

KEYW HOLDING CORP
Form 10-Q
August 01, 2012

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: June 30, 2012

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)

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Maryland 27-1594952
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

7740 Milestone Parkway, Suite 400
Hanover, Maryland 21076
(Address of principal executive offices) (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

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 July 20, 2012 was 25,598,710.

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PART I - Financial INFORMATION

ITEM I. FINANCIAL STATEMENTS

THE KEYW Holding Corporation AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollars shown in 000's except share amounts)

	June 30, 2012	December 31, 2011
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 234	\$ 1,294
Receivables	51,196	40,630
Inventories, net	8,676	7,242
Prepaid expenses	2,973	2,511
Income tax receivable	27	27
Deferred tax asset, current	1,193	1,193
Total current assets	64,299	52,897
Property and equipment, net	14,759	8,707
Goodwill	164,466	164,466
Other intangibles, net	29,264	39,002
Deferred tax asset	2,348	2,348
Other assets	212	211
TOTAL ASSETS	\$ 275,348	\$ 267,631
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,706	\$ 4,136
Accrued expenses	4,611	4,370
Accrued salaries & wages	12,640	9,644
Revolver	52,200	49,500
Deferred income taxes	1,591	1,591
Total current liabilities	75,748	69,241
Long-term liabilities:		
Non-current deferred tax liability	15,977	17,430

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Other non-current liabilities	3,851	301
TOTAL LIABILITIES	95,576	86,972
Commitments and contingencies	0	0
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5 million shares authorized, none issued	0	0
Common stock, \$0.001 par value; 100 million shares authorized, 25,569,243 and 25,770,795 shares issued and outstanding	26	26
Additional paid-in capital	171,991	173,371
Retained earnings	7,755	7,262
Total stockholders' equity	179,772	180,659
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 275,348	\$ 267,631

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 Statements of Operations

(Dollars shown in 000's except share and per share amounts)

	Three months ended June 30, 2012 (Unaudited)	Three months ended June 30, 2011 (Unaudited)	Six months ended June 30, 2012 (Unaudited)	Six months ended June 30, 2011 (Unaudited)
Revenues				
Services	\$ 39,076	\$ 42,558	\$ 78,931	\$ 81,184
Integrated Solutions	17,079	2,340	33,000	5,375
Total	56,155	44,898	111,931	86,559
Costs of Revenues				
Services	28,113	30,277	56,990	57,636
Integrated Solutions	9,109	1,584	17,079	3,646
Total	37,222	31,861	74,069	61,282
Gross Profit				
Services	10,963	12,281	21,941	23,548
Integrated Solutions	7,970	756	15,921	1,729
Total	18,933	13,037	37,862	25,277
Operating Expenses				
Operating expenses	13,089	10,333	26,501	20,330
Intangible amortization expense	4,869	2,465	9,738	4,533
Total	17,958	12,798	36,239	24,863
Operating Income	975	239	1,623	414
Non-Operating Expense net	450	206	864	228
Income before Income Taxes	525	33	759	186
Income Tax (Expense) Benefit, net	(200)	16	(266)	(74)
Net Income	\$ 325	\$ 49	\$ 493	\$ 112
<u>Weighted Average Common Shares Outstanding</u>				
Basic	25,553,097	26,058,260	25,679,720	25,832,176
Diluted	28,353,011	29,301,790	28,085,331	29,243,975
<u>Earnings per Share</u>				
Basic	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.00

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Diluted	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.00
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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 Statement of Stockholders' Equity (unaudited)

(Dollars shown in 000's except share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	(APIC)		
BALANCE, JANUARY 1, 2012	25,770,795	\$ 26	\$ 173,371	\$ 7,262	\$ 180,659
Net income	0	0	0	493	493
Option exercise	31,289	0	172	0	172
Warrant exercise	12,500	0	50	0	50
Restricted stock issuances	171,000	0	484	0	484
Restricted stock forfeitures	(20,150)	0	(31)	0	(31)
Stock repurchase	(396,191)	0	(2,948)	0	(2,948)
Stock based compensation	0	0	893	0	893
BALANCE, JUNE 30, 2012	25,569,243	\$ 26	\$ 171,991	\$ 7,755	\$ 179,772

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 Statements of Cash Flows

(Dollars shown in 000's except share amounts)

	Six months ended June 30, 2012 (Unaudited) \$ 493		Six months ended June 30, 2011 (Unaudited) \$ 112	
Net income				
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Stock compensation	1,346		1,498	
Depreciation/Amortization	11,797		5,060	
Deferred taxes	0		(223)
Changes in operating assets and liabilities:				
Receivables	(10,566	)	(4,044)
Inventory	(1,434	)	(1,669)
Prepaid expenses	(462	)	(2,623)
Accounts payable	570		253	
Accrued expenses	1,363		(4,611)
Other balance sheet changes	0		304	
Net cash provided by (used in) operating activities	3,107		(5,943)
Cash flows from investing activities:				
Acquisitions, net of cash acquired	0		(25,460)
Purchases of property and equipment	(4,141	)	(479)
Net cash used in investing activities	(4,141	)	(25,939)
Cash flows from financing activities:				
Proceeds from revolver, net	2,700		29,000	
Repurchase of Stock	(2,948	)	0	
Proceeds from option and warrant exercises	222		590	
Net cash (used in) provided by financing activities	(26	)	29,590	
Net decrease in cash and cash equivalents	(1,060	)	(2,292)
Cash and cash equivalents at beginning of period	1,294		5,795	
Cash and cash equivalents at end of period	\$ 234		\$ 3,503	
Supplemental disclosure of cash flow information:				
Cash paid for interest	\$ 878		\$ 144	
Cash paid for taxes	\$ 2,791		\$ 93	

Supplemental disclosure of non-cash investing and financing activities:

In conjunction with the JKA acquisition in March 2011, the Company issued 200,643 shares of KEYW common stock with an approximate value of \$2.5 million.

