KEYW HOLDING CORP
Form 10-Q
November 04, 2014

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

FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2014
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. Yesý 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 ý 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 x
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 ý

The number of shares outstanding of the issuer’s common stock ($0.001 par value), as of October 30, 2014 was 37,591,137.

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ITEM 1. FINANCIAL STATEMENTS

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets
(In thousands, except share and par value per share amounts)

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$47,174	$2,480
Receivables	47,941	51,198
Inventories, net	16,232	11,305
Prepaid expenses	2,623	2,009
Income tax receivable	8,952	4,133
Deferred tax asset, current	787	1,133
Total current assets	123,709	72,258
Property and equipment, net	28,068	26,826
Goodwill	297,484	297,484
Other intangibles, net	24,183	29,343
Other assets	5,515	3,038
TOTAL ASSETS	$478,959	$428,949
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Revolver	$—	$22,000
Accounts payable	10,947	8,004
Accrued expenses	7,406	5,628
Accrued salaries and wages	14,252	11,948
Term note – current portion	—	7,000
Deferred revenue	1,752	2,745
Total current liabilities	34,357	57,325
Long-term liabilities:		
Convertible senior notes, net of discount	123,096	—
Term note – non-current portion	—	56,000
Non-current deferred tax liability	7,491	8,095
Other non-current liabilities	6,842	7,292
TOTAL LIABILITIES	171,786	128,712
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, 37,583,787 and 36,925,730 shares issued and outstanding	38	37
Additional paid-in capital	317,320	302,557
Accumulated deficit	(10,185)	(2,357)
Total stockholders' equity	307,173	300,237
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$478,959	$428,949

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
(In thousands, except share and per share amounts)

	Three months ended September 30, 2014 (Unaudited)	Three months ended September 30, 2013 (Unaudited)	Nine months ended September 30, 2014 (Unaudited)	Nine months ended September 30, 2013 (Unaudited)
Revenues				
Government Solutions	$75,932	$71,762	$209,297	$223,427
Commercial Cyber Solutions	3,037	2,011	7,708	6,477
Total	78,969	73,773	217,005	229,904
Costs of Revenues, excluding amortization				
Government Solutions	51,889	48,964	143,519	154,514
Commercial Cyber Solutions	586	382	1,651	1,300
Total	52,475	49,346	145,170	155,814
Gross Profit				
Government Solutions	24,043	22,798	65,778	68,913
Commercial Cyber Solutions	2,451	1,629	6,057	5,177
Total	26,494	24,427	71,835	74,090
Operating Expenses				
Operating expenses	25,167	20,669	69,825	63,404
Intangible amortization expense	3,029	5,984	9,088	18,995
Total	28,196	26,653	78,913	82,399
Operating Loss	(1,702)	(2,226)	(7,078)	(8,309)
Non-Operating Expense, net	4,241	7,321	6,296	8,895
Loss before Income Taxes	(5,943)	(9,547)	(13,374)	(17,204)
Income Tax Benefit, net	(2,921)	(4,045)	(5,546)	(7,080)
Net Loss	$(3,022)	$(5,502)	$(7,828)	$(10,124)
Weighted Average Common Shares Outstanding				
Basic	37,571,677	36,708,835	37,394,789	36,554,964
Diluted	37,571,677	36,708,835	37,394,789	36,554,964
Loss per Share				
Basic	$(0.08)	$(0.15)	$(0.21)	$(0.28)
Diluted	$(0.08)	$(0.15)	$(0.21)	$(0.28)

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	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount			
BALANCE, JANUARY 1, 2014	36,925,730	$37	$302,557	$(2,357)	$300,237
Net loss	—	—	—	(7,828)	(7,828)
Warrant exercise, net	31,097	—	133	—	133
Option exercise, net	286,508	1	634	—	635
Restricted stock issuances	264,573	—	2,483	—	2,483
Restricted stock forfeitures	(19,987)	—	(119)	—	(119)
Equity issued as part of acquisitions, net	95,866	—	1,016	—	1,016
Stock based compensation	—	—	2,688	—	2,688
Conversion feature of convertible debt, net of expenses	—	—	26,331	—	26,331
Purchase of convertible note hedges	—	—	(18,403)	—	(18,403)
BALANCE, SEPTEMBER 30, 2014	37,583,787	$38	$317,320	$(10,185)	$307,173

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
(In thousands except share amounts)

	Nine months ended September 30, 2014 (Unaudited)	Nine months ended September 30, 2013 (Unaudited)
Net loss	$(7,828)	$(10,124)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Stock compensation	5,052	4,314
Depreciation and amortization expense	14,370	23,306
Amortization of discount on convertible debt	967	—
Write-off of deferred financing costs	1,976	—
Non-cash impact of TI earn-out reduction	—	(146)
Windfall tax benefit from option exercise	(382)	—
Deferred taxes	(258)	(5,310)
Changes in operating assets and liabilities:		
Receivables	3,257	8,580
Inventories, net	(4,863)	(1,497)
Prepaid expenses	(67)	(990)
Income taxes, net	(4,251)	96
Accounts payable	2,943	247
Accrued expenses	2,393	702
Other balance sheet changes	406	195
Net cash provided by operating activities	13,715	19,373
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(2,940)	(6,751)
Purchases of property and equipment	(6,499)	(5,443)
Capitalized software development costs	—	(2,716)
Net cash used in investing activities	(9,439)	(14,910)
Cash flows from financing activities:		
Proceeds from issuance of convertible debt	149,500	—
Purchase of convertible note hedges	(18,403)	—
Issuance cost of convertible senior notes and revolving credit facility	(6,446)	—
Repayment of revolver, net	(22,000)	(1,000)
Repayment of term note	(63,000)	(3,938)
Windfall tax benefit from option exercise	382	—
Proceeds from option and warrant exercises, net	385	1,454
Net cash provided by (used in) financing activities	40,418	(3,484)
Net increase in cash and cash equivalents	44,694	979
Cash and cash equivalents at beginning of period	2,480	5,639
Cash and cash equivalents at end of period	$47,174	$6,618
Supplemental disclosure of cash flow information:		
Cash paid for interest	$1,676	$2,711
Cash paid for taxes	$71	$2,625

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 million.
In conjunction with the NetClarity acquisition in May 2014, the Company issued 99,851 shares of KEYW common stock with an approximate value of $1 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, 2013, contained in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission on March 10, 2014. Interim results may not be indicative of our full fiscal year performance.

Corporate Organization
The KEYW Holding Corporation (“Holdco” or "KEYW") was incorporated in Maryland in December 2009. Holdco is a holding company and conducts its operations through The KEYW Corporation (“Opco”), Hexis Cyber Solutions, Inc. ("Hexis"), and their respective wholly owned subsidiaries.

KEYW is a highly specialized provider of mission-critical cybersecurity, cyber superiority and geospatial intelligence solutions to US 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 US government in national security priorities.

Principles of Consolidation
The consolidated financial statements include the transactions of KEYW, Opco, Hexis 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, cost-plus-award-fee contracts and software licensing and maintenance.

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 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.

The Company recognizes software licenses, maintenance or related 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 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.

The Company's software products are licensed on a perpetual basis. In addition, the Company provides maintenance under a separate maintenance agreement, typically for 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.

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. As of September 30, 2014 and December 31, 2013, we had an inventory reserve balance of $353,000 and $0 respectively, 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.

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

Lease Incentives
As part of entering into certain building leases, the lessors have provided the Company with tenant improvement allowances. 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. During the second quarter of 2013 the Company determined that the software being developed was substantially complete and had capitalized in total approximately $4.3 million of software development costs. The capitalized software development costs will be amortized using the greater of straight-line method or as a percentage of revenue recognized from the sale of the capitalized software. During the three and nine months ended September 30, 2014, the Company had capitalized software amortization costs of $0.3 million and $0.5 million, respectively.

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. The Company has not recorded any impairments since inception.

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. 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 and subsequent to the measurement date October 1, 2013, the Company has operated as two reporting units. The fair value of each reporting unit is estimated using either qualitative analysis or 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 year 2013 and concluded there was no impairment to the carrying value of goodwill. No events occurred during the period ended September 30, 2014 that management believes requires a new impairment test.

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 US 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 condensed 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, VSOE, inventory obsolescence reserves, income taxes and stock compensation expense. Actual results could vary from the estimates that were used.

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Cash and Cash Equivalents
We consider all highly liquid investments purchased with 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 balance sheet also includes our convertible senior note, which the fair value of is estimated using a market approach with Level 2 inputs.

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 $5.3 million and $2.3 million for the three months ended September 30, 2014 and 2013, respectively. Research and development costs totaled $13.7 million and $5.3 million for the nine months ended September 30, 2014 and 2013, respectively, and are included in the operating expenses in the condensed consolidated statement of operations.

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 during the three or nine months ended September 30, 2014.

