

KEYW HOLDING CORP  
Form 10-Q  
April 30, 2013

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

FORM 10-Q  
(Mark One)

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

For the quarterly period ended: March 31, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-34891

The KEYW Holding Corporation  
(Exact name of registrant as specified in its charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)

27-1594952  
(I.R.S. Employer  
Identification No.)

7740 Milestone Parkway, Suite 400  
Hanover, Maryland  
(Address of principal executive offices)

21076  
(Zip Code)

(443) 733-1600  
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of the issuer's common stock (\$0.001 par value), as of April 19, 2013 was 36,592,469.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(In thousands, except share and par value per share amounts)

	March 31, 2013 (Unaudited)	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$3,067	\$5,639
Receivables	59,732	58,482
Inventories, net	9,246	8,739
Prepaid expenses	1,958	1,880
Income tax receivable	2,996	96
Deferred tax asset, current	3,149	3,149
Total current assets	80,148	77,985
Property and equipment, net	25,966	23,860
Goodwill	296,513	290,861
Other intangibles, net	48,024	53,799
Deferred tax asset	14,329	13,608
Other assets	2,526	2,562
<b>TOTAL ASSETS</b>	<b>\$467,506</b>	<b>\$462,675</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Revolver	\$29,000	\$21,000
Accounts payable	9,494	7,254
Accrued expenses	7,364	5,488
Accrued salaries & wages	10,709	17,770
Term note – current portion	6,125	5,688
Deferred revenue	2,900	2,905
Deferred income taxes	1,429	1,429
Total current liabilities	67,021	61,534
Long-term liabilities:		
Term note – non-current portion	61,250	63,000
Non-current deferred tax liability	28,886	29,700
Other non-current liabilities	7,563	7,413
<b>TOTAL LIABILITIES</b>	<b>164,720</b>	<b>161,647</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5 million shares authorized, none issued	—	—
Common stock, \$0.001 par value; 100 million shares authorized, 36,583,867 and 36,135,542 shares issued and outstanding	37	36
Additional paid-in capital	296,734	292,715
Retained earnings	6,015	8,277
Total stockholders' equity	302,786	301,028
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$467,506</b>	<b>\$462,675</b>

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

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## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statements of Operations

(In thousands, except share and per share amounts)

	Three months ended March 31, 2013 (Unaudited)	Three months ended March 31, 2012 (Unaudited)
Revenues		
Services	\$58,843	\$39,855
Integrated Solutions	19,029	15,921
Total	77,872	55,776
Costs of Revenues, excluding amortization		
Services	44,408	28,877
Integrated Solutions	9,402	7,970
Total	53,810	36,847
Gross Profit		
Services	14,435	10,978
Integrated Solutions	9,627	7,951
Total	24,062	18,929
Operating Expenses		
Operating expenses	20,233	13,412
Intangible amortization expense	6,921	4,869
Total	27,154	18,281
Operating (Loss) Income	(3,092	) 648
Non-Operating Expense, net	706	414
(Loss) Income before Income Taxes	(3,798	) 234
Income Tax (Benefit) Expense, net	(1,536	) 66
Net (Loss) Income	\$(2,262	) \$168
Weighted Average Common Shares Outstanding		
Basic	36,378,929	25,811,983
Diluted	36,378,929	27,766,772
(Loss) Earnings per Share		
Basic	\$(0.06	) \$0.01
Diluted	\$(0.06	) \$0.01

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

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statement of Stockholders' Equity (unaudited)

(In thousands except share amounts)

	Common Stock		Additional Paid-In Capital (APIC)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount			
BALANCE, JANUARY 1, 2013	36,135,542	\$36	\$292,715	\$8,277	\$301,028
Net loss	—	—	—	(2,262)	(2,262)
Option exercise	95,820	—	705	—	705
Restricted stock issuances	217,550	1	542	—	543
Restricted stock forfeitures	(22,700)	—	(67)	—	(67)
Equity issued as part of an acquisition	157,655	—	2,027	—	2,027
Stock based compensation	—	—	812	—	812
BALANCE, MARCH 31, 2013	36,583,867	\$37	\$296,734	\$6,015	\$302,786

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

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## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(In thousands except share amounts)

	Three months ended March 31, 2013 (Unaudited)	Three months ended March 31, 2012 (Unaudited)	
Net (loss) income	\$(2,262	)	\$168
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Stock compensation	1,287		647
Depreciation/Amortization	8,266		5,897
Non-cash impact of TI earn-out reduction	(146	)	—
Deferred taxes	(721	)	—
Changes in operating assets and liabilities:			
Receivables	(947	)	(10,430
Inventory	70		(886
Prepaid expenses	(63	)	(721
Income tax receivable	(2,900	)	—
Accounts payable	1,675		(717
Accrued expenses	(4,154	)	(822
Other balance sheet changes	37		(7
Net cash provided by (used in) operating activities	142		(6,871
Cash flows from investing activities:			
Acquisitions, net of cash acquired	(6,725	)	—
Purchases of property and equipment	(2,108	)	(1,431
Capitalized software development costs	(1,273	)	—
Net cash used in investing activities	(10,106	)	(1,431
Cash flows from financing activities:			
Proceeds from revolver, net	8,000		11,000
Repayment of debt	(1,313	)	—
Repurchase of stock	—		(2,948
Proceeds from option exercises	705		51
Net cash provided by financing activities	7,392		8,103
Net decrease in cash and cash equivalents	(2,572	)	(199
Cash and cash equivalents at beginning of period	5,639		1,294
Cash and cash equivalents at end of period	\$3,067		\$1,095
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$980		\$449
Cash paid for taxes	\$406		\$557

## Supplemental disclosure of non-cash investing and financing activities:

In conjunction with the IDEAL acquisition in January 2013, the Company issued 157,655 shares of KEYW common stock with an approximate value of \$2.0 million.

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





## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

We prepared our interim consolidated condensed financial statements that accompany these notes in conformity with accounting principles generally accepted in the United States of America for interim information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X.

The interim financial information is unaudited, but reflects all normal adjustments that are, in our opinion, necessary to provide a fair statement of results for the interim periods presented. Certain information and note disclosures normally included in the annual financial statements have been condensed or omitted pursuant to those instructions. This interim information should be read in conjunction with the consolidated financial statements for the year ended December 31, 2012, contained in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission on March 12, 2013.

#### Corporate Organization

The KEYW Holding Corporation ("Holdco", "KEYW" or the "Company") was incorporated in Maryland in December 2009. Holdco is a holding company and conducts its operations through The KEYW Corporation ("Opco") and its subsidiaries. Opco was incorporated in Maryland in May 2008 and began operations on August 4, 2008. Opco became Holdco's wholly-owned subsidiary on December 29, 2009, as part of a corporate reorganization (the "Reorganization"). Pursuant to the Reorganization, all of the capital stock, options, and warrants of Opco were exchanged for an equal number of shares of capital stock, options, and warrants of Holdco, having substantially identical terms as the Opco instruments, except that certain terms of the Opco warrants were modified in the Reorganization when exchanged for replacement Holdco warrants so that the warrants would no longer be classified as liability instruments under current accounting guidance.

KEYW is a highly specialized provider of mission-critical cybersecurity, cyber superiority and geospatial intelligence solutions to U.S. Government defense, intelligence and national security agencies and commercial enterprises. Our core capabilities include solutions, services and products to support the collection, processing, analysis, and use of intelligence data and information in the domains of cyberspace and geospace. Our solutions are designed to respond to meet the critical needs for agile intelligence in the cyber age and to assist the U.S. government in national security priorities.

