



# FORM 10K

## FORM *10K*

This annual report contains certain forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995, including those relating to the Company's overall business and markets. You can identify these statements by the use of the words "may," "will," "would," "should," "could," "plan," "expect," "anticipate," "continue," "estimate," "project," "intend," "likely," "forecast," "probable," "potential" and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, federal procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to export regulations, increases in tax rates, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as are discussed in the Company's filings with the U.S. Securities and Exchange Commission, including its Annual Report on Form 10-K for the fiscal year ended June 30, 2016, accompanying this report. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.



Mark Aslett  
President and CEO

**"Fiscal 2016 was another great year for Mercury Systems. We successfully completed two acquisitions, one of them the largest in Mercury's history, as well as equity and debt financings to support these and future transactions."**

## To Our Shareholders:

Fiscal 2016 was another great year for Mercury Systems. We successfully completed two acquisitions, one of them the largest in Mercury's history, as well as equity and debt financings to support these and future transactions. At the same time, Mercury delivered strong growth in revenue and profitability while finishing the year with record backlog.

Acquiring Lewis Innovative Technologies (LIT) moved us forward in our strategy to become the industry's most advanced secure processing company. Following this tuck-in transaction, in the fourth quarter of fiscal 2016, we acquired a group of embedded security, RF and microwave, and custom microelectronics businesses from Microsemi Corporation. This \$300 million transaction – which transforms the company's top and bottom lines – has already begun to strengthen and help grow the core of our business, while also giving us access to new markets, customers, and programs.

Including both acquisitions, Mercury's consolidated total revenue for fiscal 2016 grew 15% year-over-year to \$270 million. Bookings were up 11% from fiscal 2015, and our year-end backlog increased 38% to a new company record of nearly \$288 million. GAAP income from continuing operations increased 37%, driven by improved operating leverage. Adjusted EBITDA rose 29%, and at 21% of revenue was above the mid-point our target business model for the year. Mercury generated \$36.9 million in cash from operations, compared with \$32.2 million in fiscal 2015, and our year-end cash balance increased 5% to \$82 million.

Mercury also performed well on an organic basis in fiscal 2016. We continued to scale the core business, delivering above industry-average growth and profitability in line with our target business model. Excluding results for the Microsemi carve-out business, revenue grew 8% from fiscal 2015, income from continuing operations increased 41%, and adjusted EBITDA was up 18%. Backlog on an organic basis reached a new record high for the third year in a row, growing 8% from fiscal 2015.

Our fiscal 2016 revenue and bookings demonstrate that Mercury is strongly positioned on a robust set of franchise programs. Our largest revenue programs during the year were SEWIP, Aegis, Patriot, F-35 and Gorgon Stare. Bookings were led by SEWIP, LRDR, E2D Hawkeye and Filthy Buzzard. These programs, as well as others on which we participate, appear to be well-funded, are currently in or moving into production, and are precisely aligned with the Defense Department's roles and missions.

Over the past few years we have leveraged our relationships with the primes, as well as our sales strategies, internal R&D investments and acquisitions, to build a best-in-class portfolio of products and capabilities, targeting the right segments of the market. Entering fiscal 2017 we continue to see significant and growing opportunities associated with radar and electronic warfare (EW) modernization. We have made substantial investments in our processing, RF and microwave product capabilities to capture these opportunities.

Our success on major EW programs such as SEWIP and Filthy Buzzard demonstrate the strength of our strategic relationships and our competitive advantages in RF, microwave and digital. These advantages stem from our investments in the technology as well as in the manufacturing assets needed to continue profitably growing Mercury's radar and EW revenues.

Our Advanced Microelectronics Center (AMC) in New Hampshire is the centerpiece for this manufacturing initiative. With its world-class scalable RF and microwave manufacturing and subsystems integration capabilities, the AMC differentiates us from our competitors as a provider of industry-leading pre-integrated secure processing subsystems. At the same time our integrated business systems have been crucial to improving the operating leverage in our business.

# Mercury Systems is a leading commercial provider of secure processing subsystems designed and made in the USA. Optimized for customer and mission success, Mercury's solutions power a wide variety of critical defense and intelligence programs.

In addition to our potential for growth in the radar and EW domain, we are clearly seeing the impact of the U.S. government's increasingly stringent mandates related to program protection security for domestic and foreign military sales. Through internal R&D investment in our industry-leading secure Intel server class product line, together with our fiscal 2016 acquisitions, we have created a unique and differentiated set of security protection capabilities. As a result, we believe that Mercury is now positioned as the defense industry's largest commercial embedded secure processing company. Security is becoming increasingly important to the Department of Defense and our customers, and we are capitalizing on this opportunity.

Our fiscal 2016 acquisitions extend a series of strategic transactions that began more than five years ago. Along the way we acquired companies like Micronetics and KOR Electronics, bringing unique new technologies, products and capabilities to our expanding portfolio. These transactions expanded our addressable market and have enabled us to provide pre-integrated secure processing subsystems. They have also created substantial cost and revenue synergies and opportunities for continued growth. The Microsemi carve-out adds still more key capabilities and provides us with exposure to new markets, such as guided missiles and precision munitions. This area is seeing increased funding and appears to be an area of future opportunity.

Going forward, we intend to remain active and disciplined in our approach to M&A. We will continue to look for deals that have the potential to be accretive in the short term and drive long-term shareholder value. As we do so, we will continue to target acquisitions that scale the technology platform we have built. We will remain focused on the key pillars of the business – RF, microwave and secure processing – while working to assemble critical and differentiated solutions for sensor and mission processing.

We will also remain focused on smaller capability-led acquisitions similar to the LIT transaction, while building our pipeline of larger opportunities, with the fiscal 2016 carve-out acquisition from Microsemi being a good example. That transaction clearly demonstrated our ability to complete a large acquisition and a complex set of financing transactions quickly and with great results. We have built strong internal corporate development, finance and business integration teams that are skilled in executing complex business combinations. In our role as a buyer we are diligent and offer sellers swift and discreet execution.

We are making good progress on integrating the businesses acquired from Microsemi and look forward to harvesting the potential synergies. The newly arrived team brings outstanding talent to Mercury. Most importantly, they are thrilled be working in the main-stream of a business that shares their mission.

The customer feedback that we have received since announcing the carve-out transaction has been exceptionally positive. The prime defense contractors are looking for a fewer number of more capable suppliers that can invest in new technologies and capabilities, while bringing greater scale. Our customers can see that we have combined two suppliers that independently were viewed as very strong but together are even stronger.

In summary, fiscal 2016 was a great year for Mercury. Our strategy is resonating with our customers and consistent with the government's defense priorities and goals for procurement reform. As a result, we believe that we are well-positioned to continue delivering important new program wins, robust bookings and above industry-average growth in revenue and profitability.

On behalf of everyone on the Mercury Systems team, I would like to extend our deep appreciation for your support over the past fiscal year. We look forward to reporting another year of strong performance in fiscal 2017.

Sincerely,



Mark Aslett  
President and Chief Executive Officer  
September, 2016

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JUNE 30, 2016

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 0-23599

**MERCURY SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

MASSACHUSETTS

(State or other jurisdiction of  
incorporation or organization)

04-2741391

(I.R.S. Employer  
Identification No.)

201 RIVERNECK ROAD  
CHELMSFORD, MA

(Address of principal executive offices)

01824

(Zip Code)

978-256-1300

(Registrant's telephone number, including area code)

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934:**

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value \$.01 Per Share	NASDAQ Global Select Market

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE  
SECURITIES EXCHANGE ACT OF 1934: NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the Common Stock held by non-affiliates of the registrant was approximately \$639.6 million based upon the closing price of the Common Stock as reported on the Nasdaq Global Select Market on December 31, 2015, the last business day of the registrant's most recently completed second fiscal quarter.

Shares of Common Stock outstanding as of July 31, 2016: 40,360,389 shares

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement for its 2016 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

Exhibit Index on Page 83

# MERCURY SYSTEMS, INC.

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## PART I

**This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference are discussed in this annual report on Form 10-K, including in the section entitled “Risk Factors.”**

When used in this report, the terms “Mercury,” “we,” “our,” “us,” and “the Company” refer to Mercury Systems, Inc. and its consolidated subsidiaries, except where the context otherwise requires or as otherwise indicated. The term “fiscal” with respect to a year refers to the period from July 1 to June 30. For example, fiscal 2016 refers to the period from July 1, 2015 to June 30, 2016.

### ITEM 1. BUSINESS

#### Our Company

Mercury Systems, Inc. is a leading commercial provider of secure processing subsystems designed and made in the U.S.A. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. Headquartered in Chelmsford, Massachusetts, we are pioneering a next-generation defense electronics business model specifically designed to meet the industry's current and emerging technology and business needs. We deliver affordable innovative solutions, rapid time-to-value and service and support to our defense prime contractor customers. Our products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program (“SEWIP”), Gorgon Stare, Predator, F-35 and Reaper. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector.

Our technologies and capabilities include embedded processing modules and subsystems, radio frequency (“RF”) and microwave multi-function assemblies as well as subsystems, and RF and microwave components. We utilize leading edge, high performance computing technologies architected by leveraging open standards and open architectures to address highly data-intensive applications that include data signal, sensor and image processing; all of this while addressing the packaging challenges, often referred to as “SWaP” (size, weight, and power) that are common in military applications. In addition, we design and build RF and microwave components and subsystems to meet the needs of the electronic warfare (“EW”), signals intelligence (“SIGINT”) and other high bandwidth communications requirements and applications.

We also provide significant capabilities relating to pre-integrated, open, affordable EW, electronic attack (“EA”) and electronic counter measure (“ECM”) subsystems, SIGINT and electro-optical/infrared (“EO/IR”) processing technologies, and radar environment test and simulation systems. We deploy these solutions on behalf of defense prime contractors and the Department of Defense (“DoD”), leveraging commercially available technologies and solutions (or “building blocks”) from our business and other commercial suppliers. We leverage this technology to design and build integrated sensor processing subsystems, often including classified application-specific software and intellectual property (“IP”) for the C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ECM markets. We bring significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

We deliver capabilities that combine technology building blocks, deep domain expertise in the defense sector and critical solution areas, and specialized skills in serving the DoD and the intelligence community.

Our revenues, income from continuing operations and adjusted EBITDA for fiscal 2016 were \$270.2 million, \$19.7 million and \$57.3 million, respectively. Our revenues, income from continuing operations and adjusted EBITDA for fiscal 2015 were \$234.8 million, \$14.4 million and \$44.4 million, respectively. See the Non-GAAP Financial Measures section of this annual report for a reconciliation of our adjusted EBITDA to net income (loss) from continuing operations.

#### Recent Developments

On May 2, 2016, we acquired the custom microelectronics, RF and microwave solutions, and embedded security operations from Microsemi Corporation (the “Carve-Out Business”), resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the “Acquisition”). Under the terms of the Purchase Agreement, we paid \$300.0 million in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments.

Net sales for the Carve-Out Business were \$99.4 million and \$87.2 million for its fiscal years ended September 27, 2015 and September 28, 2014, respectively, net income (loss) were \$6.4 million and (\$3.1) million for its fiscal years ended September 27, 2015 and September 28, 2014, respectively.

The Carve-Out Business is a leader in the design, development, and production of sophisticated electronic subsystems and components for use in high-technology products for defense and aerospace markets. The Carve-Out Business' defense electronics solutions include high-density memory modules, secure solid-state drives, secure GPS receiver modules, high-power RF amplifiers,

millimeter-wave modules and subsystems, and specialized software and firmware for anti-tamper applications. The Carve-Out Business' customers, which include many significant defense prime contractors, outsource many of their electronic design and manufacturing requirements to the Carve-Out Business as a result of its specialized capabilities in packaging electronics for SWaP-constrained environments, its focus on security and the unique requirements of defense applications, and its expertise in RF and microwave technologies. The Carve-Out Business' products and technologies are used in a variety of defense applications, including missiles and precision munitions, fighter and surveillance aircraft, airport security portals, and advanced electronic systems for radar and EW.

### *Strategic Rationale for the Acquisition*

We believe that the Acquisition will provide several significant strategic and operational benefits to us, including:

- creating the defense industry's largest commercial embedded secure processing company;
- adding secure solid-state drive ("SSDs") capabilities to our industry leading pre-integrated sensor processing subsystems;
- increasing our existing RF and microwave business by approximately 66% and adding new capabilities, scale and synergies;
- adding new capabilities in embedded security and custom microelectronics; and
- providing access to new high-growth markets, customers and programs, such as precision-guided munitions and missiles.

Key elements of our strategy to accomplish our continued growth objectives following the Acquisition include:

- *Achieve Design Wins on High-growth, High-priority Defense Programs.* We believe our advanced embedded sensor processing solutions position us well going forward to capture design wins on key high-growth, high-priority defense programs within our targeted segments of the C4ISR market. We have won designs in persistent ISR related signals intelligence-payloads on unmanned aerial vehicles ("UAVs") and other aerial platforms. As a result of these successes, we now have significant content on major UAV platforms, including Global Hawk, Predator, Triton, Reaper and Gorgon Stare. Our ballistic missile defense wins include additional designs on the Aegis program, as well as wins on the Patriot missile program. In EW, we have won key designs related to the U.S. Navy's SEWIP program and the Ships Signal Exploitation Equipment ("SSEE") programs. Additional wins in the critical EW space include the Navy's Filthy Badger and Filthy Buzzard programs, focusing on vulnerability assessment and training for manned aircraft. Together, these wins represent substantial opportunity for us in the years ahead.
- *Continue to Provide Excellent Performance on Our Existing Programs.* The foundation for our growth remains our continued involvement with existing programs that are in late-stage development or currently in production. Such programs include Aegis, SEWIP, the F-35 Joint Strike Fighter, Patriot missile, the F-16 and F-15 aircrafts, the Global Hawk, Predator and Reaper UAVs, the P-8 Multimission Maritime Aircraft as well as the Suite of Integrated Radio Frequency Countermeasures ("SIRFC") program. As part of a long-term reprioritization, the DoD is shifting its emphasis from major new weapons systems development to upgrades of existing programs and platforms. We believe the upgrades on these programs focus on four key areas: improved sensors; more advanced on-board embedded computing; enhanced ISR algorithms; and better communications on and off the platform. A key element of our strategy is to continue to provide high-performance, cost-effective solutions on these programs and for these customers.
- *Pursue Additional Strategic, Capability-Enhancing Acquisitions.* We will continue to pursue strategic acquisitions to augment our businesses using the following strategies: adding technologies or products that expand our core business by competing more effectively in the C4I, Radar, EW, and missile-defense markets; adding content and services to the defense programs and platforms in which we currently participate or could participate in the future; and enhancing key customer relationships and forming relationships with potential new customers. Our acquisition strategy also focuses on scaling our operations and broadening our program and customer base.
- *Capitalize on Outsourcing and Other Dynamics in the Defense Industry.* We are well-positioned to take advantage of several changing dynamics in the defense industry. Defense prime contractors are increasingly being awarded firm fixed-price contracts. These contracts shift risk to the defense prime contractors, and as a result they are beginning to outsource increasing levels of subsystem development and production and other higher value program content. In addition, the U.S. government is shifting toward shorter program timelines, which require increased flexibility and responsiveness from defense prime contractors. Finally, more programs are moving to open systems architectures that enable best-of-breed capabilities. We believe that these dynamics will result in defense prime contractors outsourcing increasing levels of program content to us as a provider of an increasingly wide array of differentiated products, subsystems engineering services and system integration.
- *Leverage Our Research and Development Efforts to Anticipate Market Needs and Maintain our Technology Leadership.* We devote significant resources in order to anticipate the future requirements in our target defense markets,

including monitoring and pioneering advances in advanced embedded computing hardware, security, and software, anticipating changes in U.S. government spending and procurement practices and leveraging insight from direct interaction with our customers. Our high-performance, quick reaction subsystems and capabilities require increasingly sophisticated hardware, software and middleware technology. In addition, as the defense industry shifts to products with open systems architectures, we believe that our software expertise will become increasingly important and differentiates us from many of our competitors as we have the ability to rapidly map complex algorithms onto SWaP-constrained on-board embedded sensor-processing solutions. We have invested in faster product development velocity, aligning with the U.S. government's demands on the defense prime contractors for quick reaction capabilities. By shortening our product development times, we are able to quickly launch the products we need to win new designs from the defense prime contractor community. We intend to continue utilizing company and customer-funded research and development, as well as our acquisition strategy, to develop technologies, products and solutions that have significant potential for near-term and long-term value creation in the defense industry.

We expect to realize aggregate annualized cost synergies from the Acquisition of approximately \$10.0 million per year by fiscal 2020. We expect to achieve approximately \$2.0 million of those annualized cost savings by the end of fiscal 2017 and an aggregate of approximately \$6.0 million of annualized savings by the end of fiscal 2018. Synergies are expected to be derived from sources such as manufacturing efficiencies, alignment of sales models and channel, and increased purchasing power.

During fiscal 2016, we completed a series of important internal organizational changes in order to integrate, align and scale ourselves into one business. In addition, over the past several years, we have completed several acquisitions, culminating with the Acquisition on May 2, 2016 to support our strategy of creating a better alternative for affordable, secure processing subsystems designed and made in the U.S.A. These strategic acquisitions and the associated operational and managerial changes finalized the transformation of the way the Company's executive management team, including the CEO as the chief operating decision maker ("CODM"), manage, evaluate and review the business, including how the CODM allocates resources and assesses performance. Therefore, during the fourth quarter ended June 30, 2016, we eliminated the use of Mercury Commercial Electronics ("MCE") and Mercury Defense Systems ("MDS") as reportable segments because the analogous operating segments ceased to exist. We are now comprised of one operating and reportable segment. We utilized the management approach for determining our operating segment in accordance with Financial Accounting Standard Boards ("FASB") Accounting Standards Codification ("ASC") 280, *Segment Reporting* ("FASB ASC 280").

On December 16, 2015, we acquired Lewis Innovative Technologies, Inc. ("LIT") for \$10.0 million in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments. Embedded systems security has become a requirement for new and emerging military programs, and LIT's security solutions significantly extend our capabilities and leadership in secure embedded computing, a critical differentiator from our traditional competition. LIT's solutions, combined with our next-generation secure Intel server-class product line, together with increasingly frequent mandates from the government to secure electronic systems for domestic and foreign military sales, position us well to capitalize on DoD program protection security requirements.

## **Our Market Opportunity**

Our market opportunity is defined by the growing demand for domestically designed and manufactured secure sensor and mission processing capabilities for critical defense and intelligence applications. Historically, our primary market has been centered on bringing commercially available technologies to the defense sector, specifically C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ballistic missile defense; and commercial markets, which include commercial communications and other commercial computing applications. We believe we are well-positioned in growing, sustainable market segments of the defense sector that rely on advanced technologies to improve warfighter capability and provide enhanced force protection capabilities. The Acquisition will further improve our ability to successfully compete in these market segments by allowing us to offer an even more comprehensive set of closely related capabilities.

We believe there are a number of evolving trends that are reshaping our target markets and accordingly provide us with attractive growth opportunities. These trends include:

- *The defense electronics market is expected to grow in government fiscal 2017 and beyond as requested in President Obama's recent budget submission.* According to The Teal Group, world defense electronics funding available to the U.S. was approximately \$34.9 billion in fiscal 2016, or approximately 6.7% of the government fiscal 2016 appropriated U.S. DoD base budget. The defense electronics market is projected to increase to \$36.6 billion in government fiscal 2017. Within the context of the overall defense budget and spending for defense electronics specifically we believe ISR, EW and ballistic missile defense have a high priority for future DoD spending. We continue to build on our strengths in the design and development of performance optimized electronic subsystems for the ISR and EW markets. As a leader in these markets, we often team with multiple defense prime contractors as they bid for projects, thereby increasing our chance of a successful outcome.
- *The rapidly expanding demand for tactical ISR is leading to significant growth in sensor data being generated, leading to even greater demand for the capability of our products to securely store and process data onboard platforms.* An

increase in the prevalence and resolution of ISR sensors is generating significant growth in the associated data that needs to be stored and turned into information for the warfighter in a timely manner. In addition, several factors are driving the defense and intelligence industries to demand greater capability to collect, store, and process data onboard the aircraft, UAVs, ships and other vehicles, which we refer to collectively as platforms. These factors include the limited communications bandwidth of existing platforms, the need for platforms that can operate more autonomously and possibly in denied communications environments, the need for platforms with increased persistency to enable them to remain in or fly above the battlefield for extended periods, and the need for greater onboard processing capabilities.

- *Rogue nations' missile programs and threats from peer nations are causing greater investment in advanced new radar, EW and ballistic missile defense capabilities.* There are a number of new and emerging threats, such as peer nations developing stealth technologies, including stealth aircraft, new anti-ship ballistic missiles that potentially threaten the U.S. naval fleet, and a variety of other advanced missile capabilities. Additionally, U.S. armed forces require enhanced signals intelligence and jamming capabilities. In response to these emerging threats, we have participated in key DoD programs, including Aegis, Patriot, SEWIP, LRDR, F-22 Raptor, F-35 Joint Strike Fighter and upgrade programs for the F-15 and F-16.
- *The long-term DoD budget pressure is pushing more dollars toward upgrades of the electronic subsystems on existing platforms, which may increase demand for our products.* The DoD is moving from major new weapons systems developments to upgrades of the electronic subsystems on existing platforms. These upgrades are expected to include more sensors, signal processing, ISR algorithms, multi-intelligence fusion and exploitation, computing and communications. We believe that upgrades to provide new urgent war fighting capability, driven by combatant commanders, are occurring more rapidly than traditional defense prime contractors can easily react to. We believe these trends will cause defense prime contractors to increasingly seek out our high-performance, cost-effective open architecture products.
- *Defense procurement reform is causing the defense prime contractors to outsource more work to commercial companies.* According to the VDC Webcast: Budgetary & Strategic Shifts-Creating Opportunities for Merchant Embedded COTS Systems in Mil/Aero, the portion of the defense electronics market that is captive to the defense primes is estimated to be \$35.1 billion and the portion in the merchant market is estimated to be \$1.9 billion. The U.S. government is intensely focused on making systems more affordable and shortening their development time. As a company that provides commercial items to the defense industry, we believe our products and subsystem solutions are often more affordable than solutions with the same functionality developed by a defense prime contractor. Several DoD and prime contractor factors are providing incentives for defense prime contractors to outsource more work to subcontractors with significant expertise and cost-effective technology capabilities, and we have transformed our business model over the last several years to address these long-term outsourcing trends and other needs.
- *DoD security and program protection requirements are creating new opportunities for our advanced secure processing capabilities.* The government is focused on ensuring that the U.S. military protects its defense electronic systems and the information held within from nefarious activities such as tampering, reverse engineering, and other forms of advanced attacks. The requirement to add security comes at a time when the commercial technology world continues to offshore more of the design, development, manufacturing, and support of such capabilities, making it more difficult to protect against tampering, reverse engineering and other undesired activities. The DoD has a mandate to ensure both the provenance and integrity of the technology and its associated supply chain. These factors have created a unique opportunity for us to expand beyond sensor processing into the provision of advanced secure processing subsystems and capabilities for other on-board critical compute applications-all designed, developed, manufactured, and supported in the U.S.A. In addition, advanced systems sold to foreign military buyers also require protection so that the technologies, techniques and data associated with them do not become more widely available, which further enhances our market opportunity.

## **Our Competitive Strengths**

We believe the following competitive strengths will allow us to take advantage of the evolving trends in our industry and successfully pursue our business strategy:

- *Subsystem Solutions Provider for the C4ISR and EW Markets.* Through our commercially developed, specialized processing subsystem solutions, we address the challenges associated with the collection and processing of massive, continuous streams of data and dramatically shorten the time that it takes to give information to U.S. armed forces at the tactical edge. Our solutions are specifically designed for flexibility and interoperability, allowing our products to be easily integrated into larger system-level solutions. Our ability to integrate subsystem-level capabilities allows us to provide solutions that most effectively address the mission-critical challenges within the C4ISR market, including multi-intelligence data fusion and intelligence processing onboard the platform. We leverage our deep expertise in embedded multi-computing, embedded sensor processing, with the addition of our RF and microwave subsystems and components, along with strategic investments in research and development to provide solutions across the sensor processing chain.

Our deep domain knowledge within the Company rounds out our capabilities and services to our prime contractor and DoD customers. The Acquisition adds both depth and breadth to our capabilities and offerings, and also opens new market opportunities such as missiles, precision guided munitions and homeland security.

- *Diverse Mix of Stable, Growth Programs Aligned with DoD Funding Priorities.* Our products and solutions have been deployed on more than 300 different programs and over 25 different defense prime contractors. We serve high priority markets for the DoD and foreign militaries, such as UAVs, ballistic missile defense, airborne reconnaissance, EW, ECM, and have secured positions on mission-critical programs including Aegis, Predator and Reaper UAVs, F-35 Joint Strike Fighter, Patriot missile, and SEWIP. In addition, we consistently leverage our technology and capabilities across 15 to 20 programs on an annual basis, providing significant operating leverage and cost savings. The Acquisition allows us to participate in a broader array of programs, many with customers that are already key strategic customers of ours.
- *We are a leading commercial provider of secure processing subsystems designed and made in the U.S.A.* We have a portfolio of open system architecture (“OSA”) technology building blocks across the entire sensor processing chain. We offer embedded secure processing capabilities with advanced packaging and cooling technologies that ruggedize commercial technologies while allowing them to stay cool for reliable operation. These capabilities allow us to help our customers meet the demanding SWaP requirements of today’s defense platforms. Our pre-integrated subsystems improve affordability by substantially reducing customer system integration costs and time-to-market for our solutions. System integration costs are one of the more substantial costs our customers bear in developing and deploying technologies in defense programs and platforms. Our pre-integrated solutions approach allows for more rapid and affordable modernization of existing platforms and faster deployment of new platforms.

Our strengths in this area include our position as an early and leading advocate for OSA in defense, offering Intel server class processing form factors across 3/6U OpenVPX, ATCA and rack-mount architectures, and high density, secure solutions across multiple hardware architectures to seamlessly scale to meet our customer’s SWaP requirements. In addition, we have a 30-year legacy of system management and system integration expertise that allows us to reduce technical risk, while improving affordability and interoperability. Our system integration expertise is a cornerstone in helping us support our customers in deploying pre-integrated, OSA subsystems.

- *We provide advanced, integrated security features for our products and subsystems, addressing an increasingly prevalent requirement for DoD program security.* We offer secure processing expertise that is built-in to our pre-integrated subsystems, not bolted on. By doing this we are able to provide secure building blocks that allow our customers to incorporate their own security capabilities. This assists our customers in ensuring program protection as they deploy critical platforms and programs, all in support of DoD missions. The Acquisition will bring us new security technologies and also allow us to provide enhanced security capabilities in areas such as memory and storage devices. The Acquisition also provides us with a DMEA- (“Defense Micro-Electronics Association”) certified trusted manufacturing facility for microelectronics in the Carve-Out Business’ Phoenix, Arizona facility.
- *We are pioneering a next generation business model.* The defense industrial base is currently undergoing a major transformation. Domestic political and budget uncertainty, geopolitical instability and evolving global threats have become constants. The defense budget, while stabilized in the short term, remains under pressure and R&D and technology spending are often in budgetary competition with the increasing costs of military personnel requirements, health care costs, and other important elements within the DoD and the federal budget generally. Finally, defense acquisition reform, under the banner of Better Buying Power 3.0 calls for the continued drive for innovation and competition within the defense industrial base, while also driving down acquisition cost. Our approach is built around a few key pillars:
  - We continue to leverage our expertise in building pre-integrated subsystems in support of critical defense programs, driving out procurement costs by lowering integration expenses of our customers.
  - We have been a pioneer in driving open systems architectures.
  - The DoD has asked defense industry participants to invest their own resources into R&D. This approach is a pillar of our business model.
  - Security and program protection are now critical considerations for both program modernizations as well as for new program deployment. We are now in our third generation of building secure embedded processing solutions.

