



April 30, 2013

## KEYW Inc.

### Reiterate Buy; Project G Ahead of Schedule

- We reiterate our Buy rating on KEYW on Project G, which is running ahead of schedule. The company shipped its first unit to a customer, has one waiting delivery and installation and has a queue of potential customers awaiting a cyber analytics assessment (CAA). Previously, KEYW had committed to a 2Q timetable, but this is early in the period and therefore slightly better than our expectation. We trimmed our 2013 EBITDA estimate from \$42M to \$36M to contemplate hiring to support Project G. Investor focus is on 2014 and 2015 including significant Project G sales.
- Looking at the segments, the Services business (76% of total sales) increased 14% on a pro-forma basis, while the Integrated Solutions business grew 5% in a seasonally slow quarter.
- In 1Q13, revenue of \$78M rose 40% including previous acquisitions (none in 1Q13) and was better than the prior consensus of \$76M. Upside was driven by NSA work in the Poole business acquired last September. We note that top-line outperformance has been infrequent.
- The company does not provide guidance, so our estimate revisions incorporate a slightly moderated pace of hiring to support Project G from 1Q, when KEYW added 23 individuals.
- Adjusted EPS was a loss of \$0.06 in 1Q13 was worse than the prior consensus of a loss of \$0.04 on investments in Project G, the commercial cyber solution. Adjusted EBITDA of \$6.8M compared to our \$7.3M assumption.
- In terms of catalysts, we are looking for: (1) potential partnership announcements that could facilitate more rapid CAAs than internal resources alone could achieve; and (2) Project G sale announcements. Further, FLD may field a larger reconnaissance plane in coming months. There are currently six in operation.

FYE – Dec.	2012A	2013E	2014E
EPS	Current	Previous	Current
1Q	\$0.01A	-\$0.01E	-\$0.06A
2Q	\$0.01A	\$0.02E	-\$0.03E
3Q	\$0.01A	\$0.06E	\$0.03E
4Q	\$0.00A	\$0.09E	\$0.07E
Year	\$0.03A	\$0.16E	\$0.01E
P/E	461.3x		1384.0x
Mean EPS Estimate	\$0.03		\$0.12
Revenue (mil.)	Current	Previous	Current
1Q	\$55.8A	\$77.7E	\$77.9A
2Q	\$56.2A	\$82.5E	\$80.7E
3Q	\$57.4A	\$87.1E	\$85.1E
4Q	\$74.2A	\$91.2E	\$89.7E
Year	\$243.5A	\$338.5E	\$333.3E
EV/EBITDA	17.8x		16.4x
Operating Margin	1.3%	4.5%	1.2%

### KEYW

Price (Apr. 29, 2013) \$13.84  
Mkt. Cap. (mil.) \$503.8

#### Government Services

Rating: **Buy**  
Previous: *Buy*  
Price Target: **\$18.00**  
Previous: *\$18.00*  
Risk Rank: **High**  
Previous: *High*  
Sector Rating: **Market Weight**

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#### Market Data:

52-Week Range \$16.33-\$8.39  
Shares Out. (mil.) 36.4  
Float (mil.) 36.4  
Avg. Daily Vol. (000) 199  
Dividend/Yield \$0.00/0.0%

#### Financial Highlights:

Long-Term Debt (mil.) \$96.4  
Debt/Cap. 16.0%  
Debt/EBITDA 2.9x  
ROE 12.6%  
Book Value/Share \$8.30  
Free Cash Flow/Share \$0.39  
Net Cash/Share -\$2.56  
Shareholders' Equity (mil.) \$302.8  
Est. 5-Year EPS Growth 25%

Convertible No  
Key Indices

EPS Est. Changes  
03/04/13 2013 \$0.16 2014 NA  
02/06/13 NA \$0.38  
11/01/12 NA \$0.35

