of SYS common stock. Based on the closing sale price for Kratos common stock on           , 2008, the latest practicable date before the printing of this joint proxy statement/prospectus, which we refer to as this Proxy Statement, the 1.2582 exchange ratio represented approximately $      in value for each share of SYS common stock.

Kratos common stock is listed on The Nasdaq Global Select Market under the symbol "KTOS." SYS common stock is listed on the American Stock Exchange under the symbol "SYS." We urge you to obtain current market quotations for the shares of Kratos and SYS.

**Your vote is very important.** The merger cannot be completed unless Kratos stockholders approve the issuance of Kratos common stock and SYS shareholders adopt and approve the merger agreement. Each of Kratos and SYS is holding a meeting of its stockholders to vote on the proposals necessary to complete the merger, and in the case of Kratos, to approve certain other matters described in this Proxy Statement. Information about these meetings, the merger and the other business to be considered by stockholders is contained in this Proxy Statement. We urge you to read this Proxy Statement carefully. **You should also carefully consider the risk factors beginning on page 24.**

**Whether or not you plan to attend your respective company's meeting of stockholders, please submit your proxy as soon as possible to make sure that your shares are represented at that meeting.**

**The Kratos board of directors unanimously recommends that Kratos stockholders vote FOR the proposal to approve the issuance of Kratos common stock, which is necessary to effect the merger.**

**The SYS board of directors unanimously recommends that SYS shareholders vote FOR the proposal to adopt and approve the merger agreement.**

| | |
|---|---|
| Eric M. DeMarco | Clifton L. Cooke, Jr. |
| *Chief Executive Officer and President* | *President and Chief Executive Officer* |
| Kratos Defense & Security Solutions, Inc. | SYS |

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

This Proxy Statement is dated , 2008, and is first being mailed to stockholders of Kratos and SYS on or about , 2008.

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON , 2008**

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

An annual meeting of stockholders of Kratos Defense & Security Solutions, Inc. will be held at , on , 2008 at a.m., local time, for the following purposes:

1. To elect five directors for one-year terms or until their successors are elected and duly qualified.

2. To ratify the selection of Grant Thornton LLP as Kratos' independent auditors for the fiscal year ending December 28, 2008.

3. To approve an amendment to the Kratos 1999 Employee Stock Purchase Plan to increase the aggregate number of shares that may be issued under the plan by 1,500,000 shares.

4. To approve an amendment to the Kratos 2005 Equity Incentive Plan to increase the aggregate number of shares that may be issued under the plan by 3,000,000 shares.

5. To approve the issuance of Kratos common stock, par value $0.001 per share, pursuant to the Agreement and Plan of Merger and Reorganization, dated as of February 20, 2008, by and among Kratos Defense & Security Solutions, Inc., White Shadow, Inc., and SYS, as the same may be amended from time to time (the "***Share Issuance***").

6. To approve any motion to adjourn or postpone the annual meeting to a later date or dates, if necessary, to solicit additional proxies if there are insufficient votes at the time of the annual meeting to approve the first five proposals listed above.

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

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

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

**The Kratos board of directors unanimously recommends that you vote FOR the proposal to elect five directors for one-year terms or until their successors are elected and duly qualified; FOR the proposal to ratify the selection of Grant Thornton LLP as Kratos' independent auditors for the fiscal year ending December 28, 2008; FOR the proposal to approve an amendment to the Kratos 1999 Employee Stock Purchase Plan to increase the aggregate number of shares that may be issued under the plan by 1,500,000 shares; FOR the proposal to approve an amendment to the Kratos 2005 Equity Incentive Plan to increase aggregate number of shares that may be issued under the plan by 3,000,000 shares; FOR the proposal to approve the Share Issuance; and FOR the proposal to approve any motion to adjourn or postpone the annual meeting to a later date or dates if necessary to solicit additional proxies.**

By Order of the Kratos Board of Directors,

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

**PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE PROPOSALS OR ABOUT VOTING YOUR SHARES, PLEASE CALL KRATOS' PROXY SOLICITOR GEORGESON, INC. AT (800) 561-4162 (TOLL FREE).**

**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS TO BE HELD ON , 2008**

To the Shareholders of SYS:

A special meeting of shareholders of SYS will be held at 5050 Murphy Canyon Road, Suite 200, San Diego, CA 92123, on , 2008 at 11:00 a.m., local time, for the following purposes:

1. To adopt and approve the Agreement and Plan of Merger and Reorganization, dated as of February 20, 2008, by and among Kratos Defense & Security Solutions, Inc., White Shadow, Inc., and SYS, as the same may be amended from time to time.

2. To approve any motion to adjourn or postpone the special meeting to a later date or dates, if necessary, to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the proposal to adopt the merger agreement.

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

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

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

**The board of directors of SYS recommends that you vote FOR the proposal to adopt and approve the merger agreement and FOR the proposal to approve any motion to adjourn or postpone the special meeting to a later date or dates if necessary to solicit additional proxies.**

By Order of the SYS Board of Directors,

Clifton L. Cooke, Jr.
*President and Chief Executive Officer*
, 2008

**PLEASE VOTE YOUR SHARES PROMPTLY. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD. IF YOU HAVE QUESTIONS ABOUT THE PROPOSALS OR ABOUT VOTING YOUR SHARES, PLEASE CALL MICHAEL W. FINK AT 858-244-7393 (TOLL FREE) OR VIA EMAIL AT *MFINK@SYSTECHNOLOGIES.COM.***

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**VOTING ELECTRONICALLY OR BY TELEPHONE**

Kratos stockholders of record on the close of business on , 2008, the record date for the Kratos annual meeting, may submit their proxies by telephone or Internet by following the instructions on their proxy card or voting form. If you have any questions regarding whether you are eligible to submit your proxy by telephone or by Internet, please contact Kratos' Proxy Solicitor, Georgeson, Inc. by telephone at (800) 561-4162 (toll free).

SYS shareholders of record on the close of business on , 2008, the record date for the SYS special meeting, may submit their proxies by telephone or Internet by following the instructions on their proxy card or voting form. If you have any questions regarding whether you are eligible to submit your proxy by telephone or by Internet, please contact Michael W. Fink by telephone at 858-244-7393 or via email at *mfink@systechnologies.com*.

## QUESTIONS AND ANSWERS ABOUT THE MEETINGS

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

**Q:**

**Why am I receiving these materials?**

A:

We are sending you these materials to help you decide how to vote your shares of Kratos or SYS common stock with respect to their proposed merger. Additionally, if you are a Kratos stockholder, we are sending these materials to you to help you decide how to vote your shares of Kratos common stock with respect to the other proposals at the Kratos annual meeting.

The merger cannot be completed unless Kratos stockholders approve the issuance of Kratos common stock and SYS shareholders adopt and approve the merger agreement. Each of Kratos and SYS is holding its meeting of holders of stock to vote on the proposals necessary to complete the merger. Information about these meetings, the merger and the other business to be considered by holders of stock is contained in this Proxy Statement.

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

**Q:**

**What will stockholders receive in the merger?**

A:

In the proposed merger, holders of SYS common stock will receive 1.2582 shares of Kratos common stock for each share of SYS common stock. This exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing.

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

**Q:**

**When do Kratos and SYS expect to complete the merger?**

A:

Kratos and SYS expect to complete the merger after all conditions to the merger in the merger agreement are satisfied or waived, including after stockholder approvals are received at the meetings of Kratos and SYS and all required regulatory approvals are received. Kratos and SYS currently expect to complete the merger during the first half of 2008. However, it is possible that factors outside of either company's control could require Kratos and SYS to complete the merger at a later time or not to complete it at all.

**Q:**

**How do the boards of directors of Kratos and SYS recommend that I vote?**

A:

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

The SYS board of directors unanimously recommends that SYS shareholders vote FOR the proposal to adopt the merger agreement.

**Q:**

**What do I need to do now?**

A:

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

**Q:** **How do I vote?**

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

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

You may also cast your vote in person at your company's meeting.

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

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

A: The annual meeting of Kratos stockholders will be held at 4810 Eastgate Mall, San Diego, CA, on , 2008 at , a.m., local time. Subject to space availability, all stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Since seating is limited, admission to the meeting will be on a first-come, first-served basis. Registration and seating will begin at a.m., local time.

The special meeting of SYS shareholders will be held at 5050 Murphy Canyon Road, Suite 200, San Diego, CA 92123, on , 2008 at 11:00 a.m., local time. Subject to space availability, all stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Since seating is limited, admission to the meeting will be on a first-come, first-served basis. Registration and seating will begin at a.m., local time.

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

A: Your broker or other nominee does not have authority to vote on most of the proposals described in this Proxy Statement including the proposals related to the proposed merger. Your broker or other nominee will vote your shares held by it in "street name" with respect to these matters ONLY if you provide instructions to it on how to vote. You should follow the directions your broker or other nominee provides.

**Q:** **What constitutes a quorum?**

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

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

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

A: For Kratos Stockholders:

The affirmative vote of a majority of the outstanding shares of Kratos common stock entitled to vote at the meeting is required to approve all of the Kratos proposals, including the proposal to approve the issuance of Kratos common stock in the merger, which is referred to in this Proxy Statement as the Share Issuance.

For SYS Shareholders:

The affirmative vote of a majority of the outstanding shares of SYS common stock entitled to vote is required to approve the merger agreement, which is referred to in this Proxy Statement as the Merger Proposal.

**Q:**

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

A:

If you are a Kratos stockholder and you fail to vote or fail to instruct your broker or other nominee how to vote on the Share Issuance, it will have the same effect as a vote against the Share Issuance. Similarly, if you respond with an "abstain" vote, your proxy will have the same effect as a vote against this proposal. If you submit a proxy but do not indicate how you want to vote on the Share Issuance, your proxy will be counted as a vote in favor of the Share Issuance in accordance with the recommendation of the Kratos Board.

If you are an SYS shareholder and you fail to vote or fail to instruct your broker or other nominee how to vote on the Merger Proposal, it will have the same effect as a vote against the Merger Proposal. If you respond with an "abstain" vote on the Merger Proposal, your proxy will have the same effect as a vote against the Merger Proposal. If you respond but do not indicate how you want to vote on the Merger Proposal, your proxy will be counted as a vote in favor of the Merger Proposal.

**Q:**

**What if I hold shares in both Kratos and SYS?**

A.

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

**Q:**

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

A:

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

- by sending a notice of revocation to the corporate secretary of Kratos or SYS, as applicable;

- by sending a completed proxy card bearing a later date than your original proxy card;

- by logging onto the Internet website specified on your proxy card in the same manner you would to submit your proxy electronically or by calling the telephone number specified on your proxy card, in each case if you are eligible to do so and following the instructions on the proxy card; or

- by attending the applicable meeting and voting in person. Your attendance alone will not revoke any proxy.

If you choose any of the first three methods, you must take the described action no later than the beginning of the applicable meeting.

If your shares are held in an account at a broker or other nominee, you should contact your broker or other nominee to change your vote.

**Q:**

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

A:

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

**Q:**

**Do I have appraisal rights?**

A:

The holders of Kratos common stock will not be entitled to exercise any appraisal rights in connection with the merger. Pursuant to Section 1300 of the California Corporations Code, the holders of SYS common stock are entitled to appraisal rights if they do not vote in favor of the merger and otherwise comply with the requirements of Chapter 13 of the California General Corporation Law.

**Q:**

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

A:

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

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

**Q:**

**What if I hold SYS and Kratos stock options or other stock-based awards?**

A:

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

All outstanding SYS stock options will become fully vested prior to the closing. The stock options may be exercised for SYS shares ("cashless exercise" being permissible) at or prior to closing in accordance with the terms of the stock option plans which shares would then be exchanged for Kratos shares in accordance with the exchange ratio. Any such stock option exercises may be subject to withholding taxes as a result. No outstanding SYS stock options will be assumed by or converted into options of Kratos.

**Q:**

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

A:

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

If you are a Kratos stockholder, you should contact Georgenson, Inc., the proxy solicitation agent for Kratos at (800) 561-4162 (toll-free). If you are an SYS shareholder, you should contact Michael W. Fink at 858-244-7393 or via email at mfink@systechnologies.com for SYS. If your shares are held in a stock brokerage account or by a bank or other nominee, you should call your broker or other nominee for additional information.

## SUMMARY

*This summary highlights selected information contained in this joint proxy statement/prospectus, referred to as this Proxy Statement, and does not contain all the information that may be important to you. Kratos and SYS urge you to read carefully this Proxy Statement in its entirety, including the annexes. Unless stated otherwise, all references in this Proxy Statement to Kratos refer to Kratos Defense & Security Solutions, Inc., a Delaware corporation, all references to SYS refer to SYS, a California corporation, all references to Merger Sub refer to White Shadow, Inc., a California corporation, and all* references *to the merger agreement refer to the Agreement and Plan of Merger and Reorganization, dated as of February 20, 2008, by and among Kratos, White Shadow, Inc., and SYS, a copy of which is attached as Annex A to this Proxy Statement.*

### The Merger

Each of the boards of directors of Kratos and SYS has approved a strategic merger of Kratos and SYS. Kratos and SYS have entered into an Agreement and Plan of Merger and Reorganization pursuant to which SYS will merge with a newly formed, wholly-owned subsidiary of Kratos, with SYS surviving the merger as a wholly-owned subsidiary of Kratos. In the proposed merger, SYS shareholders will receive 1.2582 shares of Kratos common stock for each share of SYS common stock. This exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing. The stockholders of Kratos will continue to own their existing shares, which will not be affected by the merger.

### The Parties

**Kratos**

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

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

Kratos derives a substantial portion of its revenue from contracts performed for federal government agencies. Kratos believes its diversified and stable client base, strong client relationships, broad array of contracts, considerable employee base possessing government security clearances, extensive list of past performance qualifications, and significant management and operational capabilities provides a sizable advantage and positions the company for continued growth. Founded in 1994, Kratos is headquartered in San Diego and has offices in California, Washington D.C. and several other locations in the U.S.

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

**SYS**

**SYS**
**5050 Murphy Canyon Road, Suite 200**
**San Diego, CA 92123**
**(858) 244-7393**

SYS and its subsidiaries provide information connectivity solutions that capture, analyze and present real-time information to customers in the Department of Defense, Department of Homeland Security, other government agencies and commercial companies. Using interoperable communications software, sensors, digital video broadcast and surveillance technologies, wireless networks, network management, decision-support tools and Net-Centric technologies, SYS's technical experts enhance complex decision-making. Founded in 1966, SYS is headquartered in San Diego and has principal offices in California and Virginia.

SYS delivers its solutions through two reportable segments, the Defense Solutions Group and the Public Safety, Security and Industrial Systems Group. The Defense Solutions Group focuses on engineering, technical and management services to Federal Government agencies. The Public Safety, Security and Industrial Systems Group focuses on providing "right-time" situation status and mission execution support solutions to government and commercial customers. Historically, SYS has generated revenues by providing information technology, systems integration and program and financial management services under long term contracts for the Department of Defense and in particular the U.S. Navy. More recently, SYS has expanded and leveraged its technical engineering services with complementary products and has broadened its customer base to include commercial enterprises and other governmental agencies beyond the Department of Defense.

These expanded products and services capabilities, together with SYS's longstanding expertise in situational awareness and systems engineering, have enabled SYS to develop a set of information technology solutions to complement SYS's services offerings for the Information Technology services and Public Safety and Security markets. SYS's customers in these markets such as federal, state and local governments, public safety first-responders, large corporations, schools and universities, all share a common need for decision support products and services that enhance or enable connecting real-time data to decision makers.

SYS also provides solution lifecycle support with program, financial, test and logistical services, including classroom and online training.

For additional information regarding SYS, visit *www.systechnologies.com*. The information on SYS's website is not a part of this prospectus.

**Merger Sub**

White Shadow, Inc., or Merger Sub, a wholly-owned subsidiary of Kratos, is a California corporation formed on February 19, 2008 for the sole purpose of effecting the merger. Upon completion of the merger, Merger Sub will merge with and into SYS, and SYS will become a wholly-owned subsidiary of Kratos.

Merger Sub has not conducted any activities other than those incidental to its formation and the matters contemplated by the merger agreement, including the preparation of applicable regulatory filings in connection with the merger.

**The Merger Agreement**

A copy of the merger agreement is attached as *Annex A* to this Proxy Statement. Kratos and SYS encourage you to read the entire merger agreement carefully because it is the principal document governing the merger. For more information on the merger agreement, see "The Merger Agreement" beginning on page 79.

**What SYS shareholders Will Receive in the Merger**

At the effective time of the merger, each outstanding share of SYS common stock will be converted into the right to receive 1.2582 shares of Kratos common stock in the merger, which number we refer to as the exchange ratio. Holders of SYS common stock will not receive any fractional Kratos shares in the merger. Instead, the total number of shares that each holder of SYS common stock will receive in the merger will be rounded down to the nearest whole number, and Kratos will pay cash for any resulting fractional share that an SYS shareholder otherwise would be entitled to receive. The amount of cash payable for a fractional share of Kratos common stock will be determined by multiplying the fraction by the average closing price for Kratos common stock on The Nasdaq Global Select Stock Market during the three days prior to the date the merger becomes effective.

*Example: If you currently own 25 shares of SYS common stock, absent the treatment of fractional shares described above, you would be entitled to receive 31.455 (25 × 1.2582) shares of Kratos common stock. Since fractional shares will not be issued, you will be entitled to 31 shares of Kratos common stock and a check for the market value of 0.455 shares of Kratos common stock based on the average closing price during the three days prior to date the merger becomes effective.*

The merger agreement provides for adjustments to the exchange ratio to reflect the effect of any stock split, stock dividend, reverse stock split, reclassification, recapitalization or other similar transaction with respect to Kratos common stock or SYS common stock that occurs prior to the effective date of the merger.

For a more complete description of the merger consideration, see "The Merger Agreement  Consideration to be Received in the Merger" beginning on page 80.

**Treatment of SYS Subordinated Convertible Notes and Warrants**

SYS has $3,125,000 of convertible notes payable outstanding, which we refer to as the Notes, which are unsecured, subordinate to its bank debt, bear interest at 10% per annum payable quarterly, are due February 14, 2009 and are convertible at any time into shares of common stock at a conversion rate of $3.60 per share. These notes are being assumed by Kratos subject to those same terms and conditions.

If the Notes are not converted prior to the merger, following the merger the Notes will not be convertible into SYS common stock. Instead, they will be convertible into the merger consideration as if they had been converted into SYS common stock immediately prior to the merger.

SYS has 508,401 warrants outstanding, which will be, following the merger, exercisable for merger consideration.

Following the merger, the holders of these warrants shall have the right to receive, upon exercise of the warrants, the same amount and kind of securities, cash or property, as they would have been entitled to receive upon the occurrence of the merger if they had been, immediately prior to the merger, the holders of the number of warrant shares then issuable upon exercise in full of these warrants.

For a more complete discussion of the treatment of SYS Subordinated Convertible Notes and Warrants, see "The Merger Subordinated Convertible Notes" and "The Merger Warrants," each beginning on page 68.

**Treatment of Stock Options and Other Stock-Based Awards**

All outstanding SYS stock options will become fully vested and exercisable into SYS shares at or prior to closing in accordance with the terms of their respective stock option plans and may be subject to withholding taxes as a result. No SYS stock options will be assumed by or converted into options of Kratos.

Effective February 20, 2008, the execution date of the merger agreement, SYS terminated the then current stock purchase period for its Employee Stock Purchase Plan, and Kratos is not assuming this plan.

For a more complete discussion of the treatment of SYS options and other stock-based awards, see "The Merger Agreement Treatment of SYS Options" beginning on page 80.

**Directors and Executive Management Following the Merger**

The directors and executive management of Kratos will remain unchanged at the effective time of the merger.

At the effective time of the merger, the directors and officers of Merger Sub will become the directors and officers of SYS until each is replaced by his or her successor.

For a more complete discussion of the directors and management of Kratos, see "The Merger Composition of Kratos Board of Directors" beginning on page 66.