We have a next generation business model built to meet the emerging needs of the DoD.

- *Value-Added Subsystem Solution Provider for Defense Prime Contractors.* Because of the DoD’s shift towards a firm fixed price contract procurement model, an increasingly uncertain budgetary and procurement environment, and increased budget pressures from both the U.S. and allied governments, defense prime contractors are accelerating their move toward outsourcing opportunities to help mitigate the increased program and financial risk. Our differentiated advanced sensor processing solutions offer meaningful capabilities upgrades for our customers and enable the rapid, cost-effective

deployment of systems to the end customer. We believe our open architecture subsystems offer differentiated sensor processing and data analytics capabilities that cannot be easily replicated. Our solutions minimize program risk, maximize application portability, and accelerate customers' time to market, all within a fixed-pricing contracting environment.

- *Delivery of Platform-Ready Solutions for Classified Programs.* We believe our integration work through our Cypress, California facility provides us with critical insights as we implement and incorporate key classified government intellectual property, including critical intelligence and signal processing algorithms, into advanced systems. This integration work provides us the opportunity to directly combine and integrate our technology building blocks along with our intellectual property into our existing embedded processing products and solutions, enabling us to deliver more affordable, platform-ready integrated ISR subsystems that leverage our OSA and address key government technology and procurement concerns. Our operations in this environment also help us identify emerging needs and opportunities to influence our future product development, so that critical future needs can be met in a timely manner with commercially-developed products and solutions.
- *Advanced Microelectronics Centers.* Our Advanced Microelectronics Centers ("AMCs") in Hudson, New Hampshire and West Caldwell, New Jersey, design, build and test both RF and microwave components and subsystems in support of a variety of key customer programs. With our fiscal 2014 move into our new AMC in Hudson, New Hampshire, including the installation of integrated business systems into both our AMCs, we have a platform for scalable, continued growth in our RF and microwave product lines. Our scalable microelectronics manufacturing operations at our AMCs enable rapid, cost-effective deployment of RF and microwave solutions to our customers. The Acquisition will give us a west coast location providing similar advanced capabilities and better proximity to certain key customer locations.
- *Long-Standing Industry Relationships.* We have established long-standing relationships with defense prime contractors, the U.S. government and other key organizations in the defense industry over our 30 years in the defense electronics industry. Our customers include BAE Systems, the Boeing Company, Harris, Lockheed Martin Corporation, Northrop Grumman Corporation, and Raytheon Company. Over this period, we have become recognized for our ability to develop new technologies and meet stringent program requirements. We believe we are well-positioned to maintain these high-level customer engagements and enhance them through the additional relationships that the Carve-Out Business has with many of the same customers.
- *Proven Management Team.* Over the past several years, our senior management team has refocused the Company on its economic core, developed a long-term compelling strategy for the defense markets and restored profitability to the business. Having completed these critical steps to rebuild the Company and with a senior management team with significant experience in growing and scaling businesses, both through operating execution and acquisitions, we believe that we have demonstrated our operational capabilities and we are well-positioned for the next phase to transform, grow and scale our business.

## **Our Business Strategy**

Our strategy is built around our key strengths as a leading commercial provider of secure and processing subsystems designed and made in the U.S.A. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. We are pioneering a next-generation defense electronics business model specifically designed to meet the industry's current and emerging technology needs. By driving this strategy consistently, we are able to help our customers, mostly defense prime contractors, reduce program cost, minimize technical risk, and stay on schedule and on budget. Tactically, we have a reputation of relentless execution on behalf of our customers that supports the successful evolution of our strategy.

We intend to accelerate our strategic direction through continued investment in advanced new products and solutions development in the fields of radio frequency, analog-to-digital and digital to analog conversion, advanced multi- and many-core sensor processing systems including GPUs, embedded security, digital storage, and digital radio frequency memory ("DRFM") solutions, software defined communications capabilities, and advanced security technologies and capabilities. We leverage our engineering development services including systems integration to accelerate our move to become a commercial outsourcing partner to the large defense prime contractors as they seek the more rapid design, development and delivery of affordable, commercially-developed, open sensor processing solutions within the markets we serve. Our services-led engagements can help lead to long-term production subsystem revenues that will continue long after the initial services are delivered. This business model positions us to be paid for non-recurring engineering work we would have previously expensed through our own income statement, to team concurrently with multiple defense prime contractors as they pursue new business with the unique solutions they develop and market to the government, and to engage with our customers much earlier in the design cycle and ahead of our competition. In fiscal 2016, we have substantially added to our technology portfolio by adding capabilities in secure embedded computing, with the acquisition of LIT and a variety of defense applications with the acquisition of the Carve-Out Businesses, including missiles and precision munitions, fighter and surveillance aircraft, airport security portals, and advanced electronic systems for radar and EW.

## Our Solutions and Products

### *Services*

As part of our strategy, we are focusing on being a commercial outsourcing partner to the large defense prime contractors as they seek the more rapid design, development and delivery of affordable, commercially developed, specialized processing solutions within the markets we serve. We deliver subsystem level engineering expertise as well as ongoing systems integration services addressing our strategy to capitalize on the multi-billion dollar subsystem market within the defense embedded electronics market segment.

As the U.S. government mandates more outsourcing and open standards, a major shift is occurring within the defense prime contractor community towards procurement of integrated subsystems that enable quick application level porting through standards-based methodologies. We believe that our core expertise in this area is well aligned to capitalize on this trend. By leveraging our open architecture and high performance modular product set, we provide defense prime contractors with rapid deployment and quick reaction capabilities through our professional services and systems integration offerings. This results in less risk for the defense prime contractors, shortened development cycles, quicker solution deployment and reduced lifecycle costs.

We define service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold by us. Examples of our service revenues include: analyst services and systems engineering support, consulting, maintenance and other support, testing and installation. We combine our product and service revenues into a single class as services revenues do not exceed 10 percent of total revenues.

### *Software Products*

We actively design, market and sell complete software and middleware environments to accelerate development and execution of complex signal and image processing applications on a broad range of heterogeneous, multi-computing platforms. Our software suite is based on open standards and includes heterogeneous processor support with extensive high performance math libraries, multi-computing fabric support, net-centric and system management enabling services, extended operating system services, board support packages and development tools.

Our software is developed using some of the most advanced integrated development environments ("IDE's"), such as Eclipse, and our work is done on multiple platforms including open source platforms such as Linux. Our software development teams are schooled in the most up-to-date software development methodologies.

Our software and middleware provides customer application-level algorithm portability across rapidly evolving hardware processor types with math and input/output, or I/O, interfaces running at industry leading performance rates. In order to develop, test and integrate software ahead of hardware availability, we have invested in the notion of a Virtual Multi-Computer. The Virtual Multi-Computer model allows for concurrent engineering internally and with customers to accelerate time to deployment, improve quality and reduce development costs. In most cases, these software products are bundled together with broader solutions including hardware and/or services, while in other cases they are licensed separately.

Our multi-computer software packages are marketed and licensed under the *MultiCore Plus*<sup>®</sup> registered trademark. These software products are a key differentiator for our systems business and represent only a modest amount of stand-alone revenue. We generally charge a user-based development license fee and bundle software run-time licenses with our hardware. We offer a standards-based software value proposition to our customers and provide this offer through several integrated software packages and service offerings.

### *Hardware Products*

We offer a broad family of products designed to meet the full range of requirements in compute-intensive, signal processing and image processing applications, multi-computer interconnect fabrics, sensor interfaces and command and control functions. To maintain a competitive advantage, we seek to leverage technology investments across multiple product lines. We are also influential in the industry-standard organizations associated with our market segments. For example, we started the OpenVPX<sup>™</sup> initiative with the goal of providing customers with multi-vendor interoperable hardware built to well-defined system standards. We continue to leverage our embedded high performance processing technologies with our Intel server-class processing products as well as graphics based processor ("GPGPU") products. While this multi-computing and embedded processing technology is a core skill of Mercury Systems, the size, weight, and power ("SWaP") constraints that occur concurrent with the high performance embedded processing create unique challenges. For example, with the heat build-up involved in small subsystems, we introduced a key innovation in fiscal 2013 designed to address this challenge. The technology is called Air-Flow-By<sup>™</sup> and it allows previously unattainable levels of processing power within a small footprint by effectively removing heat so the server-class processors can perform at maximum designed power limits. In rugged environments where air is limited, such as high altitude operations, a technology developed in fiscal 2014 called Liquid-Flow-By<sup>™</sup> has been successfully customer tested allowing maximum server-class processor performance in high altitude missions. These innovative cooling techniques for the first time allow full performance

server-class processing in rugged environments enabling new and advanced modes of operation that enhance the multi-intelligence, situational awareness and EW capabilities in military platforms.

Our hardware products are typically compute-intensive and require extremely high inter-processor bandwidth and high I/O capacity. These systems often must also meet significant size, weight and power constraints for use in aircraft, UAVs, ships and other vehicles, and be ruggedized for use in highly demanding use environments. They are used in both commercial industrial applications, such as ground radar air traffic control, and advanced defense and intelligence applications, including space-time adaptive processing, synthetic aperture radar, airborne early warning, command, control, communication and information systems, mission planning, image intelligence and signal intelligence systems. Our products transform the massive streams of digital data created in these applications into usable information in real time. The systems can scale from a few processors to thousands of processors.

We group our hardware products into the following categories:

- signal and image processing, multi-computer and sensor interfaces, including embedded processing boards, switch fabric boards, high speed input/output boards, digital receiver boards, high-density memory modules, secure solid-state drives, secure GPS receiver modules, and chassis-based systems using air, conduction, and proprietary cooling technologies;
- RF and microwave assemblies, including tuners, converters, transceivers, and switch filters; and
- RF and microwave components, including power amplifiers and limiters, switches, oscillators, and equalizers.

To address the current challenges facing the war fighter, our government and defense prime contractors, we have developed a new product architecture that supports a more dynamic, iterative, spiral development process by leveraging open architecture standards and leading-edge commercial technologies and products. Configured and productized as integrated subsystems, customers can rapidly and cost-effectively port and adapt their applications to changing threats.

Our open architecture is carried throughout our entire Ensemble<sup>®</sup> product line from the very small form-factor subsystems to the high-end, where ultimate processing power and reliability is of paramount importance to the mission. Our commercially-developed hardware and software product capabilities cover the entire ISR spectrum from acquisition and digitization of the signal, to processing of the signal, through the exploitation and dissemination of the information. We work continuously to improve our hardware technology with an eye toward optimization of SWaP demands, as outlined above.

Embedded systems security has become a requirement for new and emerging military programs, and our security solutions are a critical differentiator from our traditional competition. Our security solutions, combined with our next-generation secure Intel server-class product line, together with increasingly frequent mandates from the government to secure electronic systems for domestic and foreign military sales, position us well to capitalize on DoD program protection security requirements. In the defense market, examples of our hardware intellectual property include scalable anti-tamper and information assurance products such as EnforcIT, WhiteboxCRYPTO, and CodeSEAL. In the commercial market, examples of our hardware intellectual property products include our CANGuard product, which provides advanced security for the electronic communications and control architectures on a wide variety of automotive vehicles.

## **Research and Product Development**

Our research and development efforts are focused on developing new products and systems as well as enhancing existing hardware and software products in mission, signal and image processing. Our research and development goal is to fully exploit and maintain our technological lead in the high-performance, real-time sensor processing industry. Expenditures for research and development amounted to \$33.5 million, \$32.6 million, and \$35.7 million in fiscal 2016, 2015, and 2014, respectively. As of June 30, 2016, we had 313 employees, including hardware and software architects and design engineers, primarily engaged in engineering and research and product development activities. These individuals, in conjunction with our sales team, also devote a portion of their time to assisting customers in utilizing our products, developing new uses for these products and anticipating customer requirements for new products.

## **Manufacturing**

The majority of our sales are produced in International Organization for Standardization, or ISO, 9001:2000 quality system certified facilities. The current scope of delivered hardware products includes commercial and industrial class printed circuit board assemblies (modules), complex chassis systems, and RF & microwave components and subsystems.

Our Phoenix, Arizona facility manufactures our custom microelectronics products in ISO, 9001:2008 and AS9100 quality system certified facilities. This is a DMEA certified trusted manufacturing facility and is primarily focused on advanced secure system-on-chip design, assembly, packaging, and test. Our Camarillo, California facility manufactures our radio frequency and microwave products in ISO 9001:2008 and AS9100 quality system certified facilities. This facility is primarily focused on millimeter wave RF products up to 100GHz, gallium nitride-based power amplifiers and subsystems, analog and digital mixed signal system-on-chip capabilities, and custom modules for active electronically scanned arrays.

We rely on both subcontracting to contract manufacturers and vertical integration to meet our manufacturing needs. Our printed circuit board assemblies and chassis systems' manufacturing operations consist primarily of materials planning and procurement, final assembly and test and logistics (inventory and traffic management). We subcontract the assembly and testing of most embedded multi-computing products to contract manufacturers in the U.S. to build to our specifications. We currently rely primarily on one contract manufacturer. Our vertically integrated products rely on strong relationships with strategic suppliers to ensure on-time delivery and high quality products. We manage supplier performance and capability through quality audits and stringent source, incoming and/or first article inspection processes. We have a comprehensive quality and process control plan for each of our products, which include an effective supply chain management program and the use of automated inspection and test equipment to assure the quality and reliability of our products. We perform most post sales service obligations (both warranty and other lifecycle support) in-house through a dedicated service and repair operation. We periodically review our contract manufacturing capabilities to ensure we are optimized for the right mix of quality, affordability, performance and on-time delivery.

We built out a new microelectronics facility in Hudson, New Hampshire that opened during fiscal 2014. This facility consolidated the former microelectronics operations in Salem, New Hampshire and Hudson, New Hampshire as well as the former facilities in Ewing, New Jersey and Monroe, Connecticut. This facility is specifically aimed at providing scalable manufacturing within our critical RF and microwave businesses. We leverage best practices in design, development, manufacturing and materials handling at this facility. The facility is part of our Advanced Microelectronics Centers, which includes our RF/microwave subsystems group in West Caldwell, New Jersey. The Advanced Microelectronics Centers design, build and test both RF and microwave components and subsystems in support of a variety of key customer programs.

Although we generally use standard parts and components for our products, certain components, including custom designed ASICs, static random access memory, FPGAs, microprocessors and other third-party chassis peripherals (single board computers, power supplies, blowers, etc.), are currently available only from a single source or from limited sources. With the exception of certain components that have gone "end of life", we strive to maintain minimal supply commitments from our vendors and generally purchase components on a purchase order basis as opposed to entering into long-term procurement agreements with vendors. We have generally been able to obtain adequate supplies of components in a timely manner from current vendors or, when necessary to meet production needs, from alternate vendors. We believe that, in most cases, alternate vendors can be identified if current vendors are unable to fulfill needs.

We also design, develop, and manufacture DRFM units for a variety of modern EW applications, as well as radar environment simulation and test systems for defense and intelligence applications. We develop high performance SIGINT payloads and electro-optical/infrared ("EO/IR") technologies for small UAV platforms as well as powerful onboard UAV processor systems for real-time Wide Area Motion Imagery ("WAMI").

## **Competition**

We operate in a highly competitive marketplace characterized by rapidly changing technology, frequent product performance improvements, increasing speed of deployment to align with warfighters' needs, and evolving industry standards and requirements coming from our customers or the DoD. Competition typically occurs at the design stage of a prospective customer's product, where the customer evaluates alternative technologies and design approaches. We work with defense prime contractors as well as directly with the DoD. We help drive subsystem development and deployment in both classified and unclassified environments.

The principal competitive factors in our market are price/performance value proposition, available new products at the time of design win engagement, services and systems integration capability, effective marketing and sales efforts, and reputation in the market. Our competitive strengths include innovative engineering in both hardware and software products, subsystem design expertise, advanced packaging capability to deliver the most optimized SWaP solution possible, our ability to rapidly respond to varied customer requirements, and a track record of successfully supporting many high profile programs in the defense market. There are a limited number of competitors across the market segments and application types in which we compete. Some of these competitors are larger and have greater resources than us. Some of these competitors compete against us at purely a board-level, others at a subsystem level. We also compete with in-house design teams at our customers. The DoD as well as the defense prime contractors are pushing for more outsourcing of subsystem designs to mitigate risk and to enable concurrent design of the platform which ultimately leads to faster time to deployment. We have aligned our strategy to capitalize on that trend and are leveraging our long standing subsystem expertise to provide this value to our customers.

## **Intellectual Property and Proprietary Rights**

As of June 30, 2016, we held 67 patents of varying duration issued in the United States. We file U.S. patent applications and, where appropriate, foreign patent applications. We also file continuations to cover both new and improved designs and products. At present, we have several U.S. and foreign patent applications in process.

We also rely on a combination of trade secret, copyright, and trademark laws, as well as contractual agreements, to safeguard our proprietary rights in technology and products. In seeking to limit access to sensitive information to the greatest practical extent,

we routinely enter into confidentiality and assignment of invention agreements with each of our employees and consultants and nondisclosure agreements with our key customers and vendors.

## **Backlog**

As of June 30, 2016, we had a backlog of orders aggregating approximately \$287.7 million, of which \$239.2 million is expected to be delivered within the next twelve months. The backlog as of June 30, 2016 included \$62.9 million from the Carve-Out Business. As of June 30, 2015, backlog was approximately \$208.0 million. We include in our backlog customer orders for products and services for which we have accepted signed purchase orders, as long as that order is scheduled to ship or invoice in whole, or in part, within the next 24 months. Orders included in backlog may be canceled or rescheduled by customers, although the customer may incur cancellation penalties depending on the timing of the cancellation. A variety of conditions, both specific to the individual customer and generally affecting the customer's industry, may cause customers to cancel, reduce or delay orders that were previously made or anticipated. We cannot assure the timely replacement of canceled, delayed or reduced orders. Significant or numerous cancellations, reductions or delays in orders by a customer or group of customers could materially and adversely affect our results of operations or our ability to predict future revenues. Backlog should not be relied upon as indicative of our revenues for any future period.

## **Employees**

At June 30, 2016, we employed a total of 965 people excluding contractors, including 313 in research and development, 77 in sales and marketing, 438 in manufacturing and customer support and 137 in general and administrative functions. We have five employees located in Europe, one located in Japan, and 959 located in the United States. We do not have any employees represented by a labor organization, and we believe that our relations with our employees are good.

## **Customers**

Our revenues are concentrated in three defense prime contractors including Lockheed Martin Corporation, Raytheon Company and Northrop Grumman Corporation for the years ended June 30, 2016, 2015 and 2014. These three defense prime contractors comprised an aggregate of 51%, 61% and 43% of our revenues in each of the years ended June 30, 2016, 2015 and 2014, respectively. While sales to these customers typically compose 10% or more of our revenue, the sales to each of these customers are spread across multiple programs and platforms.

## **WEBSITE**

We maintain a website at [www.mrcy.com](http://www.mrcy.com). We make available on our website, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, including exhibits and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC"). Our code of business conduct and ethics is also available on our website. We intend to disclose any future amendments to, or waivers from, our code of business conduct and ethics within four business days of the waiver or amendment through a website posting or by filing a current report on Form 8-K with the SEC. Information contained on our website does not constitute part of this report. Our reports filed with, or furnished to, the SEC are also available on the SEC's website at [www.sec.gov](http://www.sec.gov).

## **OTHER INFORMATION**

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### **ITEM 1A. RISK FACTORS:**

**We depend heavily on defense electronics programs that incorporate our products and services, which may be only partially funded and are subject to potential termination and reductions and delays in government spending.**

Sales of our products and related services, primarily as an indirect subcontractor or team member with defense prime contractors, and in some cases directly, to the U.S. government and its agencies, as well as foreign governments and agencies, accounted for approximately 98%, 94%, and 92% of our total net revenues in fiscal 2016, 2015, and 2014, respectively. Our products and services are incorporated into many different domestic and international defense programs. Over the lifetime of a defense program, the award of many different individual contracts and subcontracts may impact our products' requirements. The funding of U.S. government programs is subject to Congressional appropriations. Although multiple-year contracts may be planned

in connection with major procurements, Congress generally appropriates funds on a fiscal year basis even though a program may continue for many years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations and prime contracts receive such funding. The reduction or delay in funding or termination of a government program in which we are involved would result in a loss of or delay in receiving anticipated future revenues attributable to that program and contracts or orders received. The U.S. government could reduce or terminate a prime contract under which we are a subcontractor or team member irrespective of the quality of our products or services. The termination of a program or the reduction in or failure to commit additional funds to a program in which we are involved could negatively impact our revenues and have a material adverse effect on our financial condition and results of operations. The U.S. defense budget frequently operates under a continuing budget resolution, which increases revenue uncertainty and volatility. During fiscal 2014, the Presidential election, bipartisan gridlock in Congress, a continuing budget resolution, and the implementation of defense budget sequestration impacted our revenues and increased uncertainty in our business and financial planning. For fiscal 2017 and beyond, the potential for further bipartisan gridlock in Congress, another continuing budget resolution, and the defense industry operating under sequestration may continue to adversely impact our revenues and increase uncertainty in our business and financial planning. In addition, delays in the funding for new or existing programs, or of the defense appropriation generally could negatively impact our revenues and have a material adverse effect on our financial condition and results of operations for the period in which such revenues were originally anticipated. Further, oil price volatility and the decline in oil prices may negatively impact foreign military sales funding program size due to oil's impact on foreign budgets.

**Economic conditions could adversely affect our business, results of operations and financial condition.**

The world's financial markets have experienced turmoil, characterized by reductions in available credit, volatility in security prices, rating downgrades of investments, and reduced valuations of securities. These events have materially and adversely impacted the availability of financing to a wide variety of businesses, including small businesses, and the resulting uncertainty has led to reductions in capital investments, overall spending levels, future product plans, and sales projections across many industries and markets. These trends could have a material adverse impact on our business. These trends could also impact our financial condition and our ability to achieve targeted results of operations due to:

- reduced and delayed demand for our products;
- increased risk of order cancellations or delays;
- downward pressure on the prices of our products;
- greater difficulty in collecting accounts receivable; and
- risks to our liquidity, including the possibility that we might not have access to our cash and short-term investments or to our line of credit when needed.

Further, the funding of the defense programs that incorporate our products and services is subject to the overall U.S. government budget and appropriation decisions and processes, which are driven by numerous factors beyond our control, including geo-political, macroeconomic, and political conditions. Increased federal budget deficits could result in reduced Congressional appropriations, such as defense budget sequestration, for the defense programs that use our defense electronics products and services. Reduced baseline defense budgets could reduce the number of funded programs in which we participate. In addition, Congress could fund U.S. government operations through a continuing budget resolution without approving a formal budget for the government fiscal year, thereby potentially reducing or delaying the demand for our products. We are unable to predict the likely duration and severity of adverse economic conditions in the United States and other countries, but the longer the duration or the greater the severity, the greater the risks we face in operating our business.

**We face other risks and uncertainties associated with defense-related contracts, which may have a material adverse effect on our business.**

Whether our contracts are directly with the U.S. government, a foreign government, or one of their respective agencies, or indirectly as a subcontractor or team member, our contracts and subcontracts are subject to special risks. For example:

- Changes in government administration and national and international priorities, including developments in the geo-political environment, could have a significant impact on national or international defense spending priorities and the efficient handling of routine contractual matters. These changes could have a negative impact on our business in the future.
- Our contracts with the U.S. and foreign governments and their defense prime contractors and subcontractors are subject to termination either upon default by us or at the convenience of the government or contractor if, among other reasons, the program itself has been terminated. Termination for convenience provisions generally entitle us to recover costs incurred, settlement expenses and profit on work completed prior to termination, but there can be no assurance in this regard.

- Because we contract to supply goods and services to the U.S. and foreign governments and their prime and subcontractors, we compete for contracts in a competitive bidding process and, in the event we are awarded a contract, we are subject to protests by disappointed bidders of contract awards that can result in the reopening of the bidding process and changes in governmental policies or regulations and other political factors. In addition, we may be subject to multiple rebid requirements over the life of a defense program in order to continue to participate on such program, which can result in the loss of the program or significantly reduce our revenue or margin from the program. The government's requirements for more frequent technology refreshes on defense programs may lead to increased costs and lower long term revenues.
- Consolidation among defense industry contractors has resulted in a few large contractors with increased bargaining power relative to us. The increased bargaining power of these contractors may adversely affect our ability to compete for contracts and, as a result, may adversely affect our business or results of operations in the future.
- Our customers include U.S. government contractors who must comply with and are affected by laws and regulations relating to the formation, administration, and performance of U.S. government contracts. In addition, when our business units contract with the U.S. government, they must comply with these laws and regulations, including the organizational conflict-of-interest regulations. A violation of these laws and regulations could result in the imposition of fines and penalties to us or our customers or the termination of our or their contracts with the U.S. government. As a result, there could be a delay in our receipt of orders from our customers, a termination of such orders, or a termination of contracts between our business units and the U.S. government.
- We sell many products to U.S. and international defense contractors and also directly to the U.S. government as a commercial supplier such that cost data is not supplied. To the extent that there are interpretations or changes in the Federal Acquisition Regulations regarding the qualifications necessary to be a commercial item supplier, there could be a material adverse effect on our business and operating results. For example, there have been legislative proposals to narrow the definition of a "commercial item" (as defined in the Federal Acquisition Regulations) that could limit our ability to contract as a commercial item supplier. In addition, growth in our defense sales relative to our commercial sales could adversely impact our status as a commercial supplier, which could adversely affect our business and operating results. Changes in our mix of business, in federal regulations, or in the interpretation of federal regulations, may subject us to audit by the Defense Contract Audit Agency ("DCAA") for certain of our products or services. Such changes may require us to implement a DCAA cost-accounting system at our commercial item business unit. Operating under a cost-accounting business model rather than our historical commercial item business model could adversely impact our revenues and profitability.
- We qualify as a "small business" for government contracts purposes under the definition of that term in an applicable NAICS code because we have fewer than 1,250 employees. As we grow and potentially have over 1,250 employees in the future, we would no longer qualify as a small business. Loss of our small business status could negatively impact us, including our customers purchases from us would not qualify as purchases from a small business, customers may flow down additional Federal Acquisition Regulation, or FAR, clauses in their contracts with us that are less favorable than our existing contract terms and conditions, and the flow down of certain FAR clauses may require us to implement a DCAA cost-accounting system at our commercial item business unit.
- We are subject to the Defense Federal Acquisition Regulations Supplement, referred to as DFARS, in connection with our defense work for the U.S. government and defense prime contractors. Amendments to the DFARS, such as the amendment to the DFARS specialty metals clause requiring that the specialty metals in specified items be melted or produced in the U.S. or other qualifying countries, may increase our costs for certain materials or result in supply-chain difficulties or production delays due to the limited availability of compliant materials. Compliance with the new conflict minerals regulations enacted pursuant to the Dodd Frank legislation poses similar risks and increases our costs.
- The U.S. government or a defense prime contractor customer could require us to relinquish data rights to a product in connection with performing work on a defense contract, which could lead to a loss of valuable technology and intellectual property in order to participate in a government program.
- We are subject to various U.S. federal export-control statutes and regulations which affect our business with, among others, international defense customers. In certain cases the export of our products and technical data to foreign persons, and the provision of technical services to foreign persons related to such products and technical data, may require licenses from the U.S. Department of Commerce or the U.S. Department of State. The time required to obtain these licenses, and the restrictions that may be contained in these licenses, may put us at a competitive disadvantage with respect to competing with international suppliers who are not subject to U.S. federal export control statutes and regulations. In addition, violations of these statutes and regulations can result in civil and, under certain circumstances, criminal liability as well as administrative penalties which could have a material adverse effect on our business and operating results.
- We anticipate that sales to our U.S. prime defense contractor customers as part of foreign military sales ("FMS") programs will be an increasing part of our business going forward. These FMS sales combine several different types of risks and

uncertainties highlighted above, including risks related to government contracts, risks related to defense contracts, timing and budgeting of foreign governments, and approval from the U.S. and foreign governments related to the programs, all of which may be impacted by macroeconomic and geopolitical factors outside of our control. For example, the decline in oil prices may negatively impact foreign defense budgets.

