KEYW HOLDING CORP
Form 10-Q
May 08, 2018
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: March 31, 2018
or

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

For the transition period from ________________ to ________________

Commission File Number: 001-34891

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

Maryland (State or other jurisdiction of incorporation or organization)	27-1594952 (I.R.S. Employer Identification No.)
7740 Milestone Parkway, Suite 400 Hanover, Maryland (Address of principal executive offices)	21076 (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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 ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Yes ¨ No ý

There were 49.9 million shares of our common stock ($0.001 par value), outstanding as of April 26, 2018.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

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

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$3,100	$17,832
Accounts receivable	37,063	49,880
Unbilled receivables	72,809	37,785
Inventories, net	20,186	20,496
Prepaid expenses	1,424	2,266
Income tax receivable	278	210
Total current assets	134,860	128,469
Property and equipment, net	41,662	43,283
Goodwill	455,197	455,197
Other intangibles, net	53,104	57,045
Other assets	2,817	2,913
TOTAL ASSETS	$687,640	$686,907
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$27,523	$25,609
Accrued expenses	20,007	17,862
Accrued salaries and wages	24,709	29,341
Term loan – current portion	6,750	6,750
Deferred revenue	7,474	6,090
Total current liabilities	86,463	85,652
Convertible senior notes, net of discount	140,663	138,998
Revolver	4,000	—
Term loan – non-current portion, net of discount	119,186	120,627
Deferred tax liability, net	18,222	19,174
Other non-current liabilities	11,005	11,444
TOTAL LIABILITIES	379,539	375,895
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, 49,867 and 49,876 shares issued and outstanding	50	50
Additional paid-in capital	424,113	422,901
Accumulated deficit	(116,062)	(111,939)
Total stockholders' equity	308,101	311,012
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$687,640	$686,907

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

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (unaudited)
(In thousands, except per share amounts)

	Three months ended March 31,	
	2018	2017
Revenue	$125,742	$68,256
Cost of revenue, excluding amortization	93,774	47,889
Operating expenses	27,024	19,984
Intangible amortization expense	3,941	1,650
Operating income (loss)	1,003	(1,267)
Interest expense, net	4,828	2,609
Other non-operating (income) loss, net	(5)	8
Loss before income taxes	(3,820)	(3,884)
Income tax benefit, net	(693)	—
Net loss	$(3,127)	$(3,884)
Weighted average common shares outstanding		
Basic	49,866	46,562
Diluted	49,866	46,562
Loss per share		
Basic	$(0.06)	$(0.08)
Diluted	$(0.06)	$(0.08)

The accompanying notes to the 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)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount			
Balance, December 31, 2017	49,876	$ 50	$ 422,901	$ (111,939)	$ 311,012
Cumulative effect of adopting ASC 606	—	—	—	(996)	(996)
Net loss	—	—	—	(3,127)	(3,127)
Option exercise, net	5	—	32	—	32
Share-based compensation	(14)	—	1,180	—	1,180
Balance, March 31, 2018	49,867	$ 50	$ 424,113	$ (116,062)	$ 308,101

The accompanying notes to the 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 (unaudited)
(In thousands)

	Three months ended March 31,	
	2018	2017
Net loss	$ (3,127)	$ (3,884)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	1,180	958
Depreciation and amortization expense	6,531	3,082
Non-cash interest expense	1,911	1,608
Loss on disposal of assets	151	—
Deferred taxes	(626)	—
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	12,817	(703)
Unbilled receivables	(33,858)	(1,249)
Inventories, net	17	(1,581)
Prepaid expenses	371	(345)
Accounts payable	1,914	(738)
Accrued expenses	(2,894)	(923)
Other non-current assets/liabilities	(344)	(60)
Net cash used in operating activities	(15,957)	(3,835)
Cash flows from investing activities:		
Purchases of property and equipment	(1,119)	(2,959)
Net cash used in investing activities	(1,119)	(2,959)
Cash flows from financing activities:		
Proceeds from stock issuance, net	—	84,586
Principal payments of term note	(1,688)	—
Proceeds from revolver	9,000	—
Repayment of revolver	(5,000)	—
Proceeds from option exercises, net	32	28
	2,344	84,614

Net cash provided by financing activities			
Net (decrease) increase in cash and cash equivalents	(14,732	)	77,820
Cash and cash equivalents at beginning of period	17,832		41,871
Cash and cash equivalents at end of period	$ 3,100		$ 119,691
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 3,786		$ 1,897
Cash paid for taxes	$ 1		$ 6

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

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THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
We prepared our interim condensed consolidated financial statements that accompany these notes in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) 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 omitted pursuant to those instructions. This interim information should be read in conjunction with the consolidated financial statements for the year ended December 31, 2017, contained in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission on March 16, 2018. 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), and its wholly owned subsidiaries. As used herein, the terms “KeyW”, the “Company,” and “we,” “us,” and “our” refer to Holdco and, unless the context requires otherwise, its subsidiaries, including Opco.

KeyW is a provider of advanced engineering and technology solutions to support the collection, processing, analysis and dissemination of information across the full spectrum of the Intelligence, Cyber and Counterterrorism Communities’ missions. Our solutions protect our nation and its allies, and are designed to meet the critical needs of agile intelligence and U.S. Government national security priorities. Our core capabilities include advanced cyber operations and training; geospatial intelligence; cloud and data analytics; engineering; and intelligence analysis and operations. Other KeyW offerings include a suite of Intelligence Surveillance and Reconnaissance (ISR) solutions deployed from an advanced sensor delivery platform, proprietary products-including electro-optical, hyperspectral and synthetic aperture radar sensors-and other products that we manufacture and integrate with hardware and software to meet unique and evolving intelligence mission requirements.

KeyW's solutions focus on Intelligence Community (IC) customers, including the Federal Bureau of Investigation (FBI), Department of Homeland Security (DHS), National Security Agency (NSA), the National Geospatial Intelligence Agency (NGA), the Army Geospatial Center (AGC) and other agencies within the IC and Department of Defense (DoD). In addition, we provide products and services to U.S. federal, state and local law enforcement agencies, foreign governments and other entities in the Cyber and Counterterrorism markets. We believe the combination of our advanced solutions, understanding of our customers’ mission; longstanding and successful customer relationships; operational capabilities; and highly skilled, cleared workforce will help expand our footprint in our core markets.

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

Revenue Recognition
Effective January 1, 2018, we adopted the requirements of Accounting Standards Update (ASU) 2014-09 and related amendments, Revenue from Contracts with Customers (ASC 606), which superseded all prior revenue recognition methods and industry-specific guidance. For additional information on our adoption of the new standard refer to

Recently Adopted Accounting Pronouncements below.

The majority of our revenues are from long-term contracts with the U.S. federal government that can span several years. The Company performs under various types of contracts including cost reimbursement (cost-plus-fixed-fee, cost-plus-award-fee), time-and-materials, fixed-price-level-of-effort, and firm-fixed-price contracts.

Under the guidance of ASC 606, the Company evaluates whether it has an enforceable contract with a customer with rights of the parties and payment terms identified, and collectability is probable. The Company also evaluates if a contract has multiple promises and if each promise should be accounted for as separate performance obligations or as a single performance obligation. Multiple promises in a contract are typically separated if they are distinct, both individually and in the context of the contract. If multiple promises in a contract are highly interrelated or comprise a series of distinct services performed over time, they are combined into a single performance obligation.

Contract modifications are evaluated to determine whether they should be accounted for as part of the original contract or as a separate contract. We consider contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. Contract modifications are accounted for as a separate contract if the modification adds distinct goods or services and increases the contract value by its standalone selling price. Modifications that are not determined to be a separate contract are accounted for either has a prospective adjustment to the original contract if the goods or services in the modification are distinct from those transferred before the modification or as a cumulative adjustment if the goods and services are not distinct and are part of a single performance obligation that is partially satisfied. The Company's services contracts frequently provide customers an option to renew for an additional period of time under the same terms and conditions as the original contract. The renewal options typically do not provide the customer any material rights under the contract and therefore are treated as separate contracts when they include distinct goods or services at standalone selling prices.