## Comments

Figure 1: Quick Snapshot of 1Q13 KEYW Results

<b>KEYW Corp. (KEYW)</b> <b>Quick Snapshot</b> <b>Quarter Ending March 31, 2013 (1Q13)</b>							
	<u>Prior Period 1Q12A</u>	<u>YoY % Change</u>	<u>Actual 1Q13A</u>	<u>Street Mean</u>	<u>Difference from Street</u>	<u>STRH Estimate 1Q13E</u>	<u>Difference from STRH</u>
Services revenue	39,855	48%	58,843	76,100	2.3%	56,366	4.4%
Integrated Solutions revenue	15,921	20%	19,029			21,380	-11.0%
<b>Contract revenue</b>	<b>55,776</b>	<b>39.6%</b>	<b>77,872</b>			<b>77,747</b>	<b>0.2%</b>
Services cost of revenue	28,877	54%	44,408	7,400	-7.9%	41,260	7.6%
Integrated Solutions cost of revenue	7,970	18%	9,402			9,194	2.3%
<b>Cost of revenue</b>	<b>36,847</b>	<b>46.0%</b>	<b>53,810</b>			<b>50,454</b>	<b>6.7%</b>
Services gross profit	10,978	31%	14,435			15,106	-4.4%
Integrated Solutions gross Profit	7,951	21%	9,627			12,187	-21.0%
<b>Gross profit</b>	<b>18,929</b>	<b>27.1%</b>	<b>24,062</b>			<b>27,293</b>	<b>-11.8%</b>
SG&A Expenses	12,383	63.4%	20,233	7,400	-7.9%	19,048	6.2%
Adjusted EBITDA	7,219	-5.6%	6,813			7,296	-6.6%
Intangible amortization expense	4,869	42%	6,921			6,859	0.9%
<b>Operating income</b>	<b>648</b>	<b>N.M.</b>	<b>(3,092)</b>			<b>142</b>	<b>-2277.0%</b>
Interest expense, (income), net	(414)	71%	(706)			(949)	N.M.
Other non-operating expense	-	N.M.	-			-	N.M.
<b>Total non-operating expense (income)</b>	<b>(414)</b>	<b>N.M.</b>	<b>(706)</b>			<b>(949)</b>	<b>N.M.</b>
<b>Pre-tax Income</b>	<b>234</b>	<b>-1723%</b>	<b>(3,798)</b>			<b>(807)</b>	<b>370.7%</b>
Taxes	66	-2427%	(1,536)	(\$0.04)	N.M.	(371)	313.8%
<b>Net Income</b>	<b>168</b>	<b>-1446%</b>	<b>(2,262)</b>			<b>(436)</b>	<b>419.1%</b>
<b>EPS</b>	<b>\$0.01</b>	<b>N.M.</b>	<b>(\$0.06)</b>			<b>(\$0.01)</b>	<b>N.M.</b>
Share Count	27,767	31%	36,379			39,336	-7.5%
<b>Margin Analysis</b>	<b>1Q12A</b>		<b>1Q13A</b>				
Gross Profit	33.9%	-3.04%	30.9%			35.1%	-4.2%
SG&A	22.2%	3.78%	26.0%			24.5%	1.5%
Adjusted EBITDA	12.9%	-4.19%	8.7%			9.4%	-0.6%
Operating Margin	1.2%	-5.13%	-4.0%			0.2%	-4.2%
Pre-tax Income	0.4%	-5.30%	-4.9%			-1.0%	-3.8%
Tax Rate	N.M.	N.M.	N.M.			46.0%	N.M.

Source: Company reports, SunTrust Robinson Humphrey

## KEYW Valuation

We value KEYW shares based on forward enterprise value to EBITDA metrics. Based on our model, we expect KEYW Group Inc. to earn \$42 million in 2013 EBITDA. Given the current price, this translates to a 2013E 16x EV/EBITDA multiple. This is a slight premium to the average EBITDA of 13x for a peer group of both government services companies and commercial security and software firms. If we assume that the current multiple moves toward the group multiple slightly and the company achieves higher growth and develops its commercial application, then we arrive at a \$18 target based on our 2014 EBITDA estimate of \$53 million.

## Risks:

We identify the following as some of the potential risks and challenges for KEYW.

- The company could experience impairment of key customer relationships.
- CEO Len Moodispaw's reputation within the cyber arena facilitates business, and damage to it or his person could jeopardize business. In addition, the loss of key management and personnel that affects operations or damages relationships with government departments could impair KEYW's future contract win percentage.
- The company may be unsuccessful in future contract wins, which could cause estimates to fall.
- The operating results may be sensitive to a slowdown in defense and government spending, or to a significant shift in priorities.
- The company could experience changes in regulations that could alter the contracting process or damage the company's competitive position.
- The company has a risk of damage to its reputation as a result of the misuse of systems, technology, and capital provided.
- The firm may face operational difficulties if it is unable to attract and retain adequate talent or if it encounters issues in integrating recently announced acquisitions.