- Certain of our employees with appropriate security clearances may require access to classified information in connection with the performance of a U.S. government contract. We must comply with security requirements pursuant to the National Industrial Security Program Operating Manual, or NISPOM, and other U.S. government security protocols when accessing sensitive information. Failure to comply with the NISPOM or other security requirements may subject us to civil or criminal penalties, loss of access to sensitive information, loss of a U.S. government contract, or potentially debarment as a government contractor.
- We may need to invest additional capital to build out higher level security infrastructure at certain of our facilities to capture new design wins on defense programs with higher level security requirements. Failure to invest in such infrastructure may limit our ability to obtain new design wins on defense programs. In addition, we may need to invest in additional secure laboratory space to efficiently integrate subsystem level solutions and maintain quality assurance on current and future programs.

**The loss of one or more of our largest customers, programs, or applications could adversely affect our results of operations.**

We are dependent on a small number of customers for a large portion of our revenues. A significant decrease in the sales to or loss of any of our major customers would have a material adverse effect on our business and results of operations. In fiscal 2016, Lockheed Martin Corporation accounted for 23% of our total net revenues, Raytheon Company accounted for 20% of our total net revenues, and Northrop Grumman Corporation accounted for 8% of our total net revenues. In fiscal 2015, Raytheon Company accounted for 37% of our total net revenues, Lockheed Martin Corporation accounted for 20% of our total net revenues, and Northrop Grumman Corporation accounted for 4% of our total net revenues. In fiscal 2014, Lockheed Martin Corporation accounted for 18% of our total net revenues, Raytheon Company accounted for 13% of our total net revenues, and Northrop Grumman Corporation accounted for 12% of our total net revenues. The defense market is highly acquisitive, which could lead to further concentration in our largest customers. Customers in the defense market generally purchase our products in connection with government programs that have a limited duration, leading to fluctuating sales to any particular customer in this market from year to year. In addition, our revenues are largely dependent upon the ability of customers to develop and sell products that incorporate our products. No assurance can be given that our customers will not experience financial, technical or other difficulties that could adversely affect their operations and, in turn, our results of operations. Additionally, on a limited number of programs the customer has co-manufacturing rights which could lead to a shift of production on such a program away from us which in turn could lead to lower revenues.

We are dependent on sales for radar applications for a large portion of our revenues. Sales related to radar applications accounted for 52%, 61% and 53% of our total net revenues for fiscal 2016, 2015, and 2014, respectively. While our radar sales relate to multiple different platforms and defense programs, our revenues are largely dependent upon our customers incorporating our products into radar applications. For the fiscal year ended June 30, 2016, the Surface Electronic Warfare Improvement Program ("SEWIP") program individually comprised 12% of the Company's revenues. For the fiscal years ended June 30, 2016, 2015, and 2014, the Aegis program individually comprised 10%, 12% and 15% of the Company's revenues, respectively. For the fiscal year ended June 30, 2015, Patriot and F-35 accounted for 18% and 16% of the Company's revenue, respectively. Loss of a significant radar program could adversely affect our results of operations.

Going forward, we believe the SEWIP program and the Patriot missile defense program could be a large portion of our future revenues in the coming years, and the loss or cancellation of these programs could adversely affect our future results. In addition, as we shift our business mix toward more services-led engagements with legacy product revenues becoming a lesser amount of our total revenues, we could experience downward pressure on margins and reduced profitability. Further, new programs may yield lower margins than legacy programs, which could result in an overall reduction in gross margins.

**If we are unable to respond adequately to our competition or to changing technology, we may lose existing customers and fail to win future business opportunities.**

The markets for our products are highly competitive and are characterized by rapidly changing technology, frequent product performance improvements and evolving industry standards. Competitors may be able to offer more attractive pricing or develop products that could offer performance features that are superior to our products, resulting in reduced demand for our products. We may be unable to keep pace with competitors' marketing and the lack of visibility in the marketplace may negatively impact design wins, bookings, and revenues. Customers may also decide to reduce costs and accept the least costly technically acceptable alternative to our products or services. In addition, customers may decide to insource products that they have traditionally outsourced to us. Due to the rapidly changing nature of technology, we may not become aware in advance of the emergence of new competitors into our markets. The emergence of new competitors into markets targeted by us could result in the loss of existing customers and may have a negative impact on our ability to win future business opportunities. In addition to adapting to rapidly changing

technology, we must also develop a reputation as a best-of-breed technology provider. Competitors may be perceived in the market as being providers of open-source architectures versus Mercury as a closed-architecture company. Perceptions of Mercury as a high-cost provider, or as having stale technology could cause us to lose existing customers or fail to win new business. Further, our lack of strong engagements with important government-funded laboratories (e.g. DARPA, MIT Lincoln Labs, MITRE) may inhibit our ability to become subsystem solution design partners with our defense prime customers. With the reduction in force in our engineering group during fiscal 2013 as part of our cost containment efforts, we have fewer engineering resources to deliver advanced, subsystem level products to satisfy our customers' demanding expectations.

With continued microprocessor evolution, low-end systems could become adequate to meet the requirements of an increased number of the lesser-demanding applications within our target markets. Workstation or blade center computer manufacturers and other low-end single-board computer, or new competitors, may attempt to penetrate the high-performance market for defense electronics systems, which could have a material adverse effect on our business. In addition, our customers provide products to markets that are subject to technological cycles. Any change in the demand for our products due to technological cycles in our customers' end markets could result in a decrease in our revenues.

**Competition from existing or new companies could cause us to experience downward pressure on prices, fewer customer orders, reduced margins, the inability to take advantage of new business opportunities, and the loss of market share.**

We compete in highly competitive industries, and our customers generally extend the competitive pressures they face throughout their respective supply chains. Additionally, our markets are facing increasing industry consolidation, resulting in larger competitors who have more market share to put more downward pressure on prices and offer a more robust portfolio of products and services. We are subject to competition based upon product design, performance, pricing, quality and services. Our product performance, engineering expertise, and product quality have been important factors in our growth. While we try to maintain competitive pricing on those products that are directly comparable to products manufactured by others, in many instances our products will conform to more exacting specifications and carry a higher price than analogous products. Many of our customers and potential customers have the capacity to design and internally manufacture products that are similar to our products. We face competition from research and product development groups and the manufacturing operations of current and potential customers, who continually evaluate the benefits of internal research, product development, and manufacturing versus outsourcing. Our defense prime contractor customers could decide to pursue secure processing one of their core competencies and insource that technology development and production rather than purchase that capability from us as a supplier. This competition could result in fewer customer orders and a loss of market share.

**Our sales in the defense market could be adversely affected by the emergence of commodity-type products as acceptable substitutes for certain of our products and by uncertainty created by emerging changes in standards that may cause customers to delay purchases or seek alternative solutions.**

Our products for the defense market are designed for operating under physical constraints such as limited space, weight, and electrical power. Furthermore, these products are often designed to be "rugged," that is, to withstand enhanced environmental stress such as extended temperature range, shock, vibration, and exposure to sand or salt spray. Historically these requirements have often precluded the use of less expensive, readily available commodity-type systems typically found in more benign non-military settings. Factors that may increase the acceptability of commodity-type products in some defense platforms that we serve include improvements in the physical properties and durability of such alternative products, combined with the relaxation of physical and ruggedness requirements by the military due to either a reevaluation of those requirements or the installation of products in a more highly environmentally isolated setting. These developments could negatively impact our revenues and have a material adverse effect on our business and operating results.

**If we fail to respond to commercial industry cycles in terms of our cost structure, manufacturing capacity and/or personnel need, our business could be seriously harmed.**

The timing, length, and severity of the up-and-down cycles in commercial industries are difficult to predict. This cyclical nature of the industries in which we operate affects our ability to accurately predict future revenue, and in some cases, future expense levels. In the current environment, our ability to accurately predict our future operating results is particularly low. During down cycles in our industry, the financial results of our customers may be negatively impacted, which could result not only in a decrease in orders but also a weakening of their financial condition that could impair our ability to recognize revenue or to collect on outstanding receivables. When cyclical fluctuations result in lower than expected revenue levels, operating results may be adversely affected and cost reduction measures may be necessary in order for us to remain competitive and financially sound. We must be in a position to adjust our cost and expense structure to reflect prevailing market conditions and to continue to motivate and retain our key employees. If we fail to respond, then our business could be seriously harmed. In addition, during periods of rapid growth, we must be able to increase manufacturing capacity and personnel to meet customer demand. We can provide no assurance that these objectives can be met in a timely manner in response to industry cycles. Each of these factors could adversely impact our operating results and financial condition.

**Implementation of our growth strategy may not be successful, which could affect our ability to increase revenues.**

Our growth strategy includes developing new products, adding new customers within our existing markets, and entering new markets, as well as identifying and integrating acquisitions and achieving revenue and cost synergies and economies of scale. Our ability to compete in new markets will depend upon a number of factors including, among others:

- our ability to create demand for products in new markets;
- our ability to manage growth effectively;
- our ability to respond to changes in our customers' businesses by updating existing products and introducing, in a timely fashion, new products which meet the needs of our customers;
- our ability to develop a reputation as a best-of-breed technology provider;
- the quality of our new products;
- our ability to respond rapidly to technological change; and
- our ability to successfully integrate any acquisitions that we make and achieve revenue and cost synergies and economies of scale.

The failure to do any of the foregoing could have a material adverse effect on our business, financial condition and results of operations. In addition, we may face competition in these new markets from various companies that may have substantially greater research and development resources, marketing and financial resources, manufacturing capability, and/or customer support organizations.

Growing our business, in particular by providing services and products such as sophisticated subsystems for major defense programs like Patriot, SEWIP and Aegis, could strain our operational capacity and working capital demands if not properly anticipated and managed. Pursuing such growth could result in our operational and infrastructure resources being spread too thin, which could negatively impact our ability to deliver quality product on schedule and on budget. Providing quality services for subsystem level products is a key driver of our growth strategy and the failure to properly scale our capabilities to support our customers at a subsystem level could result in lost opportunities and revenues. Failure to implement consistent management systems across our entire platform, to increase the level of automation to scale our operations and to establish a uniform program management process for lifecycle management could negatively impact our ability to generate efficiencies to achieve cost reduction objectives.

**Future acquisitions may adversely affect our financial condition.**

As part of our strategy for growth, we may continue to explore acquisitions or strategic alliances, which may not be completed or may not be ultimately beneficial to us.

Acquisitions may pose risks to our operations, including:

- problems and increased costs in connection with the integration of the personnel, operations, technologies, or products of the acquired businesses;
- unanticipated costs;
- failure to achieve anticipated increases in revenues and profitability;
- diversion of management's attention from our core business;
- adverse effects on business relationships with suppliers and customers and those of the acquired company;
- acquired assets becoming impaired as a result of technical advancements or worse-than-expected performance by the acquired company;
- failure to rationalize manufacturing capacity, locations, and operating models to achieve anticipated economies of scale, or disruptions to manufacturing and product design operations during the combination of facilities;
- volatility associated with accounting for earn-outs in a given transaction;
- entering markets in which we have no, or limited, prior experience;
- potential loss of key employees; and
- adversely affect our internal control over financial reporting before the acquiree's complete integration into the Company's control environment.

In addition, in connection with any acquisitions or investments we could:

- issue stock that would dilute our existing shareholders' ownership percentages;
- incur debt and assume liabilities;

- obtain financing on unfavorable terms, or not be able to obtain financing on any terms at all;
- incur amortization expenses related to acquired intangible assets or incur large and immediate write-offs;
- incur large expenditures related to office closures of the acquired companies, including costs relating to the termination of employees and facility and leasehold improvement charges resulting from our having to vacate the acquired companies' premises; and
- reduce the cash that would otherwise be available to fund operations or for other purposes.

The failure to successfully integrate any acquisitions in an efficient or timely manner may negatively impact our financial condition and operating results, or we may not be able to fully realize anticipated savings. In addition, our competitors could try to emulate our acquisition strategy, leading to greater competition for scarce acquisition targets and could lead to larger competitors if they succeed in emulating our strategy.

**We may not realize the expected benefits, including synergies, of the acquisition of the Carve-Out Business because of integration difficulties and other challenges.**

On March 23, 2016, we and Microsemi Corporation (“Microsemi”) entered into a Stock Purchase Agreement, pursuant to which, Microsemi agreed to sell all the membership interests in its custom microelectronics, RF and microwave solutions and embedded security operations from Microsemi (“the Carve-Out Business”) to us for \$300.0 million in cash on a cash-free, debt-free basis, subject to a working capital adjustment. On May 2, 2016, the transaction closed and we acquired the Carve-Out Business. While we expect the acquisition of the Carve-Out Business (“Acquisition”) to result in synergies and other financial and operational benefits, we may be unable to realize these synergies or other benefits in the timeframe that we expect or at all. The success of the Acquisition will depend, in part, on our ability to realize the anticipated benefits from integrating the Carve-Out Business with our existing businesses. The integration process may be complex, costly and time consuming.

The difficulties of integrating the operations of the Carve-Out Business include, among others:

- failure to implement our business plan for the combined business;
- unanticipated issues in integrating manufacturing, logistics, information, communications and other systems;
- unanticipated changes in applicable laws and regulations;
- failure to retain key employees;
- failure to retain key customers;
- operating risks inherent in the Carve-Out Business and our business;
- the impact of any assumed legal proceedings;
- the impact on our internal controls and compliance with the regulatory requirements under the Sarbanes-Oxley Act of 2002; and
- unanticipated issues, expenses costs, charges and liabilities related to the Acquisition.

We may not be able to maintain the levels of revenue, earnings or operating efficiency that each of Mercury and the Carve-Out Business had achieved or might achieve separately. In addition, we may not accomplish the integration of the Carve-Out Business smoothly, successfully or within the anticipated costs or timeframe. Further, we will incur implementation costs relative to these anticipated cost synergies, and our expectations with respect to integration or synergies as a result of the Acquisition may not materialize. Accordingly, you should not place undue reliance on our anticipated synergies.

**The market price of our common stock may decline as a result of the Acquisition.**

The market price of our common stock may decline as a result of the Acquisition if, among other things, we are unable to achieve the expected growth in earnings, or if the operational cost savings estimates in connection with the integration of the Carve-Out Business are not realized. The market price of our common stock also may decline if we do not achieve the perceived benefits of the Acquisition as rapidly or to the extent anticipated by financial or industry analysts or if the effect of the Acquisition on our financial results is not consistent with the expectations of financial or industry analysts.

**Our substantial indebtedness could materially adversely affect our financial condition and prevent us from fulfilling our obligations.**

Following the Acquisition, we have a significant amount of indebtedness, including a gross \$200.0 million term loan and a \$100.0 million undrawn (other than \$5.5 million of outstanding letters of credit as of June 30, 2016) revolver. Our ability to make scheduled payments on or refinance our debt obligations depends on our financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business, legislative, regulatory and other factors beyond our control. We may be unable to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness.

In addition, increases in interest rates will increase the cost of servicing our financial instruments with exposure to interest rate risk and could materially reduce our profitability and cash flows. In December 2015, the U.S. Federal Reserve announced that it would gradually raise short-term interest rates over the next three years. Each one percentage point change in interest rates would result in an approximate \$2.0 million change in the annual cash interest expense before any principal payment on our financial instruments with exposure to interest rate risk. We presently do not use fixed interest rate swaps.

Subject to the limits contained in the credit agreement that governs our new credit facilities, we may be able to incur substantial additional debt from time to time to finance working capital, capital expenditures, investments or acquisitions, or for other purposes. If we do so, the risks related to our high level of debt could intensify. Specifically, our high level of debt could have important consequences to our investors, including the following:

- making it more difficult for us to satisfy our obligations with respect to our debt; and if we fail to comply with these requirements, an event of default could result;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions or other general corporate requirements;
- requiring a substantial portion of our cash flows to be dedicated to debt service payments instead of other purposes, thereby reducing the amount of cash flows available for working capital, capital expenditures, acquisitions and other general corporate purposes;
- increasing our vulnerability to general adverse economic and industry conditions;
- exposing us to the risk of increased interest rates as certain of our borrowings have variable interest rates, which could increase the cost of servicing our financial instruments and could materially reduce our profitability and cash flows;
- limiting our flexibility in planning for and reacting to changes in the industry in which we compete;
- placing us at a disadvantage compared to other, less leveraged competitors; and
- increasing our cost of borrowing.

In addition, the agreements governing our indebtedness contain restrictive covenants that limit our ability to engage in activities that may be in our long term best interest. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all our debt. And, if we were unable to repay the amounts due and payable, the lenders under each facility could proceed against the collateral granted to them to secure that indebtedness.

**We have a significant amount of goodwill and intangible assets on our consolidated financial statements that are subject to impairment based upon future adverse changes in our business or prospects.**

At June 30, 2016, the carrying values of goodwill and identifiable intangible assets on our balance sheet were \$344.0 million and \$116.7 million, respectively. We evaluate indefinite lived intangible assets and goodwill for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Indefinite lived intangible assets are impaired and goodwill impairment is indicated when their book value exceeds fair value. We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our long-lived assets decline because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary. The value of goodwill and intangible assets from the allocation of purchase price from the Acquisition will be derived from our business operating plans and is susceptible to an adverse change in demand, input costs or general changes in our business or industry and could require an impairment charge in the future.

**We may be unable to obtain critical components from suppliers, which could disrupt or delay our ability to deliver products to our customers.**

Several components used in our products are currently obtained from sole-source suppliers. We are dependent on key vendors like LSI Logic Corporation, Xilinx, Inc., and IBM Corporation for custom-designed application-specific integrated circuits (“ASICs”) and field programmable gate arrays (“FPGAs”), Freescale Semiconductor, Inc. and IBM Corporation for PowerPC microprocessors, Intel Corporation for our next generation processors, IBM Corporation for a specific SRAM, Curtiss Wright Corporation and Motorola, Inc. for chassis and chassis components, Micron Technology, Inc. for specific memory products, and Benchmark Electronics, Inc. for board assembly, test and integration. Generally, suppliers may terminate their contracts with us without cause upon 30 days’ notice and may cease offering their products upon 180 days’ notice. If any of our sole-source suppliers limits or reduces the sale of these components, we may be unable to fulfill customer orders in a timely manner or at all. In addition, if these or other component suppliers, some of which are small companies, experienced financial difficulties or other problems that prevented them from supplying us with the necessary components, we could experience a loss of revenues due to our inability to fulfill orders. These sole-source and other suppliers are each subject to quality and performance issues, materials shortages, excess demand, reduction in capacity and other factors that may disrupt the flow of goods to us or to our customers, which would adversely affect our business and customer relationships. We have no guaranteed supply arrangements with our suppliers and there can be no assurance that these suppliers will continue to meet our requirements. If supply arrangements are interrupted, we may not be able to find another supplier on a timely or satisfactory basis. We may incur significant set-up costs and delays in manufacturing should it become necessary to replace any key vendors due to work stoppages, shipping delays, financial difficulties, natural or manmade disasters or other factors.

**We may not be able to effectively manage our relationships with contract manufacturers.**

We may not be able to effectively manage our relationship with contract manufacturers, and the contract manufacturers may not meet future requirements for timely delivery. We rely on contract manufacturers to build hardware sub-assemblies for our products in accordance with our specifications. During the normal course of business, we may provide demand forecasts to contract manufacturers up to five months prior to scheduled delivery of our products to customers. If we overestimate requirements, the contract manufacturers may assess cancellation penalties or we may be left with excess inventory, which may negatively impact our earnings. If we underestimate requirements, the contract manufacturers may have inadequate inventory, which could interrupt manufacturing of our products and result in delays in shipment to customers and revenue recognition. Contract manufacturers also build products for other companies, and they may not have sufficient quantities of inventory available or sufficient internal resources to fill our orders on a timely basis or at all.

In addition, there have been a number of major acquisitions within the contract manufacturing industry in recent periods. While there has been no significant impact on our contract manufacturers to date, future acquisitions could potentially have an adverse effect on our working relationships with contract manufacturers. Moreover, we currently rely primarily on one contract manufacturer, Benchmark Electronics, Inc. The failure of this contract manufacturer to fill our orders on a timely basis or in accordance with our customers’ specifications could result in a loss of revenues and damage to our reputation. We may not be able to replace this contract manufacturer in a timely manner or without significantly increasing our costs if such contract manufacturer were to experience financial difficulties or other problems that prevented it from fulfilling our order requirements.

With the expansion of our microelectronics and RF and microwave product lines in recent years, primarily related to the acquisition of the Carve-Out Business from Microsemi and our acquisitions of Micronetics, Inc., KOR Electronics, and LNX Corporation, the mix and volume of products that we manufacture in-house has increased. With the building of our Advanced Microelectronics Center in Hudson, New Hampshire during fiscal 2014, we are becoming more vertically integrated in our microwave and RF product lines. This vertical integration could lead to higher capital intensity, labor utilization rate volatility which could affect our profitability, and higher fixed costs. Also, the changes to business processes and IT systems required to combine two locations into a single site like our Advanced Microelectronics Center may interrupt our operations for a period of time resulting in higher costs, lower revenues and missed opportunities for design wins. In addition, Benchmark Electronics, Inc. notified us in 2016 that they would no longer contract manufacture certain of our digital processing products at their Huntsville, Alabama facility due to internal integration planning at Benchmark. As a result, we are currently exploring alternatives to replace the impacted products, including internally manufacturing the product line.

**We are exposed to risks associated with international operations and markets.**

We market and sell products in international markets, and have established offices and subsidiaries in Europe and Japan. Revenues from international operations accounted for 4%, 2% and 4% of our total net revenues in fiscal 2016, 2015 and 2014, respectively. We also ship directly from our U.S. operations to international customers. There are inherent risks in transacting business internationally, including:

- changes in applicable laws and regulatory requirements;
- export and import restrictions;

- export controls relating to technology;
- tariffs and other trade barriers;
- less favorable intellectual property laws;
- difficulties in staffing and managing foreign operations;
- longer payment cycles;
- problems in collecting accounts receivable;
- adverse economic conditions in foreign markets;
- political instability;
- fluctuations in currency exchange rates;
- expatriation controls; and
- potential adverse tax consequences.

There can be no assurance that one or more of these factors will not have a material adverse effect on our future international activities and, consequently, on our business and results of operations.

In addition, we must comply with the Foreign Corrupt Practices Act, or the FCPA. The FCPA generally requires companies to maintain adequate record-keeping and internal accounting practices to accurately reflect the transactions of the company and prohibits U.S. companies and their intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment. Under the FCPA, U.S. companies may be held liable for actions taken by strategic or local partners or representatives. If we or our intermediaries fail to comply with the requirements of the FCPA, governmental authorities in the United States could seek to impose civil and criminal penalties, which could have a material adverse effect on our business, results of operations, financial conditions and cash flows.

**We may be exposed to unfavorable currency exchange rate fluctuations, which may lead to lower operating margins, or may cause us to raise prices which could result in reduced revenues.**

Currency exchange rate fluctuations could have an adverse effect on our net revenues and results of operations. Unfavorable currency fluctuations could require us to increase prices to foreign customers, which could result in lower net revenues from such customers. Alternatively, if we do not adjust the prices for our products in response to unfavorable currency fluctuations, our results of operations could be adversely affected. In addition, most sales made by our foreign subsidiaries are denominated in the currency of the country in which these products are sold, and the currency they receive in payment for such sales could be less valuable at the time of receipt as a result of exchange rate fluctuations. We do not currently hedge our foreign currency exchange rate exposure.

**If we are unable to respond to technological developments and changing customer needs on a timely and cost-effective basis, our results of operations may be adversely affected.**

Our future success will depend in part on our ability to enhance current products and to develop new products on a timely and cost-effective basis in order to respond to technological developments and changing customer needs. Defense customers, in particular, demand frequent technological improvements as a means of gaining military advantage. Military planners have historically funded significantly more design projects than actual deployments of new equipment, and those systems that are deployed tend to contain the components of the subcontractors selected to participate in the design process. In order to participate in the design of new defense electronics systems, we must demonstrate the ability to deliver superior technological performance on a timely and cost-effective basis. There can be no assurance that we will secure an adequate number of defense design wins in the future, that the equipment in which our products are intended to function will eventually be deployed in the field, or that our products will be included in such equipment if it eventually is deployed.

Customers in our commercial markets also seek technological improvements through product enhancements and new generations of products. OEMs historically have selected certain suppliers whose products have been included in the OEMs' machines for a significant portion of the products' life cycles. We may not be selected to participate in the future design of any commercial equipment, or if selected, we may not generate any revenues for such design work.

The design-in process is typically lengthy and expensive, and there can be no assurance that we will be able to continue to meet the product specifications of customers in a timely and adequate manner. In addition, any failure to anticipate or respond adequately to changes in technology, customer preferences and future order demands, or any significant delay in product developments, product introductions or order volume, could negatively impact our financial condition and results of operations, including the risk of inventory obsolescence. Because of the complexity of our products, we have experienced delays from time

to time in completing products on a timely basis. If we are unable to design, develop or introduce competitive new products on a timely basis, our future operating results may be adversely affected.

**Our products are complex, and undetected defects may increase our costs, harm our reputation with customers or lead to costly litigation.**

Our products are extremely complex and must operate successfully with complex products of our customers and their other vendors. Our products may contain undetected errors when first introduced or as we introduce product upgrades. The pressures we face to be the first to market new products or functionality and the lapsed time before our products are integrated into our customer's systems increases the possibility that we will offer products in which we or our customers later discover problems. We have experienced new product and product upgrade errors in the past and expect similar problems in the future. These problems may cause us to incur significant warranty costs and costs to support our service contracts and divert the attention of personnel from our product development efforts. Undetected errors may adversely affect our product's ease of use and may create customer satisfaction issues. If we are unable to repair these problems in a timely manner, we may experience a loss of or delay in revenue and significant damage to our reputation and business prospects. Many of our customers rely upon our products for mission-critical applications. Because of this reliance, errors, defects, or other performance problems in our products could result in significant financial and other damage to our customers. Our customers could attempt to recover those losses by pursuing products liability claims against us which, even if unsuccessful, would likely be time-consuming and costly to defend and could adversely affect our reputation.