Transaction prices for contracts with the U.S. government are typically determined through a competitive procurement process and are based on estimated or actual costs of providing the goods or services in accordance with applicable regulations. Transaction prices for non-U.S. government customers are based on specific negotiations with each customer. In certain instances, our contracts contain award fees, incentive fees, or other provisions that can either increase or decrease the transaction price. The variable amounts generally are awarded upon achievement of certain performance metrics or program milestones and can be based upon customer discretion. We estimate variable consideration at the most likely amount to which we expect to be entitled. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the Company's anticipated performance and all information (historical, current and forecasted) that is reasonably available to us and the potential of significant reversal of revenue. The Company excludes any taxes collected or imposed when determining the transaction price.

A contract's transaction price is allocated to each distinct performance obligation and recognized when, or as, the performance obligation is satisfied. For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. Substantially none of the Company's contracts contain a significant financing component, which would require an adjustment to the transaction price of the contract.

The Company recognizes revenue on a majority of its contracts over time as there is continuous transfer of control to the customer over the contract's period of performance. Continuous transfer of control is typically supported by contract clauses which allow our customers to unilaterally terminate a contract for convenience, pay for costs incurred plus a reasonable profit, and take control of work-in-process. Revenue recognized over time is generally based on the extent of progress towards completion of the related performance obligations. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services provided. In certain instances, typically for firm-fixed-price contracts, we use the cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred. Costs to fulfill generally include direct labor, materials and subcontractors' costs, other direct costs and an allocation of indirect costs. In other instances, generally for cost reimbursable, time-and-materials, and fixed-price-level-of-effort contracts, revenue is recognized based on a right to invoice practical expedient as the Company is able to invoice the customer in an amount that corresponds directly with the value received by a customer for the Company's performance completed to date. In some instances, typically for the sale of products that have an alternative use, the Company recognizes revenue at a point in time using a rate per unit as units are delivered and the customer obtains legal title of the asset.

Changes in estimates related to contracts accounted for using the cost-to-cost method of accounting are recognized in the period in which such changes are made on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a performance obligations' percentage of completion. For the three months ended March 31, 2018, there were no material modifications recorded related to work previously performed on projects prior to the execution of formal modifications or amendments. A significant change in one or more estimates could affect the profitability of one or more of our performance obligations. When estimates of total costs to be incurred on a performance obligation exceed total estimates of revenue to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined.

Cost of Revenue

Cost of revenue 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, depreciation and subcontract efforts.

Inventories

Inventories are valued at the lower of cost or net realizable value. Our inventory consists of specialty products that we manufacture on a limited quantity basis for our customers. As of March 31, 2018 and December 31, 2017, we had an inventory reserve balance of $0.9 million for certain products where the market has not developed as expected.

Receivables

Receivables consist of amounts billed and currently due from customers and amounts currently due from customers that are not yet billed (unbilled receivables). Receivables are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance for doubtful accounts based on its assessment of the status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written-off through a charge to the allowance and a credit to accounts receivable. For the three months ended March 31, 2018 and 2017, there were no charges recorded to the allowance.

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 U.S. GAAP over the estimated useful lives of between three and seven years. Leasehold improvements are amortized over the lesser of the lives of the underlying leases or the estimated useful lives of the assets.

Lease Incentives

As part of entering into certain building leases, the lessors have provided the Company with tenant improvement allowances. Typically, such allowances 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.

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 long-lived asset 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 is recorded as goodwill. The Company tests for impairment at least annually, during the beginning of the fourth quarter, or more frequently if impairment indicators arise. 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.

At our election, we have the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If, based on our review of qualitative factors, it is more likely than not that the fair value of a reporting unit is less than its carrying value, we perform a quantitative impairment test to identify goodwill impairment and measure the amount of goodwill impairment loss to be recognized (if any) by comparing the fair value of a reporting unit with its carrying amount, using a combination of income and market approaches. An impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

Determining the fair value of a reporting unit is a judgment involving significant estimates and assumptions. These estimates and assumptions include revenue growth rates, operating margins and working capital requirements used to calculate projected future cash flows, risk-adjusted discount rates, selected multiples, control premiums and future economic and market conditions. We have based our fair value estimates on assumptions that we believe to be reasonable, but that are unpredictable and inherently

uncertain. The Company completed its annual evaluation of goodwill at the beginning of the fourth quarter of fiscal year 2017 and found no impairment to the carrying value of goodwill.

We routinely review goodwill at the reporting unit level for potential impairment as part of our internal control framework. We evaluated our reporting unit to determine if a triggering event has occurred. As of March 31, 2018, the Company concluded that there were no indicators of impairment that would cause us to believe that it is more likely than not that the fair value of any such reporting unit is less than the carrying value. Accordingly, a detailed impairment test has not been performed and no goodwill impairment charges were recorded in connection with the interim impairment reviews of any such reporting units.

A summary of the changes to goodwill is as follows (in thousands):

Goodwill as of January 1, 2018	$455,197
Acquisition	—
Goodwill as of March 31, 2018	$455,197

Intangibles

Acquired intangible assets with finite lives consist primarily of the value of customer-related intangibles acquired in various acquisitions. Acquired intangible assets with finite lives are amortized using the method that best reflects how their economic benefits are utilized or, if a pattern of economic benefits cannot be reliably determined, on a straight-line basis over their estimated useful lives. The useful lives of the intangibles range from one to sixteen 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 total revenue is derived from contracts where the end customer is the U.S. Government, and any disruption to cash payments from our end customer could put the Company at risk.

Use of Estimates

Management uses estimates and assumptions in preparing these consolidated financial statements in accordance with U.S. 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, proportional performance revenue, inventory obsolescence reserves, income taxes and stock compensation expense. Actual results could vary from the estimates that were used.

Cash and Cash Equivalents

We consider all highly liquid investments purchased with 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 notes, which have a carrying amount of $140.7 million as of March 31, 2018. The fair value of the convertible senior notes as of March 31, 2018, was estimated at $142.3 million using a market approach with Level 2 inputs (see footnote 3, Fair Value Measurements).

Research and Development

Internally funded research and development costs are expensed as incurred and are included in operating expenses in the accompanying condensed 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 $0.4 million and $1.1 million for the three months ended March 31, 2018 and 2017, respectively.

Income Taxes

Income taxes are accounted for under the asset-and-liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be

recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enacted date. In evaluating our ability to realize our deferred tax assets, we consider all available positive and negative evidence, including cumulative historic earnings, reversal of deferred tax liabilities, projected taxable income, and tax planning strategies. The assumptions utilized in evaluating both positive and negative evidence require the use of significant judgment concerning our business plans.

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 months ended March 31, 2018 or 2017.

Loss per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated by dividing net loss 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 loss if the securities were exercised. As the Company incurred a net loss for the three months ended March 31, 2018 and 2017, none of the potential dilution of stock options, warrants, and contingently issuable shares were included in the diluted share calculation for those periods as they would have been anti-dilutive.

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

	Three months ended March 31,	
	2018	2017
Net loss	$(3,127)	$(3,884)
Weighted average shares – basic	49,866	46,562
Effect of dilutive potential common shares	—	—
Weighted average shares – diluted	49,866	46,562
Net loss per share – basic	$(0.06)	$(0.08)
Net loss per share – diluted	$(0.06)	$(0.08)
Anti-dilutive share-based awards, excluded	3,178	2,126

Employee equity share options, restricted shares and warrants granted by the Company are treated as potential common shares outstanding in computing diluted loss 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 and the amount of compensation cost for future service that the Company has not yet recognized are collectively assumed to be used to repurchase shares. As the Company incurred a net loss for the three months ended March 31, 2018 and 2017, none of the outstanding dilutive share-based awards were included in the diluted share calculation for those periods as they would have been anti-dilutive.