# KEYW Corporation

Quarterly Income Statement  
(\$ Thousands Except Per Share Data)

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Last Updated April 30, 2013

	2011A	1Q12A	2Q12A	3Q12A	4Q12A	2012A	1Q13A	2Q13E	3Q13E	4Q13E	2013E	2014E
	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Dec-13	Dec-14
Services	159,747	39,855	39,076	39,665	53,180	171,776	58,843	59,349	62,291	65,927	246,410	283,853
Integrated Solutions	30,839	15,921	17,079	17,688	21,057	71,745	19,029	21,398	22,806	23,770	87,002	102,478
As a % of Revenue	15.1%	28.5%	30.4%	30.8%	28.4%	29.5%	24.4%	26.5%	26.8%	26.5%	26.1%	26.5%
<b>Revenue</b>	<b>\$203,983</b>	<b>\$55,776</b>	<b>\$56,155</b>	<b>\$57,353</b>	<b>\$74,237</b>	<b>\$243,521</b>	<b>\$77,872</b>	<b>\$80,747</b>	<b>\$85,097</b>	<b>\$89,697</b>	<b>\$333,287</b>	<b>\$386,332</b>
Sequential Change		11.4%	0.7%	2.1%	29.4%		4.9%	3.7%	5.4%	5.4%		
Yr/Yr Change	89%	33.9%	25.1%	6.3%	48.3%	19%	39.6%	43.8%	48.4%	20.8%	37%	16%
<b>Gross Profit</b>	<b>56,637</b>	<b>18,929</b>	<b>18,933</b>	<b>19,487</b>	<b>26,445</b>	<b>83,794</b>	<b>24,062</b>	<b>26,344</b>	<b>30,669</b>	<b>33,381</b>	<b>114,455</b>	<b>143,942</b>
Yr/Yr Change	80%	55%	45%	29%	63%	48%	27%	39%	57%	26%	37%	26%
Gross Margin	27.8%	33.9%	33.7%	34.0%	35.6%	34.4%	30.9%	32.6%	36.0%	37.2%	34.3%	37.3%
<b>Total operating expenses</b>	<b>188,758</b>	<b>55,128</b>	<b>55,180</b>	<b>56,649</b>	<b>73,371</b>	<b>240,328</b>	<b>80,964</b>	<b>82,255</b>	<b>82,242</b>	<b>84,107</b>	<b>329,568</b>	<b>361,316</b>
<b>Operating Profit</b>	<b>1,828</b>	<b>648</b>	<b>975</b>	<b>704</b>	<b>866</b>	<b>3,193</b>	<b>(3,092)</b>	<b>(1,509)</b>	<b>2,855</b>	<b>5,589</b>	<b>3,843</b>	<b>25,016</b>
Yr/Yr Change	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Operating Margin	0.9%	1.2%	1.7%	1.2%	1.2%	1.3%	-4.0%	-1.9%	3.4%	6.2%	1.2%	6.5%
<b>Adj EBITDA</b>	<b>19,405</b>	<b>7,219</b>	<b>7,604</b>	<b>7,760</b>	<b>10,400</b>	<b>32,978</b>	<b>6,813</b>	<b>7,051</b>	<b>9,880</b>	<b>12,179</b>	<b>35,923</b>	<b>53,318</b>
Yr/Yr Change	115%	118%	97%	43%	53%	70%	-6%	-7%	27%	17%	9%	48%
EBITDA Margin	9.5%	12.9%	13.5%	13.5%	14.0%	13.5%	8.7%	8.7%	11.6%	13.6%	10.8%	13.8%
<b>Net income</b>	<b>504</b>	<b>168</b>	<b>325</b>	<b>341</b>	<b>180</b>	<b>1,014</b>	<b>(2,262)</b>	<b>(1,177)</b>	<b>1,206</b>	<b>2,710</b>	<b>477</b>	<b>13,939</b>
Diluted shares	28,954	27,767	28,353	29,357	38,836	31,078	36,379	36,479	36,579	36,679	36,529	37,104
<b>EPS</b>	<b>\$0.02</b>	<b>\$0.01</b>	<b>\$0.01</b>	<b>\$0.01</b>	<b>\$0.00</b>	<b>\$0.03</b>	<b>(\$0.06)</b>	<b>(\$0.03)</b>	<b>\$0.03</b>	<b>\$0.07</b>	<b>\$0.01</b>	<b>\$0.38</b>
Yr/Yr Change	-97%	178%	1876%	221%	-59%	91%	-1128%	-382%	184%	1494%	-63%	2924%

Source: Company reports and SunTrust Robinson Humphrey estimates

## Company Description

KEYW Corporation, headquartered in Hanover, Maryland, is a mission-oriented government services firm that provides cybersecurity solutions to the Department of Defense, the intelligence community, and national security agencies. The company's range of offerings includes: (1) engineering services for cybersecurity challenges; (2) training, support, and testing of related services; (3) collection of data throughout the entire cyberspace spectrum; (4) processing of cyberspace data; (5) analysis and communication of information based on cyber; and (6) creating new solutions for complex cyber and intelligence problems.