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		Nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013

Net loss	$(3,022)	$(5,502)	$(7,828)	$(10,124)
Weighted average shares – basic	37,572	36,709	37,395	36,555
Effect of dilutive potential common shares	—	—	—	—
Weighted average shares – diluted	37,572	36,709	37,395	36,555
Net loss per share – basic	$(0.08)	$(0.15)	$(0.21)	$(0.28)
Net loss per share – diluted	$(0.08)	$(0.15)	$(0.21)	$(0.28)
Outstanding options and warrants, total	7,391	7,695	7,391	7,695

Employee equity share options, restricted shares 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 and unvested restricted stock. 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. As we incurred a net loss for the three and nine months ended September 30, 2014 and 2013, none of the outstanding options or warrants were included in the diluted share calculation as they would have been anti-dilutive. The Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread of our Convertible Senior Notes due 2019 (the "Notes") on diluted earnings per share, if applicable. The conversion spread will have a dilutive impact on diluted earnings per share of common stock when the average market price of our common stock for a given period exceeds the Notes' conversion price of $14.83. For the three and nine months ended September 30, 2014, the Notes have been excluded from the computation of diluted earnings per share as the effect would be anti-dilutive since the conversion price of the Notes exceeded the average market price of the Company’s common shares for the three and nine months ended September 30, 2014.

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. 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 three and nine months ended September 30, 2014 and 2013.

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 US 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 Company's expected volatility is based on its historical volatility 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. From the fourth quarter of 2011 to the fourth quarter of 2013, the Company operated two segments. These segments were Services and Integrated Solutions (ISP).

Management evaluated the Company’s segment disclosure during the fourth quarter of 2013, as a result of the increasing importance and focus on our commercial software group and the changing mix of our government contracting business. We reviewed the internal reports used by our chief operating decision makers, the methodology under which we are allocating capital and measuring performance, the growing financial impact of our commercial software group and the macro environment under which the Company operates. Based on that evaluation, we changed our segments from the previously identified Services and ISP to Government Solutions and Commercial Cyber Solutions. The Commercial Cyber Solutions group had been part of ISP beginning with the fourth quarter 2012 acquisition of Sensage, as prior to that time we had no commercial software operations.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, an accounting pronouncement related to revenue recognition (FASB ASC Topic 606), which amends the guidance in former ASC Topic 605, Revenue Recognition, and provides a single, comprehensive revenue recognition model for all contracts with customers. This standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The entity will recognize revenue to reflect the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

2. ACQUISITIONS

The Company has completed multiple 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. Most of the acquisitions resulted in the Company recording goodwill and other intangibles. The goodwill was primarily a result of the acquisitions focusing on acquiring cleared personnel to expand our presence with our main customers. The value of having that personnel generated the majority of the goodwill from the transactions and drove much of the purchase price in addition to other identified intangibles including contracts, customer relationships, contract rights and intellectual property. 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 acquisition completed since January 1, 2013 are outlined below:

IDEAL Technology Corporation

During January 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 $9.1 million. IDEAL is not considered material to the financial results of KEYW.

2014 Acquisitions

During the first nine months of 2014, the Company acquired the assets of NetClarity, Inc. ("NetClarity") and certain assets of Architecture Technology Corporation ("ATC") in two separate asset transactions. The total consideration paid for these two purchases was $2.9 million in cash and 99,851 shares of KEYW stock valued at $1.1 million. Neither of these acquisitions are considered material to the financial results of KEYW.

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

	IDEAL	NetClarity/ATC
Cash	$301	$—
Current assets, net of cash acquired	894	63
Fixed assets	70	24
Intangibles	2,056	3,928
Goodwill	6,623	—

Total Assets Acquired	9,944	4,015
Current liabilities	865	59
Total Liabilities Assumed	865	59
Net Assets Acquired	$9,079	$3,956
Net Cash Paid	$6,751	$2,890
Equity Issued	2,027	1,066
Actual Cash Paid	$7,052	$2,890

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All acquisitions were accounted for using the acquisition method of accounting. Results of operations for each acquired entity were included in the consolidated financial statements from the date of each acquisition.

Pro forma income statements are not presented for nine months ended September 30, 2014 and 2013 as there have been no material acquisitions during these periods.

3. FAIR VALUE MEASUREMENTS

We group financial assets and 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 in active markets; quoted prices for similar assets or liabilities in 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 September 30, 2014, the Company did not have any financial assets or liabilities that were carried at fair value.

4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	September 30, 2014	December 31, 2013
	(In thousands)	
Accounts Receivable		
Billed	$39,706	$35,757
Unbilled	8,235	15,441
Total Accounts Receivable	$47,941	$51,198

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 September 30, 2014 and December 31, 2013, retained amounts are insignificant and are expected to be collected subsequent to the balance sheet date.

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

5. INVENTORIES

Inventories at September 30, 2014 and December 31, 2013 consisted of work in process at various stages of production and finished goods. This inventory, which consists primarily of mobile communications devices, aeroptic cameras and radars are 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 September 30, 2014, and December 31, 2013, we had an inventory reserve balance of $353,000 and $0 respectively, for certain products where the market has not developed as expected.

6. PREPAID EXPENSES

Prepaid expenses at September 30, 2014 and December 31, 2013, primarily consist of prepaid insurance, deferred financing costs and software licenses.

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7. PROPERTY AND EQUIPMENT

Property and equipment are as follows:

	September 30, 2014 (In thousands)	December 31, 2013
Property and Equipment		
Aircraft	$10,226	$9,163
Leasehold Improvements	14,694	13,753
Manufacturing Equipment	4,350	4,064
Software Development Costs	4,263	4,263
Office Equipment	12,762	8,528
Total	$46,295	$39,771
Accumulated Depreciation	(18,227)	(12,945)
Property and Equipment, net	$28,068	$26,826

Depreciation expense charged to operations was $1.8 million and $1.5 million for the three months ended September 30, 2014 and 2013, respectively. Depreciation expense charged to operations was $5.3 million and $4.3 million for the nine months ended September 30, 2014 and 2013, respectively.

8. AMORTIZATION OF INTANGIBLE ASSETS

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

		September 30, 2014 (In thousands)		
Acquisition	Intangible	Gross Book Value	Accumulated Amortization	Net Book Value
Everest	Contracts	4,690	(3,596)	1,094
FASI	Contracts	2,775	(2,370)	405
Poole	Contract rights	20,914	(8,365)	12,549
Sensage	Intellectual Property	4,567	(3,045)	1,522
Sensage	Customer Relationships	3,682	(1,473)	2,209
Rsignia	Intellectual Property	5,001	(3,056)	1,945
Dilijent	Intellectual Property	1,000	(611)	389
IDEAL	Intellectual Property	2,056	(1,713)	343
NetClarity	Intellectual Property	692	(77)	615
NetClarity	Customer Relationships	876	(58)	818
ATC	Intellectual Property	$2,360	$(66)	$2,294
		$48,613	$(24,430)	$24,183

The Company recorded amortization expense of $3.0 million and $6.0 million for the three months ended September 30, 2014, and 2013, respectively. The Company recorded amortization expense of $9.1 million and $19.0 million for the nine months ended September 30, 2014, and 2013, respectively.

Estimated future intangible amortization expense by year as of September 30, 2014 (In thousands):

Remainder of 2014	2015	2016	2017	2018	2019
$3,074	$10,264	$6,112	$4,485	$175	$73

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9. DEBT

2.5% Convertible Senior Notes
In July 2014, the Company initially issued $130.0 million aggregate principal amount of Notes in an underwritten public offering. The Company granted an option to the underwriters to purchase up to an additional $19.5 million aggregate principal amount of Notes, which was subsequently exercised in full in August 2014, resulting in a total issuance of $149.5 million aggregate principal amount of Notes. The Notes bear interest at a rate of 2.50% per annum on the principal amount, payable semi-annually in arrears on January 15 and July 15 of each year, beginning on January 15, 2015, to holders of record at the close of business on the preceding January 1 and July 1, respectively. The Notes mature on July 15, 2019, unless earlier repurchased or converted. The Company may not redeem the Notes prior to their stated maturity date.

Holders of the Notes may convert their notes at their option under the following circumstances: (i) during any calendar quarter commencing after the calendar quarter ending September 30, 2014, if the last reported sale price of the Company’s common stock for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price for the Convertible Notes on each applicable trading day; (ii) during the five business day period immediately after any five consecutive trading day period in which the trading price per $1,000 principal amount of Convertible Notes for each trading day of that period was less than 98% of the product of the last reported sale price of Company’s common stock and the conversion rate for the Convertible Notes for each such trading day; (iii) upon the occurrence of specified corporate events; or (iv) following the Company’s delivery of a notice of the spin-off of its subsidiary, Hexis Cyber Solutions, Inc. On and after January 15, 2019, holders may convert their Notes at any time, regardless of the foregoing circumstances.

Upon conversion, the Company will settle the Notes in cash, shares of Company common stock or a combination of cash and shares of Company common stock, at the Company’s election. The Notes have an initial conversion rate of 67.41 shares of common shares per $1,000 principal amount of the Convertible Notes, which is equal to an initial conversion price of approximately $14.83 per common share. The conversion price is subject to adjustments upon the occurrence of certain specified events, including the initial public offering of the Company’s subsidiary, Hexis Cyber Solutions, Inc., as set forth in the Indenture.

In addition, upon the occurrence of a fundamental change (as defined in the Indenture), holders of the Notes may require the Company to repurchase the Notes at a purchase price of 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date.

The Company incurred approximately $5.7 million of debt issuance costs during the third quarter of 2014 as a result of issuing the Notes. Of the approximately $5.7 million incurred, the Company recorded $4.6 million and $1.1 million to deferred financing costs and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the Notes as discussed below. The Company is amortizing the deferred financing costs over the contractual term of the Notes using the effective interest method.