The Company uses the if-converted 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 months ended March

31, 2018, 10.1 million shares related to 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 months ended March 31, 2018 and 2017.

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

Share-Based Compensation
The Company applies the fair value method that requires all share-based payments to employees and non-employee directors be expensed over their requisite service period based on their fair value at the grant date, using a prescribed option-pricing model. The expense recognized is based on the straight-line amortization of each individually vesting piece of a grant. The Company has elected to account for forfeitures related to share-based awards when they occur.

The following assumptions were used for share-based awards granted.

Dividend Yield — The Company has never declared or paid dividends on its common stock and has no plans to do so in the foreseeable future.
Risk-Free Interest Rate — Risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term approximating the expected life of the share-based award 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 share-based awards.
Expected Term of the Share-based Awards — This is the period that the share-based awards granted are expected to remain unexercised. The Company estimates the expected life of the share-based award term based on the expected tenure of employees and historical experience.
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. The Company defines its reportable segment based on the way the chief operating decision maker ("CODM"), currently its chief executive officer, manages the operations of the Company for allocating resources and assessing performance. The Company conducts business as one operating and reporting segment.

Recently Adopted Accounting Pronouncements
In May 2014, the FASB issued ASU 2014-09 and related amendments, Revenue from Contracts with Customers (ASC 606), an accounting pronouncement related to revenue recognition. ASC 606 supersedes 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. ASC 606 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017.

Effective January 1, 2018, we adopted ASC 606 using the modified retrospective method. ASC 606 was not applied to contracts that were complete at December 31, 2017, and comparative information for the prior fiscal year has not been retrospectively adjusted. For contracts that were modified before the effective date, we elected the practical expedient which enabled the Company to reflect the aggregate effect of all modifications when identifying performance obligations and allocating the transaction price. The adoption of ASC 606 did not have a material impact on the Company’s condensed consolidated financial statements. The Company recorded a $1.0 million increase to accumulated deficit on January 1, 2018, as the accumulative impact of ASC 606 adoption. The primary impact related to certain contracts (or contract components) that were previously recognized on a separate basis which are now combined under ASC 606 into a single performance obligation, as they are not capable of being distinct under the new guidance. The adoption of ASC 606 did not have a significant impact on the Company’s revenue recognition policy as revenues on a majority of the Company’s contracts continue to be recognized over time.

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As a result of applying the modified retrospective method to adopt the new guidance, the following adjustments were made on the condensed consolidated balance sheet as of January 1, 2018:

	As Reported December 31, 2017	Adjustments	Adjusted January 1, 2018
	(in thousands)		
Assets:			
Unbilled receivables	$37,785	$ 1,166	$38,951
Inventories, net	20,496	(292)	20,204
Prepaid expenses	2,266	(403)	1,863
Liabilities:			
Accrued expenses	$17,862	$ 49	$17,911
Deferred revenue	6,090	1,743	7,833
Deferred tax liability, net	19,174	(325)	18,849
Equity:			
Accumulated deficit	$(111,939)	$ (996)	$(112,935)

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (ASC 842) which will supersede the current lease guidance under ASC 840 and makes several changes such as requiring an entity to recognize a right-of-use asset and corresponding lease obligation on the balance sheet. The ASU also requires enhanced disclosures of key information about leasing arrangements. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and should be adopted under the modified retrospective approach. We are currently evaluating the impact of this pronouncement on our condensed consolidated financial statements.

2. REVENUE FROM CONTRACTS WITH CUSTOMERS

Impact of New Revenue Guidance on Financial Statement Line Items

The following tables compare the reported condensed consolidated balance sheet and statement of operations as of and for the three months ended March 31, 2018, to the pro-forma amounts had ASC 605 been in effect:

	As Reported (ASC 606)	As Adjusted (ASC 605)
	(in thousands)	
Assets:		
Unbilled receivables	$72,809	$71,583
Inventories, net	20,186	21,121
Prepaid expenses	1,424	1,498
Liabilities:		
Accrued expenses	$20,007	$20,040
Deferred revenue	7,474	6,981
Deferred tax liability, net	18,222	18,351
Equity:		
Accumulated deficit	$(116,062)	$(115,948)

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	As Reported (ASC 606)	As Adjusted (ASC 605)
	(in thousands, except per share amounts)	
Revenue	$125,742	$124,432
Cost of revenue, excluding amortization	93,774	93,542
Operating income (loss)	1,003	(75)
Loss before income taxes	(3,820)	(4,898)
Income tax benefit, net	(693)	(889)
Net loss	(3,127)	(4,009)
Loss per share		
Basic	$(0.06)	$(0.08)
Diluted	$(0.06)	$(0.08)

The primary impact related to certain contracts (or contract components) that were previously recognized on a separate basis which are now combined under ASC 606 into a single performance obligation, as they are not capable of being distinct under the new guidance.

Revenue by Category

The Company disaggregates its revenue from contracts with customers by contract-type and customer-type, as we believe that they best depict how the nature, amount, timing and uncertainty of the Company's revenue and cash flows are affected by economic factors. The following table summarizes revenue from contracts with customers by contract-type and customer-type for the three months ended March 31, 2018:

Revenue by Customer Type and Contract Type	Three months ended March 31, 2018 (in thousands)
Department of Defense	
Cost Reimbursement	$ 42,828
Time & Materials and Fixed-Price-Level-of-Effort	26,145
Firm-Fixed-Price	25,228
Total Department of Defense	94,201
Non-Department of Defense U.S. Government	
Cost Reimbursement	1,778
Time & Materials and Fixed-Price-Level-of-Effort	18,900
Firm-Fixed-Price	2,781
Total Non-Department of Defense U.S. Government	23,459
Commercial and other	
Cost Reimbursement	—
Time & Materials and Fixed-Price-Level-of-Effort	1,382
Firm-Fixed-Price	6,700

Total Commercial and other	8,082
Total Revenues	$ 125,742

Remaining Performance Obligations

Remaining performance obligations represent the transaction price of firm orders for which revenue has not yet been recognized, excluding unexercised contract options and potential orders under ordering-type contracts (e.g., indefinite-delivery, indefinite-

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quantity (IDIQ)). As of March 31, 2018, the aggregate amount of transaction price allocated to remaining performance obligations was $342 million. The Company expects to recognize a majority of the remaining performance obligations over the next 12 months.

Contract Assets and Contract Liabilities
The timing of revenue recognition, billings, and cash collections result in billed accounts receivable, unbilled receivables, and customer advances and deposits. Contract assets (unbilled receivables) result from timing differences between revenue recognition and billing in accordance with agreed-upon contractual terms, which typically occurs subsequent to revenue being recognized. Contract liabilities (deferred revenue) consist of advance payments and billings in excess of revenue recognized. Our contract assets and liabilities are reported in a net position on a contract by contract basis.

The increase in contract assets (unbilled receivables) for the three months ended March 31, 2018, was primarily due to billable receivables now being classified as contract assets and to the timing of billings and revenue recognized on certain contracts. The increase in contract liabilities (deferred revenue) for the three months ended March 31, 2018, was primarily due to an impact on one of our contracts from adopting ASC 606.

During the three months ended March 31, 2018, the Company recognized revenue $3.2 million related to contract liabilities which existed at January 1, 2018. There were no impairment losses recognized on receivable and contract assets in the first quarter of 2018.

3. FAIR-VALUE MEASUREMENTS

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure the fair value of financial assets and liabilities on a recurring basis into three broad levels:

Level 1	Inputs are unadjusted quoted prices in active markets for identical assets or liabilities the Company has the ability to access.
Level 2	Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3	Inputs are unobservable for the asset or liability and rely on management’s own assumptions about what market participants would use in pricing the asset or liability.