In conjunction with the FASI acquisition in May 2011, the Company issued 171,970 shares of KEYW common stock with an approximate value of \$1.9 million.

In conjunction with the May 2012 move to the new facilities, the Company added approximately \$4.0 million of leasehold improvements that were paid for by the landlord as part of the buildout. This amount was included in other non-current liabilities as deferred rent.

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, 2011, contained in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission on March 15, 2012.

Corporate Organization

The KEYW Holding Corporation (“Holdco”) 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”). References to the “Company”, “KEYW”, “we”, “us”, or “our” refer to Opco and its subsidiaries for any period prior to December 29, 2009, and to Holdco and its subsidiaries as of and after December 29, 2009.

We support the Intelligence Community’s (“IC”) transformation to Cyber Age mission and operations by providing agile solutions that offer both flexibility and scalability to the ICs’ most challenging and highly classified problems. We provide a full range of engineering services as well as fully integrated platforms that support the entire intelligence process, including collection, analysis, processing and impact (synthesis of actionable information). Our platforms include products that we manufacture, as well as hardware and software that we integrate using the engineering services of our highly skilled and cleared workforce.

We have acquired thirteen businesses or operating entities since our inception including S&H Enterprises of Central Maryland, Inc. (“S&H”) on September 2, 2008, Integrated Computer Concepts, Incorporated (“ICCI”) on September 30, 2008, the majority of assets from Embedded Systems Design, Inc. (“ESD”) on July 23, 2009, the government

contracting assets of Leading Edge Design & Systems, Inc. (“LEDS”) on October 29, 2009, the assets of the Systems Engineering and Technical Assistance unit that supports the National Reconnaissance Office from General Dynamics Advanced Information Systems, Inc. (“Recon”) on December 8, 2009, The Analysis Group, LLC (“TAGG”) on February 22, 2010, Insight Information Technology, LLC (“IIT”) on March 15, 2010, Sycamore.US, Inc. (“Sycamore”) on November 29, 2010, Everest Technology Solutions, Inc. (“Everest”) on December 10, 2010, JKA Technologies, Inc. (“JKA”) on March 31, 2011, Forbes Analytic Software, Inc. (“FASI”) on May 2, 2011, Flight Landata, Inc. (“FLD”) on August 5, 2011 and certain government contracting assets from National Semiconductor Corporation (“TI”) on December 16, 2011. See Note 2 – Acquisitions for additional information on these acquisitions.

Principles of Consolidation

The consolidated financial statements include the transactions of KEYW and its wholly owned subsidiaries, ICCI, S&H, TAGG, IIT, Sycamore, Everest, JKA, FASI and FLD 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 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 affect 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.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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 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.

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. Consistent with December 31, 2011, we recorded an inventory reserve 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. Currently there is no valuation allowance as the Company believes all of its accounts receivable are fully collectible.

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.

Provision 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 shorter of the lives of the underlying leases or the estimated useful lives of the assets.

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. An impairment loss is recognized 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. The Company has not recorded any impairment charges since inception.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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. As of the measurement of October 1, 2011, the Company operated as a single reporting unit. The fair value of the reporting unit is estimated using a market capitalization approach. 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 performed the test during the fourth quarter of fiscal years 2011 and 2010 and found no impairment to the carrying value of goodwill. Management has concluded that there have been no events subsequent to the impairment test that would indicate an impairment of goodwill. Beginning in the fourth quarter of 2011, the Company began operating in two segments. In 2012, goodwill will be evaluated at the individual segment level.

Intangibles

Intangible assets consist of customer related and technology 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

Substantially all of the Company's cash and cash equivalents are maintained at financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC") were fully insured by the FDIC at June 30, 2012. 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 percentage of completion revenue, amortization lives, depreciation lives, 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.

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 statements 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 \$1,629,000 and \$660,000 for the three months ended June 30, 2012 and June 30, 2011, respectively. Research and development costs totaled \$2,466,000 and \$844,000 for the six months ended June 30, 2012 and June 30, 2011, respectively.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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 June 30, 2012 or December 31, 2011.

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):

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net income	\$ 325	\$ 49	\$ 493	\$ 112
Weighted average shares – basic	25,553	26,058	25,680	25,832

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Effect of dilutive potential common shares	2,800	3,244	2,405	3,412
Weighted average shares – diluted	28,353	29,302	28,085	29,244
Net income per share – basic	\$0.01	\$0.00	\$0.02	\$0.00
Net income per share – diluted	\$0.01	\$0.00	\$0.02	\$0.00
Anti-dilutive employee share-based awards, excluded	1,116	770	1,098	480
Outstanding options and warrants, total	7,212	6,719	7,212	6,719

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 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

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, 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 entire first year vesting in the first twelve months, the third vesting would be expensed over twenty-four months and the fourth tranche would be expensed 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 KEYW HOLDING CORPORATION AND SUBSIDIARIES

The following assumptions were used for option grants during the quarters ended June 30, 2012 and June 30, 2011.

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.

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 is for 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 May 2011, the FASB issued a new accounting standard on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. We are required to adopt this standard in the first quarter of 2012. The adoption of this standard did not have a material impact on our financial statements.

In June 2011, the FASB issued a new accounting standard on the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. We are required to adopt this standard as of the beginning of 2013. The adoption of this standard will only impact the presentation of our financial statements if we have elements of comprehensive income.