The Company used the net proceeds from the Notes to repay the outstanding balances under the credit facility the Company entered into in 2012, (the "2012 Credit Agreement"). Net proceeds also will be used for working capital, capital expenditures and other general corporate purposes, including potential acquisitions.

The Company allocated the $149.5 million proceeds from the issuance of the Notes between long-term debt, the liability component, and additional paid-in-capital, the equity component, in the amounts of $122.1 million and $27.4 million, respectively. The initial value of liability component was measured using the nonconvertible debt interest rate. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the Notes. Since the Company must still settle the Notes at face value at or prior to maturity, the Company will accrete the liability component to its face value resulting in additional non-cash interest expense being recognized in the Company's consolidated statements of operations while the Convertible Notes remain outstanding. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

As of September 30, 2014, the outstanding principal of the Notes was $149.5 million, the unamortized debt discount was $26.4 million, and the carrying amount of the liability component was $123.1 million, which was recorded as long-term debt within the Company's condensed consolidated balance sheet. As of September 30, 2014, the fair value of the liability component relating to the Notes, based on a market approach, was approximately $123.9 million and represents a Level 2 valuation.

During the three and nine months ended September 30, 2014, the Company recognized $1.9 million of interest expense relating to the Convertible Notes, which included $1.0 million for noncash interest expense relating to the debt discount and $0.2 million relating to amortization of deferred financing costs.

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Capped Call
During the third quarter of 2014 in conjunction with the issuance of the Notes, the Company paid approximately $18.4 million to enter into capped call transactions with respect to its common shares, (the "Capped Call Transactions"), with certain financial institutions. The Capped Call Transactions generally are expected to reduce the potential dilution to the Company's common stock upon conversion of the Notes and/or offset any cash payments the Company is required to make in excess of the principal amount of any converted Notes, as the case may be, in the event that the market price of the common stock is greater than the strike price of the Capped Call Transactions, initially set at $14.83, with such reduction of potential dilution subject to a cap based on the cap price, which is initially set at $19.38. The strike price and cap price are subject to anti-dilution adjustments under the terms of the Capped Call Transactions. As a result of the Capped Call Transactions, the Company reduced additional paid-in capital by $18.4 million during the third quarter of 2014.

2014 Revolving Credit Facility
In July 2014, the Company, as guarantor and certain of the Company's subsidiaries, entered into a senior secured credit agreement, (the "2014 Credit Agreement") with certain financial institutions. The 2014 Credit Agreement provides the Company a $42.5 million revolving credit facility (the "2014 Revolver"). The 2014 Revolver includes a swing line loan commitment of up to $10 million and a letter of credit facility of up to $15 million.

Borrowings under the 2014 Credit Agreement bear interest at a rate equal to an applicable rate plus, at the Company’s option, either (a) adjusted LIBOR or (b) a base rate. The Company is required to pay a facility fee to the Lenders for any unused commitments and customary letter of credit fees.

The 2014 Revolver will mature on the earlier to occur of (i) the fifth anniversary of the closing of the 2014 Credit Agreement, and (ii) the date that is 180 days prior to the maturity date of the Notes unless the Notes are converted into equity, repaid, refinanced or otherwise satisfied on terms permitted under the 2014 Credit Agreement. The Company may voluntarily repay outstanding loans under the 2014 Revolver at any time without premium or penalty, subject to customary fees in the case of prepayment of LIBOR based loans.

2012 Credit Facility
In the fourth quarter of 2012, the Company entered into a the 2012 Credit Agreement, which included a $70 million term loan, a $50 million revolver and an accordion feature allowing for an additional $35 million in borrowing. The 2012 Credit Agreement was a five year, multi-bank agreement with the Royal Bank of Canada, as administrative agent. In connection with the issuance of the 2012 Credit Facility the Company incurred $3.2 million in financing costs. These financing costs were being amortized using the effective interest rate method over a five year period, the expected life of the related debt. In July of 2014 in connection with issuing the Notes the Company terminated, satisfied, and discharged all of its obligations under the 2012 Credit Agreement. Interest expense recorded under the credit facilities was $2.4 million and $0.8 million during the three months ended September 30, 2014 and 2013, respectively. Interest expense recorded under the credit facilities was $4.5 million and $2.7 million during the nine months ended September 30, 2014 and 2013, respectively. The Company recognized $0.2 million and $0.2 million in amortization expense relating to deferred financing costs for the three months ended September 30, 2014 and 2013, which was included as part of interest expense. The Company recognized $0.5 million and $0.5 million in amortization expense relating to deferred financing costs for the nine months ended September 30, 2014 and 2013, which was included as part of interest expense. In July 2014 as a result of the termination of the 2012 Credit Agreement, the Company wrote off $2.0 million of unamortized deferred financing costs, which were included as part of interest expense.

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 additional restricted stock, stock options, and restricted stock units with a maximum of 2,000,000 shares.

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 nine months of 2014 consist of options issued as 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.

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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 2014, our assumptions related to these inputs were as follows:

-Dividend yield was zero as we have not paid and have no current intentions to pay any dividends

-Risk-free interest rate ranging from 1.47% - 1.66%

-Expected volatility ranging from 36.35% - 48.65%

-Forfeitures ranging from 11% - 37%

A summary of stock option activity for the period ended September 30, 2014 is as follows:

	Number of Shares	Option Exercise Price	Weighted Average Exercise Price
Options Outstanding January 1, 2014	3,081,674		
Granted	645,670	$13.16 - $17.71	$ 17.10
Exercised	(494,113)	$5.00 - $14.88	$ 8.20
Cancelled	(144,320)	$5.00 - $17.11	$ 12.27
Options Outstanding September 30, 2014	3,088,911		

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 September 30, 2014 and 2013, share-based compensation expense is based on awards ultimately expected to vest and has been reduced for estimated forfeitures.

As of September 30, 2014, outstanding stock options were as follows:

Exercise Price	Options Outstanding	Intrinsic Value	Options Vested	Intrinsic Value	Weighted Average Remaining Life (Years)
$5.00 – $5.50	481,700	$2,723,894	480,350	$2,716,375	4.89
$6.90 – $7.66	293,155	1,070,401	210,932	770,109	7.33
$7.96 – $8.14	71,587	221,313	53,003	163,903	7.13
$9.17 – $10.98	257,007	320,429	225,257	291,911	6.63
$11.18 - $11.99	373,274	—	231,941	—	7.72
$12.28 - $12.97	453,172	—	247,104	—	7.87
$13.00 - $13.48	184,510	—	82,706	—	8.39
$14.03 - $14.88	338,236	—	325,322	—	6.37
$16.08 - $17.71	636,270	—	26,332	—	9.26
	3,088,911	$4,336,037	1,882,947	$3,942,298	

2013 Stock Incentive Plan	
Total equity available to issue	2,000,000
Total equity outstanding or exercised	1,542,582
Total equity remaining for future grants	457,418

Restricted Stock Awards

During 2014, the Company has issued 264,573 shares of restricted stock for employee incentive plans, new hires and director compensation as follows: 153,580 shares to existing employees under the long-term incentive plan; 25,238 shares to existing employees as discretionary awards; 64,755 shares to new hires and 21,000 shares to board members. 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 September 30, 2014, outstanding unvested restricted stock awards were as follows:

	Unvested Shares
Outstanding January 1, 2014	603,500
Granted	264,573
Vested	(156,981)
Cancelled	(19,987)
Outstanding September 30, 2014	691,105

The total unrecognized stock compensation expense at September 30, 2014, is approximately $9.3 million, which will be recognized over three years.

11. WARRANTS

During the first nine months of 2014, warrant holders exercised 31,830 warrants, with 29,550 exercised for cash and 2,280 exercised cashlessly. The warrants exercised for cash consisted of 20,000 warrants exercised at $4.00 per share and 9,550 warrants exercised at $5.50 per share. The total cash received from these exercises was $133,000. Under our warrant agreements, warrants may also be exercised cashlessly based on the average price of the Company's common stock for the 5 days prior to exercise. Under this methodology the warrants that were exercised cashlessly were exchanged for 1,547 shares of the Company's common stock.

As of September 30, 2014, outstanding warrants were as follows:

Exercise Price	Warrants Outstanding	Warrants Vested	Weighted Average Remaining Life (Years)
$4.00	1,749,250	1,749,250	0.89
$5.50	2,184,495	2,184,495	1.64
$9.25	210,000	210,000	2.46
$12.65	158,116	158,116	5.16
	4,301,861	4,301,861	

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 nine months ended September 30, 2014 (In thousands and unaudited)		
	Government Solutions	Commercial Cyber Solutions	Corporate
Goodwill	$282,017	$15,467	$—
Intangibles, net	14,779	9,404	—
Property and Equipment, net	10,020	7,818	10,230
Depreciation Expense	2,335	1,275	1,672
Intangible Amortization	5,943	3,145	—

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	For the Nine months ended September 30, 2013 (In thousands and unaudited)		
	Government Solutions	Commercial Cyber Solutions	Corporate
Depreciation Expense	$3,070	$167	$1,074
Intangible Amortization	15,902	3,093	—

	As of December 31, 2013 (In thousands)		
	Government Solutions	Commercial Cyber Solutions	Corporate
Goodwill	$282,017	$15,467	$—
Intangibles, net	20,723	8,620	—
Property and Equipment, net	9,959	5,470	11,397

13. SUBSEQUENT EVENTS

In connection with the preparation of its financial statements for the nine months ended September 30, 2014, the Company has evaluated events that occurred subsequent to September 30, 2014, to determine whether any of these events required recognition or disclosure in the first nine months of the 2014 financial statements. The Company is not aware of any subsequent events which would require recognition or disclosure in the financial statements.