At March 31, 2018, the Company did not have any assets or liabilities measured at fair value on a recurring basis that would require disclosure based on the fair value hierarchy of valuation techniques.

4. INVENTORIES

Inventories are valued at the lower of cost (as calculated using the weighted-average method) or net realizable value and consists of work in process at various stages of production and finished goods. The inventory is primarily related to our off-the-shelf products for which revenue is recognized at a point in time such as mobile communications devices, aeroptic cameras and radars. The cost of the work in process consists of materials put into production, the cost of labor and an allocation of overhead costs. At March 31, 2018 and December 31, 2017, the Company had an inventory reserve balance of $0.9 million for certain products where the market has not developed as expected.

5. PREPAID EXPENSES

Prepaid expenses at March 31, 2018 and December 31, 2017, primarily consist of prepaid insurance and term software licenses.

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6. PROPERTY AND EQUIPMENT

Property and equipment, net, are as follows:

	March 31, 2018	December 31, 2017
	(In thousands)	
Property and equipment		
Aircraft	$29,880	$28,773
Leasehold improvements	27,158	27,934
Manufacturing equipment	6,537	6,452
Software development costs	2,132	2,132
Office equipment	16,149	16,303
Total	81,856	81,594
Accumulated depreciation	(40,194)	(38,311)
Property and equipment, net	$41,662	$43,283

Depreciation expense charged to operations was $2.6 million and $1.4 million for the three months ended March 31, 2018 and 2017, respectively.

7. INTANGIBLE ASSETS

Information regarding our purchased intangible assets is included in the following table.

	March 31, 2018			December 31, 2017		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
	(in thousands)					
Customer relationships and contracts	$58,789	$ (7,145)	$ 51,644	$66,513	$ (11,039)	$ 55,474
Software technology and other	2,162	(702)	1,460	2,162	(591)	1,571
Total intangible assets	$60,951	$ (7,847)	$ 53,104	$68,675	$ (11,630)	$ 57,045

During the first quarter of 2018, customer relationships and contracts assets of $7.7 million became fully amortized and are not included in the March 31, 2018, numbers in the table above.

The Company recorded amortization expense of $3.9 million and $1.7 million for the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, expected amortization expense relating to purchased intangible assets was as follows:

Fiscal Year Ending	(in thousands)
2018 (remainder of year)	$ 8,179
2019	9,226
2020	7,415
2021	5,973
2022	4,634
2023 and thereafter	17,677
	$ 53,104

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8. DEBT

2017 Credit Facility
On April 4, 2017, Opco entered into (a) a $135 million term loan facility (the “2017 Term Loan Facility”) and (b) a $50 million revolving credit facility (the “2017 Revolving Loan Facility”) collectively (the “2017 Credit Facility”), the terms of which are set forth in a Credit Agreement (the “2017 Credit Agreement”) dated as of April 4, 2017 (the “Closing Date”), by and among Opco, as borrower, the Company, the several lenders party thereto, Royal Bank of Canada (“RBC”), as administrative agent and collateral agent (the “Agent”), and RBC Capital Markets, as lead arranger and bookrunner. Subject to the terms and conditions of the 2017 Credit Agreement, on April 4, 2017, Opco borrowed an aggregate of $135 million under the 2017 Term Loan Facility (the “Term Loan Proceeds”) and an aggregate of $10 million under the 2017 Revolving Loan Facility (the “Revolver Proceeds”).

Interest Rates
Borrowings under the 2017 Credit Agreement were and will be incurred in U.S. Dollars. All borrowings under the Credit Agreement may, at our option, be incurred as either eurodollar loans (“Eurodollar Loans”) or base rate loans (“Base Rate Loans”).

Eurodollar Loans will accrue interest, for any interest period, at (a) the Eurodollar Rate (as defined in the 2017 Credit Agreement) plus (b) an applicable margin of 3.75%.

Base Rate Loans will accrue interest, for any interest period, at (a) a base rate per annum equal to the highest of (i) the Federal funds rate plus 1/2 of 1%; (ii) the prime commercial lending rate announced by the Royal Bank of Canada from time to time as its prime lending rate; and (iii) the Eurodollar Rate for a one month interest period plus 1.00%, plus (b) an applicable margin of 2.75%.

The applicable margin for borrowings under the Revolving Credit Facility may be decreased if our consolidated net leverage ratio decreases.

Maturity Dates
On December 21, 2017, the 2017 Credit Agreement was amended such that the 2017 Credit Facility matures on the earlier of (i) the five-year anniversary of the Closing Date, and (ii) the date that is 91 days prior to the scheduled maturity date of the Company’s 2.50% convertible senior notes (the “Notes”), unless the Notes are converted into equity or otherwise repaid or refinanced. The Notes are scheduled to mature on July 15, 2019.

Payments
The Company can voluntarily repay outstanding loans under the 2017 Credit Facility at any time without premium or penalty, other than customary breakage costs with respect to Eurodollar loans. The 2017 Term Loan Facility will require scheduled quarterly payments in an amount equal to:

- 1.25% for the quarters ending September 30, 2017 through June 30, 2019;
- 1.875% for the quarters ending September 30, 2019 through June 30, 2021; and
- 2.50% for the quarters ending September 30, 2021 through March 31, 2022, with the remaining balance payable on the maturity date.

Mandatory Prepayments
Amounts outstanding under the 2017 Credit Agreement will be subject to mandatory prepayments, subject to customary exceptions, from the net cash proceeds to us from certain asset sales or recovery events.

Certain Covenants and Events of Default

The 2017 Credit Agreement contains affirmative and negative covenants that are customary for credit agreements of this nature. The negative covenants include, among other things, limitations on asset sales, mergers and acquisitions, indebtedness, liens, investments and transactions with affiliates. The 2017 Credit Agreement contains two financial covenants: (i) a maximum total leverage ratio of consolidated total indebtedness to consolidated earnings before interest, taxes, depreciation and amortization and other adjustments described in the Credit Agreement (“consolidated EBITDA”) for the trailing four consecutive quarters of (a) 5.50 to 1.00 for any period ending on or prior to June 30, 2018; (b) 5.00 to 1.00 for any period thereafter ending on or prior to December 31, 2019; and (c) 4.50 to 1.00 for each fiscal quarter thereafter; and (ii) a minimum interest coverage ratio of consolidated EBITDA to consolidated interest expense for the trailing four consecutive quarters of 3.00 to 1.00.

The 2017 Credit Agreement includes customary events of default that include, among other things, non-payment defaults, inaccuracy of representations and warranties, covenant defaults, cross default to material indebtedness, bankruptcy and insolvency defaults, material judgment defaults, Employee Retirement Income Security Act of 1974 (ERISA) defaults and a change of control

default. The occurrence of an event of default could result in the acceleration of the obligations under the 2017 Credit Agreement and cross-default our other indebtedness.

At March 31, 2018, the Company was in compliance with all of its debt covenants under the 2017 Credit Agreement.

Security
The Company's obligations under the 2017 Credit Agreement are secured by a pledge of substantially all of its and each other guarantors' assets, including a pledge of the equity interests in certain of Opco's domestic and first-tier foreign subsidiaries, subject to customary exceptions.

In connection with the issuance of the 2017 Credit Facility the Company incurred approximately $4.7 million of debt issuance costs. The Company is amortizing the deferred financing costs over the contractual term of the 2017 Credit Facility using the effective-interest method. During the three months ended March 31, 2018, the Company recognized $2.1 million of interest expense related to the 2017 Credit Facility, which included $0.2 million relating to amortization of deferred financing costs. The effective interest rate related to the 2017 Term Loan Facility was 6.2% for the three months ended March 31, 2018.