We have acquired more than fifteen businesses or operating entities since our inception. See Note 2 - Acquisitions for additional information on these acquisitions.

#### Principles of Consolidation

The consolidated financial statements include the transactions of KEYW, Opco and their wholly owned subsidiaries from the date of their acquisition. All intercompany accounts and transactions have been eliminated.

#### Revenue Recognition

We derive the majority of our revenue from time-and-materials, firm-fixed-price, cost-plus-fixed-fee, and cost-plus-award-fee contracts. Revenues from cost reimbursable contracts are recorded as reimbursable costs are incurred, including an estimated share of the applicable contractual fees earned. For performance-based fees under cost reimbursable contracts, we recognize the relevant portion of the expected fee to be awarded by the client at the time such fee can be reasonably estimated, based on factors such as prior award experience and communications with the client regarding performance. For cost reimbursable contracts with performance-based fee incentives, we recognize the relevant portion of the fee upon customer approval. For time-and-materials contracts, revenue is recognized based on billable rates times hours delivered plus materials and other reimbursable costs incurred. For

firm-fixed price service contracts, revenue is recognized using the proportional performance based on the estimated total costs of the project. For fixed-price production contracts, revenue and cost are recognized at a rate per unit as the units are delivered or by other methods to measure services provided. This method of accounting requires estimating the total revenues and total contract costs of the contract. During the performance of contracts, these estimates are periodically reviewed and revisions are made as required. The impact on revenue and contract profit as a result of these revisions is included in the periods in which the revisions are made. This method can result in the deferral of costs or the deferral of profit on these contracts. Because we assume the risk of performing a fixed-price contract at a set price, the failure to accurately estimate ultimate costs or to control costs during performance of the work could result, and in some instances has resulted, in reduced profits or losses on such contracts. Estimated losses on contracts at completion are recognized when identified.

Contract revenue recognition inherently involves estimation. Examples of estimates include the contemplated level of effort to accomplish the tasks under the contract, the cost of the effort, and an ongoing assessment of our progress toward completing the

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

contract. From time to time, as part of our management processes, facts develop that require us to revise our estimated total costs or revenue. To the extent that a revised estimate affects contract profit or revenue previously recognized, we record the cumulative effect of the revision in the period in which the facts requiring the revision become known. In certain circumstances, and based on correspondence with the end customer, management authorizes work to commence or to continue on a contract option, addition or amendment prior to the signing of formal modifications or amendments. We recognize revenue to the extent it is probable that the formal modifications or amendments will be finalized in a timely manner and that it is probable that the revenue recognized will be collected.

Revenue from software arrangements is allocated to each element of the arrangement based on the relative fair values of the elements, such as software licenses, upgrades, enhancements, maintenance contract types and type of service delivered, installation or training. The determination of fair value is based on objective evidence that is specific to the vendor ("VSOE"). If VSOE of fair value for each element of the arrangement does not exist, all revenue from the arrangement is deferred until such time as VSOE of fair value exists or until all elements of the arrangement are delivered, except in those circumstances in which the residual method may be used as described below.

With the Sensage acquisition, the Company's software products are licensed on a perpetual basis. In addition, the Company provides maintenance under a separate maintenance agreement, typically twelve months. Maintenance includes technical support and unspecified software upgrades and enhancements if and when available. Revenue from perpetual software licenses is recognized under the residual method for arrangements in which the software is sold with maintenance and/or professional services, and the Company has established VSOE of fair value for maintenance and professional services.

The Company recognizes software licenses, maintenance or professional services revenue only when there is persuasive evidence of an arrangement, delivery to the customer has occurred, the fee is fixed and determinable and collectability is reasonably assured.

Revenue from maintenance is deferred and recognized ratably over the term of each maintenance agreement. Revenue from professional services is recognized as the services are performed.

All revenue is net of intercompany adjustments.

### Cost of Revenues

Cost of revenues consists primarily of compensation expenses for program personnel, the fringe benefits associated with this compensation and other direct expenses incurred to complete programs, including cost of materials and subcontract efforts.

### Inventories

Inventories are valued at the lower of cost (determined on a weighted average basis) or market. Our inventory consists of specialty products that we manufacture on a limited quantity basis for our customers. We manufacture at quantity levels that are projected to be sold in the six month period following production. The Company has not had any products sold below their standard pricing less applicable volume discounts. At March 31, 2013, and December 31, 2012, we had an inventory reserve balance of \$963,000 for certain products where the market has not developed as expected.

### Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Invoice terms range from net 10 days to net 45 days. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance (allowance for doubtful accounts) based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written-off through a charge to the valuation allowance and a credit to accounts receivable.

### Property and Equipment

All property and equipment are stated at acquisition cost or in the case of self-constructed assets, the cost of labor and a reasonable allocation of overhead costs (no general and administrative costs are included). The cost of maintenance and repairs, which do not significantly improve or extend the life of the respective assets, are charged to operations as incurred.

Provisions for depreciation and amortization are computed on either a straight-line method or accelerated methods acceptable under accounting principles generally accepted in the United States of America ("US GAAP") over the estimated useful lives of between 3 and 7 years. Leasehold improvements are amortized over the lesser of the lives of the underlying leases or the estimated useful lives of the assets.

#### Lease Incentives

As part of entering into the lease for the Company's current headquarters in 2012, the lessor provided the Company with a tenant

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

improvement allowance. Typically, such allowances are in the form of cash and represent reimbursements to the Company for tenant improvements made to the leased space. These improvements are capitalized as property and equipment, and the allowances are classified as a deferred lease incentive liability. This incentive is considered a reduction of rental expense by the lessee over the term of the lease and is recognized on a straight-line basis over the same term.

### Software Development Costs

Costs of internally developed software for resale are expensed until the technological feasibility of the software product has been established. In accordance with the pronouncement on software development costs of the Accounting Standards Codification ("ASC"), software development costs are capitalized and amortized over the product's estimated useful life. The Company determined that it had achieved technological feasibility during the third quarter of 2012 on certain software being developed and has capitalized balances of approximately \$2.8 million and \$1.5 million of software development costs as of March 31, 2013 and December 31, 2012, respectively. No amortization was recognized related to these capitalized software costs as of March 31, 2013 as the product was not yet available for sale.

### Long-Lived Assets (Excluding Goodwill)

The Company follows the provisions of FASB ASC topic 360-10-35, Impairment or Disposal of Long-Lived Assets in accounting for long-lived assets such as property and equipment and intangible assets subject to amortization. The guidance requires that long-lived assets be reviewed for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be fully recoverable. The possibility of impairment exists if the sum of the long-term undiscounted cash flows is less than the carrying amount of the long-lived asset being evaluated. Impairment losses are measured as the difference between the carrying value of long-lived assets and their fair market value based on discounted cash flows of the related assets. Impairment losses are treated as permanent reductions in the carrying amount of the assets.

### Goodwill

Purchase price in excess of the fair value of tangible assets and identifiable intangible assets acquired and liabilities assumed in a business combination are recorded as goodwill. In accordance with FASB ASC Topic 350-20, Goodwill, the Company tests for impairment at least annually, using a two-step approach. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The test in the fourth quarter of 2011 was performed as a single unit as it was prior to the Company's change to two segments. As of the measurement date October 1, 2012, the Company operates as two reporting units. The fair value of each reporting unit is estimated using a combination of income and market approaches. If the carrying amount of the unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. The Company evaluated goodwill during the fourth quarter of fiscal years 2012 and 2011 and found no impairment to the carrying value of goodwill.