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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, 2013, filed with the Securities and Exchange Commission on March 10, 2014.

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, 2013, filed with the Securities and Exchange Commission on March 10, 2014, the risk factors listed under Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q, as well as any other 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

KEYW is a highly specialized provider of mission-critical cybersecurity, cyber superiority and geospatial intelligence solutions to US 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 US Government in national security priorities.

We provide a full range of engineering services, cyber security and analytic products, and 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 (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.

Our engineering services 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 US federal, state and local law enforcement agencies and commercial enterprises. 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 as we expand into the cybersecurity market. 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 three 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.

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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;
- analyzing data and information that have been collected, processed, correlated, and made easily accessible to transform them into usable information for our customers;
- developing next generation cyber defense and security incident response platforms designed to detect, investigate, and remove advanced cyber threats from enterprise information technology networks;
- 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.

In July 2013, we began operations of Hexis Cyber Solutions, Inc., a wholly-owned subsidiary of The KEYW Holding Corporation, and introduced the HawkEye family of products and services. Hexis Cyber Solutions comprises KEYW's "Project G" organization and Sensage, Inc., which was acquired by KEYW in October 2012. On October 8, 2013, KEYW and Hexis announced commercial availability of HawkEye G, our flagship product designed to quickly detect advanced cyber threats and take automatic action to apply countermeasures and remove the threats from the network. Hexis also markets HawkEye AP, a high performance event data warehouse and analytics platform for applications including log management, call detail record/internet protocol data record management, and risk and compliance applications.

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, 2013. 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, 2013.

COMPARISON OF THREE MONTHS ENDED SEPTEMBER 30, 2014 AND SEPTEMBER 30, 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.

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CONSOLIDATED OVERVIEW (In thousands)	Three months ended September 30, 2014	% of Revenue		Three months ended September 30, 2013	% of Revenue	
Revenue	$78,969	100.0	%	$73,773	100.0	%
Gross Margin	26,494	33.5	%	24,427	33.1	%
Operating Expenses	25,167	31.9	%	20,669	28.0	%
Intangible Amortization	3,029	3.8	%	5,984	8.1	%
Non-operating Expense, net	4,241	5.4	%	7,321	9.9	%

Revenue increased by $5.2 million, or 7%, for the three months ended September 30, 2014, as compared to the three months ended September 30, 2013. The largest drivers of the increase were the expansion of our government cyber training initiatives, certain government services contract enhancement add-ons, increased government product sales, growth of the Radio programs acquired in connection with the Poole acquisition and increased license and professional services sales related to Hawkeye AP, partially offset by a reduction in pricing associated with the new contract for our airborne collection services and certain services contract rate reductions.

Gross margin increased in dollars and was basically flat as a percentage of revenue for the quarter ended September 30, 2014, as compared to the quarter ended September 30, 2013. The increase in gross margin dollars was predominately due to the increase in revenue discussed above.

Our cost of operations for the three months ended September 30, 2014 increased by $4.5 million compared to the same period ended September 30, 2013. This was due to increased infrastructure within the Commercial Cyber segment. We more than doubled our sales team, built a more robust customer delivery infrastructure and continued to build out our technical team.

Intangible amortization expense has decreased as a result of certain intangibles from prior acquisitions becoming fully amortized. We expect intangible amortization expense, as compared to the same period in the prior year, to decline during the remainder of 2014, as certain of our intangibles continue to become fully amortized.

Non-operating expense consists primarily of interest expense and the 2013 legal settlement costs. The decrease from 2013 is primarily due to the legal settlement costs in the third quarter of 2013 which were partially offset by $3.5 million of additional interest expense during the third quarter of 2014 due to the write off of deferred financing costs related to the termination of 2012 Credit Agreement and increased borrowing levels.

GOVERNMENT SOLUTIONS SEGMENT RESULTS (In thousands)	Three months ended September 30, 2014	% of Revenue		Three months ended September 30, 2013	% of Revenue	
Revenue	$75,932	100.0	%	$71,762	100.0	%
Gross Margin	24,043	31.7	%	22,798	31.8	%
Operating Expense	14,879	19.6	%	15,193	21.2	%
Intangible Amortization	1,881	2.5	%	4,952	6.9	%

Revenue for the three months ended September 30, 2014, increased on a year-over-year basis by $4.2 million, or 6%, as compared to the three months ended September 30, 2013. The largest drivers of the increase were the expansion of our government cyber training initiatives, certain services contract enhancement add-ons, growth of the Radio programs and increased product sales, partially offset by a reduction in pricing associated with the new contract for our airborne collection services and certain services contract rate reductions.

Gross margin increased in dollars and was basically flat as a percentage of revenue for the quarter ended September 30, 2014, as compared to the quarter ended September 30, 2013. The increase in dollars was predominately due to the increase in revenue discussed above.

Operating expenses were basically flat for the three months ended September 30, 2014, as compared to the three months ended September 30, 2013.

Amortization expense decreased primarily as a result of certain intangibles from prior acquisitions becoming fully amortized.

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COMMERCIAL CYBER SOLUTIONS SEGMENT RESULTS (In thousands)	Three months ended September 30, 2014	% of Revenue		Three months ended September 30, 2013	% of Revenue	
Revenue	$3,037	100.0	%	$2,011	100.0	%
Gross Margin	2,451	80.7	%	1,629	81.0	%
Operating Expense	10,288	338.8	%	5,476	272.3	%
Intangible Amortization	1,148	37.8	%	1,032	51.3	%

Revenue for the three months ended September 30, 2014, increased on a year-over-year basis by $1.0 million, or 51%, as compared to the three months ended September 30, 2013. The main drivers for the increase were higher license and professional services sales related to Hawkeye AP.
Gross margin increased in dollars and was basically flat as a percentage of revenue for the quarter ended three months ended September 30, 2014, as compared to the same period for 2013. The increase in dollars was predominately due to the increase in revenue discussed above.
Operating expense increased $4.8 million during the three months ended September 30, 2014, as compared to the three months ended September 30, 2013. The main driver for the increase was additional investment in infrastructure related to our new software platform. We more than doubled our sales team, built a more robust customer delivery infrastructure and continued to build out our technical team.
Intangible amortization increased slightly as a result of the 2014 acquisitions, partially offset by certain intangibles from prior acquisitions becoming fully amortized.

COMPARISON OF NINE MONTHS ENDED SEPTEMBER 30, 2014 AND SEPTEMBER 30, 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.

CONSOLIDATED OVERVIEW (In thousands)	Nine months ended September 30, 2014	% of Revenue		Nine months ended September 30, 2013	% of Revenue	
Revenue	$217,005	100.0	%	$229,904	100.0	%
Gross Margin	71,835	33.1	%	74,090	32.2	%
Operating Expenses	69,825	32.2	%	63,404	27.6	%
Intangible Amortization	9,088	4.2	%	18,995	8.3	%
Non-operating Expense, net	6,296	2.9	%	8,895	3.9	%

Revenue decreased by $12.9 million, or 6%, for the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013. The largest drivers for the decrease were residual sequestration-related reductions to the Radio programs, lower run rates on government professional services contracts and a reduction in pricing associated with the new contract for our airborne collection services.
Gross margin decreased in dollars and increased slightly as a percentage of revenue for the nine months ended September 30, 2014, as compared to the same period ended September 30, 2013. The decrease in gross margin dollars was predominately due to the decrease in revenue discussed above.
Our cost of operations for the nine months ended September 30, 2014, increased by $6.4 million and increased as a percentage of revenue as compared to the nine months ended September 30, 2013. This was due to increased infrastructure within the Commercial Cyber segment, partially offset by cost reductions in our Government Solutions segment.
Intangible amortization expense has decreased as a result of certain intangibles from prior acquisitions becoming fully amortized. We expect intangible amortization expense, as compared to the same period in the prior year, to decline during the remainder of 2014, as certain of our intangibles become fully amortized.

Non-operating expense consists primarily of interest expense and the 2013 legal settlement costs. The decrease from 2013 is primarily due to the legal settlement costs in the third quarter of 2013, which were partially offset by $3.7 million of additional interest expense during nine months ended September 30, 2014, due to the write off of deferred financing costs related to the termination of 2012 Credit Agreement and increased borrowing levels.

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GOVERNMENT SOLUTIONS SEGMENT RESULTS (In thousands)	Nine months ended September 30, 2014	% of Revenue		Nine months ended September 30, 2013	% of Revenue	
Revenue	$209,297	100.0	%	$223,427	100.0	%
Gross Margin	65,778	31.4	%	68,913	30.8	%
Operating Expense	41,694	19.9	%	50,947	22.8	%
Intangible Amortization	5,943	2.8	%	15,902	7.1	%

Revenue for the nine months ended September 30, 2014, decreased on a year-over-year basis by $14.1 million, or 6%, as compared to the nine months ended September 30, 2013. The largest drivers for the decrease were residual sequestration-related rate reductions to the Radio program, lower run rates on professional services contracts and a reduction in pricing associated with the new contract for our airborne collection services.