As of March 31, 2018, the Company had $129.9 million outstanding under the 2017 Term Loan Facility and $4.0 million outstanding under the 2017 Revolving Credit Facility. The carrying value of the term loan and the revolver approximate their fair value. Our availability under the revolving portion of the 2017 Credit Facility was $46 million as of March 31, 2018.

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 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 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 Notes for each such trading day; or (iii) upon the occurrence of specified corporate events. 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 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.

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.

As of March 31, 2018, the outstanding principal of the Notes was $149.5 million, the unamortized debt discount was $7.6 million, the unamortized deferred financing costs were $1.2 million and the carrying amount of the liability component was $140.7 million, which was recorded as long-term debt within the Company’s condensed consolidated balance sheet. As of March 31, 2018, the fair value of the liability component relating to the Notes, based on a market approach, was approximately $142.3 million and represents a Level 2 valuation.

During the three months ended March 31, 2018, the Company recognized $2.6 million of interest expense related to the Notes, which included $1.4 million for non-cash interest expense relating to the debt discount and $0.2 million relating to amortization of deferred financing costs. During the three months ended March 31, 2017, the Company recognized $2.5 million of interest expense relating to the Notes, which included $1.3 million for non-cash interest expense relating to the debt discount and $0.2

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million relating to amortization of deferred financing costs. The effective interest rate related to the Notes was 7.1% and 6.9% for the three months ended March 31, 2018 and 2017, respectively.

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.

Debt Summary

As of March 31, 2018, the composition of the Company's debt was as follows (in thousands):

Convertible notes	$149,500
Term loan	129,938
Revolver	4,000
Total debt	283,438
Less: current portion of term loan	(6,750)
Less: unamortized original issue discount costs and financing fees	(12,839)
Long-term debt	$263,849

The KeyW Holding Corporation is a holding company with no independent assets or operations (other than the ownership of its subsidiaries). Holdco contemplates that if it issues any guaranteed debt securities under any registration statement filed by it under the Securities Act of 1933, as amended, all guarantees will be full and unconditional and joint and several, and any subsidiaries of Holdco that are not subsidiary guarantors will be “minor” subsidiaries as such term is defined under the rules and regulations of the Securities and Exchange Commission. The agreements governing the Company's long-term indebtedness do not contain any significant restrictions on the ability of Holdco or any guarantor to obtain funds from its subsidiaries by dividend, loan or otherwise. Accordingly, we do not provide separate financial statements of any guarantor subsidiaries.

9. SHARE-BASED COMPENSATION

At March 31, 2018, KeyW had stock-based compensation awards outstanding under the following plans: The 2008 Stock Incentive Plan ("2008 Plan"), The 2009 Stock Incentive Plan ("2009 Plan") and The Amended and Restated 2013 Stock Incentive Plan ("2013 Plan").

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, provides for the issuance of additional restricted stock, stock options, and restricted stock units. Pursuant to an amendment approved by the Company’s shareholders on August 12, 2015, the number of shares available for issuance under the 2013 Plan was increased by 700,000 shares to a maximum of 2,700,000 shares.

2013 Stock Incentive Plan	
Total equity authorized for issuance	2,700,000
Total equity outstanding or exercised	2,309,010
Total equity remaining for future grants	390,990

The Company has awarded stock options, restricted stock awards, restricted and performance stock units and the rights to receive Long-Term Incentive Shares to attract and retain highly qualified officers, directors, key employees, and other persons, and to motivate such persons to serve the Company and to expend maximum effort to improve the business results and earnings of the Company, by providing to such persons an opportunity to acquire or increase a direct proprietary interest in the operations and future success of the Company and align employee and shareholder interests.

Stock Options

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No stock options were granted during the three months ended March 31, 2018 and 2017. Historically the Company has issued stock option awards that vest over varying periods, ranging from three to five years, and have a ten-year life. The Company estimated the fair value of stock options using the Black-Scholes option-pricing model. All stock options were issued with an exercise price at market value or higher based upon our publicly traded share price on the date of grant. 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.

A summary of stock option activity for the period ended March 31, 2018 is as follows:

	Number of Shares	Option Exercise Price	Weighted Average Exercise Price
Options Outstanding January 1, 2018	879,810		
Granted	—	—	—
Exercised	(5,500)	$5.50 - $6.90	$ 5.75
Cancelled	(32,199)	$5.50 - $17.11	$ 10.18
Options Outstanding March 31, 2018	842,111		

As of March 31, 2018, outstanding stock options were as follows:

Exercise Price	Options Outstanding and Vested	Intrinsic Value	Weighted Average Remaining Life (Years)
$5.00 – $5.50	230,150	$568,479	1.36
$6.90 – $7.66	141,386	58,348	3.82
$7.96 – $9.25	126,426	—	2.99
$9.50 - $11.67	96,100	—	4.02
$11.99 - $12.97	99,575	—	4.15
$13.00 - $14.33	63,224	—	4.57
$14.88 - $17.11	85,250	—	5.80
	842,111	$626,827	

Restricted Stock Awards

For the three months ended March 31, 2018, no restricted stock awards were issued.

The following table summarizes the activities for our unvested restricted stock awards for the three months ended March 31, 2018:

	Unvested Shares
Outstanding January 1, 2018	635,223
Granted	—
Vested	(16,259)
Cancelled	(14,475)
Outstanding March 31, 2018	604,489

Restricted Stock Units (units)

During the three months ended March 31, 2018, the Company issued 22,000 units as part of employee incentive plans and to new hires. The Company issued 1,000 units to an existing employee under the long-term incentive plan, 20,000 units to a new employee and 1,000 units to existing employees as discretionary awards.

The following table summarizes the activities for our unvested restricted stock units for the three months ended March 31, 2018:

	Unvested Units
Outstanding January 1, 2018	337,423
Granted	22,000
Vested	—
Cancelled	(4,250)
Outstanding March 31, 2018	355,173

Performance Stock Units (performance units)
No performance units were issued during the three months ended March 31, 2018.

The following table summarizes the activities for our unvested performance stock units for the three months ended March 31, 2018:

	Unvested Performance Units
Outstanding January 1, 2018	17,557
Granted	—
Vested	—
Cancelled	—
Outstanding March 31, 2018	17,557

Long-Term Incentive Share Rights (rights)
During the three months ended March 31, 2018, the Company granted rights to 130,000 Long-Term Incentive Shares. Rights to 100,000 shares were granted outside of the 2013 Plan to a new hire, in accordance with NASDAQ Listing Rule 5635(c)(4) upon commencement of his employment. The remaining rights to 30,000 shares were granted to an existing employee under the 2013 Plan.

The granting and vesting of the Long-Term Incentive Shares will be contingent upon the employees continued employment with KeyW, subject to acceleration upon certain events. The Company measured the fair value of the Long-Term Incentive Share grants using a Monte Carlo simulation approach with the following assumptions: risk-free interest rate ranging between 2.49% and 2.56%, expected volatility of 54.94% and dividend yield of 0%. The grant-date fair value of these long-term incentive shares is $0.4 million. The expense for these grants will be recognized over the requisite service period of each individual tranche, which have weighted average requisite service periods ranging from 2.7 years and 2.9 years.

The following table summarizes the activities for our Long-Term Incentive Share rights for the three months ended March 31, 2018:

	Unvested Long-Term Incentive Shares
Outstanding January 1, 2018	1,725,000
Granted	130,000
Cancelled	(50,000)
Outstanding March 31, 2018	1,805,000

These rights consist of five vesting tranches, which Long-Term incentive Shares will be awarded at any time prior to the fifth anniversary of the rights' commencement dates if the closing market price of the Company’s common stock over any 30 consecutive trading days is at or greater than the target price set forth in the table below.