### Intangibles

Intangible assets consist of the value of customer related intangibles acquired in various acquisitions. Intangible assets are amortized on a straight line basis over their estimated useful lives unless the pattern of usage of the benefits indicates an alternative method is more representative. The useful lives of the intangibles range from one to seven years.

### Concentrations of Credit Risk

We maintain cash balances that, at times exceed the federally insured limit on a per financial institution basis. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk related to cash. In addition, we have credit risk associated with our receivables that arise in the ordinary course of business. In excess of 90% of our contracts are issued by the U.S. Government and any disruption to cash payments

from our end customer could put the Company at risk.

#### Use of Estimates

Management uses estimates and assumptions in preparing these consolidated financial statements in accordance with US GAAP. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Significant estimates include amortization lives, depreciation lives, percentage of completion revenue, inventory obsolescence reserves, income taxes and stock compensation expense. Actual results could vary from the estimates that were used.

#### Cash and Cash Equivalents

We consider all highly liquid investments purchased with expected original maturities of three months or less, when purchased, to be cash equivalents.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## Fair Value of Financial Instruments

The balance sheet includes various financial instruments consisting of cash and cash equivalents, accounts receivable, and accounts payable. The fair values of these instruments approximate the carrying values due to the short maturity of these instruments. The carrying amount of the debt approximates its fair value and is based on its effective interest compared to the current market rates.

## Research and Development

Internally funded research and development expenses are expensed as incurred and are included in cost of operations in the accompanying consolidated statement of operations. In accordance with FASB ASC Topic 730 - Research and Development, such costs consist primarily of payroll, materials, subcontractor and an allocation of overhead costs related to product development. Research and development costs totaled \$1,163,000 and \$837,000 for the three months ended March 31, 2013 and March 31, 2012, respectively.

## Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enacted date. We will establish a valuation allowance if we determine that it is more likely than not that a deferred tax asset will not be realized.

For a tax position that meets the more-likely-than-not recognition threshold, the Company initially and subsequently measures the tax liability or benefit as the largest amount that it judges to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. The liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances, such as the progress of tax audits, case law developments and new or emerging legislation. Such adjustments are recognized entirely in the period in which they are identified. The effective tax rate includes the net impact of changes in the liability for unrecognized tax obligations or benefits and subsequent adjustments as considered appropriate by management. The Company's policy is to record interest and penalties as an increase in the liability for uncertain tax obligations or benefits and a corresponding increase to the income tax provision. No such adjustments were recorded as of March 31, 2013 or December 31, 2012.

## Earnings per Share

Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the diluted weighted average common shares, which reflects the potential dilution of stock options, warrants, and contingently issuable shares that could share in our income if the securities were exercised.

The following table presents the calculation of basic and diluted net income per share (in thousands except per share amounts):

	Three Months Ended	
	March 31, 2013	March 31, 2012
Net (loss) income	\$(2,262	) \$168
Weighted average shares – basic	36,379	25,812
Effect of dilutive potential common shares	—	1,955
Weighted average shares – diluted	36,379	27,767
Net (loss) income per share – basic	\$(0.06	) \$0.01
Net (loss) income per share – diluted	\$(0.06	) \$0.01



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Anti-dilutive share-based awards, excluded	3,890	1,250
Outstanding options and warrants, total	7,950	7,265

Employee equity share options, similar equity instruments, and warrants granted by the Company are treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options and in-the-money warrants. The dilutive effect of such equity awards is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible, are collectively assumed to be used to repurchase shares.

### Stock Based Compensation

As discussed in Note 10, the shareholders approved the 2013 KEYW Holding Corporation Stock Incentive Plan in August 2012. The 2013 Stock Incentive Plan, which took effect on January 1, 2013, replaced the 2009 Stock Incentive Plan. The Company adopted the 2009 Stock Incentive Plan in December 2009 in conjunction with the corporate reorganization. The Company had originally adopted a stock option plan in 2008. The Company applies the fair value method that requires all share-based payments to employees and non-employee directors, including grants of employee stock options, to be expensed over their requisite service period based on their fair value at the grant date, using a prescribed option-pricing model. We use the Black-Scholes option-pricing model to value share-based payments. Compensation expense related to share-based awards is recognized on an accelerated basis. The expense recognized is based on the straight-line amortization of each individually vesting piece of a grant. Our typical grant vests 25% at issuance and 25% per year over the next three years. We expense the initial 25% vesting at issuance, the second over twelve months, the third over twenty-four months and the fourth over thirty-six months. The calculated expense is required to be based upon awards that ultimately vest and we have accordingly reduced the expense by estimated forfeitures.

The following assumptions were used for option grants during the quarters ended March 31, 2013 and March 31, 2012.

**Dividend Yield** — The Company has never declared or paid dividends on its common stock and has no plans to do so in the foreseeable future.

**Risk-Free Interest Rate** — Risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term approximating the expected life of the option term assumed at the date of grant.

**Expected Volatility** — Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The expected volatility is based on the historical volatility of existing comparable public companies for a period that approximates the estimated life of the options. The Company used comparable public companies volatility due to insufficient trading history of our own stock until the fourth quarter of 2012, at which time the Company began using its own volatility.

**Expected Term of the Options** - This is the period of time that the options granted are expected to remain unexercised. The Company estimates the expected life of the option term based on the expected tenure of employees and historical experience.

**Forfeiture Rate** — The Company estimates the percentage of options granted that are expected to be forfeited or canceled on an annual basis before stock options become fully vested. The Company uses the forfeiture rate that is a blend of past turnover data and a projection of expected results over the following twelve month period based on projected levels of operations and headcount levels at various classification levels with the Company.

### Segment Reporting

FASB ASC Section 280, Segment Reporting, establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that these enterprises report selected information about operating segments in interim financial reports. The guidance also establishes standards for related disclosures about products and services, geographic areas and major customers. Management has concluded that the Company, beginning in the fourth quarter of 2011, operates in two segments based upon the information used by the chief operating decision maker to evaluate the performance of its business and allocating resources and capital. These segments are Services and Integrated Solutions. Our Services segment encompasses revenue generated from labor-based activities. The Integrated Solutions segment contains all activities of our Company that are product related or originated from a product.

Recently Issued Accounting Pronouncements

In July 2012, the FASB issued guidance on testing for indefinite-lived intangible assets for impairment. The new guidance provides an entity to simplify the testing for a drop in value of intangible assets such as trademarks, patents, and distribution rights. The amended standard reduces the cost of accounting for indefinite-lived intangible assets, especially in cases where the likelihood of impairment is low. The changes permit businesses and other organizations to first use subjective criteria to determine if an intangible asset has lost value. The amendments to U.S. GAAP are effective for fiscal years starting after September 15, 2012. The Company's adoption of this accounting guidance did not have a material impact on its financial statements and related disclosures as it has no indefinite-lived intangible assets other than Goodwill.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

### 2. ACQUISITIONS

The Company has completed more than fifteen acquisitions since it began operations in August 2008. The acquisitions were made to increase the Company's skill sets and to create sufficient critical mass to be able to serve as prime contractor on significant contracts. All of the acquisitions resulted in the Company recording goodwill and other intangibles. The goodwill was a result of the acquisitions focusing on acquiring cleared personnel to expand our presence with our main customer. The value of having that personnel generated the majority of the goodwill from the transactions and drove much of the purchase price. Several of the acquisitions involved issuance of Company common stock. The stock price for acquisition accounting was determined by the fair value on the acquisition date.