**We may be unsuccessful in protecting our intellectual property rights which could result in the loss of a competitive advantage.**

Our ability to compete effectively against other companies in our industry depends, in part, on our ability to protect our current and future proprietary technology under patent, copyright, trademark, trade secret and unfair competition laws. We cannot assure that our means of protecting our proprietary rights in the United States or abroad will be adequate, or that others will not develop technologies similar or superior to our technology or design around our proprietary rights. In addition, we may incur substantial costs in attempting to protect our proprietary rights.

Also, despite the steps taken by us to protect our proprietary rights, it may be possible for unauthorized third parties to copy or reverse-engineer aspects of our products, develop similar technology independently or otherwise obtain and use information that we regard as proprietary and we may be unable to successfully identify or prosecute unauthorized uses of our technology. Furthermore, with respect to our issued patents and patent applications, we cannot assure you that any patents from any pending patent applications (or from any future patent applications) will be issued, that the scope of any patent protection will exclude competitors or provide competitive advantages to us, that any of our patents will be held valid if subsequently challenged or that others will not claim rights in or ownership of the patents (and patent applications) and other proprietary rights held by us.

**If we become subject to intellectual property infringement claims, we could incur significant expenses and could be prevented from selling specific products.**

We may become subject to claims that we infringe the intellectual property rights of others in the future. We cannot assure that, if made, these claims will not be successful. Any claim of infringement could cause us to incur substantial costs defending against the claim even if the claim is invalid, and could distract management from other business. Any judgment against us could require substantial payment in damages and could also include an injunction or other court order that could prevent us from offering certain products.

**Our need for continued investment in research and development may increase expenses and reduce our profitability.**

Our industry is characterized by the need for continued investment in research and development. If we fail to invest sufficiently in research and development, our products could become less attractive to potential customers and our business and financial condition could be materially and adversely affected. As a result of the need to maintain or increase spending levels in this area and the difficulty in reducing costs associated with research and development, our operating results could be materially harmed if our research and development efforts fail to result in new products or if revenues fall below expectations. In addition, as a result of our commitment to invest in research and development, spending levels of research and development expenses as a percentage of revenues may fluctuate in the future. Further, with the reduction in force in our engineering group during fiscal 2013 as part of our cost containment efforts and with reduced levels of research and development spending in fiscal 2014 and 2015 compared with prior years, we have fewer engineering resources to deliver advanced, subsystem level products to satisfy our customers' demanding expectations.

**Our results of operations are subject to fluctuation from period to period and may not be an accurate indication of future performance.**

We have experienced fluctuations in operating results in large part due to the sale of products and services in relatively large dollar amounts to a relatively small number of customers. Customers specify delivery date requirements that coincide with their need for our products and services. Because these customers may use our products and services in connection with a variety of defense programs or other projects with different sizes and durations, a customer's orders for one quarter generally do not indicate a trend for future orders by that customer. As such, we have not been able in the past to consistently predict when our customers will place orders and request shipments so that we cannot always accurately plan our manufacturing, inventory, and working capital requirements. As a result, if orders and shipments differ from what we predict, we may incur additional expenses and build excess inventory, which may require additional reserves and allowances and reduce our working capital and operational flexibility. Any significant change in our customers' purchasing patterns could have a material adverse effect on our operating results and reported earnings per share for a particular quarter. Thus, results of operations in any period should not be considered indicative of the results to be expected for any future period.

High quarterly book-ship ratios may pressure inventory and cash flow management, necessitating increased inventory balances to ensure quarterly revenue attainment. Increased inventory balances tie up additional capital, limiting our operational flexibility. Some of our customers may have become conditioned to wait until the end of a quarter to place orders in the expectation of receiving a discount. Customers conditioned to seek quarter-end discounts increase risk and uncertainty in our financial forecasting and decrease our margins and profitability.

Our quarterly results may be subject to fluctuations resulting from a number of other factors, including:

- delays in completion of internal product development projects;
- delays in shipping hardware and software;
- delays in acceptance testing by customers;
- a change in the mix of products sold to our served markets;
- production delays due to quality problems with outsourced components;
- inability to scale quick reaction capability products due to low product volume;
- shortages and costs of components;
- the timing of product line transitions;
- declines in quarterly revenues from previous generations of products following announcement of replacement products containing more advanced technology;
- potential asset impairment, including goodwill and intangibles, or restructuring charges; and
- changes in estimates of completion on fixed price service engagements.

In addition, from time to time, we have entered into contracts, referred to as development contracts, to engineer a specific solution based on modifications to standard products. Gross margins from development contract revenues are typically lower than gross margins from standard product revenues. We intend to continue to enter into development contracts and anticipate that the gross margins associated with development contract revenues will continue to be lower than gross margins from standard product sales.

Another factor contributing to fluctuations in our quarterly results is the fixed nature of expenditures on personnel, facilities and marketing programs. Expense levels for these programs are based, in significant part, on expectations of future revenues. If actual quarterly revenues are below management's expectations, our results of operations will likely be adversely affected.

Further, the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and changes in estimates in subsequent periods could cause our results of operations to fluctuate.

**Changes in regulations could materially adversely affect us.**

Our business, results of operations, or financial condition could be materially adversely affected if laws, regulations, or standards relating to us or our products are newly implemented or changed. In addition, our compliance with existing regulations may have a material adverse impact on us. Under applicable federal securities laws, we are required to evaluate and determine the effectiveness of our internal control structure and procedures for financial reporting. Should we or our independent registered public accounting firm determine that we have material weaknesses in our internal controls, our results of operations or financial condition may be materially adversely affected or our stock price may decline.

**We rely on the significant experience and specialized expertise of our senior management and engineering staff and must retain and attract qualified engineers and other highly skilled personnel in order to grow our business successfully.**

Our performance is substantially dependent on the continued services and performance of our senior management and our highly qualified team of engineers, many of whom have numerous years of experience, specialized expertise in our business, and security clearances required for certain defense projects. If we are not successful in hiring and retaining highly qualified engineers, we may not be able to extend or maintain our engineering expertise, and our future product development efforts could be adversely affected. Competition for hiring these employees is intense, especially with regard to engineers with specialized skills and security clearances required for our business, and we may be unable to hire and retain enough engineers to implement our growth strategy. Like our defense prime contractor customers, we face the potential for knowledge drain due to the impending retirement of the older members of our engineering workforce in the coming years.

We may be unable to deliver subsystem level products and related services on time and on budget with our limited engineering resources. Without sufficient resources in hardware, software, and mechanical engineering and quality assurance we may be unable to adequately scale our business and deliver the subsystem solutions that our customers expect. We must also develop new engineering talent in our engineering base to contain high engineering costs to alleviate pressures on our margins and price points.

Increased workloads and responsibilities due to cost containment measures in recent years has led to a leaner employee base, increasing our risk of employee and organizational fatigue. Resulting lower morale and organizational disruption could lead to execution issues, missed commitments, and general employee attrition.

Our future success also depends on our ability to identify, attract, hire, train, retain and motivate highly skilled managerial, operations, sales, marketing and customer service personnel. If we fail to attract, integrate and retain the necessary personnel, our ability to maintain and grow our business could suffer significantly. Further, stock price volatility and improvements in the economy could impact our ability to attract and retain key personnel.

**If we experience a disaster or other business continuity problem, we may not be able to recover successfully, which could cause material financial loss, loss of human capital, regulatory actions, reputational harm, or legal liability.**

If we experience a local or regional disaster or other business continuity problem, such as an earthquake, terrorist attack, pandemic or other natural or man-made disaster, our continued success will depend, in part, on the availability of our personnel, our office facilities, and the proper functioning of our computer, telecommunication and other related systems and operations. As we attempt to grow our operations, the potential for particular types of natural or man-made disasters, political, economic or infrastructure instabilities, or other country- or region-specific business continuity risks increases.

**If we are unable to continue to obtain U.S. federal government authorization regarding the export of our products, or if current or future export laws limit or otherwise restrict our business, we could be prohibited from shipping our products to certain countries, which would harm our ability to generate revenue.**

We must comply with U.S. laws regulating the export of our products and technology. In addition, we are required to obtain a license from the U.S. federal government to export certain of our products and technical data as well as to provide technical services to foreign persons related to such products and technical data. We cannot be sure of our ability to obtain any licenses required to export our products or to receive authorization from the U.S. federal government for international sales or domestic sales to foreign persons including transfers of technical data or the provision of technical services. Moreover, the export regimes and the governing policies applicable to our business are subject to change. We cannot assure you of the extent that such export authorizations will be available to us, if at all, in the future. If we cannot obtain required government approvals under applicable regulations in a timely manner or at all, we would be delayed or prevented from selling our products in international jurisdictions, which could adversely affect our business and financial results.

**If we suffer any data breaches involving the designs, schematics, or source code for our products or other sensitive information, our business and financial results could be adversely affected.**

We securely store our designs, schematics, and source code for our products as they are created. A breach, whether physical, electronic or otherwise, of the systems on which this sensitive data is stored could lead to damage or piracy of our products. If we are subject to data security breaches from external sources or from an insider threat, we may have a loss in sales or increased costs

arising from the restoration or implementation of additional security measures, either of which could adversely affect our business and financial results. Other potential costs could include loss of brand value, incident response costs, loss of stock market value, regulatory inquiries, litigation, and management distraction. In addition, a security breach that involved classified information could subject us to civil or criminal penalties, loss of a government contract, loss of access to classified information, or debarment as a government contractor. Similarly, a breach that involved loss of customer-provided data could subject us to loss of a customer, loss of a contract, litigation costs and legal damages, and reputational harm.

The highly-publicized cyber-attack on Sony Pictures Entertainment demonstrates the vulnerability of companies to cyber-attacks and the severe impact these attacks can have. In addition to the potential costs discussed above, the Sony cyber-attack illustrates that such attacks can also damage physical infrastructure (e.g. corrupted servers) and destroy all copies of company intellectual property on a company's network.

**We may need to invest in new information technology systems and infrastructure to scale our operations.**

We may need to adopt new information technology systems and infrastructure to scale our business and obtain the synergies from prior and future business acquisitions. Our older information technology systems and infrastructure could create product development or production work stoppages, negatively impact product delivery times and quality, and increase our compliance costs. Failure to invest in newer information technology systems and infrastructure may lead to operational inefficiencies and increased compliance costs and risks. In addition, an inability to maximize the utility and benefit of our current information technology tools could impact our ability to meet cost reduction and planned efficiency and operational improvement goals.

**Our income tax provision and other tax liabilities may be insufficient if taxing authorities are successful in asserting tax positions that are contrary to our position. Increases in tax rates could impact our financial performance.**

From time to time, we are audited by various federal, state and local authorities regarding income tax matters. Significant judgment is required to determine our provision for income taxes and our liabilities for federal, state, local and other taxes. Although we believe our approach to determining the appropriate tax treatment is supportable and in accordance with relevant authoritative guidance it is possible that the final tax authority will take a tax position that is materially different than that which is reflected in our income tax provision. Such differences could have an adverse effect on our income tax provision or benefit, in the reporting period in which such determination is made and, consequently, on our results of operations, financial position and/or cash flows for such period. Further, future increases in tax rates may adversely affect our financial results.

**Provisions in our organizational documents and Massachusetts law and other actions we have taken could make it more difficult for a third party to acquire us.**

Provisions of our charter and by-laws could have the effect of discouraging a third party from making a proposal to acquire our company and could prevent certain changes in control, even if some shareholders might consider the proposal to be in their best interest. These provisions include a classified board of directors, advance notice to our board of directors of shareholder proposals and director nominations, and limitations on the ability of shareholders to remove directors and to call shareholder meetings. In addition, we may issue shares of any class or series of preferred stock in the future without shareholder approval upon such terms as our board of directors may determine. The rights of holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any such class or series of preferred stock that may be issued.

We also are subject to the Massachusetts General Laws which, subject to certain exceptions, prohibit a Massachusetts corporation from engaging in a broad range of business combinations with any “interested shareholder” for a period of three years following the date that such shareholder becomes an interested shareholder. These provisions could discourage a third party from pursuing an acquisition of our company at a price considered attractive by many shareholders.

**Our profits may decrease and/or we may incur significant unanticipated costs if we do not accurately estimate the costs of fixed-price engagements.**

A significant number of our system integration projects are based on fixed-price contracts, rather than contracts in which payment to us is determined on a time and materials or other basis. Our failure to estimate accurately the resources and schedule required for a project, or our failure to complete our contractual obligations in a manner consistent with the project plan upon which our fixed-price contract was based, could adversely affect our overall profitability and could have a material adverse effect on our business, financial condition and results of operations. We are consistently entering into contracts for large projects that magnify this risk. We have been required to commit unanticipated additional resources to complete projects in the past, which has occasionally resulted in losses on those contracts. We will likely experience similar situations in the future. In addition, we may fix the price for some projects at an early stage of the project engagement, which could result in a fixed price that is too low. Therefore, any changes from our original estimates could adversely affect our business, financial condition and results of operations.

**The trading price of our common stock may continue to be volatile, which may adversely affect our business, and investors in our common stock may experience substantial losses.**

Our stock price, like that of other technology companies, has been volatile. The stock market in general and technology companies in particular may continue to experience volatility. The stock prices for companies in the defense technology industry may continue to remain volatile given the uncertainty and timing of funding for defense programs. This volatility may or may not be related to our operating performance. Our operating results, from time to time, may be below the expectations of public market analysts and investors, which could have a material adverse effect on the market price of our common stock. Our low stock trading volume and small cap status could hamper existing and new shareholders from gaining a meaningful position in our stock. In addition, the continued threat of terrorism in the United States and abroad and the resulting military action and heightened security measures undertaken in response to threats may cause continued volatility in securities markets. When the market price of a stock has been volatile, holders of that stock will sometimes issue securities class action litigation against the company that issued the stock. If any shareholders were to issue a lawsuit, we could incur substantial costs defending the lawsuit. Also, the lawsuit could divert the time and attention of management.

**We have never paid dividends on our capital stock and we do not anticipate paying any dividends in the foreseeable future. Consequently, any gains from an investment in our common stock will likely depend on whether the price of our common stock increases.**

We have not declared or paid cash dividends on any of our classes of capital stock to date and we currently intend to retain our future earnings, if any, to fund the development and growth of our business. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future. Furthermore, we may in the future become subject to contractual restrictions on, or prohibitions against, the payment of dividends. Consequently, in the foreseeable future, you will likely only experience a gain from your investment in our common stock if the price of our common stock increases. There is no guarantee that our common stock will appreciate in value or even maintain the price at which you purchased your shares, and you may not realize a return on your investment in our common stock.

**If our internal controls over financial reporting are not considered effective, our business and stock price could be adversely affected.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each fiscal year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report on Form 10-K for that fiscal year. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal controls over financial reporting.

Our management, including our chief executive officer and chief financial officer, does not expect that our internal controls over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud involving a company have been, or will be, detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become ineffective because of changes in conditions or deterioration in the degree of compliance with policies or procedures. In addition, as part of our growth strategy, the Company may continue to explore acquisitions or strategic alliances that could adversely affect internal control over financial reporting during the integration period until the acquired business has been fully incorporated into the Company's internal control environment. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to consider our internal controls as ineffective. If our internal controls over financial reporting are not considered effective, we may experience a loss of public confidence, which could have an adverse effect on our business and on the market price of our common stock.

**If equity research analysts do not publish research or reports about our business or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.**

The trading market for our common stock relies in part on the research and reports that equity research analysts publish about us and our business. We do not control these analysts. The price of our common stock could decline if one or more equity analysts downgrade our common stock or if analysts issue other unfavorable commentary or cease publishing reports about us or our business.

**We may need additional capital and may not be able to raise funds on acceptable terms, if at all. In addition, any funding through the sale of additional common stock or other equity securities could result in additional dilution to our stockholders and any funding through indebtedness could restrict our operations.**

We may require additional cash resources to finance our continued growth or other future developments, including any investments or acquisitions we may decide to pursue. The amount and timing of such additional financing needs will vary principally depending on the timing of new product and service launches, investments and/or acquisitions, and the amount of cash flow from our operations. If our resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a larger credit facility. The sale of additional equity securities or securities convertible into our ordinary shares could result in additional dilution to our stockholders. The incurrence of additional indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations.

Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

- investors' perception of, and demand for, securities of defense technology companies;
- conditions of the United States and other capital markets in which we may seek to raise funds; and
- our future results of operations, financial condition and cash flows.

We cannot assure that financing will be available in amounts or on terms acceptable to us, if at all. If we fail to raise additional funds, we may need to sell debt or additional equity securities or to reduce our growth to a level that can be supported by our cash flow. Without additional capital, we may not be able to:

- further develop or enhance our customer base;
- acquire necessary technologies, products or businesses;
- expand operations in the United States and elsewhere;
- hire, train and retain employees;
- market our software solutions, services and products; or
- respond to competitive pressures or unanticipated capital requirements.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The following table sets forth our significant properties as of June 30, 2016:

<u>Location</u>	<u>Size in Sq. Feet</u>	<u>Commitment</u>
Chelmsford, MA	185,327	Leased, expiring 2017, 2 buildings
Andover, MA	145,262	Leased, expiring 2029
Phoenix, AZ	116,858	Leased, expiring 2020
Hudson, NH	100,111	Leased, expiring 2024
Cypress, CA	42,770	Leased, expiring 2021
Camarillo, CA	25,195	Leased, expiring 2020
Huntsville, AL	25,950	Leased, expiring 2018
West Caldwell, NJ	23,000	Leased, expiring 2019
Manteca, CA	20,750	Leased, expiring 2017
San Jose, CA	10,089	Leased, expiring 2016

The company actively manages its facilities and is in pursuit of lease extensions or alternative locations for facilities with expiration dates in 2016, 2017 or 2018. In addition, we lease a number of smaller offices around the world primarily for sales. For financial information regarding obligations under our leases, see Note K to the consolidated financial statements.

### **ITEM 3. LEGAL PROCEEDINGS**

We are subject to litigation, claims, investigations and audits arising from time to time in the ordinary course of our business. Although legal proceedings are inherently unpredictable, we believe that we have valid defenses with respect to those matters currently pending against us and intend to defend our self vigorously. The outcome of these matters, individually and in the aggregate, is not expected to have a material impact on our cash flows, results of operations, or financial position.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

#### **ITEM 4.1. EXECUTIVE OFFICERS OF THE REGISTRANT**

Our executive officers are appointed to office by the Board of Directors at the first board meeting following the Annual Meeting of Shareholders or at other board meetings as appropriate, and hold office until the first board meeting following the next Annual Meeting of Shareholders and until a successor is chosen, subject to prior death, resignation or removal. Information regarding our executive officers as of the date of filing of this Annual Report on Form 10-K is presented below.

*Mark Aslett*, age 48, joined Mercury in 2007 and has served as the President and Chief Executive Officer since then, and served as a member of the Board since 2007. Prior to joining Mercury, he was Chief Operating Officer and Chief Executive Officer of Enterasys Networks from 2003 to 2006, and held various positions with Marconi plc and its affiliated companies, including Executive Vice President of Marketing, Vice President of Portfolio Management, and President of Marconi Communications-North America, from 1998 to 2002. Mr. Aslett has also held positions at GEC Plessey Telecommunications, as well as other telecommunications-related technology firms.

*Christopher C. Cambria*, age 58, joined Mercury in August 2016 as Senior Vice President, General Counsel and Secretary. Prior to joining Mercury, he was Vice President, General Counsel, and Secretary of Aerojet Rocketdyne Holdings, Inc. from 2012 to 2016, and Vice President, General Counsel from 2011 to 2012. He was with L-3 Communications Holdings Inc. from 1997 through 2009 serving as Senior Vice President and Senior Counsel, Mergers and Acquisitions from 2006 to 2009, Senior Vice President, Secretary and General Counsel from 2001 to 2006, and Vice President, General Counsel and Secretary from 1997 to 2001.

*Gerald M. Haines II*, age 53, joined as Senior Vice President of Corporate Development and in 2014 was appointed Executive Vice President, CFO and Treasurer. Prior to Mercury, from 2008 to 2010 he served as Executive Vice President at Verenum Corporation, a publicly traded company engaged in the development and commercialization of biofuels and specialty enzymes, where he oversaw various corporate development, corporate finance, and joint venturing activities. Previously, Mr. Haines served as Executive Vice President of Strategic Affairs of Enterasys Networks, Inc., a publicly traded network communications company, Senior Vice President of Cabletron Systems, Inc., the predecessor of Enterasys Networks, and Vice President of Applied Extrusion Technologies, a large manufacturer of plastic films and packaging. He began his career at J.P. Morgan. Mr. Haines holds a bachelor's degree in Business Administration, magna cum laude, from Boston University, and a law degree from Cornell Law School.

*Charles A. Speicher*, age 57, joined Mercury in 2010 as Vice President, Controller, and Chief Accounting Officer. Prior to joining Mercury, Mr. Speicher held various positions at Virtusa Corporation, a publicly-traded global IT services company, including Vice President of Global Accounting Operations and Corporate Controller from 2001 to 2009. Mr. Speicher was Corporate Controller at Cerulean Technologies Inc., a software product company, from 1996 to 2001. Prior to Cerulean, Mr. Speicher held positions with Wyman-Gordon Company, Wang Laboratories Inc. and Arthur Andersen & Company, LLP. Mr. Speicher is a CPA licensed in Massachusetts.

*Didier M.C. Thibaud*, age 55, joined Mercury in 1995, and has served as our Executive Vice President, Chief Operating Officer since January 2016. Prior to that he was President of our Mercury Commercial Electronics business unit since 2012. Prior to that, he was President of our Advanced Computing Solutions business unit since 2007. Prior to that, he was Senior Vice President, Defense & Commercial Businesses from 2005 to June 2007 and Vice President and General Manager, Imaging and Visualization Solutions Group, from 2000 to 2005 and served in various capacities in sales and marketing from 1995 to 2000.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the Nasdaq Global Select Market under the symbol MRCY. The following table sets forth, for the fiscal periods indicated, the high and low sale prices per share for our common stock during such periods. Such market quotations reflect inter-dealer prices without retail markup, markdown or commission.

	High	Low
2016 Fourth quarter	\$ 24.87	\$ 18.98
Third quarter	\$ 20.85	\$ 15.67
Second quarter	\$ 19.99	\$ 15.52
First quarter	\$ 16.44	\$ 13.56
2015 Fourth quarter	\$ 15.94	\$ 13.37
Third quarter	\$ 17.59	\$ 12.76
Second quarter	\$ 14.43	\$ 10.61
First quarter	\$ 12.34	\$ 10.47

As of July 31, 2016, we had 309 record shareholders. As of July 14, 2016, we had 11,302 nominee holders.

#### Dividend Policy

We have never declared or paid cash dividends on shares of our common stock. We currently intend to retain any earnings for future growth. Accordingly, we do not anticipate that any cash dividends will be declared or paid on our common stock in the foreseeable future.

#### Net Share Settlement Plans

The following table includes information with respect to net share settlements we made of our common stock during the fiscal year ended June 30, 2016:

<u>Period of Net Share Settlement</u>	<u>Total Number of Shares Net Settled (1)</u>	<u>Average Price Per Share</u>
July 1, 2015 - September 30, 2015	232	\$ 16.00
October 1, 2015 - December 31, 2015	23	\$ 17.96
January 1, 2016 - March 31, 2016	5	\$ 17.02
April 1, 2016 - June 30, 2016	166	\$ 20.70
Total	426	

(1) Represents shares we net settled in connection with the surrender of shares to cover the minimum taxes on vesting of restricted stock.

#### Share Repurchase Plans

During fiscal 2016, we had no active share repurchase programs.

### ITEM 6. SELECTED FINANCIAL DATA

The following table summarizes certain historical consolidated financial data, restated for discontinued operations, which should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report (in thousands, except per share data):

	For the Years Ended June 30,				
	2016	2015	2014	2013	2012
<b>Statement of Operations Data:</b>					
Net revenues	\$ 270,154	\$ 234,847	\$ 208,729	\$ 194,231	\$ 237,070
Income (loss) from operations	\$ 23,973	\$ 18,355	\$ (7,405)	\$ (24,810)	\$ 29,655
Income (loss) from continuing operations	\$ 19,742	\$ 14,429	\$ (4,072)	\$ (13,782)	\$ 22,323
Adjusted EBITDA(1)	\$ 57,274	\$ 44,414	\$ 23,522	\$ 9,940	\$ 47,994
Net earnings (loss) per share from continuing operations:					
Basic	\$ 0.58	\$ 0.45	\$ (0.13)	\$ (0.46)	\$ 0.76
Diluted	\$ 0.56	\$ 0.44	\$ (0.13)	\$ (0.46)	\$ 0.74

	As of June 30,				
	2016	2015	2014	2013	2012
<b>Balance Sheet Data:</b>					
Working capital	\$ 177,748	\$ 142,472	\$ 127,375	\$ 115,483	\$ 170,761
Total assets	\$ 736,496	\$ 386,880	\$ 373,712	\$ 374,431	\$ 385,606
Long-term obligations	\$ 195,808	\$ 3,457	\$ 13,635	\$ 15,112	\$ 15,560
Total shareholders' equity	\$ 473,044	\$ 350,138	\$ 327,147	\$ 328,501	\$ 333,104

- (1) In our periodic communications, we discuss a key measure that is not calculated according to U.S. generally accepted accounting principles (“GAAP”), adjusted EBITDA. Adjusted EBITDA is defined as earnings from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense and stock-based compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining components of bonus and equity compensation for executive officers based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe the adjusted EBITDA financial measure assists in providing a more complete understanding of our underlying operational measures to manage our business, to evaluate our performance compared to prior periods and the marketplace, and to establish operational goals. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

Adjusted EBITDA is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted EBITDA financial adjustments described above, and investors should not infer from our presentation of this non-GAAP financial measure that these costs are unusual, infrequent or non-recurring. See the Non-GAAP Financial Measures section of this annual report for a reconciliation of our adjusted EBITDA to income from continuing operations.

## ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS

From time to time, information provided, statements made by our employees or information included in our filings with the Securities and Exchange Commission may contain statements that are not historical facts but that are “forward-looking statements,” which involve risks and uncertainties. You can identify these statements by the use of the words “may,” “will,” “could,” “should,” “would,” “plans,” “expects,” “anticipates,” “continue,” “estimate,” “project,” “intend,” “likely,” “forecast,” “probable,” “potential” and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company’s markets, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes

in, or in the U.S. Government's interpretation of, federal export control or procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to export regulations, increases in tax rates, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as set forth under Part I-Item 1A (Risk Factors) in this Annual Report on Form 10-K. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

## OVERVIEW

Mercury Systems, Inc. is a leading commercial provider of secure processing subsystems designed and made in U.S.A. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. Headquartered in Chelmsford, Massachusetts, we are pioneering a next-generation defense electronics business model designed to meet the industry's current and emerging business needs. We deliver affordable innovative solutions, rapid time-to-value and service and support to our defense prime contractor customers. Our products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-35 and Reaper. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector. We believe our total portfolio of services and solutions is unique in the industry for a commercial company. We operate across a broad spectrum of defense programs. In the fourth quarter of fiscal 2014, we initiated a plan to divest our Mercury Intelligence Systems ("MIS") business. Consequently, its operating results are included in discontinued operations for all periods presented. On January 23, 2015, we completed the sale of the MIS business (see Note Q to the consolidated financial statements).