Target Price Per Share	Long-Term Incentive Shares
$13.00	225,625
$16.00	225,625
$20.00	451,250
$25.00	451,250
$30.00	451,250

The Company recorded total stock compensation expense of $1.2 million and $1.0 million for the three months ended March 31, 2018 and 2017, respectively. The total unrecognized stock compensation expense at March 31, 2018, is approximately $8.0 million, which is expected to be recognized over a weighted average period of 1.9 years.

10. WARRANTS

During the three months ended March 31, 2018, no warrant holders exercised any warrants.

As of March 31, 2018, outstanding warrants were as follows:

Exercise Price	Warrants Outstanding and Vested	Remaining Life (Years)
$12.65	158,116	1.66

11. INCOME TAXES

The Company's quarterly provision for income taxes is measured using an estimated annual effective tax rate, subsequently adjusted for discrete items that occur within the quarter. The provision for income taxes for the three months ended March 31, 2018 and 2017, was a benefit of $0.7 million and $0.0 million, respectively. The effective tax rate for the three months ended March 31, 2018 and 2017, was 18.1% and 0.0%, respectively. The increase in the effective tax rate was primarily affected by the Tax Act, which enabled the Company to offset its indefinite lived intangible deferred tax liability with certain deferred tax assets that are now considered to have an indefinite life. During the three months ended March 31, 2018, the Company was able to recognize the deferred tax benefit created by the current period loss.

As a result of the adoption of ASU 2016-09 in the first quarter of 2017, the Company recorded a cumulative effect adjustment to increase deferred tax assets for the federal and state net operating losses attributable to excess tax benefits from stock-based compensation that had not been previously recognized. The impact was an increase to the deferred tax assets associated with net operating losses of approximately $0.5 million, which was offset by a corresponding increase to the valuation allowance. All excess tax benefits and deficiencies in the current and future periods will be recognized within the quarterly provision for income taxes during the reporting period in which they occur. This may result in increased volatility in the Company's effective tax rate.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act tax reform legislation. This legislation made significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforward and carryback, limitation of the tax deduction for interest expense, and a repeal of the corporate alternative minimum tax. Several of these changes are expected to impact the Company and have been included in the calculation of the quarterly provision for the three months ended March 31, 2018. Under the new law, certain deferred tax assets are considered to have indefinite lives. As a result of this change, the Company reduced its valuation allowance against these deferred assets in the fourth quarter of 2017.

As noted at year end, the Company recorded provisional estimates for valuation allowance reversal to certain state deferred tax assets based upon existing state tax law conformity to federal tax laws. Management will continue to monitor state legislative actions in states where it files during 2018. The provisional estimates for state valuation

allowance may change to the extent any state legislature modifies its conformity to the Tax Act. In other areas of the Tax Cuts and Jobs Act that had an impact, the Company was able to make reasonable estimates and has recorded provisional amounts. There are no material elements of the Tax Act for which the Company was unable to make a reasonable estimate. Once State conformity elections are known the Company expects to finalize its assessment during the one year measurement period as prescribed by the Staff Accounting Bulletin 118 and ASU 2018-05.

The Company initially recorded a full valuation allowance against the Company's deferred tax assets during the second quarter of 2015 due to uncertainty of the utilization in future periods. As described above, with the passage of the Tax Cuts and Jobs Act, the Company believes it can utilize certain deferred tax assets that are no longer considered to have definite lives and reversed a

portion of its valuation allowance in the fourth quarter of 2017. The Company continues to maintain a valuation allowance against certain deferred tax assets with definite lives due to its history of pretax losses. In evaluating the Company's ability to realize the deferred tax assets it considered all available positive and negative evidence, including cumulative historical earnings, reversal of temporary differences, projected taxable income and tax planning strategies. The Company's deferred tax assets will be evaluated in subsequent reporting periods by management using the same weighted positive and negative evidence to determine if a change in valuation allowance is required.

12. SUBSEQUENT EVENTS

On April 13, 2018, the Company announced the commencement of a cash tender (the "Tender Offer") by the Company to purchase any and all of its $149.5 million aggregate principal amount of outstanding 2.50% Convertible Senior Notes due 2019.

On May 8, 2018, the Company entered into a $340 million senior secured credit facility. The credit facility consists of a $215 million First Lien Term Loan facility maturing in May 2024, a $75 million Second Lien Term Loan facility maturing in May 2025 and a $50 million senior secured Revolving Credit Facility maturing in May 2023. The loans under the credit agreements contain a maximum total net leverage covenant with step-downs as well as affirmative and negative covenants customary for transactions of this type, including limitations with respect to indebtedness, liens, investments, dividends, disposition of assets, change in business and transactions with affiliates. The Company used a portion of the proceeds from the new credit facilities to pay off its existing 2017 Credit Facility. The balance of the proceeds from the new credit facilities will be used to repurchase all or a portion of its 2.50% Convertible Senior Notes due July 2019 and for general corporate purposes.

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 condensed consolidated financial statements and accompanying notes as well as our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission on March 16, 2018.

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, 2017, filed with the Securities and Exchange Commission on March 16, 2018, as well as any other cautionary language in this Quarterly Report, provide examples of such risks, uncertainties, and events.

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

DESCRIPTION OF THE COMPANY

We are a highly specialized provider of advanced engineering and technology solutions to support the collection, processing, analysis and dissemination of information across the full spectrum of the Intelligence, Cyber and Counterterrorism Communities' missions. Our solutions protect our nation and its allies, and are designed to meet the critical needs of agile intelligence and U.S. Government national security priorities. Our core capabilities include advanced cyber operations and training; geospatial intelligence; cloud and data analytics; engineering; and intelligence analysis and operations. Our other offerings include a suite of Intelligence Surveillance and Reconnaissance (ISR) solutions deployed from an advanced sensor delivery platform, proprietary products-including electro-optical, hyperspectral and synthetic aperture radar sensors-and other products that we manufacture and integrate with hardware and software to meet unique and evolving intelligence mission requirements.

Our solutions focus on Intelligence Community (IC) customers, including the Federal Bureau of Investigation (FBI), Department of Homeland Security (DHS), National Security Agency (NSA), the National Geospatial Intelligence Agency (NGA), the Army Geospatial Center (AGC) and other agencies within the IC and Department of Defense (DoD). In addition, we provide products and services to U.S. federal, state and local law enforcement agencies, foreign governments and other entities in the Cyber and Counterterrorism markets. We believe the combination of our advanced solutions, understanding of our customers' mission; longstanding and successful customer relationships; operational capabilities; and highly skilled, cleared workforce will help expand our footprint in our core markets.

CRITICAL ACCOUNTING POLICIES

Management’s Discussion and Analysis of Financial Condition and Results of Operations are based upon our condensed 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, 2017. 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, 2017.

SIGNIFICANT RECENT DEVELOPMENTS

Effective January 1, 2018, we adopted the requirements of Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). Please refer to Note 2 to the accompanying financial statement for a discussion of the impact on our condensed consolidated financial statements.

COMPARISON OF THREE MONTHS ENDED MARCH 31, 2018 AND MARCH 31, 2017

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements (and notes thereto) and other financial information of the Company appearing elsewhere in this report.

CONSOLIDATED OVERVIEW (In thousands)	Three months ended March 31, 2018	% of Revenue	Three months ended March 31, 2017	% of Revenue
Revenue	$125,742	100.0 %	$68,256	100.0 %
Cost of revenue, excluding amortization	93,774	74.6 %	47,889	70.2 %
Operating expenses	27,024	21.5 %	19,984	29.3 %
Intangible amortization	3,941	3.1 %	1,650	2.4 %
Interest expense, net	4,828	3.8 %	2,609	3.8 %
Income tax benefit, net	(693)	(0.6)%	—	— %

As the Company adopted Topic 606 as of January 1, 2018, using the modified retrospective method, there is a lack of comparability to the prior period presented in the table above.