Details of the acquisitions completed since January 1, 2012 are outlined below:

#### Poole and Associates, Inc.

On October 1, 2012, the Company acquired Poole and Associates, Inc. ("Poole") for \$116.0 million in cash and 794,913 shares of KEYW common stock valued at \$12.58 per share for a total purchase price of \$126.0 million adjusted for working capital targets as defined in the purchase agreement. The goodwill and intangible assets associated with this acquisition are not deductible for tax purposes, however the identified intangible assets are amortized under US GAAP. The Company has recorded \$21.7 million of intangible assets related to acquired contracts, contract based rights and trade name. These assets will be amortized over periods from 2 - 5 years.

Poole was founded in 1999 and is headquartered in Annapolis Junction, MD. Poole provides systems engineering, software development, program management, and technical support to the intelligence community as well as bringing several prime contracts to the Company. Poole had approximately 152 employees at the time of acquisition, of whom 124 have security clearances at the highest level.

#### Sensage, Inc

On October 12, 2012, the Company acquired Sensage, Inc. and its wholly owned subsidiary Sensage International, Inc ("Sensage") for \$15.0 million in cash and 713,151 shares of KEYW stock valued at \$12.62 for a total initial purchase price of \$24.0 million as adjusted for working capital targets as defined in the purchase agreement. There was additional consideration consisting of up to \$7.5 million of KEYW common stock and \$3.0 million of the cash contingent upon Sensage meeting certain revenue targets for the second half of 2012. Based on the actual performance during the earn-out period, an additional \$78,000 of cash was paid to Sensage shareholders from the earn-out. The goodwill and intangibles are not deductible for tax purposes, however the identified intangible assets are amortized under US GAAP. The Company has recorded \$8.5 million of intangible assets related to acquired customer relationships, intellectual property and trade name. These assets will be amortized over periods ranging from 1 - 5 years.

Sensage was founded in 2001 and is headquartered in Redwood City, CA. Sensage provides system incident event management software through its proprietary solution and brings commercial software experience to the Company. Sensage had approximately 35 employees at the time of acquisition most of whom were not cleared at any level.

#### Other 2012 Acquisitions

During the fourth quarter of 2012, subsequent to the above acquisitions, the Company acquired the assets of Rsignia, Inc. ("Rsignia") and Diligent Solutions, LLC ("Diligent") in two separate asset transactions. The total consideration paid for these two purchases was \$7.0 million and equity, valued at \$4.8 million, consisting of 316,231 shares of KEYW common stock and warrants to purchase another 158,116 shares at \$12.65. Neither of these acquisitions are considered material to the financial results of KEYW and are not included in the pro forma tables below for that reason.

#### IDEAL Technology Corporation

On January 31, 2013 the Company acquired IDEAL Technology Corporation ("IDEAL") for \$7.0 million in cash and 157,655 shares of KEYW stock valued at \$12.69 for a total purchase price of \$9.0 million. IDEAL is not considered

material to the financial results of KEYW and is not included in the pro forma tables below for that reason. The intangible valuation is still in progress thus the final accounting for the acquisition is not complete.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

The total purchase price paid for the acquisitions described above have been allocated as follows (in thousands):

	Poole	Sensage	Rsigna/Dilijent	IDEAL
Cash	\$4,412	\$1,948	\$(6	) \$301
Current assets, net of cash acquired	7,278	8,995	801	895
Fixed assets	755	61	123	70
Intangibles	21,709	8,498	6,001	3,000
Goodwill	110,928	9,630	5,837	5,652
Other assets	29	54	—	—
Total Assets Acquired	145,111	29,186	12,756	9,918
Current liabilities	8,045	6,700	1,333	865
Long-term obligations	9,140	—	—	—
Total Liabilities Assumed	17,185	6,700	1,333	865
Net Assets Acquired	\$127,926	\$22,486	\$11,423	\$9,053
Net Cash Paid	\$113,545	\$11,246	\$6,601	\$6,725
Equity Issued	9,969	9,292	4,828	2,027
Actual Cash Paid	\$117,957	\$13,194	\$6,595	\$7,026

All material acquisitions were accounted for using the acquisition method of accounting. Results of operations for each acquired entity are included in the consolidated financial statements from the date of each acquisition. Each of the acquisitions outlined above complements the Company's strategic plan to expand its classified intelligence offerings into the national security marketplace. These acquisitions provide the Company with access to key customers, security clearances and technical expertise. The Sensage, Rsignia, and Dilijent acquisitions also provided expertise and product offerings in the commercial software market. As a result of these factors, the Company was willing to pay a purchase price that resulted in recording goodwill as part of the purchase price allocation.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

The table below summarizes the unaudited pro forma statement of operations for the first three months of 2012, assuming these acquisitions had been completed on the first day of the year. A pro forma income statement is not presented for 2013 as there have been no material acquisitions during the first three months of 2013. These pro forma statements do not include any adjustments that may have resulted from synergies between the acquisitions or from amortization of intangibles other than during the period the acquired entities were part of the Company. The 2012 activity for Poole and Sensage represents the financial activity in 2012 prior to acquisition. Activity for the Rsignia, Diligent and IDEAL acquisitions are not included for any period presented due to their immateriality individually and in aggregate.

	For the Three Months Ended March 31, 2012 (In thousands)			
	Poole	Sensage	KEYW	Total
Revenues				
Services	\$11,959	\$—	\$39,855	\$51,814
Integrated Solutions	—	2,057	15,921	17,978
Total	11,959	2,057	55,776	69,792
Cost of Revenues				
Services	9,448	—	28,877	38,325
Integrated Solutions	—	705	7,970	8,675
Total	9,448	705	36,847	47,000
Gross Profit				
Services	2,511	—	10,978	13,489
Integrated Solutions	—	1,352	7,951	9,303
Total	2,511	1,352	18,929	22,792
Operating Expenses	1,989	2,508	18,281	22,778
Operating Income (Loss)	522	(1,156)	648	14
Non-operating Expense	2	100	414	516
Income (Loss) before Taxes	520	(1,256)	234	(502)
Tax Expense	594	—	66	660
Net (Loss) Income	\$(74)	\$(1,256)	\$168	\$(1,162)

## 3. FAIR VALUE MEASUREMENTS

We group financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

At March 31, 2013, the Company did not have any financial assets or liabilities that were carried at fair value.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## 4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	March 31, 2013 (In thousands)	December 31, 2012
Accounts Receivable		
Billed AR	\$34,596	\$40,689
Unbilled AR	25,136	17,793
Total AR	\$59,732	\$58,482

Unbilled amounts represent revenue recognized which could not be billed by the period end based on contract terms. The majority of the unbilled amounts were billed subsequent to period end. Retainages typically exist at the end of a project and/or if there is a disputed item on an invoice received by a customer. At March 31, 2013 and December 31, 2012, retained amounts are insignificant and are expected to be collected subsequent to the balance sheet date.

As part of the acquisitions in 2012, an allowance for doubtful accounts was acquired in the amount of \$351,000. The accounts receivable recorded in the acquisition accounting were net of this reserve. This reserve comprises both a specific and generic accounts receivable reserve which are evaluated at each quarter end.