As of June 30, 2016, we had 965 employees. Our revenue, income from continuing operations and adjusted EBITDA for fiscal 2016 were \$270.2 million, \$19.7 million, and \$57.3 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation of our income (loss) from continuing operations to adjusted EBITDA.

We deliver capabilities that combine technology building blocks, deep domain expertise in the defense sector and critical solution areas, and specialized skills in serving the Department of Defense ("DoD") and the intelligence community. Our technologies and capabilities include embedded processing modules and subsystems, radio frequency ("RF") and microwave multi-function assemblies as well as subsystems, and RF and microwave components.

We utilize leading edge, high performance computing technologies architected by leveraging open standards and open architectures to address highly data-intensive applications that include signal, sensor and image processing; all of this while addressing the packaging challenges, often referred to as "SWaP" (size, weight, and power) that are common in military applications. In addition, we design and build RF and microwave components and subsystems to meet the needs of the electronic warfare ("EW"), signal intelligence ("SIGINT") and other high bandwidth communications requirements and applications.

We also provide significant capabilities relating to pre-integrated, open, affordable EW, electronic attack ("EA") and electronic counter measure ("ECM") subsystems, and SIGINT and electro-optical/infrared ("EO/IR") processing technologies, and radar environment test and simulation systems. We deploy these solutions on behalf of defense prime contractors and the DoD, leveraging commercially available technologies and solutions (or "building blocks") from our business as well as other commercial suppliers. We leverage this technology to develop integrated sensor processing subsystems, often including classified application-specific software and intellectual property ("IP") for the C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ECM markets. We bring significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

Since we are an OEM supplier to our commercial markets and conduct much of our business with our defense customers via commercial items, requests by customers are a primary driver of revenue fluctuations from quarter to quarter. Customers specify delivery date requirements that coincide with their need for our products. Because these customers may use our products in connection with a variety of defense programs or other projects of different sizes and durations, a customer's orders for one quarter generally do not indicate a trend for future orders by that customer. Additionally, order patterns do not necessarily correlate amongst customers and, therefore, we generally cannot identify sequential quarterly trends.

## **BUSINESS DEVELOPMENTS:**

### **FISCAL 2016**

On May 2, 2016, we acquired the custom microelectronics, RF and microwave solutions, and embedded security operations from Microsemi Corporation (the “Carve-Out Business”), resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the “Acquisition”). Under the terms of the Purchase Agreement, we paid \$300.0 million in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments.

Net sales for the Carve-Out Business were \$99.4 million and \$87.2 million for its fiscal years ended September 27, 2015 and September 28, 2014, net income was \$6.4 million for its fiscal year ended September 27, 2015 and net loss was (\$3.1) million for its fiscal year ended September 28, 2014.

The Carve-Out Business is a leader in the design, development, and production of sophisticated electronic subsystems and components for use in high-technology products for defense and aerospace markets. The Carve-Out Business’ defense electronics solutions include high-density memory modules, secure solid-state drives, secure GPS receiver modules, high-power RF amplifiers, millimeter-wave modules and subsystems, and specialized software and firmware for anti-tamper applications. The Carve-Out Business’ customers, which include many significant defense prime contractors, outsource many of their electronic design and manufacturing requirements to the Carve-Out Business as a result of its specialized capabilities in packaging electronics for SWaP-constrained environments, its focus on security and the unique requirements of defense applications, and its expertise in RF and microwave technologies. The Carve-Out Business’ products and technologies are used in a variety of defense applications, including missiles and precision munitions, fighter and surveillance aircraft, airport security portals, and advanced electronic systems for radar and EW.

During fiscal 2016, we completed a series of important internal organizational changes in order to integrate, align and scale ourselves into one business. In addition, over the past several years, we have completed several acquisitions, culminating with the Acquisition on May 2, 2016 to support our strategy of creating a better alternative for affordable, secure processing subsystems designed and made in the U.S.A. These strategic acquisitions and the associated operational and managerial changes finalized the transformation of the way the Company’s executive management team, including the CEO as the chief operating decision maker (“CODM”), manage, evaluate and review the business, including how the CODM allocates resources and assesses performance. Therefore, during the fourth quarter ended June 30, 2016, we eliminated the use of Mercury Commercial Electronics (“MCE”) and Mercury Defense Systems (“MDS”) as reportable segments because the analogous operating segments ceased to exist. We are now comprised of one operating and reportable segment. We utilized the management approach for determining our operating segment in accordance with Financial Accounting Standard Boards (“FASB”) Accounting Standards Codification (“ASC”) 280, *Segment Reporting* (“FASB ASC 280”).

On December 16, 2015, we acquired Lewis Innovative Technologies, Inc. (“LIT”) for \$10.0 million in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments. Embedded systems security has become a requirement for new and emerging military programs, and LIT’s security solutions significantly extend our capabilities and leadership in secure embedded computing, a critical differentiator from our traditional competition. LIT’s solutions, combined with our next-generation secure Intel server-class product line, together with increasingly frequent mandates from the government to secure electronic systems for domestic and foreign military sales, position us well to capitalize on DoD program protection security requirements.

### **FISCAL 2015**

During fiscal 2015, we successfully completed the final phase of integration activities relating to our previous acquisitions. The acquisition integration plan included the consolidation of manufacturing facilities, centralization of administrative and manufacturing functions using common information systems and processes, and realignment of research and development resources. Restructuring and other charges in fiscal 2015 amounted to \$3.2 million.

During fiscal 2015, we completed the sale of our former MIS business. Since the fourth quarter of fiscal 2014, MIS has been reported as a discontinued operation for all periods presented.

### **FISCAL 2014**

During fiscal 2014, we moved into our new manufacturing facility in Hudson, New Hampshire providing a platform for continued growth in our RF and microwave product lines. During the year, we consolidated four facilities into the new plant and installed integrated business systems that will allow us to scale our RF and microwave capabilities both organically and through merger and acquisition activities.

In fiscal 2014, we announced a restructuring plan (“2014 Plan”) that was implemented as part of the final phase of integration activities relating to our recent acquisitions. The integration plan includes the consolidation of manufacturing facilities, centralization of administrative and manufacturing functions using common information systems and processes and rebalancing of research and development investments. The restructuring plan included the elimination of 70 positions largely in engineering, manufacturing and administrative functions. Additionally, we closed four facilities relocating all related activities to the Company’s

Advanced Microelectronics Center (“AMC”) in Hudson, New Hampshire. During the fourth quarter of fiscal 2014, we also consolidated facilities at our corporate headquarters. These restructuring and other charges associated with our fiscal 2014 integration plan amounted to \$5.4 million.

## RESULTS OF OPERATIONS:

### FISCAL 2016 vs. FISCAL 2015

The following tables set forth, for the periods indicated, financial data from the consolidated statements of operations:

(In thousands)	Fiscal 2016	As a % of Total Net Revenue	Fiscal 2015	As a % of Total Net Revenue
Net revenues	\$ 270,154	100.0%	\$ 234,847	100.0%
Cost of revenues	145,380	53.8	124,628	53.1
Gross margin	124,774	46.2	110,219	46.9
Operating expenses:				
Selling, general and administrative	52,952	19.6	49,010	20.9
Research and development	33,543	12.4	32,554	13.9
Amortization of intangible assets	8,842	3.2	7,008	2.9
Restructuring and other charges	1,240	0.5	3,175	1.4
Impairment of long-lived assets	231	0.1	—	—
Acquisition costs and other related expenses	3,993	1.5	117	—
Total operating expenses	100,801	37.3	91,864	39.1
Income from operations	23,973	8.9	18,355	7.8
Other income, net	1,313	0.5	440	0.2
Income from continuing operations before income taxes	25,286	9.4	18,795	8.0
Tax provision	5,544	2.1	4,366	1.9
Income from continuing operations	19,742	7.3	14,429	6.1
Loss from discontinued operations, net of income taxes	—	—	(4,060)	(1.7)
Net income	\$ 19,742	7.3%	\$ 10,369	4.4%

### REVENUES

Total revenues increased \$35.4 million, or 15%, to \$270.2 million during fiscal 2016 compared to \$234.8 million during fiscal 2015. The increase was driven by higher defense revenues of \$46.2 million, offset by lower commercial sales of \$10.8 million. The increase in total revenues is primarily attributed to higher SEWIP and F16/SABR program revenues and the inclusion of \$16.6 million of revenue from the Carve-Out Business. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, increased by \$4.6 million to \$49.9 million during fiscal 2016 compared to \$45.3 million during fiscal 2015. International revenues represented 19% of total revenues during both fiscal 2016 and 2015.

### GROSS MARGIN

Gross margin was 46.2% for fiscal 2016, a decrease of 70 basis points from the 46.9% gross margin achieved in fiscal 2015. The lower gross margin in fiscal 2016 was primarily due to inventory step-up amortization related to the acquisition of the Carve-Out Business. The remaining \$2.8 million of inventory step-up will be amortized into cost of goods sold over the first four months of fiscal 2017.

### SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$3.9 million, or 8%, to \$52.9 million during fiscal 2016 as compared to \$49.0 million during fiscal 2015. The increase was primarily due to higher compensation related costs and increased headcount driven by the recent acquisition of the Carve-Out Business. Selling, general and administrative expenses decreased as a percentage of revenue to 19.6% during fiscal 2016 from 20.9% during fiscal 2015 due to higher revenues in fiscal 2016.

## **RESEARCH AND DEVELOPMENT**

Research and development expenses increased \$1.0 million, or 3%, to \$33.5 million during fiscal 2016 compared to \$32.6 million for fiscal 2015. The increase was primarily due to increased headcount driven by the recent acquisition of the Carve-Out Business and higher compensation related costs, partially offset by increased customer funded development. Research and development expenses accounted for 12.4% and 13.9% of our revenues during fiscal 2016 and fiscal 2015, respectively.

## **AMORTIZATION OF INTANGIBLE ASSETS**

Amortization of intangible assets increased \$1.8 million to \$8.8 million during fiscal 2016 compared to \$7.0 million for fiscal 2015, primarily due to the amortization of intangible assets resulting from the acquisition of the Carve-Out Business.

## **RESTRUCTURING AND OTHER CHARGES**

Restructuring and other charges decreased \$1.9 million, or 61%, to \$1.2 million during fiscal 2016 compared to \$3.2 million in fiscal 2015. The decrease was driven by lower facility restructuring costs in fiscal 2016 as our acquisition integration activities were completed during fiscal 2015. Fiscal 2015 restructuring and other charges included the second and final phases of the Chelmsford, Massachusetts headquarters consolidation and related severance activities. We will incur nominal, periodic restructuring charges through April 2017 if we are unable to sublease the unoccupied portion of our Chelmsford, Massachusetts headquarters.

## **IMPAIRMENT OF LONG-LIVED ASSETS**

We recorded an impairment charge of \$0.2 million related to a pre-existing LIT relationship during fiscal 2016, compared to \$0.0 million in fiscal 2015.

## **ACQUISITION COSTS AND OTHER RELATED EXPENSES**

We incurred \$4.0 million of acquisition costs and other related expenses during fiscal 2016, compared to \$0.1 million during fiscal 2015. \$2.0 million of the fiscal 2016 costs related to the acquisition of the Carve-Out Business. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our capabilities within the entire sensor processing chain.

## **INTEREST INCOME**

Interest income increased to \$0.1 million in fiscal 2016, compared to less than \$0.1 million in fiscal 2015.

## **INTEREST EXPENSE**

Interest expense for fiscal 2016 increased \$1.1 million to \$1.2 million compared to less than \$0.1 million in fiscal 2015. The increase was primarily driven by \$1.2 million cash and non-cash interest expenses related to the term loan entered into in connection with acquisition of the Carve-Out Business during the fourth quarter of fiscal 2016.

## **OTHER INCOME, NET**

Other income increased \$2.0 million to \$2.4 million during fiscal 2016 compared to \$0.4 million in fiscal 2015. The increase was a result of a \$1.9 million gain on the settlement of escrow litigation associated with our fiscal 2012 acquisition of KOR Electronics. Other income included \$1.2 million in amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts during fiscal 2016 and 2015.

In fiscal 2015, we incurred foreign currency exchange losses driven by the weakening Japanese yen against the U.S. dollar. Additionally, other income, net in fiscal 2015 included \$0.3 million of bank fees which were classified as selling, general, and administrative expenses in periods prior to the third quarter of fiscal 2015.

## **INCOME TAXES**

We recorded an income tax provision of \$5.5 million in fiscal 2016 compared to \$4.4 million in fiscal 2015. The effective tax rates for fiscal 2016 and fiscal 2015 were 21.9% and 23.2%, respectively.

Our effective tax rate for fiscal 2016 differed from the federal statutory rate primarily due to benefits related to research and development tax credits, domestic manufacturing deductions, excess tax benefits for equity compensation and releases for reserves for tax contingencies, partially offset by non-deductible equity compensation.

The difference in the effective tax rates between fiscal 2016 and fiscal 2015 is mainly driven by additional research and development tax credits, excess tax benefits for equity compensation previously accounted for as equity, and a portion of the legal settlement of the escrow litigation associated with our acquisition of KOR Electronics that was classified as a reduction of cost basis in an investment for income tax purposes which occurred in fiscal 2016.

## DISCONTINUED OPERATIONS

We incurred a loss from discontinued operations of \$4.1 million from the disposal of our MIS business in fiscal 2015. The loss included a \$2.3 million impairment of goodwill and a \$0.9 million loss on the sale, which was completed on January 23, 2015.

## FISCAL 2015 Vs. FISCAL 2014

The following tables set forth, for the periods indicated, financial data from the consolidated statement of operations:

(In thousands)	Fiscal 2015	As a % of Total Net Revenue	Fiscal 2014	As a % of Total Net Revenue
Net revenues	\$ 234,847	100.0%	\$ 208,729	100.0 %
Cost of revenues	124,628	53.1	113,985	54.6
Gross margin	110,219	46.9	94,744	45.4
Operating expenses:				
Selling, general and administrative	49,010	20.9	53,685	25.7
Research and development	32,554	13.9	35,693	17.1
Amortization of intangible assets	7,008	2.9	7,328	3.5
Restructuring and other charges	3,175	1.4	5,443	2.6
Acquisition costs and other related expenses	117	—	—	—
Total operating expenses	91,864	39.1	102,149	48.9
Income (loss) from operations	18,355	7.8	(7,405)	(3.5)
Other income, net	440	0.2	1,492	0.7
Income (loss) from continuing operations before income taxes	18,795	8.0	(5,913)	(2.8)
Tax provision (benefit)	4,366	1.9	(1,841)	(0.8)
Income (loss) from continuing operations	14,429	6.1	(4,072)	(2.0)
Loss from discontinued operations, net of income taxes	(4,060)	(1.7)	(7,353)	(3.5)
Net income (loss)	\$ 10,369	4.4%	\$ (11,425)	(5.5)%

## REVENUES

Total revenues increased \$26.1 million, or 13%, to \$234.8 million during fiscal 2015 compared to \$208.7 million during fiscal 2014. The increase was driven by higher defense revenues of \$28.4 million, partially offset by lower commercial sales of \$2.3 million. The increase in total revenues is primarily attributed to increases in the F-35, Patriot, and SEWIP programs, partially offset by decreases in the Aegis and Gorgon Stare programs. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, decreased by \$6.0 million to \$45.3 million during fiscal 2015 compared to \$51.3 million during fiscal 2014. The decrease was primarily driven by lower international revenues in the Asia Pacific region. International revenues represented 19% and 25% of total revenues during fiscal 2015 and 2014, respectively.

## GROSS MARGIN

Gross margin was 46.9% for fiscal 2015, an increase of 150 basis points from the 45.4% gross margin achieved in fiscal 2014. The higher gross margin in fiscal 2015 was due to a more favorable product mix, primarily driven by stronger revenues in our higher margin digital signal processing products.

## SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses decreased \$4.7 million, or 9%, to \$49.0 million during fiscal 2015 as compared to \$53.7 million during fiscal 2014. The decrease was primarily due to lower employee compensation expenses from completion of our acquisition integration plan. Selling, general and administrative expenses decreased as a percentage of revenue to 20.9% during fiscal 2015 from 25.7% during fiscal 2014 due to higher revenues in fiscal 2015 coupled with overall expense reductions, as compared to fiscal 2014.

## RESEARCH AND DEVELOPMENT

Research and development expenses decreased \$3.1 million, or 9%, to \$32.6 million during fiscal 2015 compared to \$35.7 million for fiscal 2014. The decrease was primarily due to \$6.2 million of higher customer funded development and \$0.3 million

lower depreciation expense, partially offset by \$2.2 million of increased employee compensation expenses. Research and development expenses accounted for 13.9% and 17.1% of our revenues during fiscal 2015 and fiscal 2014, respectively.

#### **AMORTIZATION OF INTANGIBLE ASSETS**

Amortization of intangible assets decreased \$0.3 million to \$7.0 million during fiscal 2015 compared to \$7.3 million for fiscal 2014, primarily due to a portion of the Micronetics' related intangible assets being fully amortized during the first quarter of fiscal 2014.

#### **RESTRUCTURING AND OTHER CHARGES**

Restructuring and other charges decreased 42%, or \$2.2 million, to \$3.2 million during fiscal 2015 compared to \$5.4 million in fiscal 2014. In fiscal 2014, we announced a restructuring plan that was implemented as part of the final phase of integration activities relating to our recent acquisitions. This acquisition integration plan included the consolidation of manufacturing facilities, centralization of administrative functions using common information systems and processes, and realignment of research and development resources. In fiscal 2015, our acquisition integration plan was completed and we incurred restructuring and other charges of \$3.2 million, but primarily associated with the final phases of the Chelmsford, Massachusetts headquarters consolidation and severance costs.

The fiscal 2014 restructuring activities included the elimination of 70 positions largely in engineering, manufacturing and administrative functions. Additionally, in fiscal 2014 we closed four facilities, relocating all related activities to our Advanced Microelectronics Center ("AMC") in Hudson, New Hampshire and completed the first phase of our Chelmsford, Massachusetts headquarters consolidation.

#### **ACQUISITION COSTS AND OTHER RELATED EXPENSES**

We incurred \$0.1 million of acquisition costs and other related expenses during fiscal 2015. We did not incur any acquisition costs and other related expenses during fiscal 2014.

#### **OTHER INCOME, NET**

Other income decreased \$1.1 million to \$0.4 million during fiscal 2015 compared to \$1.5 million in fiscal 2014. The decrease was a result of foreign currency exchange losses during fiscal 2015 driven by the weakening Japanese yen against the U.S. dollar as compared to modest gains during fiscal 2014. In addition, other income in fiscal 2015 included \$0.3 million of bank fees which were classified as selling, general, and administrative expenses in periods prior to the third quarter of fiscal 2015. Other income included \$1.2 million in amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts during fiscal 2015 and 2014. Interest income and interest expense for fiscal years 2015 and 2014 were de minimis.

#### **INCOME TAXES**

We recorded an income tax provision of \$4.4 million in fiscal 2015 compared to an income tax benefit of \$1.8 million in fiscal 2014. The effective tax rates for fiscal 2015 and fiscal 2014 were 23.2% and 31.1%, respectively.

Our effective tax rate for fiscal 2015 differed from the federal statutory rate primarily due to benefits related to research and development tax credits, domestic manufacturing deductions and releases of reserves for tax contingencies, partially offset by non-deductible equity compensation.

The difference in the effective tax rates for fiscal 2015 and fiscal 2014 is mainly driven by tax reserves released during fiscal 2015 as a result of the expiration of applicable statutes of limitations, tax rate changes recorded in fiscal 2015, and additional deductions for stock-based compensation in fiscal 2015 compared to a shortfall in fiscal 2014.

#### **DISCONTINUED OPERATIONS**

We incurred a loss from discontinued operations of \$4.1 million in fiscal 2015 compared to a loss from discontinued operations of \$7.4 million in fiscal 2014. The losses from discontinued operations included \$2.3 million and \$6.7 million impairments of goodwill in our MIS business in fiscal 2015 and 2014, respectively. In addition, fiscal 2015 included a \$0.9 million loss on the sale of the MIS business, which was completed on January 23, 2015.

#### **LIQUIDITY AND CAPITAL RESOURCES**

During fiscal 2016, our primary sources of liquidity came from existing cash and cash generated from operations, our follow on equity offering and entering into our term loan and new revolving credit facility. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases, inventory purchase commitments with our contract manufacturers, and interest and principal payments under our term loan. We do not currently have any material commitments for capital expenditures.

Based on our current plans and business conditions, we believe that existing cash, cash equivalents, available revolving credit facility, cash generated from operations, and financing capabilities will be sufficient to satisfy our anticipated cash requirements for at least the next twelve months.

### ***Shelf Registration Statement***

On August 15, 2014, we filed a shelf registration statement on Form S-3 with the SEC. The shelf registration statement, which has been declared effective by the SEC, registered up to \$500.0 million of debt securities, preferred stock, common stock, warrants and units. We intend to use the proceeds from a financing using the shelf registration statement for general corporate purposes, which may include the following:

- the acquisition of other companies or businesses;
- the repayment and refinancing of debt;
- capital expenditures;
- working capital; and
- other purposes as described in the prospectus supplement.

We have approximately \$400.0 million of availability remaining under the shelf registration statement after the April 4, 2016 follow-on equity offering.

### ***Follow-on Equity Offering***

On April 4, 2016, we commenced an offering of 4.5 million shares of our common stock pursuant to an underwritten public offering (the "Offering"). In connection with the Offering, we granted the underwriters an over-allotment option for 30 days to purchase up to an additional 0.7 million shares of our common stock. The Offering was made pursuant to a shelf registration statement previously filed with the SEC on August 15, 2014. On April 13, 2016, we closed the Offering, including the full over-allotment allocation, selling an aggregate of 5.2 million shares of common stock for total net proceeds of \$94.4 million after underwriting fees of \$5.2 million. Total fees and expenses associated with the equity offering were \$6.9 million.

### ***Term Loan and Revolving Credit Facilities***

On May 2, 2016, we and certain of our subsidiaries, as guarantors, entered into a Credit Agreement (the "Credit Agreement") with a syndicate of commercial banks and Bank of America, N.A acting as the administrative agent. The Credit Agreement provides for a \$200.0 million term loan facility ("Term Loan") and a \$100.0 million revolving credit facility ("Revolver"). In connection with the issuance of Term Loan, we incurred \$8.0 million of debt issuance costs, which are recorded as a direct reduction to long-term debt on the face of the consolidated balance sheets.

#### ***Maturity***

The Term Loan has a five year maturity subject to the amortization payments described below. The Revolver has a five year maturity.

#### ***Interest Rates and Fees***

Borrowings under the Credit Agreement bear interest, at our option, at floating rates tied to LIBOR or the prime rate plus an applicable percentage. The applicable percentage has initially been set at 2.0% and in future fiscal quarters will be established pursuant to a pricing grid based on our total net leverage ratio. In addition to interest on the aggregate outstanding principal amounts of any borrowings, we will also pay a quarterly commitment fee on the unutilized commitments under the Revolver, which fee has initially been set at 0.3% per annum and in future fiscal quarters will be established pursuant to a pricing grid based on our total net leverage ratio. We will also pay customary letter of credit and agency fees. As of June 30, 2016, the stated interest rate of Term Loan was 2.6%.

#### ***Prepayments***

The Credit Agreement provides for quarterly amortization payments on the Term Loan, beginning with 5.0% per annum amortization and increasing to 12.5% per annum amortization over the five year term of the Term Loan. We are required to make mandatory prepayments of the term loans with the proceeds of certain non-ordinary course asset sales or the proceeds of certain debt issuances. Subject to minimum notice requirements, borrowings under the Credit Agreement may be voluntarily prepaid at any time without premium or penalty.

#### ***Covenants and Events of Default***

The Credit Agreement provides for customary negative covenants, including, among other things and subject to certain significant exceptions, restrictions on the incurrence of debt or guarantees, the creation of liens, the making of certain investments,

loans and acquisitions, mergers and dissolutions, the sale of assets including capital stock of subsidiaries, the payment of dividends, the repayment or amending of junior debt, altering the business conducted, engaging in transactions with affiliates and entering into agreements limiting subsidiary dividends and distributions. The Credit Agreement also requires us to comply with certain financial covenants, including a quarterly minimum consolidated cash interest charge ratio test and a quarterly maximum consolidated total net leverage ratio test. The Credit Agreement also provides for customary representations and warranties, affirmative covenants and events of default (including, among others, the failure to make required payments of principal and interest, certain insolvency events, and an event of default upon a change of control). If an event of default occurs, the lenders under the Credit Agreement will be entitled to take various actions, including the acceleration of amounts due under the Credit Agreement and all actions permitted to be taken by a secured creditor. As of June 30, 2016, we were in compliance with all covenants and conditions under the Credit Agreement.

#### *Guarantees and Security*

Our obligations under the Credit Agreement are guaranteed by certain of our material domestic wholly-owned restricted subsidiaries (the “Guarantors”). The obligations of both us and the Guarantors are secured by a perfected security interest in substantially all of our and the Guarantors assets, in each case, now owned or later acquired, including a pledge of all of the capital stock of substantially all of our domestic wholly-owned restricted subsidiaries and 65% of the capital stock of certain of our foreign restricted subsidiaries, subject in each case to the exclusion of certain assets and additional exceptions. The foregoing description of the Credit Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Credit Agreement, a copy of which is filed as Exhibit 10.1 to our Current Report on Form 8-K dated May 2, 2016.

#### *Former Credit Agreement with KeyBank*

On October 12, 2012, we entered into a credit agreement with a syndicate of commercial banks, with KeyBank National Association acting as the administrative agent. The credit agreement provided for a \$200.0 million senior unsecured revolving line of credit. In connection with the closing of the acquisition of the Carve-Out Business and entering into the new Credit Agreement discussed above, we terminated our credit agreement with KeyBank on May 2, 2016.

## **CASH FLOWS**

<b>(In thousands)</b> <b>As of and for the fiscal year ended</b>	<b>June 30, 2016</b>	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Net cash provided by operating activities	\$ 36,940	\$ 32,207	\$ 14,241
Net cash used in investing activities	\$ (318,208)	\$ (5,598)	\$ (6,720)
Net cash provided by financing activities	\$ 284,894	\$ 3,905	\$ 742
Net increase in cash and cash equivalents	\$ 4,105	\$ 30,299	\$ 8,161
Cash and cash equivalents at end of year	\$ 81,691	\$ 77,586	\$ 47,287

Our cash and cash equivalents increased by \$4.1 million during fiscal 2016 primarily as a result of \$192.0 million in net borrowings against our term loan, \$92.8 million net proceeds from our equity offering, and \$36.9 million in cash generated by operating activities, partially offset by \$309.8 million used in two business acquisitions, \$8.0 million used in share repurchases, and \$7.9 million in purchases of property and equipment.