In September 2011, the FASB issued guidance that simplified how entities test for goodwill impairment. This guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. This guidance is not expected to have a material effect on our financial statements.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

2. ACQUISITIONS

The Company has completed thirteen 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 four acquisitions completed since January 1, 2011 are outlined below:

JKA Technologies, Inc.

On March 31, 2011, the Company acquired all of the outstanding stock of JKA Technologies, Inc. ("JKA") for \$11.3 million in cash and 200,643 shares of KEYW common stock valued at \$12.28 per share, for a total purchase price of approximately \$14 million. This was an acquisition of a Qualified Subchapter S Subsidiary (QSub) which allows the transaction to be treated as an asset acquisition for tax purposes, thereby allowing the Company to amortize goodwill over 15 years for tax reporting. The goodwill is not amortizable for GAAP reporting.

JKA was founded in 2002 and was headquartered in Columbia, MD. JKA offers a broad range of mission critical cyber superiority solutions and support including network engineering, information assurance, and systems and software engineering. JKA had approximately 65 employees at the time of acquisition, of whom approximately 60 have security clearances at the highest level.

Forbes Analytic Software, Inc.

On May 2, 2011, the Company acquired all of the outstanding stock of Forbes Analytic Software, Inc. ("FASI") for \$14.8 million in cash and 171,970 shares of KEYW common stock valued at \$11.30 per share, for a total purchase price of approximately \$16.7 million. In conjunction with the transaction, the Company has made a 338(h)10 election that treats the transaction as an asset purchase for tax purposes, thereby permitting the Company to amortize the goodwill over 15 years for tax reporting. The goodwill is not amortizable for GAAP reporting.

FASI was founded in 1989 and was headquartered in Leesburg, VA. FASI offers a broad range of mission critical cyber superiority solutions and support including high-end software development, systems and software engineering and integration, and full lifecycle software support, from research and development to operations and maintenance. FASI had approximately 47 employees at the time of acquisition, of whom approximately 40 have security clearances at the highest level.

Flight Landata, Inc.

On August 5, 2011, the Company acquired Flight Landata, Inc. (“FLD”) and its wholly owned subsidiary FLI-HI, LLC for \$30.0 million in cash. The purchase price was subject to post-closing adjustments, including working capital and other adjustments, as of the closing date. 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.

FLD was founded in 1991 and is headquartered in North Andover, MA. FLD is a highly regarded provider of agile airborne Intelligence Surveillance and Reconnaissance (ISR) solutions and Micro Terrain Intelligence to the U.S. Defense Department and the Warfighter with significant operations in overseas theaters. FLD had approximately 28 employees at the time of acquisition, of whom 2 have security clearances.

National Semiconductor Corporation

On December 16, 2011, the Company acquired certain government contracting assets from National Semiconductor Corporation (“TI”) for \$2.0 million in cash and \$2.0 million in contingent consideration. The Company has recognized \$1.5 million of goodwill and \$2.5 million of intangibles associated with this transaction. Eighteen fully-cleared personnel joined the Company as part of this acquisition.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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

	JKA	FASI	FLD	TI
Cash	\$8	\$452	\$4,614	\$0
Current assets, net of cash acquired	2,934	2,413	5,126	0
Fixed assets	87	14	3,875	0
Intangibles	2,680	2,775	21,741	2,500
Goodwill	9,097	14,155	11,456	1,500
Total Assets Acquired	14,806	19,809	46,812	4,000
Current liabilities	1,079	2,661	944	2,000
Long-term obligations	0	0	10,636	0
Total Liabilities Assumed	1,079	2,661	11,580	2,000
Net Assets Acquired	\$13,727	\$17,148	\$35,232	\$2,000
Net Cash Paid	\$11,255	\$14,753	\$30,618	\$2,000
Equity Issued	2,464	1,943	0	0
Actual Cash Paid	\$11,263	\$15,205	\$35,232	\$2,000

All 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. 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 table below summarizes the unaudited pro forma statement of operations for the first half of 2011, assuming these acquisitions had been completed on the first day of the year. A pro forma income statement is not presented for 2012 as there have been no acquisitions during 2012. 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 2011 activity for JKA, FASI and FLD includes the financial activity in 2011 prior to acquisition. Activity for the TI acquisition is not included for any period presented due to its immateriality.

For Six Months ended June 30, 2011 (In Thousands and Unaudited)

JKA	FASI	FLD	KEYW	Total
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Revenue	\$ 3,381	\$ 3,903	\$ 13,717	\$ 86,559	\$ 107,560
Cost of Revenues	1,659	2,258	6,614	61,282	71,813
Gross Profit	1,722	1,645	7,103	25,277	35,747
Operating Expenses	1,844	3,611	2,139	24,863	32,457
Operating (Loss) Income	(122)	(1,966)	4,964	414	3,290
Non-operating (Income) Expense	(2)	39	43	228	308
(Loss) Income before Taxes	(120)	(2,005)	4,921	186	2,982
Tax Expense	0	0	2,168	74	2,242
Net (Loss) Income	\$ (120)	\$ (2,005)	\$ 2,753	\$ 112	\$ 740

The table below summarizes the unaudited pro forma statement of operations for the second quarter of 2011, assuming these acquisitions had been completed on the first day of the year.