Most of the Company's revenues are derived from contracts with the U.S. Government, in which we are either the prime contractor or a subcontractor, depending on the award.

## 5. INVENTORIES

Inventories at March 31, 2013 and December 31, 2012 consisted of work in process at various stages of production and finished goods. This inventory, which consists primarily of mobile communications devices, is valued at the lower of cost (as calculated using the weighted average method) or market. The cost of the work in process consists of materials put into production, the cost of labor and an allocation of overhead costs. At March 31, 2013, and December 31, 2012, we have reserved \$963,000, for certain inventory items where the market has not developed as expected.

## 6. PREPAID EXPENSES

Prepays at March 31, 2013 and December 31, 2012 primarily consist of prepaid insurance, bonuses, interest, rent, prepaid taxes and professional fees.

## 7. PROPERTY AND EQUIPMENT

Property and equipment are as follows:

	March 31, 2013 (In thousands)	December 31, 2012
Property and Equipment		
Aircraft	\$8,583	\$7,797
Leasehold Improvements	12,751	12,289
Manufacturing Equipment	2,710	2,605
Office Equipment	10,371	8,273
Total	\$34,415	\$30,964
Accumulated Depreciation	(8,449)	(7,104)
Property and Equipment, net	\$25,966	\$23,860



Depreciation expense charged to operations was \$1,345,000 and \$1,029,000 for the three months ended March 31, 2013 and 2012, respectively. Certain of our aircraft and equipment are stored and operated out of military bases located overseas.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

## 8. AMORTIZATION OF INTANGIBLE ASSETS

The following values were assigned to intangible assets (other than goodwill) for the acquisitions noted below:

Acquisition	Intangible	March 31, 2013 (In thousands)		
		Gross Book Value	Accumulated Amortization	Net Book Value
S&H	Contracts – Fixed Price Level of Effort	\$ 1,606	\$(1,254)	) \$352
ICCI	Contracts – Fixed Price Level of Effort	1,181	(1,078)	) 103
ICCI	Contracts – T&M and IDIQ	3,018	(2,994)	) 24
ESD	Contracts	1,207	(892)	) 315
Sycamore	Contracts	5,898	(4,587)	) 1,311
Everest	Contracts	4,690	(2,189)	) 2,501
JKA	Contracts	2,680	(1,787)	) 893
FASI	Contracts	2,775	(1,330)	) 1,445
FLD	Customer Relationships	17,549	(12,103)	) 5,446
FLD	Contracts	2,234	(1,862)	) 372
FLD	Technology Assets	1,958	(1,350)	) 608
Poole	Trade Name	795	(318)	) 477
Poole	Contract rights	20,914	(2,090)	) 18,824
Sensage	Marketing	249	(100)	) 149
Sensage	Intellectual Property	4,567	(761)	) 3,806
Sensage	Customer Relationships	3,682	(368)	) 3,314
Rsignia	Intellectual Property	5,001	(556)	) 4,445
Dilijent	Intellectual Property	1,000	(111)	) 889
IDEAL	Intellectual Property	3,000	(250)	) 2,750
		\$84,004	\$(35,980)	) \$48,024

The Company recorded amortization expense of \$6.9 million and \$4.9 million for the three month periods ended March 31, 2013 and 2012, respectively.

During the first quarter of 2013, the Company determined that the earn-out relating to the acquisition of certain government contracting assets from National Semiconductor Corporation (“TI”) would not be achieved. As such, the remaining intangible asset and accrued earn-out relating to the TI acquisition were written-down resulting in a net non-operating gain of \$146,000.

Estimated future intangible amortization expense by year as of March 31, 2013 (In thousands):

2013	2014	2015	2016	2017
\$18,170	\$12,135	\$9,111	\$4,919	\$3,689

## 9. DEBT

On October 1, 2012, the Company entered into a senior credit agreement, (the “Credit Agreement”), by and among itself, the KEYW Corporation, as the borrower (the “Borrower”), the domestic direct and indirect subsidiary guarantors of KEYW (the “Subsidiary Guarantors”), the lenders and Royal Bank of Canada, as administrative agent. Under the Credit Agreement, the Company provided a guaranty of all of the obligations of the Borrower. The Credit Agreement provides the Borrower a \$60 million term loan and a \$40 million revolving credit facility, (the “Revolver”). The

Revolver includes a \$10 million swing line and a \$15 million letter of credit sub-facility. The Credit Agreement includes an uncommitted accordion facility, permitting the Borrower to obtain up to an additional \$35 million, subject to certain conditions. The five year Credit Agreement bears cash interest at either selected LIBOR plus a specified margin based on the Company's then existing Senior Leverage Ratio (as defined in the Credit Agreement) or an alternative base rate plus a specified margin. The Term Loan and the Revolver are secured by a security interest and lien on substantially all of KEYW's, the Borrower's and the Subsidiary Guarantors' assets including a pledge of one hundred percent of the equity securities of the Borrower and the Subsidiary Guarantors.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

On November 20, 2012, the Company amended the Credit Agreement to increase both the term loan and the amount available under the Revolver by \$10 million each as well as adding additional lenders to the Credit Agreement. This brings the term loan to \$70 million and the Revolver to \$50 million. The Company is required to comply with certain financial covenants contained in the Credit Agreement. As of March 31, 2013, the Company was in compliance with all covenants as under the Credit agreement.

In connection with the issuance of the term loan and revolving credit facility in 2012 the Company incurred \$3,199,000 in financing costs. These financing costs are being amortized ratably over a five year period, the life of the related debt. The Company recognized \$159,000 in amortization expense in the first three months of 2013. The Company is estimated to incur future amortization expense of \$480,000 for the remainder of 2013 and \$640,000, \$640,000, \$640,000 and \$480,000 for the years ended December 31, 2014 - 2017 respectively. The agreement also has a \$37,500 quarterly agency fee payable as incurred. This amount is not included in the deferred financing costs as it only applies until the loans are repaid.

At March 31, 2013, the Company had fully drawn the \$70.0 million available under the term loan and had \$29.0 million outstanding under the revolver. The Company has recorded the revolver as a current debt due to the unstructured repayment terms and the Company's practice of using free cash flow to pay down debt. The term loan requires certain quarterly payments and the first two of those payments have been made as of March 31, 2013 in the amount of \$1.3 million each, bringing the term loan balance to \$67.4 million. The payment schedule for the term loan by year is as follows:

Required Future Loan Payments (In thousands) :

2013	2014	2015	2016	2017
\$4,375	\$7,000	\$7,000	\$7,000	\$42,000

Interest expense recorded under the new facilities was \$908,000 during the three months ended March 31, 2013.

In February 2011, the Company entered into a \$50 million credit facility that includes an accordion feature allowing for an additional \$25 million in borrowing. The credit facility was a 3 year agreement and was a multi-bank facility with Bank of America as lead bank. On September 28, 2012 the Company terminated, satisfied, and discharged all of its obligations under the Bank of America credit facility. Interest expense recognized related to this agreement was approximately \$412,000 for the three month period ended March 31, 2012.

## 10. STOCK - BASED COMPENSATION

On August 15, 2012, the shareholders approved the 2013 KEYW Holding Corporation Stock Incentive Plan. The 2013 plan, which took effect on January 1, 2013, replaced the 2009 plan and provides for the issuance of restricted stock, stock options, and restricted stock units with a maximum of 2,000,000 shares available for issuance.