Gross margin decreased in dollars and increased slightly as a percentage of revenue for the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013. The decrease in dollars was predominately due to the decrease in revenue discussed above.

Operating expense decreased $9.3 million for the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013. The main drivers for this decrease were cost reduction measures that were implemented mid-2013 and the beginning of 2014, staffing reductions in overhead management and synergies derived from prior acquisitions.

Amortization expense decreased primarily as a result of certain intangibles from prior acquisitions becoming fully amortized.

COMMERCIAL CYBER SOLUTIONS SEGMENT RESULTS (In thousands)	Nine months ended September 30, 2014	% of Revenue		Nine months ended September 30, 2013	% of Revenue	
Revenue	$7,708	100.0	%	$6,477	100.0	%
Gross Margin	6,057	78.6	%	5,177	79.9	%
Operating Expense	28,131	365.0	%	12,457	192.3	%
Intangible Amortization	3,145	40.8	%	3,093	47.8	%

Revenue for the nine months ended September 30, 2014, increased by $1.2 million, or 19%, as compared to the nine months ended September 30, 2013. The main drivers for the increase were additional license sales of Hawkeye AP and sales of HawkEye G in 2014, which were partially offset by lower professional services sales related to Hawkeye AP in 2014.

Gross margin as a percentage of revenue decreased slightly for the nine months ended September 30, 2014, as compared to the same period for 2013. The decrease in gross margin relates to professional services sales, which generally have a higher gross margin, being lower in 2014.

Operating expense increased $15.7 million during the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013. The main driver for the increase was additional investment in infrastructure related to our software platform. We more than doubled our sales team, built a more robust customer delivery infrastructure and continued to build out our technical team.

Intangible amortization increased slightly as a result of the 2014 acquisitions which were partially offset by certain intangibles from prior acquisitions becoming fully amortized.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled approximately $47.2 million at September 30, 2014. Our working capital, defined as current assets minus current liabilities, was $89.4 million, which represents an increase of approximately $74.4 million from December 31, 2013. The increase in working capital is primarily due to the issuance of the Company's 2.50% Convertible Senior Notes discussed below and cash generated from operations. At September 30, 2014, we

were in compliance with all of our debt covenants under our senior credit agreement.
Convertible Notes
On July 21, 2014, we initially issued $130.0 million aggregate principal amount of the Company's 2.50% Convertible Senior Notes due July 15, 2019 (the "Notes") pursuant to an underwriting agreement, dated July 16, 2014 (the “Underwriting Agreement”) with

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RBC Capital Markets, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as representatives of several underwriters (collectively, the "Underwriters"). Under the terms of the Underwriting Agreement, the Company granted the Underwriters an option, exercisable for up to 30 days after the closing of the offering, to purchase up to an additional $19.5 million principal amount of the Notes solely to cover over-allotments, if any, which was subsequently exercised in full in August 2014, resulting in a total issuance of $149.5 million aggregate principal amount of Notes.
In connection with the issuance of the Notes, the Company entered into an indenture (the "Base Indenture") with Wilmington Trust, National Association, as trustee (the "Trustee"), as supplemented by a first supplemental indenture thereto, between the same parties (the "First Supplemental Indenture," and together with the "Base Indenture," the "Indenture").

The terms of the Notes are governed by the Indenture. The Notes bear interest at a rate of 2.50% per annum on the principal amount thereof, payable semi-annually in arrears on January 15 and July 15 of each year, beginning on January 15, 2015, to holders of record at the close of business on the preceding January 1 and July 1, respectively. The Notes will mature on July 15, 2019, unless earlier repurchased or converted. The Company may not redeem the Notes prior to their stated maturity date.

The Notes are senior unsecured obligations of the Company and will rank equal in right of payment to all of the Company's existing and future senior unsecured indebtedness. The Notes will be senior in right of payment to any existing or future indebtedness which is subordinated by its terms. The Notes are structurally subordinated to all liabilities of the Company's subsidiaries and are effectively junior to the secured indebtedness of the Company to the extent of the value of the assets securing such indebtedness.

Holders may convert their Notes under the following conditions at any time prior to the close of business on the business day immediately preceding January 15, 2019, in multiples of $1,000 principal amount, under the following circumstances:

- during any calendar quarter (and only during such calendar quarter) commencing after the calendar quarter ending September 30, 2014, if the last reported sale price of the Company's common stock, $0.001 par value (the "Company common stock"), for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price for the Notes on each applicable trading day;
- during the five business day period immediately after any five consecutive trading day period in which the trading price per $1,000 principal amount of Notes for each trading day of that period was less than 98% of the product of the last reported sale price of Company common stock and the conversion rate for the Notes for each such trading day;
- upon the occurrence of specified corporate events as described in the Indenture; or
- following the Company's delivery of a notice of the spin-off of its subsidiary, Hexis Cyber Solutions, Inc. (the "Hexis spin-off").

In addition, holders may convert their Notes at their option at any time on or after January 15, 2019 until the close of business on the second scheduled trading day immediately preceding the stated maturity date of the Notes, without regard to the foregoing circumstances.

The conversion rate for the Notes is initially 67.4093 shares of Company common stock per $1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately $14.83 per share of Company common stock, and is subject to adjustments upon the occurrence of certain specified events, including the initial public offering of the Company's subsidiary, Hexis Cyber Solutions, Inc., as set forth in the Indenture. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of Company common stock or a combination of cash and shares of Company common stock, at its election, as described in the Indenture.

In addition, upon the occurrence of a fundamental change (as defined in the Indenture), holders of the Notes may require the Company to repurchase the Notes at a purchase price of 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date.

The events of default, which may result in the acceleration of the maturity of the Notes, include default by the Company in the payment of principal of the Notes, default by the Company in the payment of interest on the Notes when due and the continuance of such default for a period of 30 days, failure by the Company to comply with its conversion obligations upon exercise of a holder’s conversion right under the Indenture and such failure continuing for 3 business days, failure by the Company to provide timely notice of a fundamental change or specified corporate transaction, if required, failure by the Company to comply with its obligations in respect of certain merger transactions, failure by the Company to perform certain of its agreements required under the Indenture if such failure continues for 90 days after notice is given in accordance with the Indenture, failure by the Company to timely discharge certain other indebtedness, entry of certain judgments against the Company which are not paid, discharged or stayed within 60 days, certain events of bankruptcy or insolvency involving the Company or any significant subsidiary (as defined in the Indenture) of the Company, and failure by the Company to comply with its obligation to postpone the record date of the Hexis spin-off, if necessary.

If an event of default, other than an event of default involving bankruptcy or insolvency of the Company or a significant subsidiary of the Company, occurs and is continuing, either the Trustee or the holders of at least 25% in aggregate principal amount of the Notes then outstanding, by notice to the Company and the Trustee, may declare 100% of the principal amount of, and accrued and unpaid interest (including additional interest, if any) on all the Notes then outstanding, to be due and payable immediately. If an event of default involving bankruptcy or insolvency events with respect to the Company or a significant subsidiary of the Company occurs, then 100% of the principal amount of, and all accrued and unpaid interest on, all the Notes, will automatically become immediately due and payable without any notice or other action by the Trustee or any holder. Notwithstanding the foregoing, the Company may elect, at its option, that the sole remedy for an event of default relating to certain failures by the Company to comply with certain reporting covenants in the Indenture will consist exclusively of the right of the holders of the Notes to receive additional interest on the Notes.

Capped Call Transactions

On July 16, 2014, the Company entered into capped call transactions with each of Royal Bank of Canada and Bank of America, N.A. (collectively, the “Counterparties” and such transactions, the “Capped Call Transactions”). The Capped Call Transactions have an initial strike price of approximately $14.83 per share, which corresponds to the initial conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the Notes, and have a cap price of approximately $19.3760. The Capped Call Transactions cover, subject to anti-dilution adjustments, 8,763,209 shares of the Company’s common stock, which is the same number of shares of the Company’s common stock initially underlying the Notes.

The Capped Call Transactions are expected generally to reduce the potential dilution to the Company’s common stock upon conversion of the Notes and/or offset any cash payments the Company is required to make in excess of the principal amount of any converted Notes, as the case may be, in the event that the market price per share of the Company’s common stock, as measured under the terms of the Capped Call Transactions, is greater than the strike price of the Capped Call Transactions as adjusted pursuant to the anti-dilution adjustments. If, however, the market price per share of the Company’s common stock, as measured under the terms of the Capped Call Transactions, exceeds the cap price of the Capped Call Transactions, there would nevertheless be dilution and/or there would not be an offset of such potential cash payments, in each case, upon conversion of the Notes to the extent that such market price exceeds the cap price of the Capped Call Transactions.

The Company has been advised that the Counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivative transactions with respect to the Company’s common stock and/or purchasing or selling the Company’s common stock or other securities of the Company in secondary market transactions prior to the maturity of the Notes. This activity could also cause or avoid an increase or a decrease in the market price of the Company’s common stock or the Notes, which could affect the ability of holders of the Notes to convert the Notes.