	For Three Months ended June 30, 2011 (In Thousands and Unaudited)			
	FASI	FLD	KEYW	Total
Revenue	\$ 968	\$ 6,027	\$ 44,898	\$ 51,893
Cost of Revenues	654	3,473	31,861	35,988
Gross Profit	314	2,554	13,037	15,905
Operating Expenses	2,575	1,240	12,798	16,613
Operating (Loss) Income	(2,261)	1,314	239	(708)
Non-operating Expense	29	2	206	237
(Loss) Income before Taxes	(2,290)	1,312	33	(945)
Tax Expense (Benefit)	0	732	(16)	716
Net (Loss) Income	\$ (2,290)	\$ 580	\$ 49	\$ (1,661)

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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 (1) observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; (2) quoted prices in active markets that are not active; or (3) 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.

The Company did not have any financial assets or liabilities that were subject to valuation at June 30, 2012.

4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	June 30, 2012	December 31, 2011
Accounts Receivable (In thousands)		
Billed AR	\$39,337	\$ 25,717
Unbilled AR	11,859	14,913

Total AR \$51,196 \$ 40,630

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 June 30, 2012 and December 31, 2011, retained amounts are insignificant and are expected to be collected subsequent to the balance sheet date.

Management does not currently have an allowance for doubtful accounts recorded because management believes that all of the accounts receivable are fully collectible.

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 June 30, 2012 and December 31, 2011 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 June 30, 2012, and December 31, 2011, we have reserved \$721,000 and \$471,000, respectively, for certain inventory items where the market has not developed as expected.

6. PREPAID EXPENSES

Prepays at June 30, 2012 and December 31, 2011 primarily consist of prepaid insurance, bonuses, rent, prepaid taxes and professional fees.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

7. PROPERTY AND EQUIPMENT

Property and equipment are as follows:

	June 30, 2012	December 31, 2011
	(In thousands)	
Property and Equipment		
Aircraft	\$6,974	\$ 5,249
Buildings and Improvements	6,496	1,459
Manufacturing Equipment	2,076	1,839
Office Equipment	4,430	3,317
Total	\$19,976	\$ 11,864
Accumulated Depreciation	(5,217)	(3,157)
Property and Equipment, net	\$14,759	\$ 8,707

Depreciation expense charged to operations was \$2,055,000 and \$527,000 for the six months ended June 30, 2012 and 2011, respectively. Depreciation expense charged to operations was \$1,027,000 and \$272,000 for the three months ended June 30, 2012 and 2011, respectively. Certain of our aircraft and equipments are operated out of overseas locations.

In conjunction with the move into a new building, during the second quarter of 2012, the Company added approximately \$4.0 million of leasehold improvements that were purchased with a tenant allowance and included in deferred rent.

8. AMORTIZATION OF INTANGIBLE ASSETS

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

	June 30, 2012 (In thousands)
Acquisition Intangible	

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		Gross Book Value	Accumulated Amortization	Net Book Value
S&H	Contracts – Fixed Price Level of Effort	\$ 1,606	\$ (1,088) \$ 518
ICCI	Contracts – Fixed Price Level of Effort	1,181	(914	) 267
ICCI	Contracts – T&M and IDIQ	3,018	(2,934	) 84
ESD	Contracts	1,207	(711	) 496
LEDS	Contracts	1,019	(954	) 65
Recon	Contracts	925	(833	) 92
TAGG	Contracts	10,457	(8,206	) 2,251
IIT	Contracts	1,615	(1,234	) 381
IIT	Trade name	182	(139	) 43
Sycamore	Contracts	5,898	(3,113	) 2,785
Everest	Contracts	4,690	(1,485	) 3,205
JKA	Contracts	2,680	(1,117	) 1,563
FASI	Contracts	2,775	(809	) 1,966
FLD	Customer Relationships	17,549	(6,656	) 10,893
FLD	Contracts	2,234	(1,024	) 1,210
FLD	Technology Assets	1,958	(742	) 1,216
TI	Contracts	2,500	(271	) 2,229
		\$61,494	\$ (32,230	) \$ 29,264

The Company recorded amortization expense of \$9.7 million and \$4.5 million for the six month periods ended June 30, 2012 and 2011, respectively. The Company recorded amortization expense of \$4.9 million and \$2.5 million for the three month periods ended June 30, 2012 and 2011, respectively.

Estimated future intangible amortization
expense by year as of June 30, 2012 (In
thousands)

2012	2013	2014	2015	2016
\$9,687	\$14,814	\$2,693	\$1,591	\$479

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

9. DEBT

In February 2011, the Company entered into a new \$50 million credit facility that includes an accordion feature allowing for an additional \$25 million in borrowing. The credit facility is a 3 year agreement and is a multi-bank facility with Bank of America as lead bank. In conjunction with the FLD acquisition, the Company increased the credit facility to \$65 million and reloaded the accordion to \$25 million. The borrowing availability under this facility is based on KEYW's 'Total Leverage Ratio' which is a relationship between 'Funded Indebtedness' to EBITDA as defined in the credit agreement. The agreement contains standard financial covenants. When drawing funds on this facility we have the option of choosing between a 'Euro Rate Loan' which is based on the British Bankers Association LIBOR or a 'Base Rate Loan' which is based on the higher of (a) the Federal Funds Rate plus ½ of 1.0%, (b) the Prime Rate, or (c) The Eurodollar Rate plus 1.0%. If we select the 'Euro Rate Loan' the actual 'applicable rate' would be 200 to 300 basis points above the stated rate depending on our most recent quarterly calculation of our 'Total Leverage Ratio'. If we select the 'Base Rate Loan' the actual 'applicable rate' would be 100 to 200 basis points above the stated rate depending on our most recent quarterly calculation of our 'Total Leverage Ratio'. We are able to lock in our selected interest rates for periods of up to six months. At June 30, 2012, we have an outstanding balance of \$52.2 million under this facility at interest rates ranging from 2.49% - 4.50% depending on length of lock-in with varying original maturity dates of up to six months with a weighted average interest rate of 2.58%. While the current line expires February 28, 2014, we manage the line based on the lock in agreements which are for periods of up to six months and thus categorize the amounts as current on the balance sheet. The Company is in compliance with all loan covenants at June 30, 2012. The entire credit facility is collateralized by substantially all assets of the Company. Interest expense recognized in the first half of 2012 related to this agreement was approximately \$868,000 and was \$221,000 in the first half of 2011. Interest expense recognized for the three month period ended June 30, 2012 related to this agreement was approximately \$456,000 and \$198,000 for the three month period ended June 30, 2011.