**Recommendations of the Kratos Board of Directors**

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

For a more complete description of the Kratos reasons for the merger and the recommendations of the Kratos board of directors, see "The Merger The Kratos Board of Directors Recommendations and Reasons for the Merger" beginning on page 49.

**Recommendation of the SYS Board of Directors**

After careful consideration, the SYS board of directors unanimously recommends that holders of SYS common stock vote **FOR** the Merger Proposal.

For a more complete description of SYS's reasons for the merger and the recommendation of the SYS board of directors, see "The Merger The SYS Board of Directors' Recommendation and Reasons for the Merger" beginning on page 51.

**Opinions of Financial Advisors**

***Kratos Financial Advisor***

Wachovia Capital Markets, LLC, which we refer to as Wachovia, delivered an opinion to Kratos' board of directors that, subject to and based upon the assumptions made, procedures followed, matters considered and limitations on its review undertaken, as of February 20, 2008, the exchange ratio in the merger agreement was fair from a financial point of view to Kratos. The full text of Wachovia's written opinion, dated February 20, 2008, is attached as *Annex D* to this Proxy Statement. Holders of shares of Kratos common stock are urged to read the opinion carefully and in its entirety. Wachovia's opinion does not and shall not constitute a recommendation to any holders of shares of Kratos common stock as to how they should vote in connection with the Merger. This summary of Wachovia's opinion contained in this Proxy Statement is qualified in its entirety by reference to the full text of the opinion.

For a more complete description of Wachovia's opinion, see "The Merger Opinion of Financial Advisor to the Kratos Board of Directors" beginning on page 53. See also *Annex D* to this Proxy Statement.

***SYS Financial Advisor***

Imperial Capital, LLC, which is referred to as Imperial Capital, has rendered its opinion to the SYS board of directors to the effect that, as of February 19, 2008, and based upon and subject to the factors, assumptions, qualifications and limitations set forth therein, the exchange ratio of 1.2582 shares of Kratos common stock to be received for each share of SYS common stock pursuant to the merger agreement was fair from a financial point of view to the holders of such shares of SYS common stock.

The full text of the written opinion of Imperial Capital, dated February 19, 2008, is attached as *Annex E* to this Proxy Statement and sets forth assumptions made, general procedures followed, factors considered and limitations and qualifications on the review undertaken by Imperial in connection with its opinion. Imperial Capital provided its opinion for the information and assistance of the SYS board of directors in connection with its consideration of the merger. The Imperial Capital opinion is not a recommendation as to how any holder of shares of SYS common stock should vote with respect to the merger.

For a more complete description of the Imperial Capital opinion and engagement letter, see "The Merger Opinion of Financial Advisor to the SYS Board of Directors" beginning on page 59. See also *Annex E* to this Proxy Statement.

**Interests of SYS Directors and Executive Officers in the Merger**

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

For a further discussion of interests of directors and executive officers in the merger, see "The Merger Interests of SYS Directors and Executive Officers in the Merger" beginning on page 66.

**Material United States Federal Income Tax Consequences of the Merger**

Kratos and SYS intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Code for U.S. federal income tax purposes. Accordingly, SYS shareholders generally will not recognize gain or loss for U.S. federal income tax purposes upon the receipt of Kratos common stock in the merger, except that an SYS shareholder will recognize gain or loss with respect to any cash received in lieu of a fractional share of Kratos common stock. It is a condition to completion of the merger that Kratos and SYS each receive a legal opinion from their respective counsel that the merger will constitute a reorganization within the meaning of Section 368 of the Code In the event that such counsel does not render this opinion, this condition shall be deemed to be satisfied if the other party's counsel delivers the opinion to both Kratos and SYS.

Tax matters are very complicated and the tax consequences of the merger to you, if you are an SYS shareholder, will depend upon the facts of your situation. In addition, you may be subject to state, local or foreign tax laws that are not addressed in this Proxy Statement. You are urged to consult with your own tax advisors for a full understanding of the tax consequences of the merger to you.

For a more complete description of the material U.S. federal income tax consequences of the merger, see "Material United States Federal Income Tax Consequences" beginning on page 76.

**Accounting Treatment of the Merger**

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

**Dissenters' Rights and Appraisal Rights**

Under applicable law:

- Kratos stockholders have no dissenters' or appraisal rights with respect to the merger under Section 262 of Delaware General Corporate Law; and

- SYS shareholders are entitled to dissenters' rights under the California General Corporation Law in connection with the merger if the specific conditions set forth in the section entitled "The Merger Dissenters' Rights and Appraisal Rights," which begins on page 71, are met.

**Conditions to Completion of the Merger**

Kratos and SYS expect to complete the merger after all the conditions to the merger in the merger agreement are satisfied or waived, including after the receipt of stockholder approvals at the annual meeting of Kratos and at the special meetings of SYS. Kratos and SYS currently expect to complete the merger during the first half of 2008. However, it is possible that factors outside of either company's control could cause the merger to be competed at a later time or not at all.

Each party's obligation to complete the merger is subject to the satisfaction or waiver of various conditions, including the following:

- the receipt of the required stockholder approvals;

- the effectiveness of the registration statement of which this Proxy Statement is a part, and the registration statement not being subject to any stop order or threatened stop order;

- the absence of any injunctions or legal prohibitions preventing the consummation of the merger;

- the receipt of opinions of counsel relating to the U.S. federal income tax treatment of the merger;

- the accuracy of the other party's representations and warranties in the merger agreement, including the other party's representation that no material adverse effect has occurred;

- the other party's compliance in all material respects with its obligations under the merger agreement; and

- the receipt of authorization from The Nasdaq Global Select Stock Market for listing of Kratos common stock to be issued in connection with the merger.

Neither Kratos nor SYS is aware of the need to obtain any other material regulatory approvals in order to complete the merger.

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

For a more complete discussion of the conditions to the merger, see "The Merger Agreement  Conditions to Completion of the Merger" beginning on page 84.

**Timing of the Merger**

The merger is expected to be completed during the first half of 2008, subject to the receipt of necessary regulatory approvals and the satisfaction or waiver of other closing conditions. For a discussion of the timing of the merger, see "The Merger Agreement  Closing and Effective Time of the Merger" beginning on page 79.

**No Solicitation of Other Offers**

In the merger agreement, SYS has agreed that it will not directly or indirectly:

- solicit, initiate, or knowingly or intentionally encourage or facilitate, any inquiries, offers or proposals that constitute, or could reasonably be expected to lead to, any alternative acquisition proposal; or

- enter into, continue or otherwise participate in any discussions or negotiations regarding, furnish to any person any non-public information with respect to, assist or participate in any effort or attempt by any person with respect to, or otherwise knowingly or intentionally cooperate in any way with, any alternative acquisition.

The merger agreement does not, however, prohibit SYS from considering a bona fide acquisition proposal from a third party if certain specified conditions are met.

For a discussion of the prohibition on solicitation of acquisition proposals from third parties, see "The Merger Agreement  No Solicitation; Changes in Recommendations" beginning on page 85.

**Termination**

Generally, the merger agreement may be terminated and the merger may be abandoned at any time prior to the completion of the merger (including after stockholder approval):

- by mutual written consent of Kratos and SYS;

- by either Kratos or SYS, if

  - the merger is not consummated on or before August 20, 2008; except that such right is not available to any party whose failure to comply with the merger agreement has been a principal cause of, or resulted in, the merger not being consummated by such date and provided that this date (referred to herein as the "outside date") may be extended to February 20, 2009 by either Kratos or SYS;

  - a governmental entity issues an order, decree or ruling or takes any other nonappealable final action permanently restraining, enjoining or otherwise prohibiting the merger;

- the required Kratos or SYS shareholder vote has not been obtained at the applicable stockholder meeting or any adjournment or postponement thereof (except that this right is not available to any party who is in material breach of or has materially failed to fulfill its obligations under the merger agreement);
- the SYS board of directors changes its recommendation that its shareholders vote in favor of the merger proposal, or if SYS enters into an acquisition agreement relating to an alternative transaction; or
- the other party breaches any of its agreements or representations in the merger agreement in such a way as would cause one or more of the conditions to closing not to be satisfied, and such breach is either incurable or is not cured after 30 days' written notice;

by Kratos, if:

- SYS willfully and materially breaches its covenants with respect to non-solicitation of an alternative acquisition proposal or its obligations to hold its shareholders meeting and mail this Proxy Statement to its shareholders; or
- SYS's board of directors determines to accept an alternative acquisition proposal for a change of control transaction, in which case SYS would be required to pay the applicable termination fee (as described below); or

by SYS to accept a proposal from a third party to acquire SYS that SYS's board of directors determines to be superior to the terms of Kratos' proposed acquisition of SYS, if SYS's board of directors changes or withdraws its recommendation of the merger in response to such superior proposal and pays the applicable termination fee (as described below).

**Termination Fees and Expenses**

Pursuant to the merger agreement, SYS is required to pay a termination fee of $2,394,000 dollars to Kratos in the event the merger agreement is terminated:

By Kratos, if

- the SYS board of directors has failed to reconfirm its recommendation of approval of the SYS voting proposal after Kratos requests such reconfirmation pursuant to the terms of the merger agreement;
- the SYS board of directors or any committee of the SYS board of directors has approved or recommended to the SYS shareholders an alternative acquisition transaction;
- SYS enters into an alternative acquisition transaction; or
- SYS has willfully breached its obligations under the merger agreement pertaining to non-solicitation of alternative acquisition proposals and the SYS shareholder meeting to approve the SYS Voting Agreement.

By SYS, if its board of directors or any committee thereof has made a recommendation to accept an alternative transaction proposal and SYS enters into an alternative acquisition agreement which was the subject of such adverse recommendation change.

Whether or not the merger is completed, all costs and expenses incurred in connection with the merger agreement and the transactions contemplated by the merger agreement will be paid by the party incurring those costs or expenses, except that Kratos and SYS will share equally the expenses incurred in connection with the printing and mailing of this Proxy Statement.

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This termination fee could discourage other companies from seeking to acquire or merge with either SYS or Kratos. See "The Merger Agreement Termination," " Termination Fees and Expenses" and " Effect of Termination," beginning on pages 86, 87 and 88, respectively.

**Comparison of the rights of Kratos and SYS shareholders**

The rights of SYS shareholders as Kratos stockholders after the merger will be governed by Kratos' certificate of incorporation and bylaws, each as amended, and the laws of the State of Delaware. Those rights differ from the rights of SYS shareholders under SYS's articles of incorporation and bylaws and the laws of the State of California.

**Matters to be Considered at the Meetings**

***Kratos***

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

1. To elect five directors for one-year terms or until their successors are elected and duly qualified.

2. To ratify the selection of Grant Thornton LLP as the independent auditors of Kratos for the fiscal year ending December 28, 2008.

3. To approve an amendment to the Kratos 1999 Employee Stock Purchase Plan to increase the aggregate number of shares that may be issued under the Plan by 1,500,000 shares.

4. To approve an amendment to the Kratos 2005 Equity Incentive Plan to increase the aggregate number of shares that may be issued under the Plan by 3,000,000 shares.

5. To approve the issuance of Kratos common stock, par value $0.001 per share, pursuant to the Agreement and Plan of Merger and Reorganization, dated as of February 20, 2008, by and among Kratos Defense & Security Solutions, Inc., White Shadow, Inc., and SYS, as the same may be amended from time to time.

6. To approve any motion to adjourn or postpone the annual meeting to a later date or dates, if necessary, to solicit additional proxies if there are insufficient votes at the time of the annual meeting to approve the first five proposals listed above.

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

The Kratos board of directors unanimously recommends that Kratos stockholders vote FOR all of the proposals set forth above, as more fully described under "Kratos Annual Meeting" beginning on page 142.

***SYS***

SYS shareholders will be asked to vote on the following two proposals:

1. To adopt and approve the Agreement and Plan of Merger and Reorganization.

2. To approve any motion to adjourn or postpone the special meeting to a later date or dates, if necessary, to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the proposal to adopt the merger agreement.

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

The SYS board of directors unanimously recommends that SYS shareholders vote FOR all of the proposals set forth above, as more fully described under "SYS Special Meeting" beginning on page 193.

**Voting by Kratos and SYS Directors and Executive Officers**

On , 2008, the record date set by the Kratos board of directors, directors and executive officers of Kratos and their affiliates owned and were entitled to vote shares of Kratos common stock, or approximately %, of the total voting power of the shares of Kratos common stock outstanding on that date.

On , 2008, the record date set by the SYS board of directors, directors and executive officers of SYS and their affiliates owned and were entitled to vote shares of SYS common stock, or approximately % of the shares of SYS common stock outstanding on that date. Stockholders of SYS holding approximately 9.1% of the shares of SYS common stock outstanding on that date have executed voting agreements agreeing to vote in favor of the merger.

**SELECTED HISTORICAL FINANCIAL DATA OF KRATOS**

The tables below present summary selected consolidated historical financial data of KRATOS *(in millions except for per share data)* prepared in accordance with accounting principles generally accepted in the United States of America. This information should be read in conjunction with "INFORMATION RELATING TO KRATOS KRATOS MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS," "INFORMATION RELATING TO KRATOS BUSINESS" and Kratos' consolidated financial statements and related notes, included elsewhere in this proxy statement/prospectus.

| | Year Ended December 31, (in millions) | | | | |
|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** |
| **CONSOLIDATED STATEMENT OF OPERATIONS DATA:** | | | | | |
| Revenues | $ 43.4 | $ 116.9 | $ 152.3 | $ 153.1 | $ 193.6 |
| Operating costs and expenses: | | | | | |
| Costs of revenues | 22.2 | 87.9 | 115.7 | 124.2 | 162.0 |
| Selling, general and administrative expenses | 18.0 | 28.9 | 35.5 | 38.5 | 39.5 |
| Stock option investigation and related fees | | | | | 14.0 |
| Estimated cost for settlement of securities litigation | | | | | 4.9 |
| Loss (recovery) of unauthorized issuance of stock options | 5.7 | | | | (3.4) |
| Contingent acquisition consideration and restatement fees | | 13.9 | (2.1) | 0.1 | |
| Impairment and restructuring fees | 0.1 | | | 21.8 | 1.2 |
| Total operating costs and expenses | 46.0 | 130.7 | 149.1 | 184.6 | 218.2 |
| Operating income (loss) from continuing operations | (2.6) | (13.8) | 3.2 | (31.5) | (24.6) |
| Other (income) expense: | | | | | |
| Interest income (expense), net | 0.9 | 0.2 | 0.1 | (0.7) | (1.2) |
| Impairment of investments in unconsolidated subsidiaries | | (2.9) | | | (1.8) |
| Other income and (expense), net | (0.1) | (0.1) | 0.2 | (0.2) | 0.7 |
| Total other (income) expense | 0.8 | (2.8) | 0.3 | (0.9) | (2.3) |
| Income (loss) from continuing operations before income taxes | (1.8) | (16.6) | 3.5 | (32.4) | (26.9) |
| Provision (benefit) for income taxes from continuing operations | (1.0) | (8.4) | (0.1) | 13.8 | 1.3 |
| Income (loss) from continuing operations | (0.8) | (8.2) | 3.6 | (46.2) | (28.2) |
| Income (loss) from discontinued operations | 2.7 | 23.2 | (2.0) | (11.7) | (12.6) |
| Net income (loss) | 1.9 | 15.0 | 1.6 | (57.9) | (40.8) |
| Preference dividend requirements | | | | | |
| Net income (loss) applicable to common stock | $ 1.9 | $ 15.0 | $ 1.6 | $ (57.9) | $ (40.8) |
| Basic earnings (loss) per common share: | | | | | |
| Continuing operations | $ (0.01) | $ (0.12) | $ 0.05 | $ (0.63) | $ (0.38) |
| Discontinued operations | 0.04 | 0.34 | (0.03) | (0.16) | (0.17) |
| Net income (loss) | $ 0.03 | $ 0.22 | $ 0.02 | $ (0.79) | $ (0.55) |
| Diluted earnings (loss) per common share: | | | | | |

| | Year Ended December 31, (in millions) | | | | |
|---|---|---|---|---|---|
| Continuing operations | $ (0.01) | $ (0.12) | $ 0.05 | $ (0.63) | $ (0.38) |
| Discontinued operations | 0.04 | 0.34 | (0.03) | (0.16) | (0.17) |
| Net income (loss) | $ 0.03 | $ 0.22 | $ 0.02 | $ (0.79) | $ (0.55) |
| Weighted average common shares outstanding: | | | | | |
| Basic | 68.4 | 67.7 | 74.0 | 73.5 | 74.0 |
| Diluted | 68.4 | 67.7 | 75.0 | 73.5 | 74.0 |

| | December 31, (in millions) | | | | |
|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| **CONSOLIDATED BALANCE SHEET DATA:** | | | | | |
| Cash and cash equivalents | $ 75.8 | $ 58.0 | $ 7.7 | $ 5.4 | $ 8.6 |
| Working capital | 132.5 | 98.6 | 67.4 | (3.8) | 23.4 |
| Goodwill | 5.5 | 57.1 | 94.4 | 129.9 | 194.5 |
| Other intangible assets | 1.9 | 6.4 | 7.4 | 13.4 | 19.9 |
| Total assets | 279.3 | 330.7 | 342.0 | 337.7 | 335.3 |
| Long-term debt | | | | | 74.0 |
| Preferred stock | | | | | |
| Stockholders' equity | $ 191.9 | $ 219.6 | $ 229.7 | $ 187.1 | $ 167.2 |

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## SELECTED HISTORICAL FINANCIAL DATA OF SYS

The tables below present summary selected consolidated historical financial data of SYS *(in millions except for per share data)* prepared in accordance with accounting principles generally accepted in the United States of America. This information should be read in conjunction with "INFORMATION RELATING TO SYS  SYS MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS," "INFORMATION RELATING TO SYS  BUSINESS" and SYS's consolidated financial statements and related notes, included elsewhere in this proxy statement/prospectus.