The Company intends to exercise options it holds under the Capped Call Transactions whenever Notes are converted on or after January 15, 2019, and expects that upon any conversions of Notes prior to January 15, 2019 or any repurchase of Notes by the Company, a corresponding portion of the Capped Call Transactions will be terminated. Upon such termination, the Company expects to receive from the Counterparties either a number of shares of the Company’s common stock with an aggregate market value equal to, or an amount of cash equal to, the value of the Capped Call Transactions or a portion thereof, as the case may be, being early terminated, subject to the terms of the Capped Call Transactions. The Company has been advised that the Counterparties or their respective affiliates, in order to unwind their hedge positions with respect to those exercised or terminated options, are likely to buy or sell shares of the Company’s common stock or other securities or instruments of the Company, including the Notes, in secondary market transactions or unwind various derivative transactions with respect to such common stock during the relevant valuation period under the Capped Call Transactions, which generally corresponds to the observation period for the converted Notes. These unwind activities could have the effect of increasing or decreasing the trading price of the Company’s common stock and, to the extent the activity occurs during any observation period related to a

conversion of Notes, could have the effect of increasing or reducing the value of the consideration that holders of the Notes will receive upon conversion of the Notes.
The Capped Call Transactions are separate transactions entered into by and between the Company and the Counterparties and are not part of the terms of the Notes. Holders of the Notes will not have any rights with respect to Capped Call Transactions.

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New Revolving Credit Facility

On July 21, 2014, the Company, as a guarantor, 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 $42.5 million revolving credit facility, (the “Revolver”). The Revolver includes a $10 million swing line and a $15 million letter of credit facility.

Borrowings under the Credit Agreement bear interest at a rate equal to an applicable rate plus, at the Company’s option, either (a) adjusted LIBOR or (b) a base rate. The Company will also be required to pay a facility fee to the Lenders for any unused commitments and customary letter of credit fees.

The outstanding amount of revolving loans shall be prepaid with (a) 100% of the net cash proceeds of all asset sales or other dispositions of property by Borrower and its subsidiaries, (b) 100% of the net cash proceeds of issuances of debt obligations of Borrower and its subsidiaries after the closing date (other than permitted debt), and (c) 100% of the net cash proceeds of any public offering or disposition, after the closing date, of the equity of Borrower or its subsidiaries (other than up to 33% of the equity of Hexis Cyber Solutions, Inc. or sales to Borrower or its subsidiaries).

The Company may voluntarily repay outstanding loans under the Revolver at any time without premium or penalty, subject to customary fees in the case of prepayment of LIBOR based loans.

The Revolver will mature on the earlier to occur of (i) the fifth anniversary of the closing of the Credit Agreement, and (ii) the date that is 180 days prior to the maturity date of the Notes unless the Notes are converted into equity, repaid, refinanced or otherwise satisfied on terms permitted under the Credit Agreement.

The Credit Agreement contains a number of negative covenants that will, among other things, restrict, subject to certain exceptions, the Company and its subsidiaries’ ability to: incur additional indebtedness; incur additional liens; sell all or substantially all of the Company’s assets; consummate certain fundamental changes; change the Company’s lines of business or make certain restricted payments (including cash payments upon conversion of the Notes if a default or event of default exists under the facility or if, after giving effect to such payments and any debt incurred to make such payments, the Company is not in pro forma compliance with the financial covenants and other financial tests under the facility, or cash payments to pay the purchase price of the Notes). The Credit Agreement also contains certain customary affirmative covenants and events of default.

The Credit Agreement will require the Company to maintain a maximum consolidated senior secured leverage ratio and a minimum cash interest coverage ratio. The consolidated senior secured leverage ratio test measures the ratio of the Company’s consolidated funded indebtedness (other than consolidated funded indebtedness that is unsecured) to trailing four quarter Consolidated EBITDA (as defined in the Credit Agreement). This ratio is permitted to be no greater than 2.25 to 1.00 as of the end of any fiscal quarter during the applicable period. The cash interest coverage ratio test measures the ratio of trailing four quarter Consolidated EBITDA minus taxes paid in such period to consolidated interest expense paid in such period in cash. This ratio is permitted to be no less than 3.50 to 1.00.

The Revolver is secured by a security interest and lien on substantially all of the Company’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 Credit Agreement replaced the amended and restated credit agreement dated November 20, 2012, by and among the Company, the Borrower, the Administrative Agent and the lenders and subsidiary guarantors identified therein.

Outlook

We believe that cash from operations, the net proceeds from the Notes, and the additional funds available under the Revolver will be sufficient to fund our operations as we continue to grow. We may also use our Revolver 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 Revolver as we continue to invest in our emerging commercial software product and to expand our flight capabilities. We may also raise additional capital through future debt or equity financing.

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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 September 30, 2014, we had $149.5 million aggregate principal amount of 2.5% convertible senior notes due 2019 (the "Notes"). As the Notes are fixed rate instruments, as of September 30, 2014, our results of operations are not subject to fluctuations in interest rates.

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 September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of September 30, 2014, and the date of this filing, the Company is not party to any material 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, 2013, except as set forth below.

The following risk factors relating to our 2.50% Convertible Senior Notes due July 15, 2019 (the "Notes") are hereby added:

Risks Related to the Notes

The Notes are effectively subordinated to our secured debt and any liabilities of our subsidiaries.

The Notes will rank:

- senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Notes;
- equal in right of payment to any of our liabilities that are not so subordinated;
- effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and
- structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries.

In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the Notes will be available to pay obligations on the Notes only after the secured debt has been repaid in full from these assets. There may not be sufficient assets remaining to pay amounts due on any or all of the Notes then outstanding. The indenture governing the Notes does not prohibit us from incurring additional senior debt or secured debt, nor does it prohibit any of our subsidiaries from incurring additional liabilities.

The Notes are our obligations only and our operations are conducted through, and substantially all of our consolidated assets are held by, our subsidiaries.

The Notes are our obligations exclusively and are not guaranteed by any of our operating subsidiaries. A substantial portion of our consolidated assets is held by our subsidiaries. Accordingly, our ability to service our debt, including the Notes, depends on the results of operations of our subsidiaries and upon the ability of such subsidiaries to provide us with cash, whether in the form of dividends, loans or otherwise, to pay amounts due on our obligations, including the Notes. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to make payments on the Notes or to make any funds available for that purpose. In addition, dividends, loans or other distributions to us from such subsidiaries may be subject to contractual and other restrictions and are subject to other business considerations.

Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

Recent and future regulatory actions and other events may adversely affect the trading price and liquidity of the Notes. We expect that many investors in, and potential purchasers of, the Notes will employ, or seek to employ, a convertible arbitrage strategy with respect to the Notes. Investors would typically implement such a strategy by selling short the common stock underlying the Notes and dynamically adjusting their short position while continuing to hold the Notes. Investors may also implement this type of strategy by entering into swaps on our common stock in lieu of or in addition to short selling the common stock.

The SEC and other regulatory and self-regulatory authorities have implemented various rules and taken certain actions, and may in the future adopt additional rules and take other actions, that may impact those engaging in short selling activity involving equity securities (including our common stock). Such rules and actions include Rule 201 of SEC Regulation SHO, the adoption by the

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Financial Industry Regulatory Authority, Inc. and the national securities exchanges of a "Limit Up-Limit Down" program, the imposition of market-wide circuit breakers that halt trading of securities for certain periods following specific market declines, and the implementation of certain regulatory reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Any governmental or regulatory action that restricts the ability of investors in, or potential purchasers of, the Notes to effect short sales of our common stock, borrow our common stock or enter into swaps on our common stock could adversely affect the trading price and the liquidity of the Notes.

Volatility in the market price and trading volume of our common stock could adversely impact the trading price of the Notes.
The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated to the operating performance of companies. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this section, elsewhere in this prospectus supplement or the documents we have incorporated by reference in this prospectus supplement or for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. A decrease in the market price of our common stock would likely adversely impact the trading price of the Notes. The market price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to develop involving our common stock. This trading activity could, in turn, affect the trading price of the Notes.

Despite our current debt levels, we may still incur substantially more debt or take other actions which would intensify the risks discussed above.
Despite our current consolidated debt levels, we and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We will not be restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the Notes that could have the effect of diminishing our ability to make payments on the Notes when due. Our new revolving credit facility restricts our ability to incur additional indebtedness, including secured indebtedness, but if the facility matures or is repaid, we may not be subject to such restrictions under the terms of any subsequent indebtedness.

We may not have the ability to raise the funds necessary to settle conversions of the Notes or to repurchase the Notes upon a fundamental change, and our new revolving credit facility contains limitations on our ability to pay cash upon conversion or repurchase of the Notes.
Holders of the Notes will have the right to require us to repurchase their Notes upon the occurrence of a fundamental change at a fundamental change repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, In addition, upon conversion of the Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or Notes being converted. In addition, our ability to repurchase the Notes or to pay cash upon conversions of the Notes may be limited by law, by regulatory authority or by agreements governing our future indebtedness, including our new revolving credit facility. Our failure to repurchase Notes at a time when the repurchase is required by the indenture or to pay any cash payable on future conversions of the Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness, including our new revolving credit facility. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or make cash payments

upon conversions thereof.