10. STOCK-BASED COMPENSATION

On December 29, 2009, the Company, in conjunction with the corporate reorganization, adopted The KEYW Holding Corporation 2009 Stock Incentive Plan. The plan terms are similar to the previous 2008 plan, except that the 2009 plan has a maximum amount of shares available for issuance of 12,000,000 with a soft cap of 12% of the outstanding shares available for issuance. The 2009 plan provides for the issuance of stock options, restricted stock and restricted stock units.

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.

Because our common stock did not trade publicly until October 1, 2010, we do not use historical data to determine volatility of our stock. We determine volatility by using the historical stock volatility of public companies in our industry with similar characteristics. 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 half of 2012 consist of options issued to new hires or discretionary awards. All equity issuances are priced at market value 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 2012, 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 0.62% - 1.03%

-Expected volatility ranging from 28.35% - 36.35%

-Forfeitures ranging from 15% - 39%

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

A summary of stock option activity for the period ended June 30, 2012 is as follows:

	Number of Shares	Option Exercise Price	Weighted Average Exercise Price
Outstanding January 1, 2012	2,238,673		
Granted	574,100	\$7.06 - \$10.00	\$ 7.76
Exercised	(31,289)	\$5.00 - \$9.25	\$ 5.50
Cancelled	(146,673)	\$5.00 - \$14.57	\$ 9.65
Options Outstanding June 30, 2012	2,634,811		

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 June 30, 2012 and 2011, 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 June 30, 2012 is approximately \$4.6 million, which will be recognized over four years.

As of June 30, 2012, outstanding stock options were as follows:

Exercise Price	Options Outstanding	Intrinsic Value	Options Vested	Intrinsic Value	Weighted Average Remaining Life (Years)
\$5.00	123,500	\$622,440	94,100	\$474,264	6.20
\$5.50	787,187	3,573,829	512,712	2,327,713	7.31
\$6.90 - \$7.66	497,512	1,303,299	30,567	79,138	9.58
\$7.96 - \$8.14	95,212	195,179	23,669	48,515	9.41
\$9.17 - \$10.00	367,275	195,367	189,323	119,398	8.38
\$11.18 - \$11.99	193,125	0	88,667	0	8.65
\$12.28 - \$14.57	571,000	0	285,554	0	8.55
	2,634,811	\$5,890,114	1,224,592	\$3,049,028	

2009 Stock Incentive Plan

Total equity available to issue	3,068,309
Total equity outstanding or exercised	2,364,654
Total equity remaining	703,655

Restricted Stock Awards

During 2012, the Company has issued restricted stock for employee incentive plans and strategic hires. The Company issued 147,000 shares of restricted common stock to existing employees under the long-term incentive plan. These shares cliff vest in three years. The Company issued an additional 24,000 restricted shares to new hires. The majority of these shares 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.

As of June 30, 2012, outstanding unvested restricted stock awards were as follows:

	Unvested Shares	
Outstanding January 1, 2012	403,546	
Granted	171,000	
Vested	(34,333)
Cancelled	(20,150)
Outstanding June 30, 2012	520,063	

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

11. STOCK REPURCHASE*Issuer Purchases of Equity Securities*

On December 7, 2011, the Company announced that the board of directors approved the repurchase of up to two million outstanding shares of common stock over the following twelve months in open market or privately negotiated transactions, depending on prevailing market conditions and other factors. Subsequent to that date, the Company has repurchased 822,093 shares at an average price of \$7.34 per share, in open market or block purchases under the Safe Harbor provisions of SEC Rule 10b-18. These shares were retired upon repurchase.

Period	Total number of shares (or units) purchased	Average price paid per share (or unit)	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
December 7 – 31, 2011	425,902	\$ 7.24	425,902	1,574,098
January 1 – June 30, 2012	396,191	\$ 7.44	396,191	1,177,907
Total	822,093	\$ 7.34	822,093	1,177,907

12. WARRANTS

During the first half of 2012, a warrant holder exercised 12,500 warrants. The exercise price for all of these exercises was paid in cash. Our warrants do contain provisions that allow warrant holders to cashlessly exercise their warrants at their option.

As of June 30, 2012, outstanding warrants were as follows:

Exercise Price	Warrants Outstanding	Warrants Vested	Weighted Average Remaining Life (Years)
\$ 4.00	2,079,500	2,079,500	3.15
\$ 5.50	2,287,235	2,287,235	3.90
\$ 9.25	210,000	210,000	4.71
	4,576,735	4,576,735	

13. 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 Six Months ended June 30, 2012

(In thousands and unaudited)

	Services	Integrated Solutions	Corporate
Goodwill	\$ 155,056	\$ 9,410	\$ 0
Intangibles, net	15,946	13,318	0
Property and Equipment, net	1,922	6,985	5,852
Depreciation Expense	387	1,310	362
Intangible Amortization	5,144	4,594	0

For the Six Months ended June 30, 2011

(In thousands and unaudited)

	Services	Integrated Solutions	Corporate
Depreciation Expense	\$ 202	\$ 198	\$ 134
Intangible Amortization	4,533	0	0

As of December 31, 2011 (In thousands)

	Services	Integrated Solutions	Corporate
Goodwill	\$ 155,056	\$ 9,410	\$ 0
Intangibles, net	21,090	17,912	0
Property and Equipment, net	1,462	6,050	1,195

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

14. SUBSEQUENT EVENTS

In connection with the preparation of its financial statements for the six months ended June 30, 2012, the Company has evaluated events that occurred subsequent to June 30, 2012 to determine whether any of these events required recognition or disclosure in the first half of 2012 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, 2011, filed with the Securities and Exchange Commission on March 15, 2012.