The statement of income data for the six months ended December 28, 2007 and December 29, 2006, and the balance sheet data as of December 28, 2007 are unaudited but include, in the opinion of management of SYS, all adjustments including normal recurring adjustments, necessary for a fair presentation of such information. Results for the six months ended December 28, 2007 and December 29, 2006 are not necessarily indicative of the results that may be expected for any other interim periods or for the fiscal year as a whole.

| | Year Ended June 30, | | | | | Six Months Ended | |
|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | December 29, 2006 | December 28, 2007 |
| | (In millions) | | | | | (Unaudited) | |
| **CONSOLIDATED STATEMENT OF OPERATIONS DATA:** | | | | | | | |
| Revenues | $ 24.8 | $ 34.9 | $ 45.8 | $ 55.9 | $ 75.8 | $ 35.5 | $ 38.6 |
| Operating costs and expenses: | | | | | | | |
| Costs of revenues | 20.6 | 28.8 | 37.4 | 44.6 | 58.0 | 27.2 | 28.4 |
| Selling, general and administrative expenses | 3.5 | 4.1 | 4.9 | 8.5 | 15.5 | 6.7 | 6.8 |
| Research, engineering and development expenses | | | 0.7 | 3.6 | 4.0 | 2.0 | 2.2 |
| Legal settlement | 1.0 | | | | | | |
| Impairment charges | | | | 1.3 | | | |
| Total operating costs and expenses | 25.1 | 32.9 | 43.0 | 58.0 | 77.5 | 35.9 | 37.4 |
| Income (loss) from operations | (0.3) | 2.0 | 2.8 | (2.1) | (1.7) | (0.4) | 1.2 |
| Other (income) expense: | | | | | | | |
| Other income | | (0.1) | (0.1) | (0.2) | (0.1) | (0.1) | (0.1) |
| Interest expense | 0.2 | 0.3 | 0.5 | 0.5 | 0.8 | 0.4 | 0.2 |
| Total other income | 0.2 | 0.2 | 0.4 | 0.3 | 0.7 | 0.3 | 0.1 |
| Income (loss) from continuing operations before income taxes | (0.5) | 1.8 | 2.4 | (2.4) | (2.4) | (0.7) | 1.1 |
| Income tax (benefit) provision | (0.2) | 0.8 | 1.0 | (0.7) | (0.7) | (0.3) | 0.5 |
| Income (loss) from continuing operations | (0.3) | 1.0 | 1.4 | (1.7) | (1.7) | (0.4) | 0.6 |
| Loss from discontinued operations, net of taxes | (0.5) | | | | | | |
| Net income (loss) | (0.8) | 1.0 | 1.4 | (1.7) | (1.7) | (0.4) | 0.6 |
| Net income (loss) applicable to common stock | $ (0.8) | $ 1.0 | $ 1.4 | (1.7) | (1.7) | (0.4) | $ 0.6 |
| Basic earnings (loss) per common share: | | | | | | | |
| Continuing operations | $ (0.06) | $ 0.15 | $ 0.16 | $ (0.14) | $ (0.10) | $ (0.03) | $ 0.03 |
| Discontinued operations | (0.09) | | | | | | |

| | | | | | | Six Months Ended | |
|---|---|---|---|---|---|---|---|
| Net income (loss) | $ (0.15) | $ 0.15 | $ 0.16 | $ (0.14) | $ (0.10) | $ (0.03) | $ 0.03 |
| Diluted earnings (loss) per common share: | | | | | | | |
| Continuing operations | $ (0.06) | $ 0.13 | $ 0.15 | $ (0.14) | $ (0.10) | $ (0.03) | $ 0.03 |
| Discontinued operations | (0.09) | | | | | | |
| Net income (loss) | $ (0.15) | $ 0.13 | $ 0.15 | $ (0.14) | $ (0.10) | $ (0.03) | $ 0.03 |
| Weighted average common shares outstanding: | | | | | | | |
| Basic | 5.2 | 6.7 | 8.7 | 12.7 | 17.6 | 16.5 | 19.4 |
| Diluted | 5.2 | 8.5 | 11.2 | 12.7 | 17.6 | 16.5 | 19.5 |

| | June 30, | | | | | December 28, 2007 |
|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | (Unaudited) |
| **CONSOLIDATED BALANCE SHEET DATA:** | | | | | | |
| Cash and cash equivalents | $ | $ 2.2 | $ 3.5 | $ 2.1 | $ 2.8 | $ 2.2 |
| Working capital | 3.2 | 5.2 | 8.1 | 7.3 | 8.2 | 10.7 |
| Goodwill | | 5.5 | 7.3 | 18.6 | 23.5 | 23.1 |
| Other intangible assets | | 0.6 | 1.2 | 3.4 | 6.1 | 5.6 |
| Total assets | 7.7 | 17.7 | 24.8 | 42.2 | 52.4 | 53.4 |
| Long-term debt | 1.2 | 3.6 | 2.4 | 3.9 | 3.6 | 3.6 |
| Preference stock | 0.1 | | | | | |
| Stockholders' equity | 3.1 | 8.3 | 15.4 | 27.5 | 35.1 | 36.7 |

**SUMMARY UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL DATA**

The following summary unaudited pro forma condensed combined financial information is designed to show how the merger of Kratos and SYS might have affected historical financial statements if the merger had been completed at an earlier time and was prepared based on the historical financial results reported by Kratos, including Haverstick, and SYS. The following should be read in connection with "Unaudited Pro Forma Condensed Combined Financial Statements" beginning on page 197 and the Kratos, SYS and Haverstick audited consolidated financial statements beginning on pages FI-1, FII-1 and FIII-1, respectively.

The pro forma condensed combined financial data is presented for illustrative purposes only and is not necessarily indicative of the financial condition or results of operations of future periods or the financial condition or results of operations that actually would have been realized had the entities been a single company during these periods.

| | Year Ended December 31, 2007 | |
|---|---|---|
| | (In millions, except per share amounts) | |
| **Statements of Operations Data:** | | |
| Revenues | $ | 366.8 |
| Operating loss | | (20.6) |
| Net loss from continuing operations | | (34.0) |
| Loss per common share: | | |
| Basic | $ | (0.33) |
| Diluted | $ | (0.33) |
| Weighted average common shares outstanding: | | |
| Basic | | 104.6 |
| Diluted | | 104.6 |

| | As of December 31, 2007 | |
|---|---|---|
| **Balance Sheet Data:** | | |
| Cash and cash equivalents | $ | 3.4 |
| Property and equipment, net | | 8.9 |
| Goodwill | | 235.9 |
| Intangible assets, net | | 27.6 |
| Total assets | | 401.0 |
| Long-term debt, net of current portion | | 77.2 |
| Accumulated deficit | | (245.5) |
| Total stockholders' equity | | 218.3 |

**COMPARATIVE PER SHARE DATA (UNAUDITED)**

The following table shows per share data regarding losses from continuing operations, book value and cash dividends for Kratos, including Haverstick, and SYS on a historical, pro forma combined basis. The pro forma book value per share information was computed as if the merger had been completed on December 31, 2007. The pro forma losses from continuing operations information was computed as if the merger had been completed on January 1, 2007. The SYS pro forma equivalent information was calculated by multiplying the corresponding pro forma combined data by the exchange ratio of 1.2582. This information shows how each share of SYS common stock would have participated in the combined companies' losses from continuing operations and book value per share if the merger had been completed on the relevant dates. These amounts do not necessarily reflect future per share amounts of earnings (losses) from continuing operations and book value per share of Kratos.

The following unaudited comparative per share data is derived from the historical consolidated financial statements of each of Kratos and SYS. The information below should be read in conjunction with the audited consolidated financial statements and accompanying notes of Kratos, SYS and Haverstick, which are included in this Proxy Statement. We urge you also to read "Unaudited Pro Forma Condensed Combined Financial Statements" beginning on page 197.

| | As of and for the year ended December 31, 2007 | |
|---|---|---|
| **Kratos Historical** | | |
| Basic loss per share | $ | (0.38) |
| Diluted loss per share | $ | (0.38) |
| Book value per common share | $ | 2.26 |
| Cash dividends per share | $ | |
| **SYS Historical** | | |
| Basic loss per share | $ | (0.04) |
| Diluted loss per sharee | $ | (0.04) |
| Book value per common share | $ | 1.89 |
| Cash dividends per share | $ | |
| **Unaudited Pro Forma Combined** | | |
| Basic loss per share | $ | (0.33) |
| Diluted loss per share | $ | (0.33) |
| Book value per common share | $ | 2.09 |
| Cash dividends per share | $ | |
| **Unaudited Pro Forma Combined SYS Equivalents(1)** | | |
| Basic loss per share | $ | (0.41) |
| Diluted loss per share | $ | (0.41) |
| Book value per common share | $ | 2.64 |
| Cash dividends per share | $ | |

(1) SYS pro forma equivalent amounts are calculated by multiplying pro forma per share amounts by the exchange ratio of 1.2582.

## MARKET PRICES AND DIVIDENDS AND OTHER DISTRIBUTIONS

***Kratos***

Since November 4, 1999, the Common Stock of Kratos has been traded on the Nasdaq Global Stock Exchange under the symbols "WFII" and "KTOS." The ranges of high and low quotations during the two most recent fiscal years of Kratos are as follows:

| | High | Low |
|---|---|---|
| **Fiscal Year 2008** | | |
| First Quarter | $ 2.35 | $ 1.50 |
| **Fiscal Year 2007** | | |
| First Quarter | $ 2.94 | $ 1.20 |
| Second Quarter | $ 1.80 | $ 1.01 |
| Third Quarter | $ 2.85 | $ 1.70 |
| Fourth Quarter | $ 3.09 | $ 1.80 |
| **Fiscal Year 2006** | | |
| First Quarter | $ 5.56 | $ 3.73 |
| Second Quarter | $ 4.53 | $ 2.75 |
| Third Quarter | $ 2.94 | $ 1.85 |
| Fourth Quarter | $ 2.98 | $ 1.98 |

This summary is based on prices quoted by the Nasdaq Global Stock Exchange.

As of April 8, 2008, there were approximately 214 holders of record of the Common Stock of Kratos.

No cash dividends have been paid on Kratos Common Stock during the two most recent fiscal years of Kratos, and Kratos does not intend to pay cash dividends on its Common Stock in the immediate future.

***SYS***

Since January 3, 2005, the Common Stock of SYS has been traded on the American Stock Exchange under the symbol "SYS." Prior to that date, SYS Common Stock was traded in the over-the-counter market. The ranges of high and low quotations during SYS's two most recent fiscal years are as follows:

| | High | Low |
|---|---|---|
| **Fiscal Year 2008** | | |
| First Quarter | $ 2.52 | $ 1.90 |
| Second Quarter | $ 2.45 | $ 1.60 |
| Third Quarter | $ 2.47 | $ 1.30 |
| **Fiscal Year 2007** | | |
| First Quarter | $ 2.90 | $ 2.10 |
| Second Quarter | $ 3.14 | $ 2.11 |
| Third Quarter | $ 2.80 | $ 1.97 |
| Fourth Quarter | $ 2.34 | $ 1.73 |
| **Fiscal Year 2006** | | |
| First Quarter | $ 4.33 | $ 2.61 |
| Second Quarter | $ 5.98 | $ 3.34 |
| Third Quarter | $ 4.25 | $ 3.35 |
| Fourth Quarter | $ 3.95 | $ 2.70 |

This summary is based on prices quoted by the American Stock Exchange.

As of April 7, 2008, there were approximately 712 holders of record of SYS's Common Stock.

No cash dividends have been paid on SYS Common Stock during the two most recent fiscal years of SYS, and SYS does not intend to pay cash dividends on its Common Stock in the immediate future.

## REFERENCES TO ADDITIONAL INFORMATION

This Proxy Statement incorporates important business and financial information about Kratos from documents filed with the Securities and Exchange Commission that have not been included in or delivered with this document. This information is available at the internet website that the Securities and Exchange Commission maintains at http://www.sec.gov, as well as from other sources.

You may also request copies of these documents from Kratos, without charge, upon written or oral request to:

Kratos Defense & Security Solutions, Inc.
4810 Eastgate Mall
San Diego, California 92121
Attn: Investor Relations
(858) 812-7300

**In order to receive timely delivery of the documents, you must make your request no later than , 2008.**

For more information, see the section entitled "Where You Can Find More Information."

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

We make forward-looking statements in this Proxy Statement. These forward-looking statements relate to outlooks or expectations for earnings, revenues, expenses, asset quality or other future financial or business performance, strategies or expectations, or the impact of legal, regulatory or supervisory matters on business, results of operations or financial condition. Specifically, forward looking statements may include:

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

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

Future performance cannot be ensured. Actual results may differ materially from those in the forward-looking statements. Some factors that could cause actual results to differ include:

- the ability to obtain governmental approvals of the merger on the proposed terms and time schedule, and without the imposition of significant terms, conditions, obligations or restrictions;
- the risk that the businesses will not be integrated successfully;
- expected cost savings from the merger may not be fully realized within the expected time frames or at all;
- revenues following the merger may be lower than expected;
- the effects of vigorous competition in the markets in which Kratos and SYS operate;
- the possibility of one or more of the markets in which Kratos and SYS compete being impacted by changes in political or other factors such as monetary policy, legal and regulatory changes or other external factors over which they have no control;
- the ability of Kratos to obtain debt financing on terms favorable to it or at all, whether to complete any required refinancing of outstanding debt or otherwise;
- changes in general economic and market conditions; and
- other risks referenced from time to time in filings with the SEC and those factors listed in this Proxy Statement under "Risk Factors" beginning on page 24.

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

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

## RISK FACTORS

*In addition to the other information contained in this Proxy Statement, you should carefully consider the following risk factors in deciding how to vote on the merger. In addition, you should read and consider the risks associated with each of the businesses of Kratos and SYS because these risks will also relate to Kratos following completion of the merger.*

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

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

**Because the market price of Kratos common stock will fluctuate, SYS shareholders cannot be sure of the market value of the Kratos common stock that they will receive.**

When we complete the merger, each share of SYS common stock will be converted into the right to receive 1.2582 shares of Kratos common stock. The exchange ratio is fixed and will not be adjusted for changes in the market price of either Kratos common stock or SYS common stock. The merger agreement does not provide for any price-based termination right for either party. Accordingly, the market value of the shares of Kratos common stock that Kratos issues and SYS shareholders will be entitled to receive when the parties complete the merger will depend on the market value of shares of Kratos common stock at the time that the parties complete the merger and could vary significantly from the market value on the date of this Proxy Statement or the date of the Kratos annual meeting and the SYS special meeting. The market value of Kratos common stock will continue to fluctuate after the completion of the merger. For example, during the third and the fourth calendar quarters of 2007, the sales price of Kratos common stock ranged from a low of $1.70 to a high of $3.09, all as reported on The Nasdaq Global Select Stock Market. See "Market Prices and Dividends and Other Distributions" on page 21.

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

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

If the merger is completed, Kratos will issue up to approximately 25.3 million shares of Kratos common stock in the merger. Based on the number of shares of Kratos and SYS common stock outstanding on the Kratos and SYS record dates, SYS shareholders before the merger will own, in the aggregate, approximately 24% of the shares of Kratos common stock outstanding immediately after the merger on a fully diluted basis. The issuance of shares of Kratos common stock to SYS shareholders in the merger will cause a significant reduction in the relative percentage interest of current Kratos stockholders in the earnings, voting rights, liquidation value and book and market value of Kratos.

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

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

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

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

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

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

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

Certain of SYS's directors and executive officers have interests in the merger that are different from, or are in addition to, the interests of SYS shareholders generally. This difference of interests stems from the equity and equity-linked securities held by such persons, the change of control severance arrangements covering SYS's executive officers under which such officers are entitled to severance payments and other benefits if their employment is terminated following the merger, and the Kratos obligation under the merger agreement to indemnify SYS's directors and officers following the merger. These and other material interests of the directors and executive officers of SYS in the merger that are different than those of the other SYS shareholders are described under "The Merger Interests of SYS Directors and Executive Officers" beginning on page 66.

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

The merger agreement contains "no shop" provisions that restrict SYS's ability to solicit or facilitate proposals regarding a merger or similar transaction with another party. Further, there are only limited exceptions to SYS's agreement that its board of directors will not withdraw or adversely qualify its recommendation regarding the merger agreement. SYS's board of directors is permitted to terminate the merger agreement in response to an unsolicited third party proposal to acquire SYS, which SYS's board of directors determines to be more favorable than the merger with Kratos. However, if SYS or Kratos terminates the merger agreement because SYS has received an acquisition proposal that is deemed more favorable by its board of directors, Kratos will be entitled to collect a $2,394,000 termination fee from SYS. We describe these provisions under "The Merger Agreement Termination" beginning on page 86 and " Termination Fees and Expenses" beginning on page 87.

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

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

As of December 31, 2007, Kratos had 78,998,922 shares of common stock outstanding and approximately 8,327,306 shares of common stock subject to outstanding options and other rights to purchase or acquire its shares. Kratos currently expects that it will issue approximately 25.3 million shares of common stock in connection with the merger. The issuance of these new shares of Kratos common stock and the sale of additional shares of Kratos common stock that may become eligible for sale in the public market from time to time upon exercise of options and other equity-linked securities could have the effect of depressing the market price for shares of Kratos common stock.

**Future results of the combined company may differ materially from the unaudited pro forma financial statements presented in this Proxy Statement.**

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

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

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

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

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

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

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

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

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

- terminate Kratos' existing contracts;
- reduce potential future income from Kratos' existing contracts;
- modify some of the terms and conditions in Kratos' existing contracts;
- suspend or permanently prohibit Kratos from doing business with the federal government or with any specific government agency;
- impose fines and penalties;

subject Kratos to criminal prosecution;

- suspend work under existing multiple year contracts and related task orders if the necessary funds are not appropriated by Congress;
- decline to exercise an option to extend an existing multiple year contract; and
- claim rights in technologies and systems invented, developed or produced by Kratos.

In addition, government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted and typically impose provisions that permit cancellation in the event that necessary funds are unavailable to the public agency. Competitive procurements impose substantial costs and managerial time and effort in order to prepare bids and proposals for contracts that may not be awarded to Kratos. In many cases, unsuccessful bidders for government agency contracts are provided the opportunity to formally protest certain contract awards through various agency, administrative and judicial channels. The protest process may substantially delay a successful bidder's contract performance, result in cancellation of the contract award entirely and distract management. Kratos may not be awarded contracts for which Kratos bids, and substantial delays or cancellation of purchases may follow Kratos' successful bids as a result of such protests.

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

**A significant number of Kratos' customers are government agencies which are subject to unique political and budgetary constraints and have special contracting requirements that may affect Kratos' ability to obtain other new government customers.**

A significant number of Kratos' customers are government agencies, principally DoD agencies. These agencies often do not set their own budgets and therefore have little control over the amount of money they can spend. In addition, these agencies experience political pressure that may dictate the manner in which they spend money. Due to political and budgetary processes and other scheduling delays that frequently occur in the contract or bidding process, some government agency orders may be canceled or substantially delayed, and the receipt of revenues or payments may be substantially delayed.

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

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

- divert sales from Kratos by winning very large-scale government contracts, a risk that is enhanced by the recent trend in government procurement practices to bundle services into larger contracts;
- force Kratos to charge lower prices; or
- adversely affect Kratos' relationships with current clients, including Kratos' ability to continue to win competitively awarded engagements in which Kratos is the incumbent.

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

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

Kratos has completed several acquisitions of complementary businesses in recent years, including Kratos' October 2006 acquisition of Madison Research Technology Corporation and December 2007 acquisition of Haverstick Consulting, Inc. Kratos currently expects the merger with SYS to close by the end of the second quarter of 2008 upon receipt of the required stockholder approvals. However, the merger may not close as expected, and the anticipated synergies from the acquisition may not be fully realized or may take longer to realize than expected. The success of the merger with SYS will depend in part on the success in integrating the operations, technologies and personnel of SYS. The failure to successfully integrate the operations of the two companies or otherwise to realize any of the anticipated benefits of the acquisition could seriously harm Kratos' results of operations.

Kratos continually evaluates opportunities to acquire new businesses as part of Krato's ongoing strategy, and Kratos may in the future acquire additional companies that Kratos believes could compliment or expand Kratos' business or increase Kratos' customer base. Kratos may not be able to identify suitable acquisition candidates at prices that Kratos considers appropriate. If Kratos does identify an appropriate acquisition candidate, Kratos may not be able to successfully negotiate the terms of the acquisition or finance the acquisition on terms that are satisfactory to Kratos. Negotiations of potential acquisitions and the integration of acquired business operations could disrupt Kratos' business by diverting management attention from day-to-day operations. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in additional leverage or dilution of ownership. Kratos may encounter increased competition for acquisitions, which may increase the price of Kratos' acquisitions. Acquisitions involve numerous risks, including:

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

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

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

Kratos agreed to indemnify acquirers of Kratos' divested operations against specified losses in connection with their sale and generally retain responsibility for various legal liabilities that accrued prior to closing. Kratos also made representations and warranties to these acquirers about the condition of the divested businesses. If any acquirer makes an indemnification claim because it has suffered a loss or a third party has commenced an action against the divested business, Kratos may incur substantial expenses resolving such claims or defending against the third party action, which would harm Kratos' operating results. In addition, Kratos' ability to defend itself may be impaired because Kratos' former employees are now employees of the acquirer or other companies, and Kratos' management may have to devote a substantial amount of time to resolving the claim. In addition, these indemnity claims may divert management attention from responsibilities related to the daily ongoing concerns of the business. In addition, Kratos may be required to expend substantial resources trying to determine which party has responsibility for the claim, even if Kratos is ultimately found to be not responsible.

**A preference for minority-owned, small and small disadvantaged businesses could impact Kratos' ability to be a prime contractor on certain governmental procurements.**

As a result of an SBA set-aside program, the Federal Government may decide to restrict certain procurements to bidders that qualify as minority-owned, small or small disadvantaged businesses. As a result, Kratos would not be eligible to perform as a prime contractor on those programs and would be restricted to a maximum of 49% of the work as a subcontractor on those programs. An increase in the amount of procurements under the SBA set-aside program may impact Kratos' ability to bid on new procurements or restrict Kratos' ability to recompete on incumbent work that is placed in the set-aside program.