#### *Operating Activities*

During fiscal 2016, we generated \$36.9 million in cash from operating activities, an increase of \$4.7 million when compared to \$32.2 million in cash generated from operating activities in fiscal 2015. The increase in cash generated by operating activities was primarily a result of \$9.4 million of higher comparable net income, \$19.3 million less in cash used for accounts payable and accrued expenses and \$10.5 million less in prepaid expenses and other current assets. The increase in cash generated from operating activities was partially offset by a \$31.3 million decrease in accounts receivable collections. Our ability to generate cash from operations in future periods will depend in large part on profitability, the rate and timing of collections of accounts receivable, our inventory turns and our ability to manage other areas of working capital.

During fiscal 2015, we generated \$32.2 million in cash from operating activities, an increase of \$18.0 million when compared to \$14.2 million in cash generated from operating activities in fiscal 2014. The increase in cash generated by operating activities was primarily a result of \$21.8 million of higher comparable net income, \$18.4 million increase in accounts receivable collections, and \$4.5 million generated from lower deferred income taxes. The increase in cash generated from operating activities was partially offset by a \$11.8 million increase in cash used for prepaid expenses and other current assets, \$6.2 million in higher inventory purchases, and a \$4.4 million decrease in non-cash activity from the impairment of goodwill associated with our MIS discontinued operations.

### **Investing Activities**

During fiscal 2016, we used cash of \$318.2 million in investing activities compared to \$5.6 million used during fiscal 2015. The \$312.6 million increase in cash used in investing activities was primarily due to \$300.0 million used to acquire the Carve-Out Business and \$9.8 million for the LIT acquisition.

During fiscal 2015, we used cash of \$5.6 million in investing activities compared to \$6.7 million used during fiscal 2014. Driving the \$1.1 million decrease in cash used in investing activities were fewer purchases of property and equipment of \$0.7 million and proceeds generated from the sale of our MIS business of \$0.9 million.

### **Financing Activities**

During fiscal 2016, we generated \$284.9 million from financing activities compared to \$3.9 million cash generated from financing activities during fiscal 2015. The \$281.0 million increase in cash generated by financing activities was primarily due to a \$192.0 million net borrowing against the term loan and \$92.8 million net proceeds from the equity offering in connection to the Carve-Out Business acquisition.

During fiscal 2015, we generated \$3.9 million from financing activities compared to \$0.7 million cash generated from financing activities during fiscal 2014. The \$3.2 million change in cash from financing activities was primarily due to a \$3.1 million increase in proceeds from employee stock plans and \$0.9 million increase in excess tax benefit from stock-based compensation compared to fiscal 2014, partially offset by \$0.9 million of retired common stock.

### **COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

The following is a schedule of our commitments and contractual obligations outstanding at June 30, 2016:

(In thousands)	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
Operating leases	\$ 43,631	\$ 6,018	\$ 9,811	\$ 8,357	\$ 19,445
Purchase obligations	32,195	32,195	—	—	—
Capital lease obligations	—	—	—	—	—
Debt principal payment obligations (1)	200,000	10,000	25,000	165,000	—
	<u>\$ 275,826</u>	<u>\$ 48,213</u>	<u>\$ 34,811</u>	<u>\$ 173,357</u>	<u>\$ 19,445</u>

(1) Interest payments are due quarterly on the outstanding term loan. Future interest payments are not included in the schedule of commitments and contractual obligations due to the variable nature of the interest rate.

We have a liability at June 30, 2016 of \$1.6 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. As of June 30, 2016, the IRS has presented an agreement that would lead to the conclusion of the audit; the Company continues to negotiate specific terms of this agreement. It is reasonably possible that within the next 12 months the Company's unrecognized tax benefits, exclusive of interest, may decrease by up to \$0.8 million at the conclusion of the audit. We do not know the ultimate resolution of these uncertain tax positions and as such, do not know the ultimate timing of payments related to this liability. Accordingly, these amounts are not included in the above table.

Purchase obligations represent open non-cancelable purchase commitments for certain inventory components and services used in normal operations. The purchase commitments covered by these agreements are for less than one year and aggregated \$32.2 million at June 30, 2016.

Our standard product sales and license agreements entered into in the ordinary course of business typically contain an indemnification provision pursuant to which we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with certain intellectual property infringement claims by any third party with respect to our products. Such provisions generally survive termination or expiration of the agreements. The potential amount of future payments we could be required to make under these indemnification provisions is, in some instances, unlimited.

In connection with the sale of our former MIS business, we provided indemnification to the buyer of the business. Our indemnification obligations generally cover the buyer for damages resulting from breaches of representations, warranties and covenants contained in the purchase and sale agreement and generally cover pre-closing tax liabilities of the business. Our indemnification obligations regarding the MIS business are generally subject to caps.

As part of our strategy for growth, we continue to explore acquisitions or strategic alliances. The associated acquisition costs incurred in the form of professional fees and services may be material to the future periods in which they occur, regardless of whether the acquisition is ultimately completed.

We may elect from time to time to purchase and subsequently retire shares of common stock in order to settle an individual employees' tax liability associated with vesting of a restricted stock award. These transactions would be treated as a use of cash in financing activities in our statement of cash flows.

#### OFF-BALANCE SHEET ARRANGEMENTS

Other than our lease commitments incurred in the normal course of business and certain indemnification provisions, we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not consolidated in the financial statements. Additionally, we do not have an interest in, or relationships with, any special purpose entities.

#### RELATED PARTY TRANSACTIONS

During fiscal 2016 and 2015, we did not engage in any related party transactions.

#### NON-GAAP FINANCIAL MEASURES

In our periodic communications, we discuss certain important measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"), adjusted EBITDA, adjusted income from continuing operations, adjusted earnings per share ("adjusted EPS") and free cash flow.

Adjusted EBITDA is defined as earnings from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining a component of bonus and equity compensation for executive officers based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe the adjusted EBITDA financial measure assists in providing a more complete understanding of our underlying operational measures to manage our business, to evaluate our performance compared to prior periods and the marketplace, and to establish operational goals. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

Adjusted EBITDA is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted EBITDA financial adjustments described above, and investors should not infer from our presentation of this non-GAAP financial measure that these costs are unusual, infrequent or non-recurring.

The following table reconciles our income (loss) from continuing operations, the most directly comparable GAAP financial measure, to our adjusted EBITDA:

(In thousands)	Year Ended June 30,		
	2016	2015	2014
Income (loss) from continuing operations	\$ 19,742	\$ 14,429	\$ (4,072)
Interest expense, net	1,041	13	40
Tax provision (benefit)	5,544	4,366	(1,841)
Depreciation	6,900	6,332	7,625
Amortization of intangible assets	8,842	7,008	7,328
Restructuring and other charges	1,240	3,175	5,443
Impairment of long-lived assets	231	—	—
Acquisition and financing costs	4,701	451	—
Fair value adjustments from purchase accounting	1,384	—	—
Litigation and settlement (income) expense, net	(1,925)	—	—
Stock-based compensation expense	9,574	8,640	8,999
Adjusted EBITDA	\$ 57,274	\$ 44,414	\$ 23,522

Adjusted income from continuing operations and adjusted EPS exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. We believe that exclusion of these items assists in providing a more complete

understanding of our underlying continuing operations results and trends and allows for comparability with our peer company index and industry. We use these measures along with the corresponding GAAP financial measures to manage our business and to evaluate our performance compared to prior periods and the marketplace. We define adjusted income from continuing operations as income from continuing operations before amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expenses, stock-based compensation expense, and the tax impact of those items. Adjusted EPS expresses adjusted income from continuing operations on a per share basis using weighted average diluted shares outstanding.

Adjusted income from continuing operations and adjusted EPS are non-GAAP financial measures and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. These non-GAAP financial measures may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted income from continuing operations and adjusted EPS financial adjustments described above, and investors should not infer from our presentation of these non-GAAP financial measures that these costs are unusual, infrequent or non-recurring.

The following table reconciles income (loss) from continuing operations and diluted earnings (loss) per share, the most directly comparable GAAP measures, to adjusted income from continuing operations and adjusted EPS:

(In thousands, except per share data)	Year Ended June 30,					
	2016		2015		2014	
Income (loss) from continuing operations and diluted earnings (loss) per share	\$ 19,742	\$ 0.56	\$ 14,429	\$ 0.44	\$ (4,072)	\$ (0.13)
Amortization of intangible assets	8,842		7,008		7,328	
Restructuring and other charges	1,240		3,175		5,443	
Impairment of long-lived assets	231		—		—	
Acquisition and financing costs	4,701		451		—	
Fair value adjustments from purchase accounting (1)	1,384		—		—	
Litigation and settlement (income) expenses	(1,925)		—		—	
Stock-based compensation expense	9,574		8,640		8,999	
Impact to income taxes (2)	(9,975)		(6,733)		(5,773)	
Adjusted income from continuing operations and adjusted earnings per share	<u>\$ 33,814</u>	<u>\$ 0.96</u>	<u>\$ 26,970</u>	<u>\$ 0.82</u>	<u>\$ 11,925</u>	<u>\$ 0.38</u>
Diluted weighted-average shares outstanding		<u>35,097</u>		<u>32,939</u>		<u>31,000</u>

(1) Fiscal 2016 fair value adjustments from purchase accounting relates to Carve-Out Business inventory step up amortization.

(2) Impact to income taxes is calculated by taking the tax provision as determined for GAAP purposes and subtracting a recalculated tax provision that excludes the effect of all items added back in determining adjusted EBITDA.

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures for property and equipment, which includes capitalized software development costs. We believe free cash flow provides investors with an important perspective on cash available for investments and acquisitions after making capital investments required to support ongoing business operations and long-term value creation. We believe that trends in our free cash flow are valuable indicators of our operating performance and liquidity.

Free cash flow is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenditures similar to the free cash flow adjustment described above, and investors should not infer from our presentation of this non-GAAP financial measure that these expenditures reflect all of our obligations which require cash.

The following table reconciles cash provided by operating activities, the most directly comparable GAAP financial measure, to free cash flow:

(In thousands)	Year Ended June 30,		
	2016	2015	2014
Cash provided by operating activities	\$ 36,940	\$ 32,207	\$ 14,241
Purchases of property and equipment	(7,885)	(5,984)	(6,701)
Free cash flow	\$ 29,055	\$ 26,223	\$ 7,540

## CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

We have identified the policies discussed below as critical to understanding our business and our results of operations. The impact and any associated risks related to these policies on our business operations are discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. We believe the following critical accounting policies to be those most important to the portrayal of our financial position and results of operations and those that require the most subjective judgment.

### REVENUE RECOGNITION

We recognize revenue using three different types of accounting methods: ship and bill, multiple-deliverable arrangements and contract accounting which encompass the percentage of completion, completed contract and time and materials methods. Ship and bill revenues, multiple-deliverable arrangements and contract accounting revenues totaled 35%, 37%, and 28% of total Company revenues in fiscal 2016, respectively.

Revenue from system sales is recognized upon shipment utilizing the ship and bill method provided that title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, have been successfully demonstrated.

For multiple-deliverable revenue arrangements that may include a combination of hardware components, related integration or other services, we allocate revenue to each deliverable based on its relative fair value. We generally determine relative selling price using best estimate of the selling price ("BESP"). We determine BESP for each deliverable using a bottoms-up cost plus expected margin approach. Each deliverable within our multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting if the delivered item or items have value to the customer on a standalone basis. We consider a deliverable to have standalone value if the item is sold separately by us or another vendor or if the item could be resold by the customer.

We also have long term production type contracts that are primarily fixed-price for which we apply the percentage-of-completion method for revenue recognition. These long-term contracts involve the design, development, manufacture, or modification of complex electronic equipment and related services. Under this method, revenue is recognized based on the extent of progress towards completion of the long-term contract.

Application of the percentage-of-completion method requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, labor productivity, anticipated increases in wages and prices for subcontractor services and materials, the availability of our subcontractor's services and materials, the availability and timing of funding from our customer, and overhead rates, among other variables. We primarily use the cost-to-cost measure of progress for our long-term 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 contracts. Our estimates are based upon the professional knowledge and experience of our engineers, program managers and finance professionals, who review each long-term contract monthly to assess the contract's schedule, performance, technical matters and estimated cost at completion.

A cancellation, schedule delay, or modification of a fixed-price contract which is accounted for using the percentage-of-completion method may adversely affect our gross margins for the period in which the contract is modified or canceled. Changes in estimates are applied retrospectively and when adjustments in estimated contract costs are identified, such revisions may result in current period adjustments to earnings applicable to performance in prior periods. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. The completed contract method is utilized when reasonable and reliable cost estimates for a project cannot be made.

Our analysis of these contracts also contemplates whether contracts should be combined or segmented in accordance with the applicable criteria under GAAP. We combine closely related contracts when all the applicable criteria under GAAP are met. The combination of two or more contracts requires judgment in determining whether the intent of entering into the contracts was effectively to enter into a single project, which should be combined to reflect an overall profit rate. Similarly, we may segment a project, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable

criteria under GAAP are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement was negotiated and the performance criteria. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period. For all types of contracts, we recognize anticipated contract losses as soon as they become known and estimable. These losses are recognized in advance of contract performance and as of June 30, 2016, approximately \$1.0 million of these costs were in accrued expenses on our balance sheet.

We do not provide our customers with rights of product return, other than those related to warranty provisions that permit repair or replacement of defective goods. We accrue for anticipated warranty costs upon product shipment. Our payment terms generally range from 30 to 90 days from invoice date based on the nature of the contracts, customers' geographic locations and customer type.

We define service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold by us. Examples of our service revenues include: analyst services and systems engineering support, consulting, maintenance and other support, testing and installation. We combine our product and service revenues into a single class as services revenues are less than 10 percent of total revenues.

#### *INVENTORY VALUATION*

We value our inventory at the lower of cost (first-in, first-out) or its current estimated market value. We write down inventory for excess and obsolescence based upon assumptions about future demand, product mix and possible alternative uses. Actual demand, product mix and alternative usage may be lower than those that we project and this difference could have a material adverse effect on our gross margin if inventory write-downs beyond those initially recorded become necessary. Alternatively, if actual demand, product mix and alternative usage are more favorable than those we estimated at the time of such a write-down, our gross margin could be favorably impacted in future periods.

#### *GOODWILL, INTANGIBLE ASSETS AND LONG-LIVED ASSETS*

We evaluate our goodwill for impairment annually in the fourth quarter and in any interim period in which events or circumstances arise that indicate our goodwill may be impaired. Indicators of impairment include, but are not limited to, a significant deterioration in overall economic conditions, a decline in our market capitalization, the loss of significant business, significant decreases in funding for our contracts, or other significant adverse changes in industry or market conditions. On May 2, 2016, we closed the transaction with Microsemi Corporation to acquire the Carve-Out Business. The Carve-Out Business was treated as a separate reporting unit as of June 30, 2016 under ASC 350. There were no interim triggering events for MCE or MDS reporting units.

We test goodwill for impairment at the reporting unit level. Goodwill impairment guidance provides entities an option to perform a qualitative assessment (commonly known as "step zero") to determine whether further impairment testing is necessary before performing the two-step test. The qualitative assessment requires significant judgments by management about macro-economic conditions including the entity's operating environment, its industry and other market considerations, entity-specific events related to financial performance or loss of key personnel, and other events that could impact the reporting unit. If we conclude that further testing is required, the impairment test involves a two-step process. Step one compares the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount exceeds the fair value of the reporting unit, step two is required to determine if there is an impairment of the goodwill. Step two compares the implied fair value of the reporting unit's goodwill to the carrying amount of the goodwill. The Company estimates the fair value of its reporting units using the income approach based upon a discounted cash flow model. The income approach requires the use of many assumptions and estimates including future revenues, expenses, capital expenditures, and working capital, as well as discount factors and income tax rates. In addition, the Company uses the market approach, which compares the reporting unit to publicly-traded companies and transactions involving similar businesses, to support the conclusions of the income approach.

As part of our annual goodwill impairment testing performed on May 31, 2016, we utilized the income approach to determine the fair value of our MCE, MDS and Carve-Out Business reporting units. As part of our annual goodwill impairment testing, we utilized a discount rate for each of our reporting units that we believe represents the risks that our businesses face, considering their sizes, the current economic environment, and other industry data we believe is appropriate. The discount rates for MCE and MDS were 9% and 10%, respectively. The annual testing indicated that the fair values of our MCE and MDS reporting units significantly exceeding their carrying values, and thus no further testing was required. A one percent change in the discount rate of either reporting unit would still result in significant excess of fair value over carrying value. We performed a fair value assessment of the Carve-Out Business as of May 2, 2016 using the income approach based upon a discounted cash flow model, which we also utilized for our May 31, 2016 impairment test because of the proximity in time and no changes in financial projections.

We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our long-lived assets decline

because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary. None such impairment indicators existed during fiscal 2016.

#### *INCOME TAXES*

The determination of income tax expense requires us to make certain estimates and judgments concerning the calculation of deferred tax assets and liabilities, as well as the deductions and credits that are available to reduce taxable income. We recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been included in our consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates for the year in which the differences are expected to reverse.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results, our forecast of future earnings, future taxable income, and tax planning strategies. The assumptions utilized in determining future taxable income require significant judgment. We record a valuation allowance against deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. If it becomes more likely than not that a tax asset will be used for which a reserve has been provided, we reverse the related valuation allowance. If our actual future taxable income by tax jurisdiction differs from estimates, additional allowances or reversals of reserves may be necessary.

We use a two-step approach to recognize and measure uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. We reevaluate our uncertain tax positions on a quarterly basis and any changes to these positions as a result of tax audits, tax laws or other facts and circumstances could result in additional charges to operations.

#### *BUSINESS COMBINATIONS*

We utilize the acquisition method of accounting for business combinations and allocate the purchase price of an acquisition to the various tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. We primarily establish fair value using the income approach based upon a discounted cash flow model. The income approach requires the use of many assumptions and estimates including future revenues and expenses, as well as discount factors and income tax rates. Other estimates include:

- estimated step-ups for the fixed assets and inventory;
- estimated fair values of intangible assets; and
- estimated income tax assets and liabilities assumed from the acquiree.

While we use our best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business acquisition date, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business acquisition date, we record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. For changes in the valuation of intangible assets between preliminary and final purchase price allocation, the related amortization is adjusted in the period it occurs. Subsequent to the purchase price allocation period any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for us on July 1, 2018 and can be early adopted for the fiscal year beginning July 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, an amendment of the FASB Accounting Standards Codification. The ASU has added additional disclosure requirements to the codification. It requires management to assess, at each interim and annual reporting period, whether substantial doubt exists about the company's ability to continue as a going concern. Substantial doubt exists if it is probable (the "probable" threshold under US GAAP has generally been interpreted to be between 75 and 80 percent) that the company will be unable to meet its obligations as they become due within one year after the date the financial statements are issued or available to be issued

(assessment date). The ASU is effective for annual reporting periods beginning after December 15, 2016, and interim periods thereafter, with early adoption permitted. We do not expect a going concern uncertainty in the foreseeable future, and therefore this guidance is not expected to have a material impact to our consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the separate presentation of extraordinary items, net of tax and the related earnings per share, but does not affect the requirement to disclose material items that are unusual in nature or infrequently occurring. The ASU aligns U.S. GAAP more closely with IFRS ("International Financial Reporting Standards"). Entities will continue to evaluate whether items are unusual in nature or infrequent in their occurrence for disclosure purposes and when estimating the annual effective tax rate for interim reporting purposes. This ASU is effective for interim and annual periods in fiscal years beginning after December 15, 2015. The ASU allows prospective or retrospective applications. Early adoption is permitted if applied from the beginning of the fiscal year of adoption. We do not expect this guidance to have a material impact to our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*, an amendment of the FASB Accounting Standards Codification. This ASU changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out or retail inventory method. The ASU also eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximately normal profit margin when measuring inventory. The ASU is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. The ASU requires prospective adoption and permits early adoption. We are evaluating the effect that ASU 2015-11 will have on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. This ASU 2016-02 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. We are evaluating the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

## **RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

Effective October 1, 2015, we adopted FASB ASU No. 2014-17, *Pushdown Accounting (a consensus of the FASB Emerging Issues Task Force)*, an amendment of the FASB Accounting Standards Codification. This ASU allows an acquired entity to elect to apply pushdown accounting in its separate financial statements on a change-in-control event. The acquired entity elects whether to apply pushdown accounting individually for each change-in-control event, and may apply pushdown accounting during the reporting period in which the change-in-control event occurs. Such adoption did not have any impact to our consolidated financial statements.

Effective January 1, 2016, we adopted FASB ASU No. 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement for an acquirer to retrospectively adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. Such adoption did not have any impact to our consolidated financial statements.

Effective April 1, 2016 we adopted FASB ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, an amendment of the FASB Accounting Standards Codification. This ASU simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as non-current on the balance sheet. The ASU is effective for us on July 1, 2017; however, we have elected to early adopt as permitted by the guidance. Upon adoption, we presented deferred taxes as non-current on the consolidated balance sheets on a retrospective basis. Such adoption did not have a material impact on our financial position or results of operations.

The following table summarizes the adjustments made as of June 30, 2015 to conform prior period classifications with the new guidance:

	Balance Sheet Line Item	Balance Prior to Adoption	Increase / (Decrease)	As Adjusted
Current deferred income tax assets	Deferred income taxes	\$ 12,407	\$ (12,407)	\$ —
Long-term deferred income tax assets	Other non-current assets	1,275	9,299	10,574
Total tax assets		<u>\$ 13,682</u>	<u>\$ (3,108)</u>	<u>\$ 10,574</u>
Long-term deferred income tax liabilities	Deferred income taxes	\$ (3,108)	\$ 3,108	\$ —
Total tax liabilities		(3,108)	3,108	—
Net deferred tax asset		<u>\$ 10,574</u>	<u>\$ —</u>	<u>\$ 10,574</u>

Effective April 1, 2016, we adopted FASB ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, an amendment of the FASB Accounting Standards Codification. This ASU was issued as part of the FASB's simplification initiative, and intends to improve the accounting for share-based payment transactions. The ASU changes several aspects of the accounting for share-based payment award transactions, including: (1) accounting for excess tax benefits and shortfalls, (2) forfeitures, (3) tax withholding requirements, and (4) cash flow classifications. The ASU is effective for us on July 1, 2017; however, we have elected to early adopt on a prospective basis as of the first day of our fiscal year (July 1, 2015) as permitted by the guidance.

Upon adoption, recognition of excess tax benefits and tax shortfalls resulted in the recognition of \$1,100 of excess tax benefits as a benefit to income taxes in our consolidated statements of operations and comprehensive income (loss). In addition, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows. We have elected to continue to estimate expected forfeitures of employee equity awards to determine the amount of compensation expense to be recognized in each year and the changes in tax withholding requirements had no impact to our consolidated financial statements in fiscal 2016.

Effective April 1, 2016, we adopted FASB ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, an amendment of the FASB Accounting Standards Codification. This ASU requires entities to present debt issuance costs related to a recognized debt liability on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. Upon adoption, we no longer record the cost of issuing debt as a separate deferred financing asset. In the fourth quarter of fiscal 2016, we entered into an credit agreement to borrow a \$200.0 million term loan. We incurred debt issuance costs of \$8.0 million which were recorded as a direct deduction to our long term debt and will be amortized over the term of the loan.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### INTEREST RATE RISK

Our exposure to interest rate risk is related primarily to our investment portfolio, term loan and revolving credit facility.

Our investment portfolio includes money market funds from high quality U.S. government issuers. A change in prevailing interest rates may cause the fair value of our investments to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing rate rises, the fair value of the principal amount of our investment will probably decline. To minimize this risk, investments are generally available for sale and we generally limit the amount of credit exposure to any one issuer.

Our term loan is subject to interest rate risk since it is variable interest rate long-term debt. The estimated fair value of our outstanding debt was \$200.0 million at June 30, 2016 and the outstanding principal amount was \$200.0 million, excluding unamortized discounts and deferred financing costs of \$7.7 million. A one percent change in the level of interest rates would result in \$2.0 million change in pre-tax income for the fiscal year ended June 30, 2017.

We also are exposed to the impact of interest rate changes primarily through our borrowing activities. For our variable rate borrowings, we may use fixed interest rate swaps, effectively converting variable rate borrowings to fixed rate borrowings in order to mitigate the impact of interest rate changes on earnings. These swaps will be designated as cash flow hedges. There were no swaps outstanding at June 30, 2016.

### CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. We place our cash and cash equivalents with financial institutions that we believe are of high

credit quality. At June 30, 2016 and 2015, we had \$81,691 and \$77,586, respectively, of cash and cash equivalents on deposit or invested with our financial and lending institutions.

We provide credit to customers in the normal course of business. We perform ongoing credit evaluations of our customers' financial condition and limit the amount of credit extended when deemed necessary. At June 30, 2016, five customers accounted for 50% of our receivables, unbilled receivables and costs in excess of billings. At June 30, 2015, five customers accounted for 55% of our receivables, unbilled receivables and costs in excess of billings.

#### **FOREIGN CURRENCY RISK**

We operate primarily in the United States; however, we conduct business outside the United States through our foreign subsidiaries in Europe and Japan, where business is largely transacted in non-U.S. dollar currencies. Accordingly, we are subject to exposure from adverse movements in the exchange rates of local currencies. Local currencies are used as the functional currency for our subsidiaries in Europe and Japan. Consequently, changes in the exchange rates of the currencies may impact the translation of the foreign subsidiaries' statements of operations into U.S. dollars, which may in turn affect our consolidated statement of operations.

We have not entered into any financial derivative instruments that expose us to material market risk, including any instruments designed to hedge the impact of foreign currency exposures. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Mercury Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Mercury Systems, Inc. and subsidiaries as of June 30, 2016 and 2015, and the related consolidated statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2016. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule II. We also have audited Mercury Systems, Inc.'s internal control over financial reporting as of June 30, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Mercury Systems, Inc.'s management is responsible for these consolidated financial statements and financial statement schedule, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercury Systems, Inc. and subsidiaries as of June 30, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2016, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein. Also in our opinion, Mercury Systems, Inc. maintained, in all material respects, effective internal control over financial reporting as of June 30, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Mercury Systems, Inc. and subsidiaries acquired the custom microelectronics, RF and microwave solutions, and embedded security operations from Microsemi Corporation (the Carve-Out Business) during fiscal year 2016, and management excluded from its assessment of the effectiveness of Mercury Systems, Inc. and subsidiaries' internal control over financial reporting as of June 30, 2016, the Carve-Out Business' internal control over financial reporting associated with 46 percent of total consolidated assets (of which 37 percent represented goodwill and intangible assets included within the scope of the assessment) and 6 percent of total consolidated revenues included in the consolidated financial statements of Mercury Systems, Inc. and subsidiaries as of and for the year ended June 30, 2016. Our audit of internal control over financial reporting of Mercury Systems, Inc. and subsidiaries also excluded an evaluation of the internal control over financial reporting of the Carve-Out Business.