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, 2011, filed with the Securities and Exchange Commission on March 15, 2012, 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. Our solutions, services and products 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.

Although our heritage is in the signals intelligence (SIGINT) domain, through a combination of organic growth and acquisitions, we have expanded our footprint within the intelligence agency market to become a true “multi-INT” company (signals intelligence, geospatial intelligence, etc.), and we currently have active contracts with 11 of the 16 intelligence agencies. We believe our innovative solutions, understanding of intelligence and national security missions, management’s long-standing and successful customer relationships and significant management and operational capabilities position us to continue our growth.

KEYW’s primary areas of expertise include:

- providing engineering services and solutions that help our customers solve discreet and complex cybersecurity, cyber superiority, cloud computing, geospatial intelligence, and counter terrorism challenges;
- providing specialized training and test and evaluation services in domains such as cyber network operations; developing, testing, and deploying new sensor technologies and data processing capabilities for a range of sensor types including signals intelligence, high resolution electro-optical, long-wave infrared, multi-band synthetic aperture radar, and others;
- developing and fielding innovative applications for mobile devices to support law enforcement, military, and intelligence customer needs; and
- developing, integrating, rapidly deploying and sustaining of agile airborne intelligence, surveillance, and reconnaissance collection platforms to austere environments.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

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, 2011. 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, 2011.

Comparison of Three Months Ended JUNE 30, 2012 and JUNE 30, 2011

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 June 30, 2012 and June 30, 2011 set forth below.

Consolidated Overview (000's)

(In thousands)	Three Months		Three Months	
	Ended June 30, 2012	% of Revenue	Ended June 30, 2011	% of Revenue
Revenue	\$ 56,155	100.0%	\$ 44,898	100.0%
Gross Margin	18,933	33.7%	13,037	29.0%
Cost of Operations	13,089	23.3%	10,333	23.0%
Intangible Amortization	4,869	8.7%	2,465	5.5%
Non-operating Expense	450	0.8%	206	0.5%

Revenue for the three months ended June 30, 2012, increased on a year-over-year basis by \$11.3 million, or 25%, as compared to the three months ended June 30, 2011. The main driver for this increase was the FLD acquisition that

occurred subsequent to June 30, 2011, offset by a decrease in our Services segment revenue of \$3.5 million. Our Integrated Solutions revenue increased by \$14.7 million between the two periods due primarily to the acquisition of FLD. See additional detail in the segment discussion below.

Gross margin increased as a percentage of revenue for the quarter ended June 30, 2012 as compared to the quarter ended June 30, 2011 as a result of the increase in the higher margin Integrated Solutions revenue as a percentage of total revenue (increase was from 5.2% to 30.4% of revenue). Our Integrated Solutions margins are significantly higher than our Services margins.

Our cost of operations increased \$2.8 million from the second quarter of 2011 to the second quarter of 2012, primarily due to increases from overall corporate growth that includes facilities, overhead personnel to support the larger organization, compensation accruals consistent with the increase in staffing, and increased research and development and bid and proposal costs. Our research and development costs increased by \$1.0 million in the second quarter of 2012 as compared to the same quarter in 2011. This increase is driven by investments in our intelligence community class commercial software product, synthetic aperture radar work and continued evolution of our electro-optical products. Our headcount and facilities have expanded both through acquisition and organic growth. The cost of operations as a percentage of revenue is consistent with the second quarter of 2011 and we expect overhead costs to decrease slightly in the third quarter of 2012, as compared to the second quarter of 2012, due to lower fringe costs and certain other expenses incurred early in the year which are not expected to recur later in the year. This overhead cost pattern is consistent with prior years.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

Intangible amortization expense has increased as a result of the four acquisitions completed in 2011, including JKA, FASI, FLD and TI. The net impact of these acquisitions was \$2.4 million of additional amortization expense in the second quarter of 2012 as compared with the second quarter of 2011. We do not expect amortization expense to start to decline until late 2012 when certain earlier acquisitions become fully amortized. We expect third quarter 2012 amortization expense to remain consistent with second quarter 2012 expense.

Non-operating expense increased by \$244,000 in the second quarter of 2012 as compared with the second quarter of 2011 primarily due to increased interest expense.

SERVICES SEGMENT RESULTS (In thousands)	Three Months Ended June 30, 2012		Three Months Ended June 30, 2011	
		% of Revenue		% of Revenue
Revenue	\$39,076	100.0%	\$42,558	100.0%
Gross Margin	10,963	28.1%	12,281	28.9%
Intangible Amortization	2,572	6.6%	2,465	5.8%

Revenue for the three months ended June 30, 2012, decreased on a year-over-year basis by \$3.5 million, or 8.2%, as compared to the three months ended June 30, 2011. The main drivers for this decrease was a reduction in our Air Force services work, the reassignment of a contract, and an increased use of billable staff on non-billable activities. Those decreases were partially offset by increased staffing. During the second quarter of 2011, our Air Force services work comprised approximately 9% of our services revenue as compared with approximately 5% of our second quarter 2012 revenue. While we have seen a leveling out of our Air Force services revenue, we still have negative comparisons to prior years. We had staffed a significant portion of a prime contract with a subcontractor in 2011. Late in 2011, that subcontractor was moved to a direct prime contract vehicle at the direction of the government reducing 2012 revenue as compared with 2011 by \$2.2 million. We also increased our spending on research and development, bid and proposal, and intelligence community class commercial software product by approximately \$1.2 million in the second quarter of 2012 as compared with the second quarter of 2011. Most of this effort is staffed by otherwise billable services staff that would have been generating revenue during this time.