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

Kratos expects Kratos' revenue and operating results to vary from quarter to quarter. Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of our expenses are fixed in the short-term. Kratos may incur significant operating expenses during the start-up and early stages of large contracts and may not be able to recognize corresponding revenue in that same quarter. Kratos may also incur additional expenses when contracts expire, are terminated or are not renewed.

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

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

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

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

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

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

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

Kratos has derived, and believes that it will continue to derive, a significant portion of Kratos' revenues from a limited number of customers. To the extent that any significant customer uses less of Kratos' services or terminates its relationship with Kratos, our revenues could decline significantly. As a result, the loss of any significant client could seriously harm our business. For the fiscal year ended December 31, 2007, two customers comprised approximately 60% and 44% of Kratos' federal business revenues and total revenues, respectively, and Kratos' five largest customers accounted for approximately 84% and 62% of Kratos' total federal business revenues and total revenues, respectively. None of Kratos' customers are obligated to purchase additional services from Kratos. As a result, the volume of work that Kratos performs for a specific customer is likely to vary from period to period, and a significant client in one period may not use Kratos' services in a subsequent period.

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

Although fixed-price contracts entail a greater risk of a reduced profit or financial loss on a contract compared to other types of contracts Kratos enters into, fixed-price contracts typically provide higher profit opportunities because Kratos may be able to benefit from cost savings. In contrast, cost-plus-fee contracts are subject to statutory limits on profit margins, and generally are the least profitable of Kratos' contract types. Kratos' federal government customers typically determine what type of contract Kratos enters into. Cost-plus-fee and fixed-price contracts in Kratos' federal business accounted for approximately 51.1% and 23.3%, respectively, of Kratos' federal business revenues for the fiscal year ended December 31, 2007. To the extent that Kratos enters into more cost-plus-fee or less fixed-price contracts in proportion to Kratos' total contract mix in the future, Kratos' margins and operating results may suffer.

**The Federal Government may revise its procurement or other practices in a manner adverse to Kratos.**

The Federal Government may revise its procurement practices or adopt new contracting rules and regulations, such as cost accounting standards. It could also adopt new contracting methods relating to GSA contracts, MACs or other government-wide contracts, or adopt new standards for contract awards intended to achieve certain social or other policy objectives, such as establishing new set-aside programs for small or minority-owned businesses. In addition, the Federal Government may face restrictions from new legislation or regulations, as well as pressure from government employees and their unions, on the nature and amount of services the Federal Government may obtain from private contractors. These changes could impair Kratos' ability to obtain new contracts or contracts under which Kratos currently performs when those contracts are put up for recompetition bids. Any new contracting methods could be costly or administratively difficult for Kratos to implement, and, as a result, could harm Kratos' operating results.

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

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

**Loss of Kratos' GSA contracts or GWACs would impair Kratos' ability to attract new business.**

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

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

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

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

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

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

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

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

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

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

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

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

Kratos must comply with laws and regulations relating to the formation, administration and performance of federal government contracts, which affect how Kratos does business with Kratos' clients and may impose added costs on Kratos. In addition, the federal government, including the Defense Contract Audit Agency, which we refer to as the DCAA, audits and reviews Kratos' performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. The DCAA reviews a contractor's internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems, and the contractor's compliance with such policies. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. Adverse findings in a DCAA audit could materially affect Kratos' competitive position and result in a substantial adjustment to Kratos' revenue and profit.

**Accuracy of indirect billing rates is critical.**

Kratos' provisional indirect billing rates are approved at least annually by the Defense Contract Management Agency, which we refer to as the DCMA after being reviewed by the DCAA. These rates can differ from Kratos' actual indirect rates. Kratos budgets to have our actual indirect rates as close as possible to Kratos' government approved indirect rates at fiscal year end. Throughout the year, management assesses how these rates compare to forecasted rates for the year. If a variance is expected to exceed the amount to be billed, provisions for such variance are recognized at that time.

For interim reporting purposes, Kratos applies overhead and selling, general and administrative expenses as a percentage of direct contract costs based on annual budgeted indirect expense rates. To the extent actual expenses for an interim period are greater than the budgeted rates, the variance is deferred if management believes it is probable that the variance will be absorbed by planned contract activity. This probability assessment includes projecting whether future indirect costs will be sufficiently less than the annual budgeted rates or can be absorbed by seeking increased billing rates applied on cost-plus-fee contracts. At the end of each interim reporting period, management assesses the recoverability of any amount deferred to determine if any portion should be charged to expense. In assessing the recoverability of variances deferred, management takes into consideration estimates of the amount of direct labor and other direct costs to be incurred in future interim periods, the feasibility of modifications for provisional billing rates, and the likelihood that an approved increase in provisional billing rates can be passed along to a customer. If assumptions about the probability of recovering deferred variances change, deferred amounts could be expensed and such expenses could have a material adverse effect on the results of operations.

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

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

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

Kratos creates, implements and maintains IT solutions that are often critical to Kratos' clients' operations. We have experienced, and may in the future experience, some systems and service failures, schedule or delivery delays and other problems in connection with Kratos' work. If Kratos experiences these problems, Kratos may:

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

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

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

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

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

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

Kratos is exposed to the risk that employee fraud or other misconduct could occur. Misconduct by employees could include intentional failures to comply with federal government procurement regulations, engaging in unauthorized activities or falsifying time records. Employee misconduct could also involve the improper use of Kratos' clients' sensitive or classified information, which could result in regulatory sanctions against Kratos and serious harm to Kratos' reputation and could result in a loss of contracts and a reduction in revenues. It is not always possible to deter employee misconduct, and the precautions Kratos takes to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could cause Kratos to lose contracts or cause a reduction in revenues.

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

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

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

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

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

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

Kratos attempts to protect its trade secrets by entering into confidentiality and intellectual property assignment agreements with third parties, its employees and consultants. However, these agreements can be breached and, if they are, there may not be an adequate remedy available to Kratos. In addition, others may independently discover Kratos' trade secrets and proprietary information and in such cases Kratos could not assert any trade secret rights against such party. Enforcing a claim that a party illegally obtained and is using Kratos' trade secret is difficult, expensive and time consuming, and the outcome is unpredictable. If Kratos is unable to protect its intellectual property, its competitors could market services or products similar to its services and products, which could reduce demand for Kratos' offerings. Any litigation to enforce Kratos' intellectual property rights, protect its trade secrets or determine the validity and scope of the proprietary rights of others could result in substantial costs and diversion of resources, with no assurance of success. See "Legal Proceedings" on page 94 for additional information.

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

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

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

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

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

Kratos' past stock option granting practices and the restatement of its prior financial statements have exposed and may continue to expose Kratos to greater risks associated with litigation, regulatory proceedings and government inquiries and enforcement actions. As described in "Legal Proceedings" on page 94, several derivative complaints have been filed in state and federal courts against Kratos' current directors, some of its former directors and some of its current and former executive officers pertaining to allegations relating to stock option grants. The SEC also initiated an informal inquiry into Kratos' historical stock option granting practices and Kratos received a subpoena from the United States Attorney's Office for the Southern District of California for the production of documents relating to its historical stock option granting practices, which could result in civil and/or criminal actions seeking, among other things, injunctions against Kratos and the payment of significant fines and penalties by Kratos. On April 1, 2008, the SEC notified Kratos that it had completed its informal investigation and that it did not intend to recommend any enforcement action by the SEC against the company. Kratos is cooperating with the United States Attorney's Office for the Southern District of California, and expects to continue to do so.

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

If a Federal Government investigation uncovers improper or illegal activities, including any potential improper or illegal activities related to Kratos' stock option review or related matters, Kratos may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with federal government agencies. In addition, Kratos could suffer serious harm to its reputation and competitive position if allegations of impropriety were made against it, whether or not true. If Kratos' reputation or relationship with Federal Government agencies were impaired, or if the Federal Government otherwise ceased doing business with Kratos or significantly decreased the amount of business it does with Kratos, Kratos' revenue and operating profit would decline.

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

Effective internal controls are necessary for Kratos to provide reliable financial reports. If Kratos cannot provide reliable financial reports, Kratos' operating results could be misstated, Kratos' reputation may be harmed and the trading price of Kratos' stock could be negatively affected. Kratos' management has concluded that there are no material weaknesses in Kratos' internal controls over financial reporting as of December 31, 2007. However, there can be no assurance that Kratos' controls over financial processes and reporting will be effective in the future or that additional material weaknesses or significant deficiencies in Kratos' internal controls will not be discovered in the future. Any failure to remediate any future material weaknesses or implement required new or improved controls, or difficulties encountered in their implementation, could harm Kratos' operating results, cause Kratos to fail to meet Kratos' reporting obligations or result in material misstatements in Kratos' financial statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in Kratos' reported financial information, which could have a negative effect on the trading price of Kratos' stock. In addition, from time to time we acquire businesses which could have limited infrastructure and systems of internal controls. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is costly and requires considerable management attention, particularly in the case of newly acquired entities.

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

Kratos currently anticipates that Kratos' available capital resources, including Kratos' credit facility and operating cash flows, will be sufficient to meet Kratos' expected working capital and capital expenditure requirements for at least the next 12 months. However, such resources may not be sufficient to fund the long-term growth of Kratos' business or the expenses associated with the ongoing litigation, litigation settlements and government inquiries. In particular, Kratos may experience a negative operating cash flow due to billing milestones and project timelines in certain of Kratos' contracts.

Kratos may raise additional funds through public or private debt or equity financings if such financings become available on favorable terms or Kratos may expand Kratos' credit facility to fund future acquisitions and for general corporate purposes. However, due to the current challenges in the lending markets, Kratos can provide no assurance that the lender would agree to extend additional or continuing credit under that facility. Kratos could fall out of compliance with financial and other covenants contained in Kratos' credit facility which, if not waived, would restrict Kratos' access to capital and could require Kratos to pay down Kratos' existing debt under the credit facility. Any new financing or offerings would likely dilute Kratos' stockholders' equity ownership. In addition, additional financing may not be available on terms favorable to Kratos, or at all. If adequate funds are not available or are not available on acceptable terms, Kratos may not be able to take advantage of unanticipated opportunities, develop new products or otherwise respond to competitive pressures. In any such case, Kratos' business, operating results or financial condition could be materially adversely affected.

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

Kratos' debt service obligations are estimated to be approximately $11 million to $13 million in 2008, including approximately $2.6 million of principal repayments. This debt service may have an adverse impact on Kratos' earnings and cash flow, which could in turn negatively impact Kratos' stock price.

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

- Kratos must dedicate a substantial portion of Kratos' cash flows from operations to the payment of Kratos' indebtedness, reducing the funds available for future working capital requirements, capital expenditures, acquisitions or other general corporate requirements;

- a significant portion of Kratos' borrowings are, and will continue to be, at variable rates of interest, which may result in higher interest expense in the event of increases in interest rates;

- Kratos may be more vulnerable to a downturn in the industries in which Kratos operates or a downturn in the economy in general;

- Kratos may be limited in Kratos' flexibility to plan for, or react to, changes in Kratos' businesses and the industries in which Kratos operates;

- Kratos may be placed at a competitive disadvantage compared to Kratos' competitors that have less debt;
- Kratos may determine it to be necessary to dispose of certain assets or one or more of Kratos' businesses to reduce Kratos' debt; and
- Kratos' ability to borrow additional funds in excess of Kratos' current financing may be limited.

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

**Kratos is subject to restrictive debt covenants pursuant to Kratos' indebtedness. These covenants may restrict Kratos' ability to finance Kratos' business and, if Kratos does not comply with the covenants or otherwise default under them, Kratos may not have the funds necessary to pay all amounts that could become due and the lenders could foreclose on substantially all of Kratos' assets.**

Kratos' indebtedness contains covenants that, among other things, significantly restricts and, in some cases, effectively eliminates Kratos' ability and the ability of Kratos' subsidiaries to:

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

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

The covenants contained in Kratos' indebtedness and any credit agreement governing future debt may significantly restrict Kratos' future operations. Furthermore, upon the occurrence of any event of default, Kratos' lenders could elect to declare all amounts outstanding under such agreements, together with accrued interest, to be immediately due and payable. If those lenders were to accelerate the payment of those amounts, Kratos' assets may not be sufficient to repay those amounts in full.

Kratos is also subject to interest rate risk due to Kratos' indebtedness at variable interest rates, based on a base rate or LIBOR plus an applicable margin. Shifts in interest rates could have a material adverse effect on Kratos.

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

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

**Kratos' stock price may be volatile, which may result in lawsuits against Kratos and Kratos' officers and directors.**

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

- quarterly variations in operating results;
- announcements of new services by Kratos or Kratos' competitors;
- the gain or loss of significant customers;
- changes in analysts' earnings estimates;
- rumors or dissemination of false information;
- pricing pressures;
- short selling of Kratos' common stock;
- impact of litigation and ongoing government inquiries;
- general conditions in the market;
- political and/or military events associated with current worldwide conflicts; and
- events affecting other companies that investors deem comparable to Kratos.

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

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

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

- authorizing the board of directors to issue preferred stock;

- prohibiting cumulative voting in the election of directors;

- prohibiting stockholder action by written consent;

- establishing advance notice requirements for nominations for election to Kratos' board of directors or for proposing matters that can be acted on by stockholders at meetings of Kratos' stockholders;

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

- a number of Kratos' executives have agreements with Kratos that entitle them to payments in certain circumstances following a change in control.

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

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

A significant portion of Kratos' net assets come from goodwill and other intangible assets. In accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, "Goodwill and Other Intangible Assets," Kratos periodically reviews the carrying values of Kratos' goodwill to determine whether such carrying values exceed the fair market value. Our acquired companies are subject to annual review for goodwill impairment. If impairment testing indicates that the carrying value of a reporting unit exceeds its fair value, the goodwill of the reporting unit is deemed impaired. Accordingly, an impairment charge would be recognized for that reporting unit in the period identified, which could reduce Kratos' profitability.

# THE MERGER

*The following is a discussion of the merger and the material terms of the merger agreement between Kratos and SYS. You are urged to read carefully the merger agreement in its entirety, a copy of which is attached as Annex A to this Proxy Statement and incorporated by reference herein.*

**Background of the Merger**

SYS has regularly reviewed and assessed trends and conditions impacting SYS, the information connectivity solutions business, the government services industry generally and the related impacts of all of these factors on SYS's stock price and market capitalization. Further, from time to time, the SYS board of directors, which we refer to as the SYS Board, and management has reviewed various strategic options potentially available to achieve SYS's desired business objectives, including internal growth through expanded services capabilities and product initiatives and growth through acquisitions of other businesses. More recently and, in particular during calendar 2007, as a direct result of increasing competition, changes within the government contract services industry affecting smaller service providers, overall consolidation within the industry and general market conditions limiting or inhibiting small cap funds from investing in small publicly traded companies and the ever increasing costs associated with being a publicly traded company, the SYS management and SYS Board began considering more fully the possibilities of various strategic alternatives including a business combination.

In this regard, over a period of time ranging from January 2007 through August 2007 Clifton L. Cooke, Jr., President and CEO of SYS, held various informal discussions with key decision makers at numerous companies in the government services sector as to their potential interest in acquiring SYS at some point in the future and with regard to the specific criteria that would drive their decision making process. These discussions helped Mr. Cooke shape the strategic direction of SYS, as these discussions provided valuable data points regarding the product and service capabilities as well as the types of government programs which were sought after by these companies as part of their merger and acquisition strategies. Most of these conversations were held with executives with whom Mr. Cooke had developed relationships over the course of his 30+ year career in the industry; and in addition to helping shape the strategic direction of SYS, these discussions also provided a means by which to measure SYS's progress toward building a business capable of creating value for its shareholders through such a strategic transaction.

Several of these discussions took place in or around the last quarter of SYS's 2007 fiscal year between April 1$^{st}$ and June 30$^{th}$. Three companies expressed a willingness to engage in general discussions about potential business combinations but wanted to defer detailed discussions until SYS completed its fourth quarter and fiscal year 2007 and its budget cycle process for fiscal year 2008. Accordingly, SYS and these companies mutually agreed to defer further conversations until SYS could complete its audit for the fiscal year ended June 30, 2007 and so that SYS could complete its business planning for fiscal year 2008, at which time SYS could provide any such interested parties with updated pro forma financial information as a basis for more detailed discussions. Throughout this period, Mr. Cooke notified the SYS Board of such discussions at the regularly scheduled board meetings as part of his ongoing business and strategic update.

Since 2004, Kratos has undertaken a number of strategic acquisitions and since 2006, has also undertaken a number of divestitures and, as a result of successfully executing the plan to divest all of its previous Commercial Wireless Communications Infrastructure business, has successfully completed its initial transition to being substantially a "pure-play" Government services solution provider. Kratos' stated strategy is to grow the business, organically and through strategic acquisitions, into the premier mid-market Federal Government Security, IT, and Engineering Solutions provider. As a result the Kratos board of directors has reviewed numerous strategic opportunities (i) to reach new customers and acquire additional contract vehicles, (ii) to quickly follow changes in government priorities, (iii) to position the company for changes in the coming years from Base Realignment and Closure, or BRAC, activities, (iv) to broaden and improve the company's services offerings, and (v) to ultimately grow Kratos' revenue and improve profit margins. In furtherance of these goals, and as a result of increased competition and consolidation in the defense and security solutions industry, Kratos regularly reviews possible strategic actions, including acquisitions and combinations, and has discussions from time to time with various parties regarding such possible actions. For example, and as part of pursuing this strategic agenda, on December, 31, 2007, Kratos completed its acquisition of the Haverstick business.

Subsequent to completing its fiscal year ended June 30, 2007 and in preparation for implementing its operating plan for the fiscal year ending June 30, 2008, SYS management and the SYS Board began to engage in a series of discussions regarding both the near-term and long-term strategy for SYS in light of its financial results, current industry trends and general stock market conditions. During this same approximate timeframe, Mr. Cooke and the CEO and President of Kratos, Eric DeMarco, met informally to discuss common industry issues and trends affecting both companies, business operations challenges and the continuing difficulties of growing their respective businesses while maintaining and expanding their shareholder bases. During these discussions, the concept of the two companies joining forces was broached, but nothing specific was concluded.

During its regularly scheduled board meeting in September 2007, SYS management and the SYS Board engaged in further discussions regarding the status of the industry, the capital markets and the continuing decrease of investment funds available to invest in micro cap stocks, the general strategy of SYS and various courses of action that would best serve the interests of its shareholders. The SYS Board discussed the formation of a strategic working group, which we refer to as the Committee, to formally assess strategic alternatives.

In the late summer and early fall of 2007, Mr. Cooke met with defense industry analysts and investment bankers and attended conferences with the goal of gaining current information on merger and acquisition trends in the government contracting arena. In addition to providing relevant and timely valuation metrics, these activities highlighted various market issues affecting mergers and acquisitions, including political uncertainty, the impact on valuations resulting from recent changes in the small business contract rules, the recent downturn in the credit markets and federal and defense budget spending impacts from the ongoing war effort.

At the SYS Board meeting on October 26, 2007, Mr. Cooke briefed the SYS Board on this conference and presented a strategic working group charter together with a proposed plan of action and a timetable. After discussing the proposed charter, the SYS Board resolved to form the Committee to further explore the various alternatives outlined in the charter in order to determine which path would best maximize shareholder value given the circumstance described above. The Committee was tasked to complete its detailed review and analysis and to report back to the SYS Board with a recommendation at the next regularly scheduled meeting on December 7, 2007. These alternatives included conducting assessments of internal growth opportunities, further SYS acquisitions, divestitures of existing products and/or business lines and an outright sale of SYS. SYS management was further authorized to extend the engagement letter with its financial advisory services firm, USBX Advisory Services LLC, which we refer to as USBX, to assist management in this undertaking. Mr. Cooke also advised the SYS Board that he had been having some general business discussions with Mr. DeMarco; and, given the nature of the activities being undertaken by management and the Committee, on October 26, 2007, Kratos and SYS signed a mutual nondisclosure agreement in connection with such discussions.