Revenue increased by $57.5 million, or 84%, for the three months ended March 31, 2018, compared to the three months ended March 31, 2017. The increase was primarily attributable to contracts acquired through the acquisition of Sotera Holdings Inc., a Delaware corporation and its wholly owned subsidiary Sotera Defense Solutions Inc., a Delaware corporation (Sotera) and increased product sales associated with our Intelligence, Surveillance and Reconnaissance core focus area.

Cost of revenue increased by $45.9 million for the three months ended March 31, 2018, compared with the period ended March 31, 2017. The increase in the cost of revenue was driven largely by the increase in revenue. The increase in cost of revenue as a percentage of total revenue was primarily due to the contracts acquired through the Sotera acquisition.

Our operating expenses for the three months ended March 31, 2018, increased by $7.0 million and decreased as a percentage of revenue compared to the same period ended March 31, 2017. The increase is due primarily to the addition of Sotera to our financial results. Operating expenses in the quarter included $0.8 million of acquisition and integration costs and an additional $1.9 million of non-recurring expenses.

Intangible amortization expense increased $2.3 million for the three months ended March 31, 2018, primarily due to additional amortization related to the Sotera acquisition.

Interest expense increased by $2.2 million for the three months ended March 31, 2018, compared with the three months ended March 31, 2017. The increase in interest expense was due primarily to higher interest expense related to borrowings under the 2017 Credit Facility.

The effective tax rate for the three months ended March 31, 2018 and 2017 was 18.1% and 0.0%, respectively. During the three months ended March 31, 2018, the Company was able to recognize the deferred tax benefit created by the current period loss.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act tax reform legislation. This legislation made significant changes in U.S. tax law including a reduction in the corporate tax rates, changes to net operating loss carryforward and carryback, limitation of the tax deduction for interest expense, and a repeal of the corporate alternative minimum tax. Several of these changes are expected to impact the Company and have been included in the calculation of the quarterly provision for the three months ended March 31, 2018. Under the new law, certain deferred tax assets are considered to have indefinite lives. As a result of this change, the Company reduced its valuation allowance against these deferred assets in the fourth quarter of 2017.

The Company recorded provisional estimates for valuation allowance reversal to certain state deferred tax assets based upon existing state tax law conformity to federal tax laws. Management will continue to monitor state legislative actions in states where

it files during 2018. The provisional estimates for state valuation allowance may change to the extent any state legislature modifies its conformity to the Tax Act. In other areas of the Tax Cuts and Jobs Act that had an impact, the Company was able to make reasonable estimates and has recorded provisional amounts. There are no material elements of the Tax Act for which the Company was unable to make a reasonable estimate. Once State conformity elections are known the Company expects to finalize its assessment during the one year measurement period as prescribed by the Staff Accounting Bulletin 118 and ASU 2018-05.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled $3.1 million at March 31, 2018. Our working capital, defined as current assets minus current liabilities, was $48.4 million, which represents an increase of approximately $5.6 million from December 31, 2017. At March 31, 2018, we were in compliance with all of our debt covenants under our 2017 Credit Facility.

Cash Flow from Operations

Cash flow used in operations for the three months ended March 31, 2018, was approximately $16.0 million compared to $3.8 million in the prior year quarter. The increase in cash flow used in operations was primarily due to a temporary increase in days sales outstanding (DSO) which were 79 days for the quarter and a seasonal increase in payroll and related expenditures. The increase in DSO was a result of complexities associated with contract novation and systems integration and we expect DSO to return to more normalized levels by the end of the fiscal year. Cash and cash equivalents at March 31, 2018, was $3.1 million. A number of non-cash adjustments contributed to our net loss for the three months ended March 31, 2018, including $3.9 million of intangible amortization, $2.6 million of depreciation, $1.2 million of stock compensation expense, and $1.9 million of amortization of convertible debt discount and deferred financing costs.

Cash Flow from Investing and Financing

Cash flows from investing and financing activities provided $1.2 million of cash during the three months ended March 31, 2018, a decrease of $80.4 million as compared to the same period in the prior year. The decrease in cash provided from investing and financing activity was driven largely by the $84.6 million of net proceeds from our January 2017 offering of common stock, partially offset by the $4.0 million in net proceeds from borrowings under our 2017 Revolving Loan Facility during the first quarter of 2018.

Convertible Notes

During the third quarter of 2014, we issued $149.5 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 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.

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 that 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, 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; or
- upon the occurrence of specified corporate events as described in the Indenture.

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.

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 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.

Capped Call Transactions

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.

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.

2017 Credit Facility

On April 4, 2017, Opco entered into (a) the $135 million 2017 Term Loan Facility and (b) the $50 million 2017 Revolving Credit Facility, the terms of which are set forth in a Credit Agreement (the "2017 Credit Agreement"), dated as of April 4, 2017 (the "Closing Date"), by and among Opco, as borrower, the Company, the several lenders party thereto, Royal Bank of Canada ("RBC"), as administrative agent and collateral agent (the "Agent"), and RBC Capital Markets, as lead arranger and bookrunner. The 2017 Credit Agreement replaced the 2014 Credit Agreement. Subject to the terms and conditions of the 2017 Credit Agreement, on April 4, 2017, Opco borrowed an aggregate of $135 million under the Term Loan Facility (the "Term Loan Proceeds") and an aggregate of $10 million under the Revolving Loan Facility (the "Revolver Proceeds").

Interest Rates

Borrowings under the 2017 Credit Agreement were and will be incurred in U.S. Dollars. All borrowings under the Credit Agreement may, at our option, be incurred as either eurodollar loans ("Eurodollar Loans") or base rate loans ("Base Rate Loans").

Eurodollar Loans will accrue interest, for any interest period, at (a) the Eurodollar Rate (as defined in the 2017 Credit Agreement) plus (b) an applicable margin of 3.75%.

Base Rate Loans will accrue interest, for any interest period, at (a) a base rate per annum equal to the highest of (i) the Federal funds rate plus 1/2 of 1%, (ii) the prime commercial lending rate announced by the Royal Bank of Canada from time to time as its prime lending rate and (iii) the Eurodollar Rate for a one month interest period plus 1.00%, plus (b) an applicable margin of 2.75%.

The applicable margin for borrowings under the Revolving Credit Facility may be decreased if our consolidated net leverage ratio decreases.

Maturity Dates

On December 21, 2017, the 2017 Credit Agreement was amended such that the 2017 Credit Facility matures on the earlier of (i) the five-year anniversary of the Closing Date, and (ii) the date that is 91 days prior to the scheduled maturity date of the Company's 2.50% convertible senior notes (the "Notes"), unless the Notes are converted into equity or otherwise repaid or refinanced. The Notes are scheduled to mature on July 15, 2019.

Payments

The Company can voluntarily repay outstanding loans under the 2017 Credit Facility at any time without premium or penalty, other than customary breakage costs with respect to Eurodollar loans. The Term Loan Facility will require scheduled quarterly payments in an amount equal to:

- 1.25% for the quarters ending September 30, 2017 through June 30, 2019;
- 1.875% for the quarters ending September 30, 2019 through June 30, 2021; and
- 2.50% for the quarters ending September 30, 2021 through March 31, 2022, with the remaining balance payable on the maturity date.

Mandatory Prepayments
Amounts outstanding under the 2017 Credit Agreement will be subject to mandatory prepayments, subject to customary exceptions, from the net cash proceeds to us from certain asset sales or recovery events.

Certain Covenants and Events of Default
The 2017 Credit Agreement contains affirmative and negative covenants that are customary for credit agreements of this nature. The negative covenants include, among other things, limitations on asset sales, mergers and acquisitions, indebtedness, liens, investments and transactions with affiliates. The 2017 Credit Agreement contains two financial covenants: (i) a maximum total leverage ratio of consolidated total indebtedness to consolidated earnings before interest, taxes, depreciation and amortization and other adjustments described in the Credit Agreement (“consolidated EBITDA”) for the trailing four consecutive quarters of (a) 5.50 to 1.00 for any period ending on or prior to June 30, 2018; (b) 5.00 to 1.00 for any period thereafter ending on or prior to December 31, 2019; and (c) 4.50 to 1.00 for each fiscal quarter thereafter; and (ii) a minimum interest coverage ratio of consolidated EBITDA to consolidated interest expense for the trailing four consecutive quarters of 3:00 to 1:00.