Gross margins decreased as a percentage of revenue for the quarter ended June 30, 2012 as compared to the quarter ended June 30, 2011 as a result of the acquisitions made in 2011 that had lower gross margins than our existing work and the impact of some billing rate reductions as staff were reassigned to new contracts upon contract completions. We expect full-year Services 2012 margins to remain consistent with second quarter 2012 margins.

INTEGRATED SOLUTIONS SEGMENT RESULTS (In thousands)	Three Months Ended June 30, 2012	% of Revenue	Three Months Ended June 30, 2011	% of Revenue
Revenue	\$ 17,079	100.0%	\$ 2,340	100.0%
Gross Margin	7,970	46.7%	756	32.3%
Intangible Amortization	2,297	13.5%	0	0.0%

Revenue for the three months ended June 30, 2012, increased on a year-over-year basis by \$14.7 million, or 630%, as compared to the three months ended June 30, 2011. The main driver for this increase was the acquisition of FLD in August 2011 that contributed approximately \$13.0 million of revenue in the second quarter of 2012. Our overall revenue, outside of FLD, increased by \$1.7 million due primarily to growth in product related services particularly our radar work and an increase in product sales.

Gross margins increased as a percentage of revenue for the quarter ended June 30, 2012 as compared to the quarter ended June 30, 2011 as result of the FLD acquisition in 2011 and the maturity of the products sold in 2012.

Comparison of SIX Months Ended JUNE 30, 2012 and JUNE 30, 2011

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 six month periods ended June 30, 2012 and June 30, 2011 set forth below.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

Consolidated Overview (000's)

(In thousands)	Six Months Ended June 30, 2012	% of Revenue	Six Months Ended June 30, 2011	% of Revenue
Revenue	\$ 111,931	100.0%	\$ 86,559	100.0%
Gross Margin	37,862	33.8%	25,277	29.2%
Cost of Operations	26,501	23.7%	20,330	23.5%
Intangible Amortization	9,738	8.7%	4,533	5.2%
Non-operating Expense	864	0.8%	228	0.3%

Revenue for the six months ended June 30, 2012, increased on a year-over-year basis by \$25.4 million, or 29%, as compared to the six months ended June 30, 2011. The main drivers for this increase were the acquisitions that occurred in 2011, including JKA, FASI and FLD offset in part by decreases in our Services segment revenue of \$7.0 million. The acquisitions accounted for approximately \$20 million of the 2012 revenue increase. Our Integrated Solutions revenue increased by \$27.6 million between the two periods due to the acquisition of FLD and the growth of our product related services and sales. See additional detail in the segment discussion below.

Gross margin increased as a percentage of revenue for the first half ended June 30, 2012 as compared to the first half ended June 30, 2011 as a result of the higher margin Integrated Solutions revenue as a percentage of total revenue (increase was from 6% to 29% of revenue) and higher gross margins in the Integrated Solutions segment, partially offset by lower Services gross margins. Our Integrated Solutions margins are significantly higher than our Services margins.

Our cost of operations increased by \$6.2 million from the first half of 2011 to the first half of 2012, primarily due to increases from overall corporate growth that includes facilities, overhead personnel to support the larger organization, compensation accruals consistent with the increases in staffing and revenue, and increased research and development and bid and proposal costs. Our headcount and facilities have expanded both through acquisition and organic growth. The combination of research and development and bid and proposal costs increased by \$2.2 million from 2011 to 2012. This increase is driven by investments in our intelligence community class commercial software product, synthetic aperture radar work and continued evolution of our electro-optical products. In 2012 we have had several large proposal efforts where we did not have similar activity in 2011. The acquisitions of FLD and FASI contributed an additional \$2.0 million of the increased cost. The cost of operations as a percentage of revenue is consistent with the first half of 2011 and we expect overhead costs to decrease slightly in the second half of 2012, as compared to the first half of 2012, due to lower fringe costs and certain other expenses incurred during the first half which are not expected to recur later in the year. This overhead cost pattern is consistent with prior years.

Intangible amortization expense has increased as a result of the four acquisitions completed in 2011, including JKA, FASI, FLD and TI. The net impact of these acquisitions was \$5.2 million of additional amortization expense in the first half of 2012 as compared with the first half of 2011. We do not expect amortization expense to start to decline until late 2012 when certain earlier acquisitions become fully amortized. We expect second half 2012 amortization expense to decrease slightly from the first half 2012 expense.

Non-operating expense increased by \$636,000 in the first half of 2012 as compared with the first half of 2011 primarily due to increased interest expense.