During the first two weeks of November 2007, Messrs. Cooke and DeMarco met to further assess the prospects of a potential merger between the two companies. Initial discussions included the potential synergies between the two companies that existed between customers, capabilities and programs as well as potential cost savings that might be expected. Additionally, preliminary discussions were held regarding business valuation expectations, forms of potential consideration, impacts on their employees and customers and preliminary estimated timetables to complete such a transaction if approved by their respective boards of directors.

Subsequent to its conference call on November 13, 2007, concerning its first quarter results and based on the direction of the SYS Board, management, together with its financial advisor, commenced and conducted a rigorous and detailed analysis of SYS's business prospects in advance of a Committee meeting held on November 29, 2007, the results of which would be presented to the SYS Board on December 7, 2007.

Between November 14, 2007 and November 29, 2007, Messrs. Cooke and DeMarco continued these discussions and established an objective to develop a preliminary valuation based on information shared to date. and transaction structure that Mr. Cooke could incorporate into the work the Committee was performing as a frame of reference for its strategic discussions to be held on November 29, 2007.

These discussion led to a "preliminary" enterprise value for SYS on the low end of a range of $50 million to $55 million, subject to the treatment of outstanding debt and other equity related instruments, with the purchase price to be paid in registered shares of Kratos stock. This enterprise value represented a premium to the then market capitalization of SYS. The low end of the range was predicated on the most recent last twelve months SYS financial results and market based EBITDA multiples applied to those results. This enterprise value also reflected the concern that certain of the SYS small business contracts might be at risk to the acquirer due to recent changes in the rules governing the treatment of small business contracts after an acquisition.

On November 27, 2007, management from the two companies met and reviewed a presentation provided by Edward Lake, Executive Vice President and CFO of SYS, that provided a general business overview, recent actual financial results, estimated financial results for the fiscal year ended June 30, 2008, and a pro forma analysis of what the SYS financial results would look like absent certain non-recurring costs, such as the costs of being a publicly traded company, among other EBITDA adjustments customary in such circumstances. During this same timeframe, management from Kratos briefed the management of SYS with a similar presentation and financial analysis.

In the SYS Committee meeting held on November 29, 2007, SYS management and its financial advisor presented a comprehensive analysis to the Committee that included, among other things: (i) the current status of the business, (ii) current public company challenges, (iii) valuation metrics and issues, (iv) SYS financial projections under a variety of scenarios, (v) strategic alternatives including staying the course, selling the business, taking the company private and continuing to pursue acquisitions as an acquirer, and (vi) key drivers that management considered relevant to this decision process. During these discussions, management provided the Committee with a synopsis of the discussions that had been held to date with Kratos, including preliminary valuation estimates and information regarding another government IT services company that SYS management considered as a potential acquisition candidate for SYS.

As a result of this meeting, SYS management was tasked with: (i) preparing a final concise summary of its findings and recommendations to be delivered in advance of and for full discussion at the SYS Board meeting scheduled for December 7, 2007, (ii) continuing its discussions with Kratos management, (iii) together with its financial advisor, continuing to build on other discussions that had taken place from time to time with other potential interested acquirers, and (iv) developing and pursuing a focused target list of other potential acquirers that SYS management believed would represent viable candidates who were capable of making a decision and who could execute on that decision in a timely manner.

During the period from November 29, 2007 through December 7, 2007, SYS management and its financial advisor finalized a list of other potential acquirers based on prior discussions or indications of interest and that represented a fair sampling of companies in the government IT services industry that could quickly review and assess a management presentation of SYS's capabilities and provide SYS management with an indication of interest and a general estimate of value for comparative purposes.

Also during this time, Messrs. Cooke and Demarco, together with Mr. Lake and the respective financial and legal advisors of SYS and Kratos, continued to review and refine the preliminary valuation analysis and worked to develop customary terms and conditions that might lead to a non-binding indication of interest which could be presented to the SYS Board on December 7, 2007.

Through this process, SYS was able to provide financial and other information that supported a higher valuation based on the pro forma analysis of what the SYS financial results would look like absent certain non-recurring costs, such as the costs of being a publicly traded company, among other EBITDA adjustments customary in such circumstances, its projections for the remainder of fiscal year 2008 and fiscal year 2009, potential key new contract wins during those periods and was further able to demonstrate that the risk of losing any of its small business contracts was minimal. As a result, the parties developed a "revised" preliminary enterprise valuation of $60 million less the value of the outstanding subordinated debt of $3.1 million for a post-debt equity value of $56.9 million and such that, after the transaction and after the completion of the then pending Haverstick transaction by Kratos, the SYS shareholders would own approximately 24% of the issued and outstanding stock of Kratos post-closing.

On December 3, 2007 Kratos engaged Wachovia Capital Markets, LLC as its financial advisor with respect to a potential business combination of Kratos and SYS.

On December 4, 2007, Kratos delivered its preliminary proposal to SYS, expressing Kratos' interest in a potential stock-for-stock merger with SYS at an enterprise value for SYS of $60 million subject to a fixed stock price assumption of Kratos' common stock of $2.25 per share. With its letter of intent, Kratos included proposed exclusivity provisions and requested that SYS agree to exclusive negotiations with respect to its proposal.

On December 7, 2007 the SYS Board met with management to review the report and findings previously briefed to the Committee and the initial letter of intent from Kratos. As a result of these discussions, the SYS Board instructed management to continue working with Kratos management to negotiate a letter of intent that might be deemed acceptable to both parties, to continue discussions with the other potential acquirers, and to report those findings to the SYS Board. The SYS Board also authorized management to have SYS legal counsel conduct a thorough legal due diligence review of litigation in which Kratos was involved and which Kratos has recently resolved. A telephonic board meeting was scheduled for December 21, 2007 to reconvene and assess the outcome of the aforementioned activities.

From the period between December 7, 2007 and December 21, 2007, SYS management and its financial advisor continued to pursue the efforts recommended by the SYS Board as outlined below:

1. They conducted face to face and/or telephonic meetings with the short list of other potential acquirers. Each of these companies was provided with a significant amount of information relevant to determining a level of interest in acquiring SYS and were provided with current information as to the status of SYS' deliberations;

2. They directed legal counsel to conduct a thorough review of the outstanding litigation matters involving Kratos, which resulted in the preparation of a detailed analysis that was then reviewed with management and its financial advisor; and

3. They continued to hold meetings with Kratos to better understand the detailed aspects of Kratos' business and continued to work on terms and conditions that would lead to an acceptable non-binding letter of intent, including valuation, the treatment of outstanding

SYS options and warrants, a break-up fee upon termination of the agreement and other items customary in a non-binding letter of intent.

On December 21, 2007 SYS received a revised letter of intent from Kratos.

Also on December 21, 2007 SYS management and the SYS board of directors met to review the results of management's efforts over the previous few weeks. Management reported that, based on the results of its meetings with other companies, that the other companies either were not interested in pursuing a transaction with SYS or, if they did want to pursue further discussions, that it was not likely that they would put forth an offer that would exceed the then current market capitalization for SYS which was considerably lower than the $60 million enterprise value contemplated in the non-binding letter of intent with Kratos.

The SYS Board then reviewed and discussed the proposed terms in the non-binding letter of intent from Kratos and authorized management to continue refining certain terms and, if successful in achieving those refinements, to execute the non-binding letter of intent. The SYS Board further discussed and reviewed the terms of the engagement letter with the company's financial advisor, USBX, which had been assigned to Imperial Capital LLC, which we refer to as Imperial Capital, upon its acquisition of USBX and approved the fee structure for completing a transaction in accordance with the engagement letter.

On December, 24, 2007, Kratos executed and delivered a revised letter of intent to SYS which contained the changes deemed acceptable and necessary to the SYS Board which was then executed by Mr. Cooke on behalf of SYS. Pursuant to this letter of intent, SYS agreed to negotiate exclusively with Kratos until February 22, 2008.

During the period from December 28, 2007 through February 19, 2008, Kratos, SYS, Wachovia and Imperial Capital, financial advisors for Kratos and SYS, respectively, and DLA Piper and Luce, Forward, Hamilton & Scripps, which we refer to as Luce Forward, legal counsel for Kratos and SYS, respectively, engaged in a lengthy and detailed process of completing due diligence, drafting a definitive merger agreement and completing all the other matters necessary to determine if a final agreement could be reached, which included assessing the impacts of such a transaction on existing contract vehicles, customers, employees, facilities and shareholders.

On December 31, 2007, Kratos completed its acquisition of Haverstick Consulting, Inc.

On January 1, 2008, DLA Piper delivered to Luce Forward an initial draft of the merger agreement. From January 1, 2008 until the execution of the merger agreement, Kratos and SYS and their representatives exchanged drafts of the merger agreement and held extensive negotiations relating to its terms and conditions.

On January 7, 2008, the parties held an organizational meeting at which SYS provided a business presentation to a broader set of both Kratos and SYS management and their respective financial advisors.

From January 7, 2008 onward, management from both companies, together with their respective financial advisors and legal counsel, conducted due diligence via an analysis of items in an electronic data room, meetings and conference calls.

On January 31, 2008, the senior management teams of Kratos and SYS, as well as DLA Piper and Luce Forward met to negotiate the merger agreement.

On February 8, 2008, the senior management teams of Kratos and SYS, as well as Wachovia and Imperial Capital met to review SYS's projected financial statements and to discuss other due diligence items.

On February 12, 2008, Kratos, SYS, Wachovia and Imperial Capital met to review Kratos' projected financials and to discuss other due diligence items.

On February 13, 2008, Kratos, SYS, DLA Piper and Luce Forward met to review outstanding items in, and schedules to, the merger agreement.

On February 19, 2008, the SYS Board met to review and discuss the terms and conditions of the definitive agreement, the fairness opinion of SYS's financial advisor, an update of the litigation status of Kratos as prepared by SYS's legal counsel and the proposed timetable for the transaction taking into consideration the required SEC filings and shareholder approval process. The full text of the Imperial Capital opinion, which sets forth, among other things, the procedures followed, assumptions made, matters considered and limitations on the scope of the review undertaken by Imperial Capital in rendering its opinion, is attached as *Annex E* to this Proxy Statement. The SYS Board discussed the various presentations and the terms of the transaction and approved the merger agreement and the share issuance. The SYS Board then approved moving forward with the transaction.

Also on February 19, 2008, the Kratos board of directors convened a special meeting to consider the proposed transaction with SYS. Representatives of Kratos' senior management, as well as representatives of Wachovia and DLA Piper were present at the meeting. The Kratos board of directors reviewed and discussed the terms and conditions of the definitive agreement, Wachovia's fairness opinion and the proposed timetable for the transaction taking into consideration the required SEC filings and stockholder approval process. Representatives of Wachovia reviewed Wachovia's financial analyses of the proposed exchange ratio and rendered the oral opinion of Wachovia, subsequently confirmed by delivery of its written opinion dated February 20, 2008, that as of such date and based upon and subject to the various considerations described in its written opinion, the exchange ratio provided for in the merger agreement was fair, from a financial point of view, to Kratos. The full text of the Wachovia opinion, which sets forth, among other things, the procedures followed, assumptions made, matters considered and limitations on the scope of the review undertaken by Wachovia in rendering its opinion, is attached as *Annex D* to this Proxy Statement. The Kratos board of directors discussed the various presentations and the terms of the transaction and approved the merger agreement and the share issuance.

On February 20, 2008, Kratos, SYS, DLA Piper and Luce Forward finalized the merger agreement and the schedules thereto. Kratos and SYS thereafter executed the merger agreement. Concurrently, certain of Kratos' directors, executive officers and significant stockholders executed the Kratos voting agreement, the form of which is included as *Annex B* to this Proxy Statement, and certain of SYS's directors and executive officers executed the SYS voting agreement, the form of which is included as *Annex C* to this Proxy Statement.

On February 21, 2008, Kratos and SYS each issued a press release announcing the transaction and the execution of the merger agreement.

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

**The Kratos board of directors believes that the merger and the merger agreement, and related transactions, are advisable and in the best interests of Kratos and its stockholders. Accordingly, the Kratos board of directors has approved the merger and the merger agreement, and related transactions, and recommends that Kratos stockholders vote "FOR" " approval of the Share Issuance.**

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

- The government market is an attractive market to continue to expand into due to relative stability and steady cash flow generation;
- The merger would allow Kratos to access new customers and obtain new/more contract vehicles;
- The combined company, with greater scale, size, more past performance qualifications and a larger number of employees, especially those with security clearances, will be able to bid on larger/more contracts in the prime contract position/role;
- The merger will improve the offerings of Kratos to its customers
- Obtaining several hundred hard-to-find employees with skill sets that are very marketable, and in high demand;
- Expand the reach of Kratos with SPAWAR one of Kratos' major customers;
- Help Kratos achieve growth objectives and profitability targets.

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

- The information concerning the respective historic businesses of Kratos and SYS, financial results and prospects, including the result of Kratos due diligence review of SYS;
- The assessments of Kratos that SYS's business can effectively and efficiently be integrated;
- The opinion of the financial advisor of Kratos, Wachovia, that, subject to and based on the assumptions made, procedures followed, matters considered and limitations on its review undertaken, as of February 20, 2008, the exchange ratio of 1.2582 shares of Kratos common stock for each share of SYS common stock was fair to Kratos from a financial point of view;
- The exchange ratio and the fact that the exchange ratio is fixed and will not fluctuate based upon changes in the Kratos stock price between signing and closing, reflecting the strategic purpose of the merger and consistent with market practices for a merger of this type;
- The expectation that SYS shareholders and option holders, immediately after completion of the merger, would hold approximately 24% of the outstanding shares of common stock of Kratos, on a fully diluted basis;
- The risk that U.S. and foreign antitrust and competition authorities may not approve the merger or may impose terms and conditions on their approvals that, if accepted, would materially and adversely affect the projected financial results of the combined company;
- The potential impact of the restrictions under the merger agreement on the ability of Kratos to take certain actions during the period prior to the closing of the merger, which may delay or prevent Kratos from undertaking business opportunities that may arise pending completion of the merger;

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

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

- The fees and expenses associated with completing the merger; and
- The risk that anticipated cost savings will not be achieved.

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

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

**The SYS Board of Directors' Recommendations and Reasons for the Merger**

**The SYS board of directors believes that the merger and the merger agreement are advisable and in the best interests of SYS and its shareholders. Accordingly, the SYS board of directors has unanimously approved the merger and the merger agreement and unanimously recommends that SYS shareholders vote "FOR" approval of the Merger Proposal. When SYS's shareholders consider the SYS board of directors' recommendation, SYS's shareholders should be aware that SYS's directors may have interests in the merger that may be different from, or in addition to, their interests. These interests are described in "Interests of SYS's Directors and Executive Officers in the Merger" beginning on page 9.**

At a special meeting of the SYS Board held on February 19, 2008, the SYS Board of directors voted unanimously to approve the merger agreement, the merger, and the other transactions contemplated by the merger agreement, to direct that the merger agreement and the merger be submitted to a vote of SYS's shareholders and to recommend that SYS's shareholders vote to adopt and approve the merger agreement and the merger. In the course of reaching its decision to enter into the merger agreement, SYS's Board consulted with its senior management, outside legal counsel and Imperial Capital, reviewed a significant amount of information and considered a number of factors, the most relevant of which include the following:

- that by combining complementary operations, the combined company would have better opportunities for future growth;
- the opportunity for SYS's shareholders to participate in a larger, more diversified organization and to benefit from the potential appreciation in the value of Kratos' common stock;
- information concerning the business, earnings, operations, competitive position and prospects of SYS and Kratos both individually and on a combined basis;
- the opportunity for SYS shareholders to receive a significant premium over the existing market price for shares of SYS's common stock prior to the announcement of the merger;
- discussions with, SYS senior management and legal and financial advisor regarding certain business, financial, legal and accounting aspects of the merger, the results of the legal and financial due diligence and a review of the terms and conditions of the merger;
- the opinion of Imperial Capital that, as of February 19, 2008, and subject to the assumptions and limitations set forth in the fairness opinion, the exchange ratio in the merger was fair, from a financial point of view, to the holders of SYS's common stock;

the possibility, as alternatives to the merger, of seeking to acquire another company, seeking to engage in one or more joint ventures, seeking to raise additional capital, or seeking to engage in a business combination with an organization other than Kratos;

the likely impact of the merger on SYS's employees and customers;

the interests that certain executive officers and directors of SYS may have with respect to the merger, in addition to their interests as shareholders of SYS generally, as described in "THE MERGER  CERTAIN ARRANGEMENTS BETWEEN SYS AND ITS EXECUTIVE OFFICERS, DIRECTORS AND AFFILIATES" starting on page 70;

the fact that the parties intend for the merger to qualify as a tax-free transaction for U.S. federal income tax purposes which would permit SYS's shareholders to receive Kratos common stock in a tax-free exchange; and

the history of contacts with other potential strategic partners and the judgment of SYS's Board and management that it was unlikely that any other party would be a more attractive strategic partner or make a proposal more favorable to SYS and its shareholders than Kratos.

SYS's Board also considered a number of potentially negative factors in its deliberations concerning the merger. The negative factors considered by the Board of SYS included:

the risk that the merger would not be completed in a timely manner or at all;

the possible negative effects of the public announcement of the merger on SYS's sales, relationships with customers, suppliers, and employees; and operating results;

the fact that SYS shareholders will not receive the full benefit of any future growth in the value of their equity that SYS may have achieved as an independent company, and the potential disadvantage to SYS shareholders in the event that Kratos does not perform as well in the future as SYS may have performed as an independent company;

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

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

the other risks and uncertainties discussed above under "RISK FACTORS" starting on page 24 of this proxy statement/prospectus including the various outstanding shareholder and stock option litigation matters involving Kratos and the potential future impacts of those matters on the merger consideration being issued to the SYS shareholders.

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

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**Opinion of Financial Advisor to the Kratos Board of Directors**

At the February 19, 2008 meeting of Kratos' board of directors, Wachovia indicated to Kratos' board of directors, that subject to and based on the assumptions made, procedures followed, matters considered and limitations on its review undertaken, that assuming that the merger agreement was substantially in the form provided at the meeting, Wachovia would, at the time of execution of the merger agreement, be able to provide its opinion that, as of the date of the merger agreement, the 1.2582 to 1 exchange ratio pursuant to the merger agreement was fair from a financial point of view to Kratos. Wachovia subsequently delivered a written opinion to Kratos' board of directors to the effect that, subject to and based on the assumptions made, procedures followed, matters considered and limitations on its review undertaken, as of February 20, 2008, the exchange ratio pursuant to the merger agreement was fair from a financial point of view to Kratos.

The full text of Wachovia's opinion, dated February 20, 2008, which sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the review undertaken by Wachovia in connection with the opinion, is attached as *Annex D* to this Proxy Statement. Holders of shares of Kratos common stock are urged to read the opinion carefully and in its entirety. This summary is qualified in its entirety by reference to the full text of the opinion.

Wachovia's opinion only addressed the fairness of the exchange ratio offered to Kratos from a financial point of view and did not address any other term of the Merger or any other agreement, arrangement or understanding entered into in connection with the Merger or otherwise, and did not address the relative merits of the Merger compared with other business strategies that may have been considered by Kratos' management or its board of directors, nor did its opinion address the merits of the underlying decision by Kratos to enter into the merger agreement. Wachovia's opinion does not and shall not constitute a recommendation to any holders of shares of Kratos common stock as to how they should vote in connection with the Merger.