### Stock Options

The Company generally issues stock option awards that vest over varying periods, ranging from three to five years, and have a ten-year life. We estimate the fair value of stock options using the Black-Scholes option-pricing model. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. All option awards terminate within ninety days or sooner after termination of service with the Company, except as provided in certain circumstances under our senior executive employment agreements.

The option grants during the first three months of 2013 consist of options issued to new hires or discretionary awards. All equity issuances have an exercise price at market value or higher based upon our publicly-traded share price on the date of grant.

The Black-Scholes model requires certain inputs related to dividend yield, risk-free interest rate, expected volatility and forfeitures in order to price the option values. During 2013, our assumptions related to these inputs were as follows:

-Dividend yield was zero as we have no current intentions to pay any dividends

-Risk-free interest rate ranging from 0.75% -0.88%

-Expected volatility ranging from 37.29% - 51.37%

-Forfeitures ranging from 15%- 39%

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## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

A summary of stock option activity for the period ended March 31, 2013 is as follows:

	Number of Shares	Option Exercise Price	Weighted Average Exercise Price
Outstanding January 1, 2013	3,186,414		
Granted	332,100	\$11.27 - \$14.03	\$11.57
Exercised	(95,820	) \$5.00 - \$14.57	\$7.36
Cancelled	(110,799	) \$5.00 - \$14.57	\$11.80
Options Outstanding March 31, 2013	3,311,895		

All stock based compensation has been recorded as part of operating expenses. Accounting standards require forfeitures to be estimated at the time an award is granted and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeiture estimates are disclosed in the information regarding the option grants above. For the periods ended March 31, 2013 and 2012, share-based compensation expense is based on awards ultimately expected to vest and has been reduced for estimated forfeitures. The total unrecognized stock compensation expense at March 31, 2013 is approximately \$10.3 million, which will be recognized over four years.

As of March 31, 2013, outstanding stock options were as follows:

Exercise Price	Options Outstanding	Intrinsic Value	Options Vested	Intrinsic Value	Weighted Average Remaining Life (Years)
\$5.00	97,800	\$1,088,514	86,100	\$958,293	5.46
\$5.50	702,037	7,462,653	616,437	6,552,726	6.58
\$6.90 – \$7.66	359,573	3,131,461	179,007	1,559,011	8.83
\$7.96 – \$8.14	90,649	738,258	41,544	338,845	8.65
\$9.17 - \$10.98	394,945	2,537,958	243,991	1,597,119	7.91
\$11.18 - \$11.99	453,817	2,129,782	111,264	487,929	9.17
\$12.28 - \$12.97	611,899	2,105,856	93,511	330,150	9.39
\$13.00 - \$14.57	601,175	1,248,692	355,213	648,713	8.36
	3,311,895	\$20,443,174	1,727,067	\$12,472,786	

## 2013 Stock Incentive Plan

Total equity available to issue	2,000,000
Total equity outstanding or exercised	539,100
Total equity remaining	1,460,900

## Restricted Stock Awards

During 2013, the Company has issued restricted stock for employee incentive plans and strategic hires. The Company issued 66,000 shares of restricted common stock to existing employees under the long-term incentive plan and an additional 15,000 shares of restricted common stock to board members. These shares cliff vest in three years. The Company issued an additional 37,750 restricted shares to employees from the Sensage Acquisition. These shares vest 75% on February 8, 2014 and 25% on August 8, 2014. The Company also issued 98,800 shares of restricted common stock to 46 founding employees of KEYW for recognition of their continued service and loyalty going into our 5<sup>th</sup> year of business. Of these shares 40,800 cliff vest in one year and 58,000 cliff vest in three years. The expense for these shares will be recognized over the vesting life of each individual tranche of shares based upon the fair value of a share of stock at the date of grant. All restricted stock awards have no exercise price.



## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

As of March 31, 2013, outstanding unvested restricted stock awards were as follows:

	Unvested Shares	
Outstanding January 1, 2013	452,583	
Granted	217,550	
Vested	(6,000	)
Cancelled	(22,700	)
Outstanding March 31, 2013	641,433	

## 11. WARRANTS

During the first three months of 2013, no warrant holders exercised any warrants.

As of March 31, 2013, outstanding warrants were as follows:

Exercise Price	Warrants Outstanding	Warrants Vested	Weighted Average Remaining Life (Years)
\$4.00	2,023,250	2,023,250	2.39
\$5.50	2,246,780	2,246,780	3.15
\$9.25	210,000	210,000	3.96
\$12.65	158,116	158,116	6.66
	4,638,146	4,638,146	

## 12. SEGMENTS

The Company specifically identifies acquired goodwill and intangibles with specific segments. Fixed assets are segregated by segment with assets also being assigned to Corporate for those assets that are not specifically identified for either segment.

As of and for the Three Months ended March 31, 2013  
(In thousands and unaudited)

	Services	Integrated Solutions	Corporate
Goodwill	\$277,474	\$19,039	\$—
Intangibles, net	34,329	13,695	—
Property and Equipment, net	2,764	10,659	12,543
Depreciation Expense	394	546	405
Intangible Amortization	4,009	2,912	—

For the Three Months ended March 31, 2012  
(In thousands and unaudited)

	Services	Integrated Solutions	Corporate
Depreciation Expense	\$166	\$774	\$88
Intangible Amortization	2,572	2,297	—



## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

	As of December 31, 2012 (In thousands)		
	Services	Integrated Solutions	Corporate
Goodwill	\$271,822	\$19,039	\$—
Intangibles, net	37,192	16,607	—
Property and Equipment, net	4,633	6,869	12,358

## 13. SUBSEQUENT EVENTS

In connection with the preparation of its financial statements for the three months ended March 31, 2013, the Company has evaluated events that occurred subsequent to March 31, 2013 to determine whether any of these events required recognition or disclosure in the first three months of 2013 financial statements. The Company is not aware of any subsequent events which would require recognition or disclosure in the financial statements.

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides information that management believes is relevant to an assessment and an understanding of the Company's operations and financial condition. This discussion should be read in conjunction with the attached unaudited consolidated financial statements and accompanying notes as well as our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission on March 12, 2013.

FORWARD-LOOKING STATEMENTS

The matters discussed in this Quarterly Report may constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, activity levels, performance or achievements to be materially different from any future results, activity levels, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as "could", "expect", "estimate", "may", "potential", "will", and "would", or similar words. You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. There may be events in the future that we are not able to predict or control accurately, and numerous factors may cause events, our results of operations, financial performance, achievements, or industry performance, to differ materially from those reflected in the forward-looking statements. The factors listed in the section captioned "Risk Factors," contained in our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission on March 12, 2013, as well as any cautionary language in this Quarterly Report, provide examples of such risks, uncertainties, and events.

You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report. Subsequent events and developments may cause our views to change. While we may elect to update the forward-looking statements at some point in the future, we specifically disclaim any obligation to do so.

DESCRIPTION OF THE COMPANY

We provide mission-critical cybersecurity, cyber superiority and geospatial intelligence solutions to defense, intelligence and national security agencies and commercial enterprises. Our core capabilities include solutions, services and products to support the collection, processing, analysis, and use of intelligence data and information in the domains of cyberspace and geospace. Our solutions are designed to respond to meet the critical needs for agile intelligence in the cyber age and to assist the U.S. government in national security priorities.