/s/ KPMG LLP

Boston, Massachusetts

August 16, 2016

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**MERCURY SYSTEMS, INC.**

**CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share data)

	June 30,	
	2016	2015
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 81,691	\$ 77,586
Accounts receivable, net of allowance for doubtful accounts of \$92 and \$56 at June 30, 2016 and 2015, respectively	73,427	31,765
Unbilled receivables and costs in excess of billings	22,467	22,021
Inventory	58,284	31,960
Prepaid income taxes	3,401	3,747
Prepaid expenses and other current assets	6,122	8,678
Total current assets	<u>245,392</u>	<u>175,757</u>
Restricted cash	264	264
Property and equipment, net	28,337	13,226
Goodwill	344,027	168,146
Intangible assets, net	116,673	17,998
Deferred income taxes	—	10,574
Other non-current assets	1,803	915
Total assets	<u>\$ 736,496</u>	<u>\$ 386,880</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 26,723	\$ 6,928
Accrued expenses	10,273	9,005
Accrued compensation	13,283	9,875
Deferred revenues and customer advances	7,365	7,477
Current portion of long-term debt	10,000	—
Total current liabilities	<u>67,644</u>	<u>33,285</u>
Deferred income taxes	11,842	—
Income taxes payable	700	1,459
Long-term debt	182,275	—
Other non-current liabilities	991	1,998
Total liabilities	<u>263,452</u>	<u>36,742</u>
Commitments and contingencies (Note K)		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.01 par value; 85,000,000 shares authorized; 38,675,340 and 32,570,959 shares issued and outstanding at June 30, 2016 and 2015, respectively	387	326
Additional paid-in capital	357,500	254,568
Retained earnings	114,210	94,468
Accumulated other comprehensive income	947	776
Total shareholders' equity	<u>473,044</u>	<u>350,138</u>
Total liabilities and shareholders' equity	<u>\$ 736,496</u>	<u>\$ 386,880</u>

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

**MERCURY SYSTEMS, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**

(In thousands, except per share data)

	For the Years Ended June 30,		
	2016	2015	2014
Net revenues	\$ 270,154	\$ 234,847	\$ 208,729
Cost of revenues	145,380	124,628	113,985
Gross margin	124,774	110,219	94,744
Operating expenses:			
Selling, general and administrative	52,952	49,010	53,685
Research and development	33,543	32,554	35,693
Amortization of intangible assets	8,842	7,008	7,328
Restructuring and other charges	1,240	3,175	5,443
Impairment of long-lived assets	231	—	—
Acquisition costs and other related expenses	3,993	117	—
Total operating expenses	100,801	91,864	102,149
Income (loss) from operations	23,973	18,355	(7,405)
Interest income	131	21	9
Interest expense	(1,172)	(34)	(49)
Other income, net	2,354	453	1,532
Income (loss) from continuing operations before income taxes	25,286	18,795	(5,913)
Tax provision (benefit)	5,544	4,366	(1,841)
Income (loss) from continuing operations	19,742	14,429	(4,072)
Loss from discontinued operations, net of income taxes	—	(4,060)	(7,353)
Net income (loss)	\$ 19,742	\$ 10,369	\$ (11,425)
Basic net earnings (loss) per share:			
Income (loss) from continuing operations	\$ 0.58	\$ 0.45	\$ (0.13)
Loss from discontinued operations, net of income taxes	—	(0.13)	(0.24)
Net income (loss)	\$ 0.58	\$ 0.32	\$ (0.37)
Diluted net earnings (loss) per share:			
Income (loss) from continuing operations	\$ 0.56	\$ 0.44	\$ (0.13)
Loss from discontinued operations, net of income taxes	—	(0.13)	(0.24)
Net income (loss)	\$ 0.56	\$ 0.31	\$ (0.37)
Weighted-average shares outstanding:			
Basic	34,241	32,114	31,000
Diluted	35,097	32,939	31,000
Comprehensive income (loss):			
Net income (loss)	\$ 19,742	\$ 10,369	\$ (11,425)
Foreign currency translation adjustments	171	(235)	65
Net unrealized loss on investments	—	—	(16)
Total comprehensive income (loss)	\$ 19,913	\$ 10,134	\$ (11,376)

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

**MERCURY SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
For the Years Ended June 30, 2016, 2015 and 2014  
(In thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
Balance at June 30, 2013	30,381	\$ 304	\$ 231,711	\$ 95,524	\$ 962	\$ 328,501
Issuance of common stock under employee stock incentive plans	811	8	698	—	—	706
Issuance of common stock under employee stock purchase plan	92	—	778	—	—	778
Stock-based compensation	—	—	9,244	—	—	9,244
Tax shortfall from employee stock plan awards	—	—	(706)	—	—	(706)
Net loss	—	—	—	(11,425)	—	(11,425)
Net unrealized loss on investments	—	—	—	—	(16)	(16)
Foreign currency translation adjustments	—	—	—	—	65	65
Balance at June 30, 2014	31,284	312	241,725	84,099	1,011	327,147
Issuance of common stock under employee stock incentive plans	1,275	13	3,697	—	—	3,710
Issuance of common stock under employee stock purchase plan	79	1	837	—	—	838
Retirement of common stock	(67)	—	(944)	—	—	(944)
Stock-based compensation	—	—	8,728	—	—	8,728
Tax benefit from employee stock plan awards	—	—	525	—	—	525
Net income	—	—	—	10,369	—	10,369
Foreign currency translation adjustments	—	—	—	—	(235)	(235)
Balance at June 30, 2015	32,571	326	254,568	94,468	776	350,138
Issuance of common stock under employee stock incentive plans	1,267	12	6,867	—	—	6,879
Issuance of common stock under employee stock purchase plan	88	1	1,217	—	—	1,218
Retirement of common stock	(426)	(4)	(7,951)	—	—	(7,955)
Follow-on public stock offering	5,175	52	92,726	—	—	92,778
Stock-based compensation	—	—	9,666	—	—	9,666
Net income	—	—	—	19,742	—	19,742
Share-based business combination consideration	—	—	407	—	—	407
Foreign currency translation adjustments	—	—	—	—	171	171
Balance at June 30, 2016	38,675	\$ 387	\$ 357,500	\$ 114,210	\$ 947	\$ 473,044

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

**MERCURY SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	For the Years Ended June 30,		
	2016	2015	2014
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ 19,742	\$ 10,369	\$ (11,425)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>			
Depreciation and amortization expense	15,742	13,840	15,608
Stock-based compensation expense	9,574	8,728	9,244
Deferred income taxes	(3,061)	(1,038)	(5,499)
Impairment of goodwill and long-lived assets	231	2,283	6,687
Excess tax benefit from stock-based compensation	—	(943)	(21)
Loss on sale of discontinued operations	—	892	—
Non-cash interest expense	301	—	—
Other non-cash items	(722)	(495)	(619)
<b>Changes in operating assets and liabilities, net of effects of businesses acquired:</b>			
Accounts receivable, unbilled receivables, and costs in excess of billings	(25,396)	5,935	(12,428)
Inventory	(865)	(345)	5,818
Prepaid income taxes	346	(2,265)	887
Prepaid expenses and other current assets	2,964	(4,964)	3,728
Other non-current assets	(778)	565	1,006
Accounts payable and accrued expenses	18,871	(475)	1,163
Deferred revenues and customer advances	(194)	1,138	129
Income taxes payable	253	(938)	274
Other non-current liabilities	(68)	(80)	(311)
<b>Net cash provided by operating activities</b>	<b>36,940</b>	<b>32,207</b>	<b>14,241</b>
<b>Cash flows from investing activities:</b>			
Acquisition of businesses, net of cash acquired	(309,756)	—	—
Purchases of property and equipment	(7,885)	(5,984)	(6,701)
Proceeds from sale of discontinued operations	—	885	—
Increase in other investing activities	(567)	(499)	(19)
<b>Net cash used in investing activities</b>	<b>(318,208)</b>	<b>(5,598)</b>	<b>(6,720)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from equity offering, net	92,778	—	—
Proceeds from employee stock plans	8,097	4,548	1,484
Payment for retirement of common stock	(7,955)	(944)	—
Excess tax benefit from stock-based compensation	—	943	21
Proceeds from issuance of term debt, net	194,900	—	—
Payments of debt issuance cost	(2,926)	—	—
Payments of capital lease obligations	—	(642)	(763)
<b>Net cash provided by financing activities</b>	<b>284,894</b>	<b>3,905</b>	<b>742</b>
Effect of exchange rate changes on cash and cash equivalents	479	(215)	(102)
<b>Net increase in cash and cash equivalents</b>	<b>4,105</b>	<b>30,299</b>	<b>8,161</b>
Cash and cash equivalents at beginning of year	77,586	47,287	39,126
<b>Cash and cash equivalents at end of year</b>	<b>\$ 81,691</b>	<b>\$ 77,586</b>	<b>\$ 47,287</b>
<b>Cash paid during the period for:</b>			
Interest	\$ 1,041	\$ 34	\$ 49
Income taxes	\$ 7,975	\$ 7,875	\$ 3,192
<b>Supplemental disclosures—non-cash activities:</b>			
Issuance of restricted stock awards to employees	\$ 9,051	\$ 10,177	\$ 8,904
Share-based business combination consideration	\$ 407	\$ —	\$ —
Capital lease financings	\$ —	\$ —	\$ 494

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

## MERCURY SYSTEMS, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

#### A. Description of Business

Mercury Systems, Inc. (the “Company” or “Mercury”) is a leading commercial provider of secure processing subsystems designed and made in the U.S.A. Optimized for customer and mission success, its solutions power a wide variety of critical defense and intelligence programs. Headquartered in Chelmsford, Massachusetts, it is pioneering a next-generation defense electronics business model specifically designed to meet the industry's current and emerging technology and business needs. The Company delivers affordable innovative solutions, rapid time-to-value and service and support to its defense prime contractor customers. The Company's products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program (“SEWIP”), Gorgon Stare, Predator, F-35 and Reaper. The Company's organizational structure allows it to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector.

On May 2, 2016, the Company acquired the custom microelectronics, RF and microwave solutions, and embedded security operations from Microsemi Corporation (the “Carve-Out Business”), resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the “Acquisition”). Under the terms of the Stock Purchase Agreement, the Company paid \$300,000 in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments. On December 16, 2015, the Company acquired Lewis Innovative Technologies, Inc. (“LIT”) for \$10,000 in cash on a cash-free, debt-free basis, subject to working capital and other post-closing adjustments. See Note C to consolidated financial statements.

During fiscal 2016, the Company completed a series of important internal organizational changes in order to integrate, align and scale the Company into one business. In addition, over the past several years, the Company has completed several acquisitions, culminating with the Acquisition on May 2, 2016 to support its strategy of creating a better alternative for affordable, secure processing subsystems designed and made in the U.S.A. These strategic acquisitions and the associated operational and managerial changes finalized the transformation of the way the Company's executive management team, including the CEO as the chief operating decision maker (“CODM”), manage, evaluate and review the business, including how the CODM allocates resources and assesses performance. Therefore, during the fourth quarter ended June 30, 2016, the Company eliminated the use of Mercury Commercial Electronics (“MCE”) and Mercury Defense Systems (“MDS”) as reportable segments because the analogous operating segments ceased to exist. The Company is now comprised of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with Financial Accounting Standard Boards (“FASB”) Accounting Standards Codification (“ASC”) 280, *Segment Reporting* (“FASB ASC 280”).

In June 2014, the Company initiated a plan to divest its Mercury Intelligence Systems (“MIS”) business, based on the Company's strategic direction and investment priorities focusing on its core business. As a result, the Company's MIS business met the “held for sale” criteria in accordance with FASB ASC 205, *Presentation of Financial Statements*, as of June 30, 2014 (see Note Q to consolidated financial statements). On January 23, 2015, the Company completed the sale of its MIS business. The consolidated financial statements, excluding the statements of shareholders' equity and cash flows, and the notes to the consolidated financial statements were restated for all periods presented to reflect the discontinuation of the MIS business, in accordance with FASB ASC 205.

#### B. Summary of Significant Accounting Policies

##### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

##### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

##### BUSINESS COMBINATIONS

The Company utilizes the acquisition method of accounting under FASB ASC 805, *Business Combinations*, (“FASB ASC 805”), for all transactions and events which it obtains control over one or more other businesses, to recognize the fair value of all assets and liabilities acquired, even if less than one hundred percent ownership is acquired, and in establishing the acquisition date fair value as measurement date for all assets and liabilities assumed. The Company also utilizes FASB ASC 805 for the initial

recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in business combinations. Other estimates include:

- estimated step-ups for the fixed assets and inventory;
- estimated fair values of intangible assets; and
- estimated income tax assets and liabilities assumed from the acquiree.

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business acquisition date, the estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. For changes in the valuation of intangible assets between the preliminary and final purchase price allocation, the related amortization is adjusted in the period it occurs. Subsequent to the purchase price allocation period, any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined.

## REVENUE RECOGNITION

The Company relies upon FASB ASC 605, *Revenue Recognition*, to account for its revenue transactions. Revenue is recognized upon shipment provided that title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, have been successfully demonstrated. Out-of-pocket expenses that are reimbursable by the customer are included in revenue and cost of revenue.

Certain contracts with customers require the Company to perform tests of its products prior to shipment to ensure their performance complies with the Company's published product specifications and, on occasion, with additional customer-requested specifications. In these cases, the Company conducts such tests and, if they are completed successfully, includes a written confirmation with each order shipped. As a result, at the time of each product shipment, the Company believes that no further customer testing requirements exist and that there is no uncertainty of acceptance by its customer.

The Company uses FASB Accounting Standards Update ("ASU") No. 2009-13 ("FASB ASU 2009-13"), *Multiple-Deliverable Revenue Arrangements*. FASB ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence ("VSOE") if available; (2) third-party evidence ("TPE") if VSOE is not available; and (3) best estimated selling price ("BESP"), if neither VSOE nor TPE is available. Additionally, FASB ASU 2009-13 expands the disclosure requirements related to a vendor's multiple-deliverable revenue arrangements.

The Company enters into multiple-deliverable arrangements that may include a combination of hardware components, related integration or other services. These arrangements generally do not include any performance-, cancellation-, termination- or refund-type provisions.

In accordance with the provisions of FASB ASU 2009-13, the Company allocates arrangement consideration to each deliverable in an arrangement based on its relative selling price. The Company generally expects that it will not be able to establish VSOE or TPE due to limited single element transactions and the nature of the markets in which the Company competes, and, as such, the Company typically determines its relative selling price using BESP.

The Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact if the product or service were sold by the Company on a standalone basis.

The Company's determination of BESP involves the consideration of several factors based on the specific facts and circumstances of each arrangement. Specifically, the Company considers the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, the Company's ongoing pricing strategy and policies (as evident from the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable and the characteristics of the varying markets in which the deliverable is sold.

The Company analyzes the selling prices used in its allocation of arrangement consideration at a minimum on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in the Company's business necessitates a more timely analysis or if the Company experiences significant variances in its selling prices.

Each deliverable within the Company's multiple-deliverable revenue arrangements is accounted for as a separate unit of accounting under the guidance of FASB ASU 2009-13 if both of the following criteria are met: the delivered item or items have value to the customer on a standalone basis; and for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. The Company's revenue arrangements generally do not include a general right of return relative to delivered products. The Company considers a deliverable to have standalone value if the item is sold separately by the Company or another vendor or if the item could be resold by the customer.

Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting.

The Company also engages in long-term contracts for development, production and services activities which it accounts for consistent with FASB ASC 605-35, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and other relevant revenue recognition accounting literature. The Company considers the nature of these contracts and the types of products and services provided when determining the proper accounting for a particular contract. Generally for fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method or, for certain short-term contracts, by the completed contract method. Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate input or output methods to measure service provided, and contract costs are expensed as incurred. The Company establishes billing terms at the time project deliverables and milestones are agreed. Revenues recognized in excess of the amounts invoiced to clients are classified as unbilled receivables. The Company expects to bill substantially all of the unbilled receivables during fiscal 2017. The risk to the Company on a fixed-price contract is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. For all types of contracts, the Company recognizes anticipated contract losses as soon as they become known and estimable.

The Company also considers whether contracts should be combined or segmented in accordance with the applicable criteria under GAAP. The Company combines closely related contracts when all the applicable criteria under GAAP are met. The combination of two or more contracts requires judgment in determining whether the intent of entering into the contracts was effectively to enter into a single project, which should be combined to reflect an overall profit rate. Similarly, the Company may separate a project, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria under GAAP are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement was negotiated and the performance criteria. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period.

The use of contract accounting requires significant judgment relative to estimating total contract revenues and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, anticipated increases in wages and prices for subcontractor services and materials, and the availability of subcontractor services and materials. The Company's estimates are based upon the professional knowledge and experience of its engineers, program managers and other personnel, who review each long-term contract monthly to assess the contract's schedule, performance, technical matters and estimated cost at completion. Changes in estimates are applied retrospectively and when adjustments in estimated contract costs are identified, such revisions may result in current period adjustments to earnings applicable to performance in prior periods.

Contract costs also may include estimated contract recoveries for matters such as contract changes and claims for unanticipated contract costs. The Company records revenue associated with these matters only when the amount of recovery can be estimated reliably and realization is probable. Assumed recoveries for claims included in contracts in process were not material at June 30, 2016 or 2015.

The Company defines service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold. Examples of the Company's service revenues include: analyst services and systems engineering support, consulting, maintenance and other support, testing and installation. The Company combines its product and service revenues into a single class as service revenues are less than 10 percent of total revenues.

The Company does not provide its customers with rights of product return, other than those related to warranty provisions that permit repair or replacement of defective goods. The Company accrues for anticipated warranty costs upon product shipment. Revenues from product royalties are recognized upon invoice by the Company. Additionally, all revenues are reported net of government assessed taxes (e.g. sales taxes or value-added taxes).

#### **CASH AND CASH EQUIVALENTS**

Cash equivalents, consisting of highly liquid money market funds and U.S. government and U.S. government agency issues with original maturities of 90 days or less at the date of purchase, are carried at fair market value which approximates cost.

#### **RESTRICTED CASH**

The Company had restricted cash balances of \$264 at June 30, 2016 and 2015. The balances are classified as restricted cash on the accompanying consolidated balance sheet and are reflected in non-current assets. The balances at June 30, 2016 and 2015 included restrictions related to certain contracts with foreign customers that require a certificate of deposit to be held at a commercial bank until performance of the contracts have been completed.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company measures at fair value certain financial assets and liabilities, including cash equivalents, restricted cash and contingent consideration. FASB ASC 820, *Fair Value Measurement and Disclosures*, specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1—Quoted prices for identical instruments in active markets;

Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

## CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company places its cash and cash equivalents with financial institutions that management believes are of high credit quality. At June 30, 2016 and 2015, the Company had \$81,691 and \$77,586, respectively, of cash and cash equivalents on deposit or invested with its financial and lending institutions.

The Company provides credit to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. At June 30, 2016, five customers accounted for 50% of the Company's receivables, unbilled receivables and costs in excess of billings. At June 30, 2015, five customers accounted for 55% of the Company's receivables, unbilled receivables and costs in excess of billings.

## INVENTORY

Inventory is stated at the lower of cost (first-in, first-out) or market value, and consists of materials, labor and overhead. On a quarterly basis, the Company evaluates inventory for net realizable value. Once an item is written down, the value becomes the new inventory cost basis. The Company reduces the value of inventory for excess and obsolete inventory, consisting of on-hand and non-cancelable on-order inventory in excess of estimated usage. The excess and obsolete inventory evaluation is based upon assumptions about future demand, product mix and possible alternative uses.

## SEGMENT INFORMATION

The Company uses the management approach for segment disclosure, which designates the internal organization that is used by management for making operating decisions and assessing performance as the source of its reportable segments. The Company manages its business on the basis of one reportable segment, as a commercial provider of secure processing subsystems for critical defense and intelligence applications.

## GOODWILL AND INTANGIBLE ASSETS

Goodwill is the amount by which the cost of the net assets obtained in a business acquisition exceeded the fair values of the net identifiable assets on the date of purchase. Goodwill is not amortized in accordance with the requirements of FASB ASC 350, *Intangibles-Goodwill and Other* ("FASB ASC 350"). Goodwill is assessed for impairment at least annually, on a reporting unit basis, or when events and circumstances occur indicating that the recorded goodwill may be impaired. If the book value of a reporting unit exceeds its fair value, the implied fair value of goodwill is compared with the carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recorded in an amount equal to that excess.

Intangible assets result from the Company's various business acquisitions (see Note H) and certain licensed technologies, and consist of identifiable intangible assets, including completed technology, licensing agreements, customer relationships, trademarks, backlog, and non-compete agreements. Intangible assets are reported at cost, net of accumulated amortization and are either amortized on a straight-line basis over their estimated useful lives of up to twelve years or over the period the economic benefits of the intangible asset are consumed.

## **LONG-LIVED ASSETS**

Long-lived assets primarily include property and equipment and acquired intangible assets. The Company regularly evaluates its long-lived assets for events and circumstances that indicate a potential impairment in accordance with FASB ASC 360, *Property, Plant, and Equipment* (“FASB ASC 360”). The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the estimated undiscounted cash flows of the asset as compared to the recorded value of the asset. If impairment is indicated, the asset is written down to its estimated fair value.

Property and equipment are the long-lived, physical assets of the Company acquired for use in the Company’s normal business operations and are not intended for resale by the Company. These assets are recorded at cost. Renewals and betterments that increase the useful lives of the assets are capitalized. Repair and maintenance expenditures that increase the efficiency of the assets are expensed as incurred. Equipment under capital lease is recorded at the present value of the minimum lease payments required during the lease period. Depreciation is based on the estimated useful lives of the assets using the straight-line method (see Note F).

As assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations.

Expenditures for major software purchases and software developed for internal use are capitalized and depreciated using the straight-line method over the estimated useful lives of the related assets, which are generally three years. For software developed for internal use, all external direct costs for material and services and certain payroll and related fringe benefit costs are capitalized in accordance with FASB ASC 350. During fiscal 2016, 2015 and 2014, the Company capitalized \$0, \$0 and \$362 of software development costs.

## **DEFERRED REVENUES AND CUSTOMER ADVANCES**

Deferred revenues consist of deferred product revenue, billings in excess of revenues, and deferred service revenue. Deferred product revenue represents amounts that have been invoiced to customers, but are not yet recognizable as revenue because one or more of the conditions for revenue recognition have not been met. Billings in excess of revenues represents milestone billing arrangements on percentage of completion projects where the billings of the contract exceed recognized revenues. Deferred service revenue primarily represents amounts invoiced to customers for annual maintenance contracts or extended warranty concessions, which are recognized ratably over the term of the arrangements. Customer advances represent deposits received from customers on an order.

## **INCOME TAXES**

The Company accounts for income taxes under FASB ASC 740, *Income Taxes* (“FASB ASC 740”). The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the Company’s consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates for the year in which the differences are expected to reverse. The Company records a valuation allowance against net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

FASB ASC 740 requires a two-step approach to recognizing and measuring uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

## **PRODUCT WARRANTY ACCRUAL**

The Company’s product sales generally include a 12 month standard hardware warranty. At time of product shipment, the Company accrues for the estimated cost to repair or replace potentially defective products. Estimated warranty costs are based upon prior actual warranty costs for substantially similar transactions and any specifically identified warranty requirements. Product warranty accrual is included as part of accrued expenses in the accompanying consolidated balance sheets. The following table presents the changes in the Company's product warranty accrual.

	Fiscal 2016	Fiscal 2015	Fiscal 2014
Beginning balance at July 1,	\$ 1,974	\$ 2,078	\$ 2,522
Warranty assumed from Carve-Out Business	114	—	—
Accruals for warranties issued during the period	1,976	1,465	1,951
Settlements made during the period	(2,541)	(1,569)	(2,395)
Ending balance at June 30,	<u>\$ 1,523</u>	<u>\$ 1,974</u>	<u>\$ 2,078</u>

#### RESEARCH AND DEVELOPMENT COSTS

Research and development costs are expensed as incurred. Research and development costs are primarily made up of labor charges and prototype material and development expenses.

#### STOCK-BASED COMPENSATION

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of the awards that will be forfeited. Stock-based compensation expense for the Company's performance-based restricted stock awards are amortized over the requisite service period using graded vesting. The Company's other restricted stock awards recognize expense over the requisite service period on a straight-line basis. The Company uses the Black-Scholes valuation model for estimating the fair value on the date of grant of stock options.

#### RETIREMENT OF COMMON STOCK

Stock that is repurchased or received in connection with the exercise of stock options or in order to cover tax payment obligations triggered by exercise of stock options or the vesting of restricted stock is retired immediately upon the Company's repurchase. The Company accounts for this under the cost method and upon retirement the excess amount over par value is charged against additional paid-in capital.

#### NET EARNINGS PER SHARE

Basic net earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net earnings per share computation includes the effect of shares which would be issuable upon the exercise of outstanding stock options and the vesting of restricted stock, reduced by the number of shares which are assumed to be purchased by the Company under the treasury stock method. For all periods presented, income (loss) from continuing operations is the control number for determining whether securities are dilutive or not.

Basic and diluted weighted average shares outstanding were as follows:

	Years Ended June 30,		
	2016	2015	2014
Basic weighted-average shares outstanding	34,241	32,114	31,000
Effect of dilutive equity instruments	856	825	—
Diluted weighted-average shares outstanding	<u>35,097</u>	<u>32,939</u>	<u>31,000</u>

Equity instruments to purchase 7,453 and 3,526 shares of common stock were not included in the calculation of diluted net earnings per share for the fiscal years ended June 30, 2016, 2015 and 2014, respectively, because the equity instruments were anti-dilutive.

#### ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes foreign currency translation adjustments and unrealized gains on investments. The components of accumulated other comprehensive income were \$947 and \$776 of accumulated foreign currency translation adjustments at June 30, 2016 and 2015. There were no material accumulated net unrealized gains on investments at June 30, 2016 and 2015.

#### FOREIGN CURRENCY

Local currencies are the functional currency for the Company's subsidiaries in Europe and Japan. The accounts of foreign subsidiaries are translated using exchange rates in effect at period-end for assets and liabilities and at average exchange rates during the period for results of operations. The related translation adjustments are reported in accumulated other comprehensive income in shareholders' equity. Gains (losses) resulting from foreign currency transactions are included in other income (expense) and were immaterial for all periods presented.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on July 1, 2018 and can be early adopted for the fiscal year beginning July 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, an amendment of the FASB Accounting Standards Codification. The ASU has added additional disclosure requirements to the codification. It requires management to assess, at each interim and annual reporting period, whether substantial doubt exists about the Company's ability to continue as a going concern. Substantial doubt exists if it is probable (the "probable" threshold under U.S. GAAP has generally been interpreted to be between 75 and 80 percent) that the Company will be unable to meet its obligations as they become due within one year after the date the financial statements are issued or available to be issued (assessment date). The ASU is effective for annual reporting periods beginning after December 15, 2016, and interim periods thereafter, with early adoption permitted. The Company does not expect a going concern uncertainty in the foreseeable future, and therefore this guidance is not expected to have a material impact to its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the separate presentation of extraordinary items, net of tax and the related earnings per share, but does not affect the requirement to disclose material items that are unusual in nature or infrequently occurring. The ASU aligns U.S. GAAP more closely with IFRS (International Financial Reporting Standards). Entities will continue to evaluate whether items are unusual in nature or infrequent in their occurrence for disclosure purposes and when estimating the annual effective tax rate for interim reporting purposes. This ASU is effective for interim and annual periods in fiscal years beginning after December 15, 2015. The ASU allows prospective or retrospective applications. Early adoption is permitted if applied from the beginning of the fiscal year of adoption. The Company does not expect this guidance to have a material impact to its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*, an amendment of the FASB Accounting Standards Codification. This ASU changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out or retail inventory method. The ASU also eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximately normal profit margin when measuring inventory. The ASU is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. The ASU requires prospective adoption and permits early adoption. The Company is evaluating the effect that ASU 2015-11 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. This ASU 2016-02 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

## RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective October 1, 2015, the Company adopted FASB ASU No. 2014-17, *Pushdown Accounting (a consensus of the FASB Emerging Issues Task Force)*, an amendment of the FASB Accounting Standards Codification. This ASU allows an acquired entity to elect to apply pushdown accounting in its separate financial statements on a change-in-control event. The acquired entity elects whether to apply pushdown accounting individually for each change-in-control event, and may apply pushdown accounting during the reporting period in which the change-in-control event occurs. Such adoption did not have any impact to the consolidated financial statements.