In arriving at its opinion, Wachovia, among other things:

- Reviewed the merger agreement including the proposed financial terms of the merger set forth therein.
- Reviewed Annual Reports to Stockholders and Annual Reports on Form 10-K for Kratos.
- Reviewed certain interim reports to Stockholders and Quarterly Reports on Form 10-Q for Kratos.
- Reviewed certain other business, financial, and other information, including certain confidential information, regarding Kratos and its prospects, including financial forecasts, which were furnished to Wachovia, and that Wachovia discussed with the management of Kratos and its agents or representatives.
- Reviewed Annual Reports to Stockholders and Annual Reports on Form 10-K for SYS.
- Reviewed certain interim reports to Stockholders and Quarterly Reports on Form 10-Q for SYS.
- Reviewed certain business, financial, and other information, including certain confidential information, regarding SYS and its subsidiaries and their respective prospects, which were publicly available or furnished to Wachovia by, and that Wachovia has discussed with, the respective managements of SYS and Kratos, including financial forecasts for SYS furnished to Wachovia by SYS, and reviewed and discussed with Kratos estimates for SYS prepared by Kratos.
- Compared certain business, financial, and other information regarding SYS and Kratos with publicly available business, financial and other information regarding certain publicly traded companies that Wachovia deemed relevant.

Compared the proposed financial terms of the merger with the financial terms of certain other business combinations and transactions that Wachovia deemed relevant.

Reviewed a discounted cash flow model based upon the Kratos forecasts for Kratos and SYS, respectively, on a stand-alone basis.

Reviewed the potential pro forma impact of the merger on the Kratos financial statements on a Pro Forma and GAAP basis based upon Kratos' forecasts for Kratos and SYS.

Reviewed a contribution analysis based upon Kratos' forecasts for Kratos and SYS.

Reviewed the historic reported stock price and trading volumes of the Kratos common stock and SYS common stock.

Considered other information such as financial studies, analyses and investigations as well as financial, economic and market criteria that Wachovia deemed relevant.

In connection with its review, Wachovia relied upon and assumed for purposes of its opinion, the accuracy and completeness of the foregoing financial and other information, including all accounting, legal, regulatory and tax information Wachovia obtained and reviewed for the purpose of its opinion, and Wachovia did not assume any responsibility for any independent verification of such information nor has it undertaken an independent evaluation or appraisal of any of the assets or liabilities of SYS and its subsidiaries or Kratos and its subsidiaries or been furnished with any such evaluation or appraisal. Wachovia also assumed that the forecasts, including the forecasts for the combined company following the merger provided by Kratos management, estimates, judgments, and all assumptions expressed by management of Kratos, have been reasonably formulated and that they are the best currently available forecasts, estimates, judgments, and assumptions of Kratos as to the expected future financial performance of SYS or Kratos, as the case may be. Wachovia assumed no responsibility for and expressed no view as to any such forecasts, estimates, judgments, or the assumptions upon which they are based. In arriving at its opinion, Wachovia did not prepare or obtain any independent evaluations or appraisals of the assets or liabilities of SYS or Kratos, including any contingent liabilities.

In rendering its opinion, Wachovia assumed that the merger would be consummated on the terms described in the merger agreement, without waiver of any material terms or conditions, and that in the course of obtaining any necessary legal, regulatory or third-party consents or approvals, no restrictions or conditions will be imposed that will have an adverse effect on the merger, Kratos, SYS or other actions contemplated by the merger agreement. Wachovia's opinion was necessarily based on economic, market, financial and other conditions and the information made available to Wachovia as of the date thereof. Wachovia did not consider, nor did Wachovia express any opinion with respect to, the price at which Kratos common stock would trade following the announcement of the merger or the price at which such stock will trade following the consummation of the Merger. Further, Wachovia did not express any opinion as to the fairness or nature of the compensation to be received by either the Kratos or SYS directors, officers, employees or other insiders, or class of such persons, in connection with the Merger relative to the exchange ratio.

The following summaries of Wachovia's material financial analyses present some information in tabular format. In order to fully understand the financial analyses used by Wachovia, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Accordingly, the analyses listed in the tables and described below must be considered as a whole. Considering any portion of such analyses and the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying Wachovia's opinion.

***Historical Trading Analysis:*** Wachovia reviewed general trading information concerning SYS and Kratos, including the stock price, average stock price and volume over various periods and dates ending February 19, 2008 and the stock trading history of SYS common stock and Kratos common stock. The table below illustrates the range of stock prices over those periods:

| | Share Price | |
|---|---|---|
| | **SYS** | **Kratos** |
| 1-Day Prior | $ 1.60 | $ 2.11 |
| 5-Day Average | 1.59 | 2.10 |
| 20-Day Average | 1.61 | 2.06 |
| 60-Day Average | 1.85 | 2.09 |
| 1-Year Average | 2.13 | 2.00 |
| 52-Week High | 2.78 | 3.04 |
| 52-Week Low | 1.35 | 1.07 |

***Historical Exchange Ratio Analysis:*** Wachovia analyzed the ratios of the daily closing prices of SYS common stock to those of Kratos common stock over various periods and dates ending February 19, 2008. The table below illustrates the average of those exchange ratios for those periods or the exchange ratio for such dates and the premiums or discounts based on an implied exchange ratio of 1.2582 shares of Kratos common stock for each share of SYS common stock:

| | **Exchange Ratio** | **Implied Premium** |
|---|---|---|
| 1-Day Prior | 0.7583x | 65.9% |
| 5-Day Average | 0.7579x | 66.0% |
| 20-Day Average | 0.7817x | 61.0% |
| 60-Day Average | 0.8834x | 42.4% |
| 1-Year Average | 1.1229x | 12.1% |
| 52-Week High | 1.9907x | (36.8)% |
| 52-Week Low | 0.6622x | 90.0% |

***Comparable Companies Analysis:*** Using publicly available information, Wachovia analyzed certain trading multiples of selected publicly traded Government Information Technology services companies that it believed were reasonably comparable to SYS and Kratos.

These companies included the following:

CACI International, Inc.

Dynamics Research Corp.

ManTech International Corp.

NCI, Inc.

SAIC, Inc.

SI International, Inc.

SRA International, Inc.

Stanley, Inc.

For each of the comparable companies, Wachovia analyzed the following metrics:

Multiple of enterprise value, defined as the market value of equity plus net debt plus preferred stock plus minority interest, to last twelve months, or LTM, revenue and estimated revenue for calendar years ended 2008 and 2009; and

Multiple of enterprise value to LTM EBITDA and estimated EBITDA for the calendar years ended 2008 and 2009.

Estimates for the comparable companies were as reported by First Call and Kratos management for SYS and Kratos. This analysis produced multiples of selected valuation data which Wachovia compared to multiples for SYS based on the implied value of the merger consideration of 1.2582 Kratos shares and Kratos, in each case based on the closing price of shares of Kratos common stock on February 19, 2008. The following table presents, for the periods indicated the multiples implied by the ratio of the enterprise value to LTM revenue and EBITDA and calendar years ended 2008 and 2009 revenue and EBITDA estimates:

| | | | Comparable Company Multiple | | | |
|---|---|---|---|---|---|---|
| | SYS | Kratos | Low | Mean | Median | High |
| LTM Enterprise Value / Revenue | 0.7x | 0.8x | 0.4x | 0.9x | 0.9x | 1.2x |
| CY08 Enterprise Value / Revenue | 0.7x | 0.7x | 0.4x | 0.8x | 0.8x | 1.0x |
| CY09 Enterprise Value / Revenue | 0.6x | 0.7x | 0.7x | 0.8x | 0.8x | 0.8x |
| LTM Enterprise Value / EBITDA | 23.0x | 12.6x | 5.2x | 10.3x | 10.3x | 13.6x |
| CY08 Enterprise Value / EBITDA | 8.7x | 11.2x | 4.6x | 8.7x | 9.1x | 10.5x |
| CY09 Enterprise Value / EBITDA | 7.9x | 10.8x | 7.0x | 8.1x | 8.3x | 9.0x |

None of the companies utilized in the above analyses for comparative purposes is identical to SYS or Kratos. Accordingly, a complete analysis of the results of the foregoing calculations cannot be limited to a quantitative review of such results and involves complex considerations and judgments concerning the differences in the financial and operating characteristics of the comparable companies and other factors that could affect the public trading value of the comparable companies as well as the potential trading value of SYS or Kratos.

***Precedent Transactions Analysis:*** Using publicly available information, Wachovia examined selected transactions announced since January 1, 2006 involving privately held and publicly traded Government Information Technology services companies it believed were reasonably comparable to SYS and Kratos.

For each of the selected precedent transactions, Wachovia analyzed the following metrics:

Multiple of enterprise value to LTM revenue and estimated next twelve months, or NTM, revenue; and

Multiple of enterprise value to LTM EBITDA and estimated NTM EBITDA.

Estimates for the selected precedent transactions were as available through First Call reports, SEC filings and press releases. This analysis produced multiples of selected valuation data which Wachovia then compared to multiples for SYS based on the implied value of the merger consideration of 1.2582 shares of Kratos stock and Kratos based on the closing price of shares of Kratos common stock on February 19, 2008. The following table presents, for the periods indicated, the multiples for the selected precedent transactions implied by the ratio of the enterprise value to LTM revenue and EBITDA and NTM revenue and EBITDA estimates:

| | | | Selected Transactions | | | |
|---|---|---|---|---|---|---|
| | SYS | Kratos | Low | Mean | Median | High |
| LTM Enterprise Value / Revenue | 0.7x | 0.8x | 0.3x | 1.2x | 1.2x | 3.1x |
| NTM Enterprise Value / Revenue | 0.7x | 0.7x | 0.3x | 1.3x | 1.1x | 2.7x |
| LTM Enterprise Value / EBITDA | 23.0x | 12.6x | 6.2x | 10.7x | 10.8x | 16.4x |
| NTM Enterprise Value / EBITDA | 8.7x | 11.2x | 9.4x | 11.3x | 10.5x | 15.6x |

***Premiums Paid Analysis:*** Wachovia reviewed transactions involving publicly traded companies in the U.S. technology and services industry ranging in value from $25 million to $500 million to determine the premium or discount paid by the acquiror relative to the closing market price of the target company's common shares for one-day prior, one-week prior and one-month prior. Using publicly available information, Wachovia calculated, among other things, the high, low, mean and median premiums paid in these selected transactions and compared the implied value of the merger consideration of 1.2582 shares of Kratos stock to the closing price of shares of SYS common stock on February 19, 2008, one-week prior and one-month prior. The following table sets forth information concerning the stock price premiums implied by the Merger and the stock price premiums (and discounts) in the selected transactions:

| | | Selected Transactions | | | |
|---|---|---|---|---|---|
| | SYS | Low | Mean | Median | High |
| One-Day Prior Premium | 65.6% | (54.4)% | 30.1% | 24.5% | 151.4% |
| One-Week Prior Premium | 60.6% | (46.2)% | 33.0% | 27.1% | 151.4% |
| One-Month Prior Premium | 76.7% | (49.6)% | 35.8% | 28.2% | 144.9% |

***Discounted Cash Flow Analysis:*** Wachovia estimated a range of values for Kratos common stock and SYS common stock based upon the discounted present value of the projected after-tax cash flows of Kratos and SYS described in the respective financial forecasts provided by Kratos, for the nine months ending December 31, 2008 through the year ending December 31, 2012, and of the terminal values of Kratos and SYS based upon multiples of EBITDA and perpetuity growth rates. This analysis was based upon certain assumptions described by, projections supplied by and discussions held with management of Kratos. In performing this analysis, Wachovia utilized discount rates for Kratos ranging from 11.0% to 13.0% and for SYS ranging from 13.0% to 15.0%. The discount rates were selected based on weighted average cost of capital calculations for each of Kratos and SYS, respectively. Wachovia utilized terminal multiples of EBITDA for Kratos and SYS ranging from 9.0 times to 11.0 times and perpetuity growth rates for Kratos and SYS ranging from 3.5% to 4.5%.

This analysis resulted in implied exchange ratios ranging from 0.6991x to 3.2768x.

Additionally, Wachovia analyzed implied exchange ratios assuming a constant Kratos stock price equal to the closing price of Kratos common stock on February 19, 2008. This analysis resulted in implied exchange ratios ranging from 0.6692x to 1.5326x.

***Contribution Analysis:*** Wachovia analyzed the respective contributions of fiscal year 2007, estimated fiscal year 2008 and estimated fiscal year 2009 revenues, EBITDA, Pro Forma EBIT and Pro Forma net income of Kratos and SYS to the combined company, based on the projected financial results of Kratos and SYS prepared by Kratos and the implied exchange ratios resulting from this analysis. Pro Forma EBIT and net income excluded amortization of intangibles and non-recurring items. Wachovia's analysis resulted in a range of implied exchange ratios from 0.3345x to 2.5321x.

***Pro Forma Earnings Analysis:*** Wachovia analyzed the potential effect of the proposed merger on the pro forma earnings per share, or EPS, of Kratos for the six months ending December 31, 2008 and fiscal year 2009, assuming that the merger closed on June 30, 2008. This analysis was based upon the respective financial forecasts for Kratos and SYS provided by Kratos. This analysis was done on a GAAP as well as a pro forma basis. Pro Forma forecasts excluded amortization of intangibles and non-recurring items for Kratos and SYS.

This analysis indicated that the proposed Merger would be accretive to Kratos' pro forma six months ending December 31, 2008 and fiscal year 2009 GAAP and Pro Forma EPS assuming no synergies as a result of the transaction.

The summary above does not purport to be a complete description of the analyses performed by Wachovia, but describes, in summary form, the material elements of the analyses underlying its opinion dated February 20, 2008. The preparation of a fairness opinion is a complex process and is not necessarily susceptible to a partial analysis or summary description. In arriving at its opinion, Wachovia considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor considered by it. Wachovia believes that the summary provided and the analyses described above must be considered as a whole and that selecting portions of these analyses, without considering all of them, would create an incomplete view of the process underlying its analyses and opinion.

In performing its analyses, Wachovia made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond Kratos' and SYS's control. No company, transaction or business used in the analyses described above is identical to Kratos, SYS or the merger. Any estimates contained in Wachovia's analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by these estimates. The analyses performed were prepared solely as a part of Wachovia's analysis of the fairness, from a financial point of view, to Kratos of the exchange ratio pursuant to the terms of the merger agreement and were conducted in connection with the delivery by Wachovia of its opinion dated February 20, 2008, to Kratos' board of directors. The exchange ratio was determined through negotiations between Kratos, SYS, members of their respective senior management teams and respective advisors, and was approved by Kratos' board of directors. Wachovia did not recommend any specific consideration to Kratos or that any given consideration constituted the only appropriate consideration for the merger.

Wachovia's opinion was one of the many factors taken into consideration by Kratos' board of directors in making its determination to approve the merger. Wachovia's analyses summarized above should not be viewed as determinative of the opinion of Kratos' board of directors with respect to Kratos' value or of whether Kratos' board of directors would have been willing to agree to a different form of consideration.

Wachovia Capital Markets, LLC is a nationally recognized investment banking and advisory firm and a subsidiary of Wachovia Corporation. Wachovia and its affiliates provide a full range of financial advisory, securities and lender services for which it receives customary fees. Wachovia Capital Markets, LLC and its affiliates, including Wachovia Corporation and its affiliates, may provide additional banking or other financial services, including, but not limited to, investment banking services to SYS or Kratos in the future for which Wachovia would also be paid fees and may receive other compensation. In the ordinary course of its business, Wachovia and its affiliates may actively trade or hold the securities (including derivative securities) of Kratos for its own account or for the account of its customers and, accordingly, may at any time hold a long or short position in such securities. Wachovia was previously engaged by Wireless Facilities, Inc. (Kratos' former name), and received a fee for advising Wireless Facilities in the divestiture of its U.S. Engineering Business to LCC International in May 2007 and its

Wireless Deployment Business to Platinum Equity in July 2007. In the ordinary course of business, Wachovia may provide in the future, equity or other research coverage of the securities of Kratos.

Pursuant to a letter agreement dated December 3, 2007, Kratos engaged Wachovia as its exclusive financial advisor with respect to a possible transaction involving SYS. Pursuant to the terms of the letter agreement, Kratos engaged Wachovia to deliver its opinion and has agreed to pay Wachovia a significant portion of its compensation as a transaction fee contingent upon consummation of the merger.

Kratos has also agreed to reimburse Wachovia for its expenses incurred in performing its services, including the fees and expenses of Wachovia's counsel, and to indemnify Wachovia and its affiliates, their respective directors, officers, agents and employees and each person, if any, controlling Wachovia or any of its affiliates against certain liabilities and expenses, including certain liabilities under federal securities laws, related to or arising out of Wachovia's engagement and any related transactions.

**Opinion of Financial Advisor to the SYS Board of Directors**

On February 19, 2008, at a meeting of SYS's Board held to evaluate the proposed merger, Imperial Capital delivered to SYS's Board an oral opinion, confirmed by delivery of a written opinion, dated February 19, 2008, to the effect that, as of that date and based on and subject to various assumptions, matters considered and limitations described in its opinion, the exchange ratio in the merger was fair, from a financial point of view, to the holders of SYS common stock.

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

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

- Analyzed certain publicly available information of SYS that it believed to be relevant to its analysis, including SYS's annual reports on Form 10-K for the fiscal years ending June 30, 2005, June 30, 2006, and June 30, 2007, and SYS's quarterly reports on Form 10-Q for the quarters ending September 30, 2007 and December 31, 2007;

- Analyzed certain publicly available information about Kratos that Imperial believed to be relevant to its analysis, including the Kratos annual report on Form 10-K for the fiscal year ending December 31, 2006 and the Kratos quarterly reports on Form 10-Q for the quarters ending March 31, 2007, June 30, 2007, and September 30, 2007;

- Reviewed the Kratos internal draft income statements for the quarter and year ending December 31, 2007;

- Reviewed certain internal financial forecasts and budgets prepared and provided by the SYS and Kratos management including the Kratos pro forma model prepared by management;

Met with and held discussions with certain members of the SYS and Kratos management to discuss the SYS and Kratos operations and future prospects;

Reviewed industry reports and publications;

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

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

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

Reviewed the letter of intent and term sheet sent to SYS by Kratos dated December 21, 2007;

Reviewed the draft definitive agreement, including material schedules and exhibits, dated February 18, 2008 which is referred to in this section as the Merger Agreement; and

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

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

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

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

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

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

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

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

***Contribution Analysis***

Imperial Capital reviewed and compared each party's relative financial contribution to the pro forma combined entity. For each party, Imperial Capital considered the (1) pre-deal market capitalization as of February 15, 2008, (2) pre-transaction enterprise value, (3) revenue, gross profit, and EBITDA for the latest twelve-month period ending December 31, 2007, and (4) revenue, EBITDA, and net income estimated for the 2008 calendar year. Financial data for SYS and Kratos were based on the most recent available filings with the Securities and Exchange Commission and on projections provided by the SYS and Kratos management. This analysis indicated the following relative financial contribution of each party to the pro forma combined entity:

| | SYS | Kratos |
|---|---|---|
| Pro Forma Equity Ownership per Proposed Deal | 23.6% | 76.4% |
| Pre-deal Market Cap | 15.3% | 84.7% |
| Pre-Transaction Enterprise Value | 12.1% | 87.9% |
| 2007 Revenue | 20.9% | 79.1% |
| 2007 Gross Profit | 26.8% | 73.2% |
| 2007 EBITDA | 9.7% | 90.3% |
| 2008 Revenue | 21.3% | 78.7% |
| 2008 EBITDA | 26.2% | 73.8% |
| 2008 Net Income | 34.7% | 65.3% |

***Premiums Paid Analysis***

Imperial Capital reviewed and compared premiums paid per share of stock in selected change of control transactions to the premium to be received by SYS on a current, historical and volume weighted average basis. The implied per share consideration was calculated by multiplying the exchange ratio of 1.2582 by the Kratos closing stock price of $2.09 per share on February 15, 2008. The result, $2.63, was then compared to selected stock prices and volume weighted average prices from the previous six months to determine the implied per share consideration's premium. This analysis gave the following results:

| | Premium |
|---|---|
| Market Price as of 2/15/08 | 70.7% |
| 30-Day Prior | 60.3% |
| 60-Day Prior | 27.0% |
| 90-Day Prior | 25.2% |
| 180-Day Prior | 11.9% |
| 30-Day Volume Weighted Average Price | 73.0% |
| 60-Day Volume Weighted Average Price | 59.0% |
| 90-Day Volume Weighted Average Price | 43.5% |
| 180-Day Volume Weighted Average Price | 26.5% |

The results of this analysis were then compared to the Control Premium Studies conducted by FactSet Mergerstat, LLC which revealed an average control premium of 27.0% and a median control premium of 22.1% for domestic deals completed during the first three quarters of 2007.