We provide a full range of engineering services as well as fully integrated platforms that support the entire intelligence process, including collection, processing, analysis and impact. Our platforms include a number of modified commercial turboprop aircraft for imagery and light detection and ranging, or LIDAR, collection, products that we manufacture, as well as hardware and software that we integrate using the engineering services of our highly skilled and security-cleared workforce.

KEYW solutions are focused on Intelligence Community customers including the National Security Agency (NSA), the National Reconnaissance Office (NRO), the National Geospatial Intelligence Agency (NGA), the Army Geospatial Center (AGC) and various other agencies within the Intelligence Community and Department of Defense (DoD). In addition, we provide our products and services to U.S. federal, state and local law enforcement agencies. Our innovative solutions, understanding of intelligence and national security missions, management's long-standing and successful customer relationships and operational capabilities, and best-in-class employee base position us to continue our growth. We are highly focused on assisting our customers in achieving their mission of cyber superiority

both defensively and offensively, within the entire domain of cyberspace, and doing so in time to observe, respond to, and, where possible, prevent threat events, actions and agents from inflicting harm. Additionally, over the past two years, we have expanded our solutions to encompass a broad spectrum of geospatial intelligence, or GEOINT, capabilities. We believe today's complex, geographically distributed cyber threat environment is driving a convergence of cyber intelligence and geospatial intelligence.

KEYW's primary areas of expertise include:

- providing sophisticated engineering services and solutions that help our customers solve discreet and complex cybersecurity, cyber superiority, and geospatial and other intelligence challenges;
- using multiple intelligence collection techniques to collect data and information in cyberspace, encompassing the entire electromagnetic spectrum;
- processing data and information from cyberspace to make it accessible to a wide range of analytical needs and resources;

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

- analyzing data and information that have been collected, processed, correlated, and made easily accessible to transform them into usable information for our customers;
- developing data warehousing and business intelligence solutions to address the most advanced use cases in Security Information and Event Management, log management, and Call Detail Record (CDR) retention and retrieval;
- providing specialized training, field support, and test and evaluation services;
- development, integration, rapid deployment and sustainment of agile airborne intelligence, surveillance, and reconnaissance collection platforms to austere environments; and
- responding quickly and decisively to demanding and emergent customer requirements, with agile processes and methods that enable us to satisfy requirements that are constantly changing to meet an agile, aggressive and ever-changing threat environment.

More recently, we have been developing and are testing a cybersecurity solution platform for use with government, commercial and critical infrastructure customers. In July 2012, we announced the installation of our new cyber awareness and response platform, code named “Project G,” in its first operational network to address the growing threat to governmental agencies and commercial enterprises. We have begun a commercial testing program for Project G with a select group of early adopter customers. Project G is being developed to find, fix and finish malicious cyber threats within customers' networks through the use of automated tools and continuous updates to cyber threat profiles and alert levels. Project G was derived from our work protecting Intelligence Community networks, and is intended to address new markets beyond the Intelligence Community, including government agencies, commercial and critical infrastructure customers. General release of the Project G platform is expected in 2013.

## CRITICAL ACCOUNTING POLICIES

Management’s Discussion and Analysis of Financial Condition and Results of Operations are based upon our consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and determine whether contingent assets and liabilities, if any, are disclosed in the financial statements. On an ongoing basis, we evaluate our estimates and assumptions, including those related to long-term contracts, product returns, bad debts, inventories, fixed asset lives, income taxes, environmental matters, litigation, and other contingencies. These estimates and assumptions are described in more detail in our Annual Report on Form 10-K for the year ended December 31, 2012. We base our estimates and assumptions on historical experience and on various factors that are believed to be reasonable under the circumstances, including current and expected economic conditions, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from our estimates under different assumptions or conditions. There have been no material changes to our critical accounting policies, estimates and assumptions or the judgments affecting the application of those estimates and assumptions since the filing of our Annual Report on Form 10-K for year ended December 31, 2012.

## COMPARISON OF THREE MONTHS ENDED MARCH 31, 2012 AND MARCH 31, 2013

The following discussion and analysis should be read in conjunction with the unaudited financial statements (and notes thereto) and other financial information of the Company appearing elsewhere in this report. In addition, see Note 2 – Acquisitions to our unaudited financial statements included in this Quarterly Report for specific information with respect to the assumptions and adjustments made in calculating the pro forma financial information for the three month periods ended March 31, 2013 and March 31, 2012 set forth below.

CONSOLIDATED OVERVIEW (In thousands)	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012		
		% of Revenue		% of Revenue	
Revenue	\$77,872	100.0	% \$55,776	100.0	%

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Gross Margin	24,062	30.9	% 18,929	33.9	%
Cost of Operations	20,233	26.0	% 13,412	24.0	%
Intangible Amortization	6,921	8.9	% 4,869	8.7	%
Non-operating Expense, net	706	0.9	% 414	0.7	%

Revenue increased by \$22.1 million or 40% for the three month ended March 31, 2013 as compared to the three months ended March 31, 2012. The main drivers for the revenue increase in the first three months of 2013 as compared to the first three months of 2012 were the acquisitions of Poole and Sensage in the fourth quarter of 2012 and organic growth within both operating segments.

## THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

On a pro forma basis, revenue increased by approximately \$8.0 million between the periods with the majority of that growth in the Services segment and driven largely by growth in a new contract awarded to Poole in 2012. We expect similar type revenue comparisons in the second quarter of 2013 as compared to the second quarter of 2012 on both an actual and pro forma basis.

Gross margin decreased as a percentage of revenue for the three months ended March 31, 2013 as compared to the same period from 2012 as a result of the acquisition of Poole. A significant portion of the revenue from the Poole acquisition is generated by subcontract labor that is at a much lower gross margin than our self-performed work. Accordingly, a large part of the revenue growth in our Services segment was generated from subcontract labor at a lower gross margin than we have historically seen in that segment and outpaced our higher margin revenue growth in the Integrated Solutions segment, resulting in a decrease in overall gross margin as a percentage of revenue.

Our cost of operations increased by \$6.8 million for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012. The main drivers for this increase are facility costs as a result of our new office space and training facilities, the acquisitions in late 2012, infrastructure spending for the introduction of our commercial software product and stock option expense. Our facility costs increased by \$1.3 million between the two periods mainly due to lease costs and depreciation associated with the build-out of the new facilities and the increased number of facilities as a result of acquisitions. In preparation for the general release of our commercial software product we have increased our staffing in both sales and operations within our commercial software group. On a pro forma basis, operating expenses increased by \$2.3 million as a result of the move to our new office space, infrastructure spending on our commercial software product and stock option expense. The majority of the increased stock option expense is due to the acquisitions in the fourth quarter of 2012 as we grant all employees an equity stake in the company.

Intangible amortization expense has increased as a result of the new acquisitions, partially offset by the expiring of certain intangibles from prior acquisitions. We expect intangible amortization expense to decline during 2013 as older intangibles become fully amortized. Comparison to prior year will continue to show a higher level of amortization in 2013 for all period comparisons to prior year due to the 2012 acquisitions.

Non-operating expense primarily consists of interest expense of \$914,000 less the non-cash gain of \$146,000 associated with the write-down of the TI earn-out and related intangible assets. The increase from 2012 is due to an increase in interest expense of \$497,000.