SERVICES SEGMENT RESULTS (In thousands)	Six Months Ended June 30, 2012	% of Revenue	Six Months Ended June 30, 2011	% of Revenue
Revenue	\$ 78,931	100.0%	\$ 81,184	100.0%
Gross Margin	21,941	27.8%	23,548	29.0%
Intangible Amortization	5,144	6.5%	4,533	5.6%

Revenue for the six months ended June 30, 2012, decreased on a year-over-year basis by \$2.3 million, or 2.8%, as compared to the six months ended June 30, 2011. The main drivers for this decrease were the reduction in Air Force services revenue, the reassignment of a contract, and the use of billable staff for research and development and bid and proposal activities. Offsetting the decreases were significant headcount additions since mid-2011 and the JKA and FASI acquisitions which increased revenue by \$5.0 million. During the first half of 2011, our Air Force services work comprised approximately 11% of our services revenue as compared with approximately 5% of our first half 2012 revenue. While we have seen a leveling out of our Air Force services revenue, we still have negative comparisons to the prior year. We had staffed a significant portion of a prime contract with a subcontractor in 2011. Late in 2011, that subcontractor was moved to a direct prime contract vehicle at the direction of the government reducing 2012 revenue as compared with 2011 by \$3.5 million.

The KEYW HOLDING CORPORATION AND SUBSIDIARIES

Gross margins decreased as a percentage of revenue for the first half ended June 30, 2012 as compared to the first half ended June 30, 2011 as a result of the acquisitions made in 2011 that had lower gross margins than our existing work and the impact of billing rates as staff were reassigned to new contracts upon contract completions. We expect full-year Services 2012 margins to remain consistent with first half 2012 margins.

INTEGRATED SOLUTIONS SEGMENT RESULTS (In thousands)	Six Months Ended June 30, 2012	% of Revenue	Six Months Ended June 30, 2011	% of Revenue
Revenue	\$ 33,000	100.0%	\$ 5,375	100.0%
Gross Margin	15,921	48.2%	1,729	32.2%
Intangible Amortization	4,594	13.9%	0	0.0%

Revenue for the six months ended June 30, 2012, increased on a year-over-year basis by \$27.6 million, or 514%, as compared to the six months ended June 30, 2011. The main driver for this increase was the acquisition of FLD in August 2011 that contributed approximately \$25.6 million of revenue in the first half of 2012. Our product sales were lower in the first half of 2012 but that decrease was offset by an increase in our radar work. We expect revenue to increase slightly in the second half of 2012 from the first half of 2012.

Gross margins increased as a percentage of revenue for the first half ended June 30, 2012 as compared to the first half ended June 30, 2011 as result of the FLD acquisition in 2011, the maturity of the products sold in 2012 and the release of unused accrued warranty expense during the first half of 2012. We typically take a warranty reserve on products for one year post-sale to address any product related issues. We incurred significantly less warranty expense than we expected and have adjusted our reserves accordingly.

Liquidity and Capital Resources

Cash and cash equivalents totaled approximately \$0.2 million at June 30, 2012. Our working capital, defined as current assets minus current liabilities, was (\$11.5) million at June 30, 2012. This represents an improvement of \$4.8 million from December 31, 2011 primarily from cash generated from operations. During the first half of 2012, we borrowed \$2.7 million for working capital purposes, primarily due to payment term changes within our Integrated Solutions segment that lengthened the payment terms from 25 days to 45 days on certain large contracts, stock repurchases, fixed asset expenditures, and tax payments. At June 30, 2012, the Company was in compliance with all debt covenants.

We believe that our 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. Continual expansion of our FLD flight operations may require the acquisition of additional aircraft assets, as has occurred in 2012, and may limit the amount by which we are able to pay down debt. We may utilize our line of credit to fund acquisitions and to provide liquidity in the event of federal governmental budgetary issues, including failure or delay by Congress and the President in approving federal budgets in the future.

We will continue to acquire companies when there is a strategic fit. At June 30, 2012, we had approximately \$38.0 million of availability under the revolving credit facility, including our accordion feature, with which to complete additional acquisitions under our existing credit facilities. We may need to raise additional capital either through debt or equity issuances to complete large acquisitions that require a significant cash component. To facilitate this, we have filed a shelf registration statement on Form S-3 that has been declared effective by the SEC to register the offer and sale of up to \$100.0 million of our securities. This registration statement enables us to issue shares of our common stock, shares of our preferred stock, warrants, debt securities as well as units that include any of these securities. Under the rules governing shelf registration statements, we will file a prospectus supplement and advise the SEC of the amount and type of securities each time we issue securities under this registration statement.

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 June 30, 2012, we had \$52.2 million outstanding under our revolving credit facility with variable interest rates. 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 have locked in the interest rate for all of our debt for up to six months. 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 foreign currency risk, and accordingly estimate that an immediate 10% 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 June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of June 30, 2012 and the date of this filing, the Company is not party to any on-going legal proceedings.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 6. EXHIBITS

Exhibits – See Exhibit Index

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: August 1, 2012 By: /s/ Leonard E. Moodispaw
Leonard E. Moodispaw
President and Chief Executive
Officer

Date: August 1, 2012 By: /s/ John E. Krobath
John E. Krobath
Chief Financial Officer

Exhibit No.	Exhibit Description	
10.1*	Amended Employment Agreement, dated June 29, 2012, between The KEYW Corporation and Leonard E. Moodispaw	(1)
10.2*	Amended Employment Agreement, dated June 29, 2012, between The KEYW Corporation and John E. Kroboth	(1)
10.3*	Amended Employment Agreement, dated June 29, 2012, between The KEYW Corporation and Mark A. Willard	(1)
10.4*	Amended Employment Agreement, dated June 29, 2012, between The KEYW Corporation and Kimberly J. DeChello	(1)
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.

*

Indicates management contract or compensatory agreement.

**This exhibit is being “furnished” with this periodic report and is not deemed “filed” with the Securities and Exchange Commission and is 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.

⁽¹⁾ Filed as Exhibits 10.1, 10.2, 10.3 and 10.4 to Registrant's Current Report on Form 8-K filed July 3, 2012, (File No. 001-34891).