***Selected Public Companies Analysis***

Imperial Capital reviewed and compared selected financial information for SYS with corresponding financial information and multiples for the following publicly traded companies relevant to SYS:

| Large Caps (> $1 billion) | Medium Caps ($200 million - $1 billion) | Small Caps (< $200 million) |
|---|---|---|
| CACI International Inc. | ICF International, Inc. | ATS Corporation |
| DynCorp International Inc. | MAXIMUS, Inc. | Dynamics Research Corp. |
| ManTech International Corp. | MTC Technologies, Inc. | Paradigm Holdings Inc. |
| QinetiQ Group Plc | NCI, Inc. | SM&A |
| SAIC, Inc. | SI International, Inc. | TechTeam Global, Inc. |
| SRA International Inc. | Stanley, Inc. | VSE Corp. |

For each of the selected public companies, Imperial Capital considered, among other things, (1) market capitalization (computed using closing stock prices as of February 15, 2008), (2) enterprise values, (3) enterprise values as a multiple of the latest twelve month period and estimated 2008 revenue, and (4) enterprise values as a multiple of the latest twelve month period and estimated 2008 earnings before interest, taxes, depreciation and amortization, commonly referred to as EBITDA. Financial data for the selected public companies were based on the most recent available filings with the Securities and Exchange Commission and on the Institutional Brokers' Estimate System's and First Call estimates. Financial data for SYS and Kratos were based on the most recent available filings with the Securities and Exchange Commission and on estimates provided by SYS's and Kratos' managements. This analysis indicated the following implied equity value per share ranges of SYS based on selected small cap company trading multiples applied to SYS's revenue and EBITDA:

| | Implied Equity Value per Share | | |
|---|---|---|---|
| Based on | Low | Mid | High |
| 2007 Revenue | $ 1.31 | $ 1.70 | $ 2.09 |
| 2008 Revenue | $ 1.32 | $ 1.75 | $ 2.18 |
| 2007 EBITDA | $ 0.44 | $ 0.49 | $ 0.54 |
| 2008 EBITDA | $ 1.43 | $ 1.61 | $ 1.79 |

This analysis also indicated the following implied equity value per share ranges of Kratos based on selected medium company trading multiples applied to Kratos' pro forma revenue and EBITDA including Haverstick:

| | Implied Equity Value per Share | | |
|---|---|---|---|
| Based on | Low | Mid | High |
| 2007 Pro Forma Revenue | $ 2.04 | $ 2.41 | $ 2.77 |
| 2008 Revenue | $ 1.86 | $ 2.25 | $ 2.64 |
| 2007 Pro Forma EBITDA | $ 1.07 | $ 1.18 | $ 1.30 |
| 2008 EBITDA | $ 1.00 | $ 1.13 | $ 1.25 |

***Selected Transactions Analysis***

Imperial Capital reviewed and compared selected financial information for SYS with corresponding financial information for the following selected transactions involving companies relevant to SYS that closed in 2007:

| Date Closed | Target | Buyer |
|---|---|---|
| December 2007 | Haverstick Consulting, Inc. | Kratos Defense & Security Solutions |
| November 2007 | Number Six Software, Inc. | ATS Corp |
| November 2007 | Dragon Development Corporation | CACI International |
| October 2007 | PA Corp | Quintegra Solutions Ltd |
| August 2007 | Potomac Management Group | ATS Corp |
| June 2007 | Wexford | CACI International |
| June 2007 | Z-Tech Corp. | ICF International Inc. |
| June 2007 | Karta Technologies Inc. | NCI, Inc. |
| June 2007 | Logtec, Inc. | SI International, Inc. |
| June 2007 | NewVectors | TechTeam Government Solutions |
| April 2007 | ITS Corp. | QinetiQ Group PLC |
| January 2007 | VTC, LLC | Fortress America Acquisition Corp. |
| January 2007 | Advanced Technology Systems Inc | ATS Corp |

In its review of selected transactions, Imperial Capital considered the enterprise value implied in each of the selected transactions as a multiple of revenue and EBITDA for the latest 12 months as of the time of the respective transaction, to the extent such data were publicly available. Imperial Capital then compared the multiples derived from the selected transactions with the corresponding multiples implied in the merger for SYS based on the exchange ratio. Multiples for the selected transactions were based on information from Mergerstat, Mergermarket, Capital IQ and company press releases. This analysis indicated the following implied equity value per share range of SYS based on selected M&A transaction multiples applied to SYS's revenue and EBITDA:

| | Implied Equity Value per Share | | |
|---|---|---|---|
| **Based on** | **Low** | **Mid** | **High** |
| 2007 Revenue | $ 3.53 | $ 3.92 | $ 4.32 |
| 2007 EBITDA | $ 0.85 | $ 0.90 | $ 0.95 |

This analysis indicated the following implied equity value per share range of Kratos based on selected transaction multiples applied to Kratos' pro forma revenue and EBITDA including Haverstick:

| | Implied Equity Value per Share | | |
|---|---|---|---|
| **Based on** | **Low** | **Mid** | **High** |
| 2007 Pro Forma Revenue | $ 2.53 | $ 2.89 | $ 3.26 |
| 2007 Pro Forma EBITDA | $ 1.35 | $ 1.46 | $ 1.58 |

***Discounted Cash Flow Analysis***

Imperial Capital performed a discounted cash flow analysis of SYS using projections and financial information for the period ranging from the beginning of fiscal year 2008 through the end of fiscal year 2012 (the "projection period") provided by SYS's management. Imperial Capital calculated the implied present values of free cash flows for SYS for the projection period using discount rates ranging from 16.0% to 18.0% based on the weighted average cost of capital. Imperial Capital calculated the terminal values for SYS based on multiples of 6.5x to 7.5x. Due to SYS's projected growth in EBITDA and unlevered free cash flow through fiscal year 2012, Imperial Capital applied the multiples method to calculate the terminal value only. The estimated terminal values were then discounted to implied present values using discount rates ranging from 16.0% to 18.0% based on the weighted average cost of capital. For each combination of discount rate and terminal value multiple, Imperial Capital added the implied present value of free cash flows to the implied present value of the terminal value to arrive at implied enterprise value for SYS. For each combination of discount rate and terminal value multiple, Imperial Capital then calculated the implied equity value of SYS as the implied enterprise value less the net debt as of December 31, 2007. Implied equity value per share of SYS common stock was calculated using fully-diluted shares outstanding of SYS, as provided by management of SYS. This analysis resulted in a range of implied equity values per share of SYS common stock of approximately $2.78 to $3.31.

***Exchange Ratio Comparison***

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

| **Method** | **Low** | **High** |
| --- | --- | --- |
| Premiums Paid Analysis | $ 1.95 | $ 1.97 |
| Selected Public Companies Analysis 2007 Revenue | $ 1.31 | $ 2.09 |
| Selected Public Companies Analysis 2007 EBITDA | $ 0.44 | $ 0.54 |
| Selected Public Companies Analysis 2008 Revenue | $ 1.32 | $ 2.18 |
| Selected Public Companies Analysis 2008 EBITDA | $ 1.43 | $ 1.79 |
| Selected Transaction Analysis 2007 Revenue | $ 3.53 | $ 4.32 |
| Selected Transaction Analysis 2007 EBITDA | $ 0.85 | $ 0.95 |
| Discounted Cash Flow Analysis | $ 2.78 | $ 3.31 |
| Average | $ 1.70 | $ 2.14 |

And the ranges calculated for Kratos:

| Method | Low | High |
|---|---|---|
| Premiums Paid Analysis | $ 2.64 | $ 2.67 |
| Selected Public Companies Analysis 2007 Pro Forma Revenue | $ 2.04 | $ 2.77 |
| Selected Public Companies Analysis 2007 Pro Forma EBITDA | $ 1.07 | $ 1.30 |
| Selected Public Companies Analysis 2008 Revenue | $ 1.86 | $ 2.64 |
| Selected Public Companies Analysis 2008 EBITDA | $ 1.00 | $ 1.25 |
| Selected Transaction Analysis 2007 Pro Forma Revenue | $ 2.53 | $ 3.26 |
| Selected Transaction Analysis 2007 Pro Forma EBITDA | $ 1.35 | $ 1.58 |
| Average | $ 1.78 | $ 2.21 |

Imperial Capital reviewed and compared the exchange ratio in the transaction with exchange ratios calculated using the high and low ranges for SYS and Kratos with the following results:

| | | Exchange Ratio |
|---|---|---|
| Exchange Ratio in the Transaction | | 1.2582 |
| SYS Low / Kratos Low | $1.70 / $1.78 | 0.9524 |
| SYS High / Kratos Low | $2.14 / $1.78 | 1.2011 |
| SYS Low / Kratos High | $1.70 / $2.21 | 0.7689 |
| SYS High / Kratos High | $2.14 / $2.21 | 0.9697 |

Under the terms of the agreement with Imperial Capital, SYS agreed to pay Imperial Capital a transaction fee of $750,000 in connection with the sale of SYS and an opinion fee of $150,000 due upon the delivery of a fairness opinion regardless of the conclusions reached therein. In addition, SYS agreed to pay all fees, disbursements and out-of-pocket expenses incurred by Imperial Capital in connection with its services in connection with the merger and to indemnify Imperial Capital and related parties against any liabilities arising out of or in connection with advice or services rendered or to be rendered pursuant to the engagement letter agreement.

SYS selected Imperial Capital as its financial advisor based on its experience with merger transactions and familiarity with the company. Imperial Capital is a full-service investment banking firm offering a wide range of advisory, finance and trading services. USBX and certain former USBX professionals, now employed by Imperial Capital, provided financial advisory and investment banking services for SYS in the past, including advising SYS on its acquisition of Ai Metrix, Inc. in October 2006 and its acquisition of Reality Based Information Technology Services, Ltd. in April 2006. In the ordinary course of its business, Imperial Capital may actively trade the debt and equity securities of SYS and Kratos for its own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

**Composition of Kratos Board of Directors**

The size and composition of the Kratos board of directors will not be affected by this transaction.

**Interests of SYS Directors and Executive Officers in the Merger**

In considering SYS's unanimous determination that the merger is fair and advisable and recommendation that SYS's stockholders vote "**FOR**" approval of the merger agreement, you should be aware that members of SYS's board of directors and members of SYS's management team have agreements or arrangements that provide them with interests in the merger that differ from and are in addition to those of other SYS shareholders. The SYS board of directors was aware of these agreements and arrangements during its deliberations of the merits of the merger and in determining to recommend to you that you vote "**FOR**" approval of the merger agreement.

**Employment Agreement**

Kratos has required as a condition to the merger that Clifton L. Cooke, Jr., SYS's president and chief executive officer and a director, agree to enter into a Kratos employment agreement providing for his continued employment with Kratos immediately prior to the merger which employment agreement will be effective immediately after the merger.

**Voting Agreements**

SYS's president and chief executive officer and its chief financial officer, who in the aggregate beneficially own approximately 9.1% of SYS's common stock as of April 7, 2008, have agreed with Kratos to vote their SYS shares in favor of the approval of the merger agreement. See *"Voting Agreements"* on page 89 of this document.

*Treatment of SYS Options and Other Equity-Based Awards*

SYS has granted stock options to its employees, officers and directors under SYS's 1997 Incentive Stock Option and Restricted Stock Plan and the SYS 2003 Stock Option Plan. As of April 7, 2008, there are 2,117,100 options issued and outstanding under these plans. Of that amount 685,500 options are held by officers and directors.

All outstanding SYS stock options will become fully vested prior to the closing and may be exercised for SYS shares ("cashless exercise" being permissible) at or prior to closing in accordance with the terms of the stock option plans, which shares would then be exchanged for Kratos shares in accordance with the exchange ratio. Any such stock option exercises may be subject to withholding taxes as a result. No SYS stock options will be assumed by or converted into options of Kratos.

During 2003, the SYS board of directors approved the SYS 2003 Employee Stock Purchase Plan. The purpose of the SYS 2003 Employee Stock Purchase Plan is to provide employees of SYS and its designated subsidiaries with an opportunity to purchase SYS common stock. The 2003 Employee Stock Purchase Plan provides for enrollment on the first day of a six-month period in which the employees can elect payroll deductions for the purchase of SYS common stock. The 2003 Employee Stock Purchase Plan allows employees to designate a portion of their base compensation to be used to purchase SYS common stock at a purchase price per share at 85% of the lower of the fair market value on the first or last day of each offering period. Each offering period lasts six months.

Effective February 20, 2008, the date of executing the merger agreement, SYS terminated the then current six month stock purchase period for its Employee Stock Purchase Plan, and this Plan is not being assumed by Kratos. SYS employees who were enrolled in the Plan from the period January 1, 2008 through February 20, 2008 were eligible to purchase shares during this stub period consistent with the provisions of the Plan.

The following table sets forth as of April 7, 2008, the unvested SYS stock options held by SYS directors and executive officers which will vest upon the effective time of the merger:

| Name | Unvested SYS Stock Options |
|---|---|
| Clifton L. Cooke, Jr. | 0 |
| Edward M. Lake | 61,100 |
| Michael W. Fink | 12,500 |
| Thomas A. Page | 7,200 |
| Alfred M. Gray | 7,200 |
| John R. Hicks | 6,300 |
| Gail K. Naughton | 6,300 |
| Philip P. Trahanas | 4,500 |
| Charles E. Vandeveer | 4,500 |

**Subordinated Convertible Notes**

SYS has $3,125,000 of convertible notes payable outstanding, which we refer to as the Notes. The Notes are unsecured and subordinate to its bank debt, bear interest at 10% per annum payable quarterly, are due February 14, 2009 and are convertible at any time into shares of common stock at a conversion rate of $3.60 per share. The Notes are being assumed by Kratos subject to their existing terms and conditions.

Following the merger, the Notes will not be convertible into SYS common stock. Instead, they will be convertible into the merger consideration as if they had been converted into SYS stock immediately prior to the merger.

Certain officers and directors of SYS hold $975,000 of these notes.

**Warrants**

The following SYS warrants are outstanding:

Exercisable into 313,401 shares of common stock at $2.50 per share that were issued in June 2005 in conjunction with the sale of common stock and expire in June 2010

Exercisable into 50,000 shares of common stock at $3.85 per share that were issued in September 2005 in conjunction with the acquisition of technology from Lomasoft and expire in September 2010.

Exercisable into 110,000 shares of common stock at $4.00 per share that were issued in October 2005 to the investment bankers that assisted with a private offering of SYS's common stock and expire October 2010.

Exercisable into 20,000 shares of common stock at $2.44 per share that were issued in April 2006 related to the acquisition of Logic Innovations and expire in April 2011

Exercisable into 15,000 shares of common stock at $2.25 per share that were issued on September 18, 2007 related to consulting services and expire on September 18, 2012

Holders of the foregoing warrants will, following the merger, be entitled to receive upon exercise of such warrants, the number of shares of Kratos common stock that they would have received pursuant to the merger had they exercised such warrants immediately prior to the merger.

**Directors and Officers of SYS after the Merger**

The directors of Merger Sub will be the initial directors of SYS as the surviving corporation of the merger, and will serve until their successors have been duly elected or appointed and qualified, or until their earlier death, resignation or removal. The officers of Merger Sub will be the initial officers of SYS as the surviving corporation of the merger, subject to the authority of the board of directors of the surviving corporation, as provided by California law and the bylaws of the surviving corporation.

**Indemnification and Insurance**

The merger agreement provides that for six years after the effective time of the merger and to the fullest extent permitted by law, Kratos will cause the surviving corporation to honor all rights to indemnification for acts or omissions prior to the effective time of the merger existing in favor of SYS directors or officers as provided in SYS's organizational documents and its indemnification agreements with such individuals. The merger agreement also provides that, prior to the effective time of the merger, SYS will purchase six-year "tail" officers' and directors' liability insurance policies on terms and conditions no less favorable than SYS's existing directors' and officers' liability insurance. If SYS cannot purchase these "tail" policies for 200% or less of the annual premium paid by SYS for its existing insurance, SYS will purchase as much insurance coverage as can be obtained within the 200% cap. Kratos and the surviving corporation are obligated to maintain such tail policies in full force and effect and continue to honor their respective obligations thereunder for the full term thereof.

**Potential Change of Control or Severance Payments**

From and after the effective time of the merger, each of SYS's executive officers listed in the chart below may become eligible to receive Change of Control or severance payments for a period ranging from twelve months to twenty-four months, based on the terms of their existing employment agreements, which we refer to as the Agreements and their base salary, if terminated for any of the following reasons:

- Their position or duties are modified in a way which materially reduces their responsibilities or the level of management to which they report;

- A reduction in level of compensation as of the date of a change of control (including base salary and fringe benefits);

- A relocation of their place of employment by more than 50 miles, provided and only if such change, reduction, or relocation is effected without the employee's express consent.

Notwithstanding the foregoing and pursuant to the Agreements, if any amounts due to any such officer pursuant to their agreement are determined to be "Parachute Payments" as such term is defined in Section 280G of the Internal Revenue Code of 1986, as amended, which we refer to as the Code, and the regulations promulgated thereunder, then the total compensation paid to such officer together with any other payment or the value of any benefit received or to be received by them which is treated as a Parachute Payment will not exceed 2.99 times such officer's Base Amount (as such term is defined in Section 280G of the Code). In the event a reduction of a change of control or severance payment is required such officer may select the compensation which will be reduced in order to fall within the 2.99 times Base Amount limitation.

From and after the effective time of the merger, each of SYS's executive officers listed below may become eligible to receive severance payments subject to the parachute payment provision in their agreements as follows:

| Name | Title | Approximate Amount of Potential Change of Control or Severance Payment |
|---|---|---|
| Edward M. Lake | Chief Financial Officer | $ 138,250 |
| Michael W. Fink | Secretary and Sr. Vice President | $ 262,500 |

In addition, to these executive officers certain other SYS employees have employment agreements with similar terms and conditions.

As of April 7, 2008 directors and executive officers of SYS beneficially owned 4,870,433 shares of SYS common stock, which represented approximately 23.7% of the shares of SYS common stock then issued and outstanding. SYS's president and chief executive officer, and chief financial officer, who in the aggregate beneficially own approximately 9.1% of SYS common stock as of April 7, 2008, have agreed with Kratos to vote their shares of SYS's common stock to approve the merger agreement. For more information see "SYS Voting Agreement" at *Annex C*.

**Certain Arrangements between SYS and its Executive Officers, Directors and Affiliates**

On December 6, 2007, the SYS Board approved an Incentive Compensation Plan as proposed by the Compensation and Nominating Committee. The Incentive Compensation Plan was established in the amount of $1.65 million to be allocated to certain named executive officers and members of management in the event of the acquisition of SYS within certain financial parameters and subject to further specificity as to the allocation of the Incentive Compensation Plan Amount. On February 19, 2008, the SYS Board reviewed a preliminary proposed allocation of the Incentive Compensation Plan and authorized Clifton L. Cooke to make a final allocation recommendation to the Compensation and Nominating Committee and the SYS Board after taking into consideration any other retention or bonus arrangements being considered by Kratos and SYS.

On March 20, 2008, the Compensation and Nominating Committee met and approved a final allocation. Listed in the table below are the amounts approved for distribution upon closing of the merger for the SYS named executive officers which in total amounts to $1.325 million of the $1.65 million approved:

| Name | Title | Amount of Incentive Compensation |
|---|---|---|
| Clifton L. Cooke | President and Chief Executive Officer | $ 700,000 |
| Edward M. Lake | Chief Financial Officer | $ 500,000 |
| Michael W. Fink | Secretary and Sr. Vice President | $ 125,000 |

The remaining $0.325 million has been allocated to four other members of the management team.