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### Rating And Price Target History (KEYW)

Date	Rating	Target	Closing
11/10/2010	Buy	\$17.00	\$13.09
12/15/2010		\$19.00	\$13.98
09/27/2011		\$13.00	\$7.75
10/19/2011	Neutral		\$8.22
09/14/2012	Buy	\$16.00	\$12.99
03/04/2013		\$17.00	\$13.93
04/12/2013		\$18.00	\$14.36

## Definition of Ratings

SunTrust Robinson Humphrey assigns one of three ratings to stocks covered by our Research Department: **Buy, Neutral, or Reduce.**

In addition, we assign a risk rank to each stock based on a combination of fundamental and stock volatility factors:

**Low** = Low stock price volatility reflected by high predictability of financial results.

**Moderate** = Moderate stock price volatility reflected by medium predictability of financial results.

**High** = High stock price volatility reflected by inconsistent predictability of financial results.

**Speculative** = Greatest stock price volatility reflected by low predictability of financial results.

**Venture** = Recommended only for maximum risk oriented and well-diversified portfolios.

Our ratings are a function of the risk ranking (higher return expectations for higher risk) and the absolute expected total return (price appreciation plus dividends) that result in our estimated 12-month price target. Please refer to the grid below for additional detail.

Performance Definition Scale				
<i>Total return (capital gain/loss + dividends) expected over the next 12 months</i>				
Rating	Low Risk	Moderate Risk	High Risk	Speculative
Buy	Over 10%	Over 15%	Over 20%	Over 25%
Neutral	-5% to 10%	-5% to 15%	-10% to 20%	-10% to 25%
Reduce	-5% or Worse	-5% or Worse	-10% or Worse	-10% or Worse

SunTrust Robinson Humphrey assigns one of three ratings to industries/sectors covered by our Research Department: Overweight, Market Weight or Underweight. These terms are relative to the appropriate S&P 500 industries/sectors.

Deviations from expected price targets due to price movement and/or volatility will be reviewed by the analyst and research management on a timely basis. Price targets are only required on Buy rated stocks; the analyst may choose to have price targets on Neutral or Reduce rated stocks, but it is not required. Action taken by an investor should be based upon their personal investment objectives and risk tolerance compared to a stock's expected performance and risk ranking.

#### SunTrust Robinson Humphrey ratings distribution as of 04/30/2013:

Coverage Universe			Investment Banking Clients Past 12 months		
Rating	Count	Percent	Rating	Count	Percent*
Buy	163	46	Buy	49	14
Hold/Neutral	184	52	Hold/Neutral	28	8
Sell/Reduce	9	3	Sell/Reduce	0	0

\*Percentage of Investment Banking clients in Coverage Universe by rating

## Financial Definitions

Average Daily Volume = The cumulative number of shares traded over 200 days ÷ number of trading sessions in that period

Book Value/Share = Shareholders' equity ÷ shares outstanding

Debt/Cap. = Debt ÷ shareholders' equity + debt

Debt/EBITDA = Long-term debt ÷ earnings before interest, tax, depreciation, and amortization

Dividend/Yield = Annual dividend per share ÷ share price

Est. 5-Year EPS Growth = Expected 5-year CAGR from latest actual

Float = Number of shares outstanding available for public trading

Free Cash Flow/Share = Trailing four quarters cash flow from operations - yearly CAPEX ÷ shares outstanding

Long-Term Debt = Loans and financial obligations extending beyond one year

Net Cash/Share = Cash + liquid securities - total debt (short and long term) ÷ shares outstanding

ROE (last year actual) = Net income ÷ shareholders' equity

Shareholders' Equity = Share capital + retained earnings - treasury shares

#### Key Indices:

DJIA – Dow Jones

RUI – Russell 1000

RUT – Russell 2000

MID – S&P MidCap 400  
SPX – S&P 500  
SML – S&P SmallCap 600

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