SERVICES SEGMENT RESULTS (In thousands)	Three Months		Three Months		
	Ended March 31, 2013	% of Revenue	Ended March 31, 2012	% of Revenue	
Revenue	\$58,843	100.0	% \$39,855	100.0	%
Gross Margin	14,435	24.5	% 10,978	27.5	%
Intangible Amortization	4,009	6.8	% 2,572	6.5	%

Revenue for the three months ended March 31, 2013 increased on a year over year basis by \$19.0 million, or 48% as compared to the three months ended March 31, 2012. The majority of this increase is the acquisition of Poole that contributed approximately \$16.6 million of the growth. On a pro forma basis, revenue grew \$7.0 million, or 14%, with the expansion of several programs predominantly from the Poole acquisition. We expect similar revenue comparisons in the second quarter of 2013 as compared to the second quarter of 2012 on both an actual and pro forma basis.

Gross margin decreased as a percentage of revenue for the quarter ended March 31, 2013 as compared to the quarter ended March 31, 2012 as a result of the inclusion of the Poole contracts and related reliance on subcontractor revenue. A significant portion of Poole's revenue has been generated through subcontractors which have a lower gross profit margin than our self-performed work. There was no significant change in the gross margins in our services business outside of the Poole contracts during the first quarter of 2013 as compared to the first quarter of 2012. We expect the margin trend to continue in the second quarter of 2013 as we will have a similar contractor ratio as we had in the first quarter of 2013.

Amortization expense increased in 2013 primarily as a result of the Poole acquisition in the fourth quarter of 2012 that contributed \$1.2 million of expense in the first quarter of 2013.



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INTEGRATED SOLUTIONS SEGMENT RESULTS (In thousands)	Three Months		Three Months		
	Ended March 31, 2013	% of Revenue	Ended March 31, 2012	% of Revenue	
Revenue	\$19,029	100.0	% \$15,921	100.0	%
Gross Margin	9,627	50.6	% 7,951	49.9	%
Intangible Amortization	2,912	15.3	% 2,297	14.4	%

Revenue for the three months ended March 31, 2013 increased on a year-over-year basis by \$3.1 million, or 20%, as compared to the three months ended March 31, 2012. The main driver for this was the acquisitions in 2012 and 2013 that contributed approximately \$3.0 million of revenue during the first quarter of 2013. The remaining growth is due to expanded flight operations between the two periods. We expect revenue to increase in the second quarter of 2013, from the first quarter, due to increased software and products sales. As we are introducing a new software platform for general availability during the second quarter of 2013, we are unable to provide specific growth numbers.

Gross margin as a percentage of revenue increased slightly in the first quarter of 2013 as compared to the same quarter in the prior year due to the revenue mix. We anticipate that gross margins will increase as a percentage of revenue from the first to second quarter of 2013 as our software sales increase.

Intangible amortization has increased primarily from the acquisition of Sensage in October 2012. We expect to have a similar amount of intangible expense for the remainder of 2013 when the expense associated with the FLD acquisition is complete.

#### Liquidity and Capital Resources

Cash and cash equivalents totaled approximately \$3.1 million at March 31, 2013. Our working capital, defined as current assets minus current liabilities, was \$13.1 million. This represents a decrease of approximately \$3 million, primarily due to increased borrowings on our revolver under our credit facility to fund the acquisition of IDEAL, offset by increased taxes receivable and a reduction in the accrued earn-out payable related to the TI acquisition. During the first three months of 2013 we have borrowed a net \$8 million to fund the IDEAL acquisition and to pay down the term note. We anticipate that we will be in a net repayment position for the second quarter and for the rest of 2013 excluding any acquisitions. At March 31, 2013, we are in compliance with our debt covenants.

We believe that cash from operations will be sufficient to fund our operations as we continue to grow in addition to allowing us to continue to pay down our outstanding debt. Given the timing of payrolls and bonus payments in the first quarter of 2013, we utilized our cash flow to satisfy employee obligations. This timing is isolated to the first quarter. We may use our line of credit to fund acquisitions and to provide liquidity in the event of federal government budgetary issues, including the failure or delay by Congress and the President in approving federal budgets in the future. We may also use the line of credit as we continue to invest in our emerging commercial software product and to expand our flight capabilities.

We will continue to acquire companies when there is a strategic fit. At March 31, 2013, we had approximately \$46 million of available cash, including our accordion feature, with which to complete additional acquisitions under our existing credit facilities. We may need to increase our credit facilities to complete large acquisitions that require a significant cash component. It is management's intention to not expand our credit facilities such that our leverage ratio would exceed 3.5 times trailing earnings of ourselves and any material acquisitions.



THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In addition to the risks inherent in our operations, we are exposed to financial, market, political and economic risks. The following discussion provides additional detail regarding our exposure to interest rates and foreign exchange rate risks.

Interest Rate Risk

At March 31, 2013, we had \$96 million outstanding balance under credit facilities. Historically, we have not mitigated our exposure to fluctuations in interest rates by entering into interest rate hedge agreements, nor do we have any plans to do so in the immediate future. We believe that a 10 percent change in interest rates would be immaterial to the Company over the next six months.

Foreign Exchange Risk

We currently do not have any material foreign currency risk, and accordingly estimate that an immediate 10 percent change in foreign exchange rates would have no impact on our reported net income. We do not currently utilize any derivative financial instruments to hedge foreign currency risks.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based on management's evaluation (with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO)), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of March 31, 2013 and the date of this filing, the company is not party to any material on-going legal proceedings.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On January 31, 2013 the Company issued 157,655 shares of KEYW common stock valued at \$12.69 per share in connection with its acquisition of IDEAL Technology Corporation. Such shares of KEYW common stock were offered and sold pursuant to Section 4(2) of the Securities Act of 1933, as amended, which provides an exemption for transactions by an issuer not involving any public offering.

ITEM 6. EXHIBITS

Exhibits – See Exhibit Index

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE KEYW HOLDING CORPORATION

Date: April 30, 2013

By: /s/ Leonard E. Moodispaw  
Leonard E. Moodispaw  
President and Chief Executive Officer

Date: April 30, 2013

By: /s/ John E. Krobath  
John E. Krobath  
Chief Financial Officer

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

Exhibit No.	Exhibit Description	
3.1	Amended and Restated Articles of Incorporation of the Company, as filed on October 6, 2010	(1)
3.2	Amended and Restated Bylaws of the Company	(2)
4.3	Specimen of Common Stock Certificate	(3)
31.1	Certification of the Chief Executive Officer pursuant to R Rule 13a-14(a)/15d-14(a)	x
31.2	Certification of the Chief Financial Officer pursuant to R Rule 13a-14(a)/15d-14(a)	x
32.1*	Certification of the Chief Executive Officer and the Chief Financial Officer and Principal Accounting Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002	x
101.INS**	XBRL Instance Document	x
101.SCH**	XBRL Taxonomy Extension Schema Document	x
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document	x
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document	x
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document	x
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document	x

x Filed herewith.

- (1) Filed as Exhibit 3.1 to the Registrant's Form 10-K filed March 29, 2011, File No. 001-34891.
- (2) Filed as Exhibit 3.2 to the Registrant's Form 10-K filed March 29, 2011, File No. 001-34891.
- (3) Filed as Exhibit 4.3 to the Registrant's Registration Statement on Form S-1, as amended (File No. 333-167608). This exhibit is being "furnished" with this periodic report and are not deemed "filed" with the Securities and Exchange Commission and are not incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation by reference language in any such filing.

\*\* Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.