Our new senior secured credit facility limits our ability to pay any cash amount upon the conversion of the Notes.
Our new senior secured credit facility prohibits us from making any cash payments on the conversion of the Notes if a default or an event of default exists under that facility or if, after giving effect to such cash payment (and any additional indebtedness incurred to make such payments), we would not be in pro forma compliance with our financial covenants and other financial tests under that facility. Any new credit facility that we may enter into may have similar restrictions.

The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.
In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under

applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, is the subject of recent changes that could have a material effect on our reported financial results.
Under Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes.

In addition, under certain circumstances, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share would be adversely affected.

Future sales of our common stock in the public market could lower the market price for our common stock and adversely impact the trading price of the Notes.
In the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock are reserved for issuance upon the exercise of stock options and upon conversion of the Notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the Notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

Holders of Notes will not be entitled to any rights with respect to our common stock, but they will be subject to all changes made with respect to them to the extent our conversion obligation includes shares of our common stock.
Holders of Notes will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock) prior to the conversion date relating to such Notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), but holders of Notes will be subject to all changes affecting our common stock. For example, if an amendment is proposed to our certificate of incorporation or bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to the conversion date related to a holder's conversion of its Notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any

fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), such holder will not be entitled to vote on the amendment, although such holder will nevertheless be subject to any changes affecting our common stock.

The conditional conversion feature of the Notes could result in Note holders receiving less than the value of our common stock into which the Notes would otherwise be convertible.
Prior to the close of business on the business day immediately preceding January 15, 2019, holders of the Notes may convert their Notes only if specified conditions are met. If the specific conditions for conversion are not met, holders of the Notes will not be able to convert their Notes, and may not be able to receive the value of the cash, common stock or a combination of cash and common stock, as applicable, into which the Notes would otherwise be convertible.

Upon conversion of the Notes, holders of the Notes may receive less valuable consideration than expected because the value of our common stock may decline after exercise of the conversion right but before we settle our conversion obligation.

Under the Notes, a converting holder will be exposed to fluctuations in the value of our common stock during the period from the date such holder surrenders Notes for conversion until the date we settle our conversion obligation.

Upon conversion of the Notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to satisfy our conversion obligation in cash or a combination of cash and shares of our common stock, the amount of consideration that Note holders will receive upon conversion of their Notes will be determined by reference to the volume-weighted average price of our common stock for each trading day in a 60 trading day observation period. This period would be (i) subject to clause (ii), if the relevant conversion date occurs prior to January 15, 2019, the 60 consecutive trading day period beginning on, and including, the second trading day immediately succeeding such conversion date; (ii) if the relevant conversion date occurs during the 10 scheduled trading day period beginning on, and including, the scheduled trading day immediately succeeding the date we deliver notice of the record date of the Hexis spin-off, the 60 consecutive trading day period beginning on, and including, the trading day immediately succeeding the final day of such 10 scheduled trading day period; and (iii) subject to clause (ii), if the relevant conversion date occurs on or after January 15, 2019, the 60 consecutive trading days beginning on, and including, the 62nd scheduled trading day immediately preceding the maturity date. Accordingly, if the price of our common stock decreases during this period, the amount and/or value of consideration Note holders receive will be adversely affected. In addition, if the market price of our common stock at the end of such period is below the average volume-weighted average price of our common stock during such period, the value of any shares of our common stock that Note holders will receive in satisfaction of our conversion obligation will be less than the value used to determine the number of shares that Note holders will receive.

If we elect to satisfy our conversion obligation solely in shares of our common stock upon conversion of the Notes, we will be required to deliver the shares of our common stock, together with cash for any fractional share, on the third business day following the relevant conversion date. Accordingly, if the price of our common stock decreases during this period, the value of the shares that Note holders receive will be adversely affected and would be less than the conversion value of the Notes on the conversion date.

The Notes are not protected by restrictive covenants.
The indenture governing the Notes does not contain any financial or operating covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. The indenture contains no covenants or other provisions to afford protection to holders of the Notes in the event of a fundamental change or other corporate transaction involving us except in certain circumstances.

The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change or the Hexis spin-off may not adequately compensate Note holders for any lost value of their Notes as a result of such transaction.
If a make-whole fundamental change occurs prior to the maturity date or we deliver a notice of the record date of the Hexis spin-off, under certain circumstances, we will increase the conversion rate by a number of additional shares of our common stock for Notes converted in connection with such make-whole fundamental change or the Hexis spin-off, as the case may be. The increase in the conversion rate will be determined based on (i) the date on which the specified corporate transaction becomes effective or, in the case of the Hexis spin-off, the date we deliver notice of the record date of the Hexis spin-off and (ii) the price paid (or deemed to be paid) per share of our common stock in such transaction or, in the case of the Hexis spin-off, the average of the last reported sale prices of our common stock over the five trading days prior to the date we deliver notice of the record date of the Hexis spin-off, The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change or the Hexis spin-off, as the case may be, may not adequately compensate Note holders for any lost value of their Notes as a result of such transaction. In addition, if the price of our common stock in such transaction or when we deliver notice of the record date of the Hexis spin-off is greater than $45.00 per share or less than $12.11 per share (in each case, subject to adjustment), no additional shares will be added to the conversion rate. Moreover, in no event will the conversion rate

per $1,000 principal amount of Notes as a result of this adjustment exceed 82.5763 shares of common stock, subject to certain adjustments set forth in the indenture. Our obligation to increase the conversion rate for Notes converted in connection with a make-whole fundamental change or the Hexis spin-off could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

The conversion rate of the Notes may not be adjusted for all dilutive events.
The conversion rate of the Notes is subject to adjustment for certain events, including, but not limited to, the issuance of certain stock dividends on our common stock, the issuance of certain rights or warrants, subdivisions, combinations, distributions of capital stock, indebtedness, or assets, cash dividends and certain issuer tender or exchange offers However, the conversion rate will not be adjusted for other events, such as a third-party tender or exchange offer or an issuance of common stock for cash, that may adversely affect the trading price of the Notes or our common stock. An event that adversely affects the value of the Notes may occur, and that event may not result in an adjustment to the conversion rate.

Holders of Notes will not be entitled to any rights with respect to the common stock of Hexis.
The conversion rate of the Notes is subject to adjustment upon the Hexis IPO. However, holders of Notes will not be entitled to receive any shares of common stock of Hexis solely as a result of holding or converting the Notes. Further, after the Hexis IPO, holders of the Notes will not be entitled to any rights with respect to the common stock of Hexis (including, without limitation, voting rights and rights to receive any dividends or other distributions on Hexis's common stock) solely as a result of holding or converting the Notes.

Whether we effect the Hexis IPO will depend on a number of factors, many of which are beyond our control. We cannot provide assurance that the Hexis IPO will occur prior to the maturity date of the Notes or at all.

Holders of Notes that convert their Notes in connection with the Hexis spin-off may not receive any shares of our common stock upon conversion.
If we notify holders of Notes of the record date of the Hexis spin-off, holders will be entitled to convert their Notes during the period of 10 scheduled trading days beginning on, and including, the scheduled trading day immediately succeeding the date we deliver such notice. We may settle any such conversions in cash, shares of our common stock or any combination thereof. Unless we elect to settle such conversions entirely in shares of our common stock, holders of Notes that wish to participate in the Hexis spin-off will have to purchase our common stock in the public market for settlement prior to the record date for such spin-off.

Whether we effect the Hexis spin-off will depend on a number of factors, many of which are beyond our control. We cannot provide assurance that the Hexis spin-off will occur prior to the maturity date of the Notes or at all.

Some significant restructuring transactions and significant changes in the composition of our board may not constitute a fundamental change, in which case we would not be obligated to offer to repurchase the Notes.
Upon the occurrence of a fundamental change, holders of the Notes have the right to require us to repurchase their Notes. However, the fundamental change provisions will not afford protection to holders of Notes in the event of other transactions that could adversely affect the Notes. For example, transactions such as leveraged recapitalizations, refinancings, restructurings, or acquisitions initiated by us may not constitute a fundamental change requiring us to repurchase the Notes. In the event of any such transaction, the holders would not have the right to require us to repurchase the Notes, even though each of these transactions could increase the amount of our indebtedness, or otherwise adversely affect our capital structure or any credit ratings, thereby adversely affecting the holders of Notes.

In addition, certain circumstances involving a significant change in the composition of our board, including in connection with a proxy contest where our board does not endorse a dissident slate of directors but approves them as "continuing directors" as defined under the indenture may not constitute a fundamental change. In the event of any such significant change in the composition of our board, the holders would not have the right to require us to repurchase the Notes and would not be entitled to an increase in the conversion rate upon conversion.

We cannot provide assurance that an active trading market will develop for the Notes.
Prior to this offering, there has been no trading market for the Notes, and we do not intend to apply to list the Notes on any securities exchange or to arrange for quotation on any automated dealer quotation system. We have been informed by the underwriters that they currently intend to make a market in the Notes after the offering is completed. However, the underwriters may discontinue their market-making at any time without notice. In addition, the liquidity of the trading market in the Notes, and the market price quoted for the Notes, may be adversely affected by changes in the overall market for this type of security and by changes in our financial performance or prospects or in the prospects for companies in our industry generally. As a result, we cannot provide assurance that an active trading market will develop for the Notes. If an active trading market does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected. In that case Note holders may not be able to sell their Notes at a particular time or may not be able to sell their Notes at a favorable price.