The 2017 Credit Agreement includes customary events of default that include, among other things, non-payment defaults, inaccuracy of representations and warranties, covenant defaults, cross default to material indebtedness, bankruptcy and insolvency defaults, material judgment defaults, ERISA defaults and a change of control default. The occurrence of an event of default could result in the acceleration of the obligations under the 2017 Credit Agreement and cross-default our other indebtedness.

At March 31, 2018, we were in compliance with all of our debt covenants under the 2017 Credit Agreement.

Security
Our obligations under the 2017 Credit Agreement are secured by a pledge of substantially all of our and each other guarantors’ assets, including a pledge of the equity interests in certain of Opco’s domestic and first-tier foreign subsidiaries, subject to customary exceptions.

Events Subsequent to March 31, 2018

On April 13, 2018, the Company announced the commencement of a cash tender (the “Tender Offer”) by the Company to purchase any and all of its $149.5 million aggregate principal amount of outstanding 2.50% Convertible Senior Notes due 2019.

On May 8, 2018, the Company entered into a $340 million senior secured credit facility. The credit facility consists of a $215 million First Lien Term Loan facility maturing in May 2024, a $75 million Second Lien Term Loan facility maturing in May 2025 and a $50 million senior secured Revolving Credit Facility maturing in May 2023. The loans under the credit agreements contain a maximum total net leverage covenant with step-downs as well as affirmative and negative covenants customary for transactions of this type, including limitations with respect to indebtedness, liens, investments, dividends, disposition of assets, change in business and transactions with affiliates. The Company used a portion of the proceeds from the new credit facilities to pay off its existing 2017 Credit Facility. The balance of the proceeds from the new credit facilities will be used to repurchase all or a portion of its 2.50% Convertible Senior Notes due July 2019 and for general corporate purposes.

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

Our exposure to market risk relates to changes in interest rates for borrowings under our 2017 Credit Facility. A hypothetical 1% increase in interest rates would have increased our interest expense by approximately $0.3 million for the three months ended March 31, 2018, and likewise decreased our income and cash flows.

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 not have a material impact on our reported net income. We do not currently utilize any derivative financial instruments to hedge foreign currency risks.

Equity Price Risk

We do not currently own nor have we ever owned any marketable equity investments to include marketable equity securities and equity derivative instruments such as warrants and options. Therefore, since we do not currently own investments that are subject to market price volatility, our equity price risk is very low.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our filings and submissions to the Securities and Exchange Commission (the “SEC”) under the Exchange Act is recorded, processed, and reported within the time periods specified in the SEC’s rules and forms. Such controls include those designed to ensure that information is accumulated and communicated to management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), as appropriate, to allow timely decisions regarding required disclosures.

An evaluation was conducted under the supervision and with the participation of management, including the CEO and CFO, on the effectiveness of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based on this evaluation, the CEO and CFO concluded that as of December 31, 2017, our disclosure controls and procedures were not effective because of the material weaknesses described in Management's Annual Report on Internal Control Over Financial Reporting contained in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission on March 16, 2018. In light of the material weaknesses identified at December 31, 2017, management has implemented processes and procedures to begin to remediate the identified material weaknesses.

We have also conducted an evaluation, under the supervision and with the participation of our management, including our CEO and CFO, pursuant to Rule 13a-15 of the Exchange Act, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2018. Based on that evaluation, our CEO and CFO concluded that, because the material weaknesses in our internal controls over financial reporting described above had not been fully remediated as of March 31, 2018, our disclosure controls and procedures were not effective as of March 31, 2018.

Notwithstanding the existence of these material weaknesses, our management has concluded that our condensed consolidated financial statements in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows for all periods and dates presented.

Management's Plan for Remediation

Management is committed to the planning and implementation of remediation efforts to address the material weaknesses. These remediation efforts, summarized below, which have been implemented or are in process of implementation are intended to both address the identified material weaknesses and to enhance our overall financial control environment and control activities. In this regard, our initiatives include:

- Enhancements to the Company's control environment - The Company has identified and is in the process of implementing several enhancements including: (i) the evaluation of competence of all current accounting personnel, including outsourced service providers, to support achievement of the Company's control objectives; (ii) the creation of a new position, Technical Accounting Director, which is in the process of being filled and will be responsible for reviewing and monitoring

all unique, complex, and/or significant accounting transactions; (iii) the creation of a new position, Director of Internal Controls and SOX Compliance, who will be responsible for overseeing the design of controls, remediation of prior control deficiencies, and enhancement of control activities; (iv) development of comprehensive training and development program for senior-level management, control owners and accounting personnel; (v) establishment of an Internal Controls Council (ICC) that will include key control owners across the organization and will directly enforce accountability and ownership over internal control responsibilities; (vi) enforce adherence to a quarterly sub-certification of internal controls by key control owners; (vii) continue to evaluate the effectiveness of control owners' remediation of internal controls; and (viii) continue to evaluate the resources required to right-size the accounting and financial reporting, internal audit, and information technology functions.

- Enhancement to the Company's control activities - The Company has identified specific actions to be implemented during the first half of FY 2018 in support of improving the performance over internal control activities including: (i) development of a detailed accounting close checklist that identifies control owners, responsibilities for effectively performing controls, and requirements for timely completion of those activities and; (ii) implementation of automated workflows to reduce reliance on manual processes in support of timely and effective control activities.

Our remediation efforts are ongoing. Consistent with our comprehensive remediation plan and schedule several of the initiatives above commenced during the quarter ended March 31, 2018. Additionally, to date, we have hired several new finance and accounting team members with the appropriate experience, certifications, education, and training including a new Chief Accounting Officer and Director of Internal Controls and SOX Compliance.

When fully implemented and operational, we believe the measures described above will remediate the material weaknesses we have identified and strengthen our internal control over financial reporting. Additional controls may also be required over time. Until the remediation steps set forth above are fully implemented and tested, the material weaknesses described above will continue to exist.

Changes in Internal Control over Financial Reporting

Except for the implementation of the remediation measures described above, there have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As of March 31, 2018, and the date of this filing, the Company is not party to any material on-going legal proceedings.

ITEM 1A. RISK FACTORS

Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2017, includes certain risk factors that could materially affect our business, financial condition, or future results. 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, 2017.

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

During the three months ended March 31, 2018, 100,000 long-term incentive share rights were granted to a new hire outside of the 2013 Plan, in accordance with Section 4(2) of the Securities Act of 1933.

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:	May 8, 2018	By: /s/ William J. Weber William J. Weber President and Chief Executive Officer
Date:	May 8, 2018	By: /s/ Michael J. Alber Michael J. Alber 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	Specimen of Common Stock Certificate	(4)
4.2	Indenture, dated July 21, 2014, between the Company and Wilmington Trust, National Association, as trustee	(5)
4.3	First Supplemental Indenture, dated July 21, 2014, between the Company and Wilmington Trust, National Association, as trustee	(5)
4.4	Form of 2.50% Convertible Senior Note due 2019 (incorporated by reference to Exhibit 4.2 hereto)	(5)
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
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

THE KEYW HOLDING CORPORATION AND SUBSIDIARIES

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 Pre-Effective Amendment No. 4 to the Registrant's Registration Statement on Form S-1, filed September 30, 2010, File No. 333-167608.
(5) Filed as Exhibits 4.1 and 4.2 respectively to the Registrant’s Current Report on Form 8-K filed July 21, 2014, File No. 001-38491.

* 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.