It should be further emphasized that the Incentive Compensation Plan has no impact on the consideration to be received by the SYS shareholders as there are no requirements pursuant to the merger agreement to deliver a specified amount of working capital on the closing balance sheet. The fixed exchange ratio was based on a fixed enterprise value of SYS less the subordinated convertible debt that is being assumed by Kratos.

**Accounting Treatment**

The merger will be accounted for as an acquisition of SYS by Kratos under the purchase method of accounting in accordance with U.S. generally accepted accounting principles. Under the purchase method of accounting, the assets and liabilities of the acquired company are, as of completion of the merger, recorded at their respective fair values and added to those of the acquiror, including an amount for goodwill representing the difference between the purchase price and the fair value of the identifiable net assets. Financial statements of Kratos issued after the merger will reflect only the operations of SYS after the merger and will not be restated retroactively to reflect the historical financial position or results of operations of SYS.

All unaudited pro forma condensed combined financial statements contained in this Proxy Statement were prepared using the purchase method of accounting. The final allocation of the purchase price will be determined after the merger is completed and after completion of an analysis to determine the fair value of SYS's assets and liabilities. Accordingly, the final purchase accounting adjustments may be materially different from the unaudited pro forma adjustments. Any decrease in the fair value of the assets or increase in the fair value of the liabilities of SYS as compared to the unaudited pro forma information included in this Proxy Statement will have the effect of increasing the amount of the purchase price allocable to goodwill.

**Restrictions on Sales of Shares of Kratos Common Stock Received in the Merger**

Kratos shares of common stock issued in the merger will not be subject to any restrictions on transfer arising under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except for Kratos shares issued to any SYS shareholder who may be deemed to be an "affiliate" of Kratos after completion of the merger. Former SYS shareholders who were affiliates of SYS at the time of the SYS special meeting and who are not affiliates of Kratos after the completion of the merger may sell their Kratos shares at any time. Former SYS shareholders who are or become affiliates of Kratos after completion of the merger will remain or be subject to the volume and sale limitations of Rule 144 under the Securities Act until they are no longer affiliates of Kratos. This Proxy Statement does not cover resales of Kratos common stock received by any person upon completion of the merger, and no person is authorized to make any use of this Proxy Statement in connection with any resale.

**Dissenters' Rights and Appraisal Rights**

***Kratos Stockholders***

Pursuant to Section 262 of the Delaware General Corporation Law, Kratos stockholders are not entitled to exercise dissenters' rights or appraisal rights or to demand payment for their shares of Kratos common stock under applicable law as a result of the merger.

***SYS Shareholders***

The following summarizes Chapter 13 of the California General Corporation Law, which sets forth the procedures for SYS shareholders to dissent from the merger and to demand statutory dissenters' rights under the California General Corporation Law. This summary does not purport to be a complete statement of the provisions of California law relating to the rights of dissenting SYS shareholders and is qualified in its entirety by reference to Sections 1300 through 1313 of the California General Corporation Law, the full text of which is attached as *Annex F* to this Proxy Statement. Failure to follow the following procedures exactly could result in the loss of dissenters' rights.

If SYS shareholders approve the terms of the merger by a majority of the outstanding shares entitled to vote thereon and the merger agreement is not abandoned or terminated, SYS shareholders who vote against the merger may, by complying with Sections 1300 through 1313 of the California General Corporation Law, be entitled to dissenters' rights as described therein. To exercise dissenters' rights, an SYS shareholder must comply with all of the procedures required by California law. The holders of SYS common stock who do exercise their dissenters' rights with respect to the approval of the terms of the merger are referred to herein as Dissenting Shareholders, and the shares of stock with respect to which they exercise dissenters' rights are referred to herein as Dissenting Shares. If an SYS shareholder has a beneficial interest in SYS common stock that is held of record in the name of another person, such as a trustee or nominee, and such shareholder desires to perfect any dissenters' rights he, she or it may have, such beneficial shareholder must act promptly to cause the holder of record to follow the steps summarized below timely and properly.

**Dissenters' rights cannot be validly exercised by persons other than SYS shareholders of record, regardless of the beneficial ownership of the shares.**

**Any SYS shareholder who holds his, her or its shares in a brokerage account or other nominee form and who wishes to exercise dissenters' rights is urged to consult with his, her or its broker to determine appropriate procedures for exercising dissenters' rights by such nominee.**

**Any SYS shareholder who wishes to exercise dissenters' rights or who wishes to preserve his, her or its right to do so should review this section and *Annex F* (sections 1300 through 1313 of the California General Corporation Law) carefully and should consult his, her or its legal advisor, since failure to timely comply with the procedures set forth therein will result in the loss of such rights.**

***Dissenters' Rights Under California Law***

In order for any SYS shareholder who holds freely transferable shares (i.e., shares with respect to which there exist no restrictions on transfer imposed by SYS or by any law or regulation) to receive dissenters' rights, at least 5% of the outstanding shares of SYS common stock must satisfy each of the following requirements to qualify as Dissenting Shares under the California General Corporation Law:

- the SYS common stock must have been outstanding on [                    ], 2008 the record date;

- the SYS common stock must have been voted against the merger; and

- no later than the date of SYS's special meeting, the holder of such SYS common stock must make a written demand that SYS repurchase his Dissenting Shares at fair market value (as described below).

The above requirements having been met, the holder of such SYS common stock must submit certificates for endorsement upon notice of approval of the merger agreement (as described below).

In order for any SYS shareholder who holds shares with respect to which there exists any restriction on transfer imposed by SYS or by any law or regulation, such shareholder must meet the bullet point requirements listed above to receive dissenters' rights with respect to such transfer-restricted shares, but no minimum number of outstanding shares are required to perfect dissenters' rights.

***Demand for Repurchase of Shares***

Pursuant to Sections 1300 through 1313 of the California General Corporation Law, holders of Dissenting Shares may require SYS to repurchase their Dissenting Shares at a price equal to the fair market value of such shares determined as of the day before the first announcement of the terms of the merger, excluding any appreciation or depreciation as a consequence of the proposed merger, but adjusted for any stock split, reverse stock split or stock dividend that becomes effective thereafter.

A vote against the merger does not in and of itself constitute a demand for appraisal under the California General Corporation Law.

No later than the date of SYS's special meeting, a Dissenting Shareholder must demand that SYS repurchase such shareholder's Dissenting Shares in a statement setting forth the number and class of Dissenting Shares held of record by such Dissenting Shareholder, that the Dissenting Shareholder demands that SYS repurchase such Dissenting Shares, and a statement of what the Dissenting Shareholder claims to be the fair market value of the Dissenting Shares as of the day before the announcement of the proposed merger. The statement of fair market value in such demand by the Dissenting Shareholder constitutes an offer by the Dissenting Shareholder to sell the Dissenting Shares at such price. An SYS shareholder who elects to exercise dissenters' rights pursuant to Chapter 13 should mail or deliver the written demand to:

SYS
5050 Murphy Canyon Road, Suite 200
San Diego, CA 92123
Attention: Michael W. Fink, Corporate Secretary

If the shares are owned of record by a person in a fiduciary capacity, such as a trustee, guardian or custodian, the demand should be executed in that capacity. If the shares are owned of record by more than one person, as in a joint tenancy or tenancy in common, the demand should be executed by or on behalf of all owners. An authorized agent, including an agent for two or more joint owners, may execute a demand that SYS repurchase such shares on behalf of an SYS shareholder; however, the agent must identify the record owner or owners and expressly disclose the fact that, in executing the demand, the agent is acting as an agent for such owner or owners. A record holder, such as a broker who holds shares as nominee for several beneficial owners, may exercise dissenters' rights with respect to the shares held for one or more beneficial owners while not exercising these rights with respect to the shares held for one or more other beneficial owners. In this case, the written demand should set forth the number of shares as to which appraisal is sought, and, where no number of shares is expressly mentioned, the demand will be presumed to cover all shares held in the name of the record owner.

***Submission of Certificates for Endorsement***

Next, the Dissenting Shareholder must affirmatively vote his, her or its shares against the approval of the terms of the merger at SYS's special meeting. If a Dissenting Shareholder fails to vote at all, abstains from voting on the proposal regarding the terms of the merger or votes "FOR" that proposal at SYS's special meeting, he, she or it will lose the right to payments as a Dissenting Shareholder and such shareholder will be paid the merger consideration described in the merger agreement.

After SYS's special meeting, if SYS shareholders have approved the terms of the merger and, in the case of freely transferable shares, at least 5% of the SYS shareholders have properly delivered demands for payment to SYS and voted against the approval of the terms of the merger, SYS is required, within ten days, to mail to each appropriately Dissenting Shareholder notice of approval of the terms of the merger, a statement of the price determined by SYS to represent the fair market value of Dissenting Shares (which will constitute an offer by SYS to purchase such Dissenting Shares at such stated price), and a description of the procedures such holders should follow in order to exercise their rights as Dissenting Shareholders.

Within 30 days after the notice of approval of the terms of the merger is mailed to shareholders, the shareholder must also submit to SYS, for endorsement as Dissenting Shares, the stock certificates representing the SYS shares as to which the Dissenting Shareholder is exercising dissenters' rights.

*Payment for Dissenting Shares*

If upon the Dissenting Shareholder's surrender of the certificates representing the Dissenting Shares, SYS and a Dissenting Shareholder agree upon the price to be paid for the Dissenting Shares and agree that such shares are Dissenting Shares, then the agreed price is required by law to be paid to the Dissenting Shareholder with interest thereon at the legal rate on judgments from the date of the agreement within the later of 30 days after the date of such agreement or 30 days after any statutory or contractual conditions to the consummation of the merger are satisfied or waived.

If SYS denies that shares are Dissenting Shares or the SYS shareholder fails to agree with SYS as to the fair market value of the shares, then, within the time period provided by Section 1304(a) of the California General Corporation Law, any SYS shareholder who has made a valid written demand and has not voted in favor of approval of the terms and conditions of the merger may file a complaint in the Superior Court in the proper California county requesting a determination as to whether the shares are Dissenting Shares or as to the fair market value of the holder's shares, or both, or may intervene in any pending action brought by any other SYS shareholder.

On the trial of the action, the court determines the issues. If the status of the shares as Dissenting Shares is in issue, the court first resolves that issue. If the fair market value of the Dissenting Shares is in issue, the court determines, or appoints one or more impartial appraisers to determine, the fair market value of the shares.

If the court appoints an appraiser or appraisers, they proceed to determine the fair market value per share. Within the time fixed by the court, the appraisers, or a majority of the appraisers, make and file a report in the office of the clerk of the court. Thereafter, on the motion of any party, the report is submitted to the court and considered on such evidence as the court considers relevant. If the court finds the report reasonable, the court may confirm it.

If the single appraiser or a majority of the appraisers fails to make and file a report within 10 days after the date of their appointment or within such further time as the court allows, or if the court does not confirm the report, the court determines the fair market value of the Dissenting Shares. Subject to Section 1306 of the California General Corporation Law, judgment is rendered against the corporation for payment of an amount equal to the fair market value of each Dissenting Share multiplied by the number of Dissenting Shares that any dissenting shareholder who is a party, or who has intervened, is entitled to require the corporation to purchase, with interest at the legal rate from the date on which the judgment is entered.

The costs of the action, including reasonable compensation to the appraisers to be fixed by the court, is assessed or apportioned as the court considers equitable. However, if the price determined by the court is more than 125% of the price offered by the corporation, the corporation pays the costs (including, in the discretion of the court, attorneys' fees, fees of expert witnesses and interest at the legal rate on judgments from the date the shareholder made the demand and submitted shares for endorsement).

Except as expressly limited by Chapter 13 of the California General Corporation Law, holders of Dissenting Shares continue to have all the rights and privileges incident to their shares until the fair market value of their shares is agreed upon or determined.

For federal income tax purposes, SYS shareholders who receive cash for their shares of SYS common stock after exercising dissenters' rights will recognize taxable gain or loss.

If an SYS shareholder fails to perfect his, her or its dissenters' rights or effectively withdraws or loses such rights, such holder's SYS common stock will thereupon be deemed to have been canceled and converted as set forth in the merger agreement.

**Failure to follow the steps required by Chapter 13 of the California General Corporation Law for perfecting dissenters' rights may result in the loss of dissenters' rights, in which event you will be entitled to receive the consideration with respect to your Dissenting Shares in accordance with the merger agreement. In view of the complexity of the provisions of Chapter 13 of the California General Corporation Law, if you are an SYS shareholder and are considering exercising your dissenters' rights under the California General Corporation Law, you should consult your own legal advisor.**

**Listing of Kratos Common Stock on The Nasdaq Global Select Stock Market**

Kratos has agreed that, prior to the completion of the merger, it will cause the shares of Kratos common stock to be issued in the merger to be approved for listing on The Nasdaq Global Select Stock Market. Such approval is a condition to the completion of the merger.

## MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

**General.**

The following general discussion summarizes the material United States federal income tax consequences of the merger to Kratos, Merger Sub, SYS and to holders of common stock of SYS who are "United States persons," as defined for United States federal income tax purposes and who hold their SYS common stock as a capital asset within the meaning of Section 1221 of the Code. For United States federal income tax purposes, a "United States person" is:

- a United States citizen or resident of the United States;
- a corporation, partnership or other entity created or organized in the United States or under the laws of the United States, or any state within the United States;
- an estate whose income is includible in gross income for United States federal income tax purposes regardless of its source; or
- a trust, whose administration is subject to the primary supervision of a United States court and that has one or more U.S. persons who have the authority to control all substantial decisions of the trust.

The term "non-United States person" means a person or holder other than a "United States person."

This section does not discuss all of the United States federal income tax considerations that may be relevant to a particular shareholder in light of his or her individual circumstances or to shareholders subject to special treatment under the federal income tax laws, including, without limitation:

- brokers or dealers in securities or foreign currencies;
- shareholders who are subject to the alternative minimum tax provisions of the Code;
- tax-exempt organizations;
- shareholders who are "non-United States persons;"
- expatriates;
- shareholders that have a functional currency other than the United States dollar;
- banks, mutual funds, financial institutions or insurance companies;
- shareholders who acquired SYS common stock in connection with stock option or stock purchase plans or in other compensatory transactions;
- shareholders who hold SYS common stock as part of an integrated investment, including a straddle, hedge, or other risk reduction strategy, or as part of a conversion transaction or constructive sale;

- shareholders who acquired their shares through SYS's 401(k) plan, deferred compensation plan or other retirement plan; or
- shareholders whose SYS common stock is "qualified small-business stock" for purposes of Section 1202 of the Code.

No ruling has been or will be sought from the Internal Revenue Service as to the United States federal income tax consequences of the merger, and the following summary is not binding on the Internal Revenue Service or the courts. This discussion is based upon the Code, regulations, judicial authority, rulings and decisions in effect as of the date of this Proxy Statement, all of which are subject to change, possibly with retroactive effect. This summary does not address the tax consequences of the merger under state, local and foreign laws or under United States federal tax law other than income tax law.

**SYS shareholders are strongly urged to consult their tax advisors as to the specific tax consequences to them of the merger, including any applicable federal, state, local and foreign tax consequences.**

It is a condition to the obligation of Kratos to consummate the merger that Kratos receive an opinion from its counsel, DLA Piper US LLP, and it is a condition to the obligation of SYS to consummate the merger that SYS receive an opinion from its counsel, Luce, Forward, Hamilton & Scripps LLP, in each case, to the effect that, based upon certain facts, representations and assumptions, the merger will constitute a "reorganization" within the meaning of Section 368(a) of the Code and such opinions shall not have been withdrawn; provided, however, that if the counsel to either Kratos or SYS does not render such opinion, this condition shall be deemed to be satisfied if counsel to the other party renders the opinion to both parties that the merger will constitute a tax-free reorganization within the meaning of Section 368(a) of the Code. The issuance of the opinions is conditioned on, among other things, the receipt by DLA Piper US LLP and Luce, Forward, Hamilton & Scripps LLP, of representation letters from each of Kratos, Merger Sub and SYS, in each case, in form and substance reasonably satisfactory to DLA Piper US LLP and Luce, Forward, Hamilton & Scripps LLP. An opinion of counsel represents that counsel's best legal judgment and is not binding on the Internal Revenue Service or any court.

The following summary assumes that the merger will be completed as described in the merger agreement and this Proxy Statement and that the merger will constitute a "reorganization" within the meaning of Section 368(a) of the Code.

- SYS shareholders will not recognize any gain or loss upon the receipt of Kratos common stock in exchange for SYS common stock in connection with the merger, except to the extent of cash received in lieu of a fractional share of Kratos common stock, as discussed below;

- cash payments received by an SYS shareholder for a fractional share of Kratos common stock will be treated as if such fractional share had been issued in connection with the merger and then redeemed by Kratos for cash. SYS shareholders will recognize capital gain or loss with respect to such cash payment, measured by the difference, if any, between the amount of cash received and the tax basis in such fractional share;

- the aggregate tax basis of the Kratos common stock received by an SYS shareholder in connection with the merger will be the same as the aggregate tax basis of the SYS common stock surrendered in exchange for Kratos common stock, reduced by any amount allocable to a fractional share of Kratos common stock for which cash is received;

- the holding period of the Kratos common stock received by an SYS shareholder in connection with the merger will include the holding period of the SYS common stock surrendered in connection with the merger; and

- Kratos, Merger Sub and SYS will not recognize gain or loss as a result of the merger.

**Backup Withholding.**

If you are a non-corporate holder of SYS common stock you may be subject to information reporting and a 28% backup withholding on any cash payments received in lieu of a fractional share interest in Kratos common stock. You will not be subject to backup withholding, however, if you:

furnish a correct taxpayer identification number and certify that you are not subject to backup withholding on the substitute Form W-9 or successor form included in the letter of transmittal to be delivered to you following the completion of the merger (or the appropriate Form W-8, as applicable); or

are otherwise exempt from backup withholding.

Any amounts withheld under the backup withholding rules will be allowed as a refund or credit against your United States federal income tax liability, provided you furnish the required information to the Internal Revenue Service.

**Tax Return Reporting Requirements.**

If you receive Kratos common stock as a result of the merger, you will be required to retain records pertaining to the merger, and you will be required to file with your United States federal income tax return for the year in which the merger takes place a statement setting forth certain facts relating to the merger as provided in Treasury Regulations Section 1.368-3.

**The preceding discussion does not purport to be a complete analysis or discussion of all potential tax effects relevant to the merger. SYS shareholders are urged to consult their own tax advisers as to the specific consequences of the merger to them, including tax return reporting requirements, the applicability and effect of federal, state, local, foreign and other tax laws and the effects of any proposed changes in the tax laws.**

## THE MERGER AGREEMENT

*The following discussion summarizes material provisions of the Agreement and Plan of Merger and Reorganization, which we refer to as the merger agreement, a copy of which is attached as Annex A to this Proxy Statement and is incorporated by reference herein. The rights and obligations of the parties are governed by the express terms and conditions of the merger agreement and not by this summary. This summary is not complete and is qualified in its entirety by reference to the complete text of the merger agreement. We urge you to read the merger agreement carefully in its entirety, as well as this Proxy Statement, before making any decisions regarding the merger.*

*The representations and warranties described below and included in the merger agreement were made by Kratos and SYS to each other as of specific dates. The assertions embodied in those representations and warranties were made solely for purposes of the merger agreement and may be subject to important qualifications and limitations agreed to by Kratos and SYS in connection with negotiating its terms, including, but not limited to, the qualifications and limitations listed in the disclosure schedules to the merger agreement. Moreover, the representations and warranties may be subject to a contractual standard of materiality that may be different from what may be viewed as material to stockholders, or may have been used for the purpose of allocating risk between Kratos and SYS rather than establishing matters as facts. The merger agreement is described in this Proxy Statement and included as Annex A only to provide you with information regarding its terms and conditions, and not to provide any other factual i*