Any adverse rating of the Notes may cause their trading price to fall.
We do not intend to seek a rating on the Notes. However, if a rating service were to rate the Notes and if such rating service were to lower its rating on the Notes below the rating initially assigned to the Notes or otherwise announces its intention to put the Notes on credit watch, the trading price of the Notes could decline.

Note holders may be subject to tax if we make or fail to make certain adjustments to the conversion rate of the Notes even though Note holders do not receive a corresponding cash distribution.
The conversion rate of the Notes is subject to adjustment in certain circumstances, including the payment of cash dividends. If the conversion rate is adjusted as a result of a distribution that is taxable to our common stockholders, such as a cash dividend, Note holders may be deemed to have received a dividend subject to US federal income tax without the receipt of any cash. In addition, a failure to adjust (or to adjust adequately) the conversion rate after an event that increases Note holders proportionate

interest in us could be treated as a deemed taxable dividend to Note holders. If a make-whole fundamental change or the Hexis spin-off occurs prior to the maturity date, under some circumstances, we will increase the conversion rate for Notes converted in connection with the make-whole fundamental change or the Hexis spin-off. Such increase may also be treated as a distribution subject to US federal income tax as a dividend. If a Note holder is a non-US holder, any deemed dividend would be subject to US federal withholding tax at a 30% rate, or such lower rate as may be specified by an applicable treaty, which may be withheld from subsequent payments on the Notes.

The capped call transactions may affect the value of the Notes and our common stock.
In connection with the pricing of the Notes, we entered into capped call transactions with the option counterparties. The capped call transactions are expected to reduce the potential dilution and/or offset any cash payments due in excess of the principal amount of converted Notes, as the case may be, upon any conversion of the Notes, with such reduction and/or offset subject to a cap. If the underwriters exercise their over-allotment option, we may enter into additional capped call transactions.
In connection with establishing their initial hedge of the capped call transactions, the option counterparties and/or their respective affiliates expect to enter into various derivative transactions with respect to our common stock and/or purchase shares of our common stock concurrently with or shortly after the pricing of the Notes. This activity could increase (or reduce the size of any decrease in) the market price of our common stock or the Notes at that time.

In addition, the option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions following the pricing of the Notes and prior to the maturity of the Notes (and are likely to do so during any observation period related to a conversion of Notes). This activity could also cause or avoid an increase or a decrease in the market price of our common stock or the Notes, which could affect Note holders' ability to convert the Notes and, to the extent the activity occurs during any observation period related to a conversion of Notes, it could affect the number of shares and value of the consideration that Note holders will receive upon conversion of the Notes.

In addition, if any such capped call transactions fail to become effective, whether or not this offering of Notes is completed, the option counterparties and/or their respective affiliates may unwind their hedge positions with respect to our common stock, which could adversely affect the value of our common stock and, if the Notes have been issued, the value of the Notes.

The price of our common stock historically has been volatile. This volatility may affect the price at which Note holders could sell the common stock you receive upon conversion of their Notes, if any, and the sale of substantial amounts of our common stock could adversely affect the price of our common stock and the value of the Notes.
The market price for our common stock has varied significantly in past periods. This volatility may affect the price at which Note holders could sell the common stock, if any, they receive upon conversion of their Notes, and the sale of substantial amounts of our common stock could adversely affect the price of our common stock and the value of the Notes. Our stock price is likely to continue to be volatile and subject to significant price and volume fluctuations in response to market and other factors, including the other factors discussed in "Risks Related to Our Business" in our Annual Report on Form 10-K for the year ended December 31, 2013; variations in our quarterly operating results from our expectations or those of securities analysts or investors; downward revisions in securities analysts' estimates; and announcement by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments.

In addition, the sale of substantial amounts of our common stock could adversely impact its price. The sale or the availability for sale of a large number of shares of our common stock in the public market could cause the price of our common stock, and the value of the Notes, to decline.

Provisions in our organizational documents and in Maryland law may inhibit potential acquisition bids that our stockholders may consider favorable, which could decrease the value of shares of our common stock and the Notes.
Our charter and bylaws contain provisions that may have an anti-takeover effect and inhibit a change in our board of directors and management. These provisions include the following:

- Our charter permits our board of directors to issue preferred stock with terms that may discourage a third party from acquiring us. Our charter permits our board of directors to issue up to 5 million shares of preferred stock, having preferences, conversion or other rights, voting powers, restrictions,
- limitations as to distributions, qualifications or terms or conditions of redemption as determined by our board of directors. Our board of directors could authorize the issuance of preferred stock with terms and conditions that could have the effect of discouraging a takeover or other transaction in which holders of some or a majority of our shares might receive a premium for their shares over the then-prevailing market price; and
- Our charter and bylaws contain other possible anti-takeover provisions. Our charter and bylaws contain other provisions that may have the effect of delaying, deferring or preventing a change-of-control or the removal of existing directors and,

as a result, could prevent our stockholders from being paid a premium for their common stock over the then-prevailing market price. These provisions include the advance notice requirements for stockholder proposals and director nominations.

In addition, Maryland law provides protection for Maryland corporations against unsolicited takeovers by limiting, among other things, the duties of the directors in unsolicited takeover situations. The duties of directors of Maryland corporations do not require them to:

- accept, recommend or respond to any proposal by a person seeking to acquire control of the corporation;
- authorize the corporation to redeem any rights under, or modify or render inapplicable, any stockholder rights plan;
- make a determination under the Maryland Business Combination Act or the Maryland Control Share Acquisition Act; or
- act or fail to act solely because of the effect that the act or failure to act might have on an acquisition or potential acquisition of control of the corporation or the amount or type of consideration that may be offered or paid to the stockholders in an acquisition.

Maryland law also contains a statutory presumption that an act of a director of a Maryland corporation satisfies the applicable standards of conduct for directors under Maryland law.

Any one or more of these provisions, singularly or together, may have an anti-takeover effect that discourages potential acquisition bids that our stockholders may consider favorable, which, under certain circumstances, could reduce the market price of our common stock and the value of the Notes.

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: November 4, 2014	By: /s/ Leonard E. Moodispaw Leonard E. Moodispaw President and Chief Executive Officer
Date: November 4, 2014	By: /s/ Philip L. Calamia Philip L. Calamia Executive Vice President and 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	Certificate of Correction of Articles of Amendment and Restatement	(2)
3.3	Amended and Restated Bylaws of the Company, effective as of August 13, 2014	(3)
4.1	Indenture, dated July 21, 2014, between the Company and Wilmington Trust, National Association, as trustee.	(4)
4.2	First Supplemental Indenture, dated July 21, 2014, between the Company and Wilmington Trust, National Association, as trustee.	(5)
4.3	Form of 2.50% Convertible Senior Note due 2019	(6)
4.4	Specimen of Common Stock Certificate	(7)
10.1	Base Call Option Transaction Confirmation, dated as of July 16, 2014, between the Company and Royal Bank of Canada	(8)
10.2	Base Call Option Transaction Confirmation, dated as of July 16, 2014, between the Company and Bank of America, NA	(9)
10.3	Credit Agreement, dated as of July 21, 2014, among The KEYW Corporation, as the Borrower, certain subsidiaries of the Borrower and the Company, as Guarantors, the lenders identified in the Credit Agreement and Royal Bank of Canada, as Administrative Agent	(10)
10.4	Employment Agreement, dated August 11, 2014, between Hexis Cyber Solutions, Inc. and Philip L. Calamia	(11)
10.5	Additional Call Option Transaction Confirmation, dated as of August 12, 2014, between the Company and Royal Bank of Canada	(12)
10.6	Additional Call Option Transaction Confirmation, dated as of August 12, 2014, between the Company and Bank of America, NA	(13)
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)	x
31.2	Certification of the Chief Financial Officer pursuant to 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

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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 3.1 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(3) Filed as Exhibit 3.1 to the Registrant's Form 8-K reporting under Items 5.02, 5.03, 5.07, filed August 15, 2014, File No. 001-34891.
(4) Filed as Exhibit 4.1 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(5) Filed as Exhibit 4.2 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(6) Filed as part of Exhibit 4.2 the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(7) Filed as Exhibit 4.3 to the Registrant's Registration Statement on Form S-1, as amended, File No. 333-167608.
(8) Filed as Exhibit 10.1 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(9) Filed as Exhibit 10.2 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(10) Filed as Exhibit 10.3 to the Registrant's Form 8-K filed July 15, 2014, File No. 001-34891.
(11) Filed as Exhibit 10.1 to the Registrant's Form 8-K reporting under Items 5.02, 5.03, 5.07, and 9.01, filed August 15, 2014, File No. 001-34891.
(12) Filed as Exhibit 10.1 to the Registrant's Form 8-K reporting under Items 2.03, 8.01, and 9.0, filed August 15, 2014, File No. 001-3489.
(13) Filed as Exhibit 10.2 to the Registrant's Form 8-K reporting under Items 2.03, 8.01, and 9.0, filed August 15, 2014, File No. 001-34891.

* 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.