Effective January 1, 2016, the Company adopted FASB ASU No. 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement for an acquirer to retrospectively adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. Such adoption did not have any impact to the consolidated financial statements.

Effective April 1, 2016, the Company adopted FASB ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, an amendment of the FASB Accounting Standards Codification. This ASU simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as non-current on the balance sheet. The ASU is effective for the Company on July 1, 2017; however, the Company has elected to early adopt as permitted by the guidance. Upon adoption, the Company applied

ASU 2015-17 to its deferred taxes and presented deferred taxes as non-current on the consolidated balance sheets on a retrospective basis. Such adoption did not have a material impact on our financial position or results of operations.

The following table summarizes the adjustments made as of June 30, 2015 to conform prior period classifications under the new guidance:

	Balance Sheet Line Item	Balance Prior to Adoption	Increase / (Decrease)	As Adjusted
Current deferred income tax assets	Deferred income taxes	\$ 12,407	\$ (12,407)	\$ —
Long-term deferred income tax assets	Other non-current assets	1,275	9,299	10,574
Total tax assets		\$ 13,682	\$ (3,108)	\$ 10,574
Long-term deferred income tax liabilities	Deferred income taxes	\$ (3,108)	\$ 3,108	\$ —
Total tax liabilities		(3,108)	3,108	—
Net deferred tax asset		\$ 10,574	\$ —	\$ 10,574

Effective April 1, 2016, the Company adopted FASB ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, an amendment of the FASB Accounting Standards Codification. This ASU was issued as part of the FASB's simplification initiative, and intends to improve the accounting for share-based payment transactions. The ASU changes several aspects of the accounting for share-based payment award transactions, including: (1) accounting for excess tax benefits and shortfalls, (2) forfeitures, (3) tax withholding requirements, and (4) cash flow classifications. The ASU is effective for the Company on July 1, 2017; however, the Company has elected to early adopt on a prospective basis as of the first day of its fiscal year (July 1, 2015) as permitted by the guidance.

Upon adoption, recognition of excess tax benefits and tax shortfalls resulted in the recognition of \$1,100 of excess tax benefits as a benefit to income taxes in its consolidated statements of operations and comprehensive income (loss). In addition, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows. The Company has elected to continue to estimate expected forfeitures of employee equity awards to determine the amount of compensation expense to be recognized in each year and the changes in tax withholding requirements had no impact to the Company's consolidated financial statements in fiscal 2016.

Effective April 1, 2016, the Company adopted FASB ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, an amendment of the FASB Accounting Standards Codification. This ASU requires entities to present debt issuance costs related to a recognized debt liability on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. Upon adoption, the Company no longer records the cost of issuing debt as a separate deferred financing asset. In the fourth quarter of fiscal 2016, the Company entered into an credit agreement that provided for a \$200,000 term loan facility and a \$100,000 revolving credit facility. The Company incurred debt issuance costs of \$8,026 which were recorded as a direct deduction to the long-term debt and will be amortized over the term of the term loan.

## C. Acquisitions

### CARVE-OUT BUSINESS AQUISION

On March 23, 2016, the Company and Microsemi Corporation ("Microsemi") entered into a Stock Purchase Agreement, pursuant to which, Microsemi agreed to sell all the membership interests in its custom microelectronics, RF and microwave solutions and embedded security operations (the "Carve-Out Business") to the Company for \$300,000 in cash on a cash-free, debt-free basis, subject to a working capital adjustment. On May 2, 2016, the transaction closed and the Company acquired the Carve-Out Business. Pursuant to the terms of the Stock Purchase Agreement, all outstanding Carve-Out Business employee stock awards that were unvested at the closing were replaced by Mercury. The replacement stock awards granted were determined based on a conversion ratio provided in the Stock Purchase Agreement. Mercury funded the acquisition with a combination of a new \$200,000 bank term loan facility (see Note L) and cash on hand, which included net proceeds of approximately \$92,788 raised from an underwritten common stock public offering (see Note M).

The following table presents the net purchase price and the preliminary fair values of the assets and liabilities of the Carve-Out Business:

	<u>Amounts</u>	
Consideration transferred		
Cash paid at closing	\$	300,000
Value allocated to replacement awards		407
Net purchase price	<u>\$</u>	<u>300,407</u>
Estimated fair value of tangible assets acquired and liabilities assumed		
Accounts receivable and cost in excess of billings	\$	17,082
Inventory		25,477
Fixed assets		14,021
Other current and non-current assets		524
Current liabilities		(4,263)
Non-current deferred tax liabilities		<u>(25,477)</u>
Estimated fair value of net tangible assets acquired		27,364
Estimated fair value of identifiable intangible assets		102,800
Estimated goodwill		170,243
Estimated fair value of assets acquired	<u>\$</u>	<u>300,407</u>
Net purchase price	<u>\$</u>	<u>300,407</u>

The amounts above represent the preliminary fair value estimates as of June 30, 2016 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimates include customer relationships of \$70,900, completed technology of \$29,700 and backlog of \$2,200. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$170,243 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The Carve-Out Business provides the Company with additional capability and expertise related to embedded security custom microelectronics, and microwave and radio frequency technology. The acquisition is directly aligned with the Company's strategy of expanding its capabilities, services and offerings along the sensor processing chain. The goodwill from this acquisition is reported under the Carve-Out Business reporting unit. As of June 30, 2016, the Company had \$29,684 of goodwill deductible for tax purposes.

The revenues and net income from the Carve-Out Business included in the Company's consolidated results for the fiscal year ended June 30, 2016 were \$16,638 and \$1,345, respectively. The Carve-Out Business acquisition costs and other related expenses were \$2,012 during the year ended June 30, 2016.

#### *Pro Forma Financial Information*

The following tables summarize the supplemental statements of operations information on an unaudited pro forma basis as if the Carve-Out Business acquisition had occurred on July 1, 2014:

	<u>Year Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>
Pro forma net revenues	\$ 344,601	\$ 333,362
Pro forma net income	\$ 18,125	\$ 5,697
Basic pro forma net earnings per share	\$ 0.47	\$ 0.15
Diluted pro forma net earnings per share	\$ 0.46	\$ 0.15

The unaudited pro forma results presented above are for illustrative purposes only for the applicable periods and do not purport to be indicative of the actual results which would have occurred had the transaction been completed as of the beginning of the period, nor are they indicative of results of operations which may occur in the future.

## LEWIS INNOVATIVE TECHNOLOGIES ACQUISITION

On December 16, 2015, the Company entered into a share purchase agreement (the “Share Purchase Agreement”) with Lewis Innovative Technologies, Inc. (“LIT”) and the holders of the equity interests of LIT. Pursuant to the Share Purchase Agreement, the Company completed its purchase of all of the equity interests in LIT, and LIT became a wholly-owned subsidiary of the Company. Based in Decatur, Alabama, LIT provides advanced security technology and development services necessary for protecting systems critical to national security while meeting strict Department of Defense (“DoD”) program protection requirements.

The Company acquired LIT for a cash purchase price of \$9,756. The Company funded the purchase with cash on hand. The purchase price was subject to a post-closing adjustment based on a determination of LIT's closing net working capital. In accordance with the Share Purchase Agreement, \$1,000 of the purchase price was placed into escrow to support the post-closing working capital adjustment and the sellers' indemnification obligations. The escrow is available for indemnification claims through June 16, 2017. The Company acquired LIT free of debt.

The following table presents the net purchase price and the preliminary fair values of the assets and liabilities of LIT:

	<u>Amounts</u>
Consideration transferred	
Cash paid at closing	\$ 10,290
Working capital adjustment	(244)
Less cash and cash equivalents acquired	(290)
Net purchase price	<u>\$ 9,756</u>
Estimated fair value of tangible assets acquired and liabilities assumed	
Cash and cash equivalents	\$ 290
Accounts receivable and cost in excess of billings	290
Other current and non-current assets	132
Current liabilities	(264)
Estimated fair value of net tangible assets acquired	<u>448</u>
Estimated fair value of identifiable intangible assets	3,960
Estimated goodwill	<u>5,638</u>
Estimated fair value of assets acquired	10,046
Less cash and cash equivalents acquired	(290)
Net purchase price	<u>\$ 9,756</u>

The amounts above represent the preliminary fair value estimates as of June 30, 2016 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimates include completed technology of \$3,240, customer relationships of \$590 and backlog of \$130. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$5,638 arising from the LIT acquisition largely reflects the potential synergies and expansion of the Company's service offerings across product lines and markets complementary to the Company's existing products and markets. The LIT acquisition provides the Company with additional capabilities and expertise related to secure embedded processing applications. The acquisition is directly aligned with the Company's strategy of assembling critical and differentiated capabilities across the entire sensor processing chain. The goodwill from the LIT acquisition is included in the Company's Mercury Defense Systems ("MDS") reporting unit.

The Company and the shareholders of LIT have agreed to treat the acquisition of LIT as an asset purchase for tax purposes by filing the required election forms under IRC Section 338(h)(10). The Company has estimated the tax value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. As of June 30, 2016, the Company had \$5,638 of goodwill deductible for tax purposes.

Pursuant to the completion of the LIT acquisition, the Company incurred \$231 of impairment expense related to a pre-existing relationship between the Company and LIT. LIT acquisition costs and other related expenses were immaterial during the year ended June 30, 2016. Additionally, the Company has not furnished pro forma financial information relating to LIT because such information is not material to the Company's financial results.

#### D. Fair Value of Financial Instruments

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at June 30, 2016:

	Fair Value Measurements			
	June 30, 2016	Level 1	Level 2	Level 3
Assets:				
Certificates of deposit	\$ 30,075	\$ —	\$ 30,075	\$ —
Total	\$ 30,075	\$ —	\$ 30,075	\$ —

The carrying values of cash and cash equivalents, including money market funds, restricted cash, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The fair value of the Company's certificates of deposit are determined through quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable. The Company determined the face value of its long-term debt approximates fair value at June 30, 2016 due to the recent issuance and stability of interest rates during this period. The cost-method investment, which is presented within other non-current assets in the accompanying consolidated balance sheets, does not have a readily determinable fair value, as such the Company recorded the investment at cost and will continue to evaluate the asset for impairment on a quarterly basis.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at June 30, 2015:

	Fair Value Measurements			
	June 30, 2015	Level 1	Level 2	Level 3
Assets:				
Certificates of deposit	\$ 30,000	\$ —	\$ 30,000	\$ —
Total	\$ 30,000	\$ —	\$ 30,000	\$ —

#### E. Inventory

Inventory was comprised of the following:

	June 30,	
	2016	2015
Raw materials	\$ 31,205	\$ 15,864
Work in process	15,967	11,190
Finished goods	11,112	4,906
Total	\$ 58,284	\$ 31,960

The \$26,324 increase in inventory was primarily due to the inclusion of inventory from the Carve-Out Business. There are no amounts in inventory relating to contracts having production cycles longer than one year.

## F. Property and Equipment

Property and equipment consisted of the following:

	Estimated Useful Lives (Years)	June 30,	
		2016	2015
Computer equipment and software	3-4	\$ 62,409	\$ 58,562
Furniture and fixtures	5	8,547	7,614
Leasehold improvements	lesser of estimated useful life or lease term	8,515	4,003
Machinery and equipment	5	29,078	16,383
		108,549	86,562
Less: accumulated depreciation		(80,212)	(73,336)
		<u>\$ 28,337</u>	<u>\$ 13,226</u>

The \$15,111 increase in property and equipment was primarily due to the inclusion of fixed assets from the Carve-Out Business. In fiscal 2016 and 2015, the Company retired \$32 and \$733, respectively, of fully depreciated computer equipment and software assets that were no longer in use by the Company.

Depreciation expense related to property and equipment for the fiscal years ended June 30, 2016, 2015 and 2014 was \$6,900, \$6,332 and \$7,625, respectively.

On April 20, 2007, the Company entered into a sales agreement and a lease agreement in connection with a sale-leaseback of the Company's headquarters in Chelmsford, Massachusetts. Pursuant to the agreements, the Company sold all land, land improvements, buildings and building improvements related to the facilities and leased back those assets. The term of the lease is ten years and includes two five year options to renew, which the Company does not plan to exercise. Under the provisions of sale-leaseback accounting, the transaction was considered a normal leaseback; thus the realized gain of \$11,569 was deferred and will be amortized to other income on a straight-line basis over the initial lease term.

The unamortized deferred gain consisted of the following of which the current portion is included in accrued expenses and the non-current portion is separately classified within other non-current liabilities in the accompanying consolidated balance sheets:

	June 30,	
	2016	2015
Current portion	\$ 929	\$ 1,156
Non-current portion	—	929
Total unamortized deferred gain	<u>\$ 929</u>	<u>\$ 2,085</u>

## G. Goodwill

The following table summarizes the changes in goodwill at the Company's three reporting units for the years ended June 30, 2016 and 2015:

	MCE	MDS	Carve-Out Business	Total
Balance at June 30, 2014 and 2015	\$ 134,378	\$ 33,768	\$ —	\$ 168,146
Goodwill arising from the LIT acquisition	—	5,638	—	5,638
Goodwill arising from the Carve-Out Business Acquisition	—	—	170,243	170,243
Balance at June 30, 2016	<u>\$ 134,378</u>	<u>\$ 39,406</u>	<u>\$ 170,243</u>	<u>\$ 344,027</u>

In accordance with FASB ASC 350, *Intangibles-Goodwill and Other* "FASB ASC 350", the Company determines its reporting units based upon whether discrete financial information is available, if management regularly reviews the operating results of the component, the nature of the products offered to customers and the market characteristics of each reporting unit. A reporting unit is considered to be an operating segment or one level below an operating segment also known as a component. Component level financial information is reviewed by management at: Mercury Commercial Electronics ("MCE") and Mercury Defense Systems ("MDS"). On May 2, 2016, the Company completed the Carve-Out Business acquisition for which discrete financial information is reviewed by management.

As defined by FASB ASC 350, goodwill is tested for impairment on an interim basis at the occurrence of certain triggering events or at a minimum on an annual basis. In fiscal 2016, there were no triggering events which required an interim goodwill impairment test.

The Company follows FASB ASC 350 in assessing whether the fair value of a reporting unit is less than its carrying amount. As of June 30, 2016, MCE, MDS and the Carve-Out Business had goodwill balances and the annual impairment analysis was performed for each reporting unit in the fourth quarter of fiscal 2016. The results of the Company's step one interim goodwill impairment test indicated that the fair values of the MCE and MDS reporting units were substantially in excess of their carrying values, and the Carve-Out Business reporting unit carrying value was equal to its fair value. As such, step two of the goodwill impairment testing was not required. The valuation of the MCE, MDS reporting units was based upon a discounted cash flow model and corroborated by a market-based analysis which compares the trading multiples of public companies in similar lines of business. The valuation of the Carve-Out Business reporting unit, as of May 2, 2016, was determined using the income approach based upon a discounted cash flow model, which we also utilized for our May 31, 2016 impairment test because of the proximity in time and no changes in financial projections.

## H. Intangible Assets

Intangible assets consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
<b>June 30, 2016</b>				
Customer relationships	\$ 105,370	\$ (23,824)	\$ 81,546	9.9 years
Licensing agreements and patents	756	(38)	718	4.0 years
Completed technologies	35,840	(3,545)	32,295	7.6 years
Backlog	2,330	(216)	2,114	2.0 years
	<u>\$ 144,296</u>	<u>\$ (27,623)</u>	<u>\$ 116,673</u>	
<b>June 30, 2015</b>				
Customer relationships	\$ 33,880	\$ (17,364)	\$ 16,516	6.8 years
Licensing agreements and patents	2,245	(2,096)	149	5.0 years
Completed technologies	5,570	(4,237)	1,333	5.3 years
	<u>\$ 41,695</u>	<u>\$ (23,697)</u>	<u>\$ 17,998</u>	

Estimated future amortization expense for intangible assets remaining at June 30, 2016 is as follows:

	Year Ending June 30,
2017	\$ 17,703
2018	16,744
2019	12,957
2020	11,374
2021	10,860
Thereafter	47,035
Total future amortization expense	<u>\$ 116,673</u>

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the Carve-Out Business acquisition. These assets are included in the Company's gross and net carrying amounts as of June 30, 2016.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
Customer relationships	\$ 70,900	\$ (1,122)	\$ 69,778	11.5 years
Completed technologies	29,700	(670)	29,030	7.8 years
Backlog	2,200	(183)	2,017	2.0 years
	<u>\$ 102,800</u>	<u>\$ (1,975)</u>	<u>\$ 100,825</u>	

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the LIT acquisition. These assets are included in the Company's gross and net carrying amounts as of June 30, 2016.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
Completed technologies	\$ 3,240	\$ (231)	\$ 3,009	7.0 years
Customer relationships	590	(42)	548	7.0 years
Backlog	130	(33)	97	2.0 years
Total	<u>\$ 3,960</u>	<u>\$ (306)</u>	<u>\$ 3,654</u>	

## I. Restructuring

During fiscal 2016, the Company incurred restructuring and other charges of \$1,240, primarily related to executive severance and facility consolidation.

During fiscal 2015, the Company incurred restructuring and other charges of \$3,175 as the Company completed its acquisition integration plan. Additionally, during the fourth quarter of fiscal 2015, the Company eliminated 16 positions, primarily in operations.

During fiscal 2014, the Company announced a restructuring plan ("2014 Plan") that was implemented as part of the final phase of integration activities relating to the Company's recent acquisitions. The acquisition integration plan included the consolidation of manufacturing facilities, centralization of administrative functions using common information systems and processes, and realignment of research and development resources. The acquisition integration plan included the elimination of 70 positions largely in engineering, manufacturing and administrative functions. Additionally, the Company closed four facilities relocating all related activities to the Company's Advanced Microelectronics Center ("AMC") in Hudson, New Hampshire. The Company also completed the first phase of the Chelmsford, Massachusetts headquarters consolidation in the fourth quarter of fiscal 2014. These restructuring and other charges associated with the Company's fiscal 2014 restructuring plan amounted to \$5,443. In the event that the Company is unable to sublease the unoccupied portion of its headquarters complex in Chelmsford, Massachusetts, it will incur nominal, periodic restructuring charges through fiscal 2017.

All of the restructuring and other charges are classified as operating expenses in the consolidated statements of operations and any remaining severance obligations are expected to be paid within the next twelve months. The remaining restructuring liability is classified as accrued expenses in the consolidated balance sheets.

The following table presents the detail of expenses for the Company's restructuring plans:

	Severance & Related	Facilities & Other	Total
Restructuring liability at June 30, 2014	\$ 1,371	\$ 772	\$ 2,143
Restructuring charges	1,663	1,812	3,475
Cash paid	(2,164)	(1,162)	(3,326)
Reversals (*)	(213)	(87)	(300)
Restructuring liability at June 30, 2015	657	1,335	1,992
Restructuring charges	752	589	1,341
Cash paid	(1,118)	(1,188)	(2,306)
Reversals (*)	(101)	—	(101)
Restructuring liability at June 30, 2016	<u>\$ 190</u>	<u>\$ 736</u>	<u>\$ 926</u>

(\*) Reversals result from the unused outplacement services and operating costs.

## J. Income Taxes

The components of income (loss) from continuing operations before income taxes and income tax expense (benefit) were as follows:

	Year Ended June 30,		
	2016	2015	2014
Income (loss) from continuing operations before income taxes:			
United States	\$ 25,194	\$ 18,443	\$ (6,068)
Foreign	92	352	155
	<u>\$ 25,286</u>	<u>\$ 18,795</u>	<u>\$ (5,913)</u>
Tax provision (benefit):			
Federal:			
Current	\$ 6,707	\$ 4,267	\$ 3,184
Deferred	(2,627)	(458)	(5,281)
	<u>\$ 4,080</u>	<u>\$ 3,809</u>	<u>\$ (2,097)</u>
State:			
Current	\$ 1,839	\$ 1,372	\$ 594
Deferred	(424)	(921)	(375)
	<u>\$ 1,415</u>	<u>\$ 451</u>	<u>\$ 219</u>
Foreign:			
Current	\$ 59	\$ 58	\$ (12)
Deferred	(10)	48	49
	<u>\$ 49</u>	<u>\$ 106</u>	<u>\$ 37</u>
	<u>\$ 5,544</u>	<u>\$ 4,366</u>	<u>\$ (1,841)</u>

The following is the reconciliation between the statutory federal income tax rate and the Company's effective income tax (benefit) rate for continuing operations:

	Year Ended June 30,		
	2016	2015	2014
Tax provision (benefit) at federal statutory rates	35.0%	35.0%	(35.0)%
State income tax, net of federal tax benefit	5.0	4.9	(3.1)
Research and development credits	(8.4)	(4.8)	(14.7)
Excess tax benefits on stock compensation	(4.4)	—	—
Domestic manufacturing deduction	(3.5)	(3.2)	(5.3)
Income from legal settlement excluded from taxable income	(2.8)	—	—
Deemed repatriation of foreign earnings	(0.2)	(0.4)	0.7
Foreign tax credits	—	—	(13.3)
Equity compensation	0.3	(0.1)	2.2
Officers' compensation	2.3	2.8	11.1
Stock compensation shortfalls	—	—	24.1
Deferred tax asset and liability adjustments	—	(4.2)	—
Change in state tax rates	—	(3.1)	—
Reserves for tax contingencies	(3.2)	(5.0)	—
Other	1.8	1.3	2.2
	<u>21.9%</u>	<u>23.2%</u>	<u>(31.1)%</u>

The components of the Company's net deferred tax assets (liabilities) for continuing operations were as follows:

	June 30,	
	2016	2015
Deferred tax assets:		
Inventory valuation and receivable allowances	\$ 12,768	\$ 9,264
Accrued compensation	3,267	2,563
Equity compensation	3,201	4,229
Federal and state research and development tax credit carryforwards	15,870	16,262
Gain on sale-leaseback	371	834
Other accruals	1,570	1,889
Capital loss carryforwards	3,562	3,562
Other temporary differences	4,011	1,800
	<u>44,620</u>	<u>40,403</u>
Valuation allowance	(18,472)	(18,864)
Total deferred tax assets	26,148	21,539
Deferred tax liabilities:		
Prepaid expenses	(773)	(1,103)
Property and equipment	(2,451)	(1,578)
Intangible assets	(33,826)	(7,110)
Tax method of accounting change	(570)	(854)
Other temporary differences	(370)	(320)
Total deferred tax liabilities	<u>(37,990)</u>	<u>(10,965)</u>
Net deferred tax (liabilities) assets	<u>\$ (11,842)</u>	<u>\$ 10,574</u>
As reported:		
Deferred tax assets	\$ —	\$ 10,574
Deferred tax liabilities	(11,842)	—
	<u>\$ (11,842)</u>	<u>\$ 10,574</u>

At June 30, 2016, the Company evaluated the need for a valuation allowance on deferred tax assets. In assessing whether the deferred tax assets are realizable, management considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the Company's past operating results, its forecast of future earnings, future taxable income, and tax planning strategies. The Company continues to conclude that it is more likely than not that most domestic deferred tax assets would be realizable based on recent financial performance, projected future taxable income and the reversal of existing deferred tax liabilities.

The Company continues to record a full valuation allowance on certain state research and development (“R&D”) and investment tax credits, and capital loss carryforwards as of June 30, 2016 as management continues to believe that it is not more likely than not that these deferred tax assets would be realized. Any future reversals of the valuation allowance will impact income tax expense.

The Company had federal research and development credit carryforwards of \$959, which will expire from 2032 through 2033. The Company had state research and development credit carryforwards of \$14,798, which will expire from 2016 through 2029. The Company also had state investment tax credits carryforwards of \$113.

Upon consideration of changing business conditions and cash position in its foreign subsidiaries, management has determined that it does not need to indefinitely reinvest the earnings of certain foreign subsidiaries. Therefore, the Company has accrued deferred taxes in association with \$724 in undistributed earnings and profits.

The Company files income tax returns in all jurisdictions in which it operates. The Company has established reserves to provide for additional income taxes that management believes will more likely than not be due in future years as these previously filed tax returns are audited. These reserves have been established based upon management’s assessment as to the potential exposures. All tax reserves are analyzed quarterly and adjustments are made as events occur and warrant modification.

The changes in the Company’s reserves for unrecognized income tax benefits are summarized as follows:

	Year Ended June 30,	
	2016	2015
Unrecognized tax benefits, beginning of period	\$ 2,190	\$ 3,142
Increases for previously recognized positions	79	123
Reductions as a result of a lapse of the applicable statute of limitations	—	(1,197)
Increases for currently recognized positions	302	122
Reductions for previously recognized positions deemed effectively settled	(681)	—
Reductions for previously recognized positions	(324)	—
Unrecognized tax benefits, end of period	<u>\$ 1,566</u>	<u>\$ 2,190</u>

The \$1,566 of unrecognized tax benefits as of June 30, 2016, if released, would reduce income tax expense.

The Company’s major tax jurisdiction is the U.S. and the open tax years are fiscal 2011 through 2016.

The Company is currently under audit by the Internal Revenue Service for fiscal year 2013. As of June 30, 2016, the IRS has presented an agreement that would lead to the conclusion of the audit; the Company continues to negotiate specific terms of this agreement. It is reasonably possible that within the next 12 months the Company’s unrecognized tax benefits, exclusive of interest, may decrease by up to \$757 at the conclusion of the audit. We expect that the decrease, if recognized, would not affect the effective tax rate.

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of June 30, 2016 and 2015, the total amount of gross interest and penalties accrued was \$258 and \$62, respectively. In connection with tax matters, the Company recognized interest and penalty expense in fiscals 2016, 2015 and 2014 of \$204, \$26 and \$5, respectively.

## **K. Commitments and Contingencies**

### **LEGAL CLAIMS**

The Company is subject to litigation, claims, investigations and audits arising from time to time in the ordinary course of our business. Although legal proceedings are inherently unpredictable, the Company believes that it has valid defenses with respect to any matters currently pending against the Company and intends to defend itself vigorously. The outcome of these matters, individually and in the aggregate, is not expected to have a material impact on the Company's cash flows, results of operations, or financial position.

## INDEMNIFICATION OBLIGATIONS

The Company's standard product sales and license agreements entered into in the ordinary course of business typically contain an indemnification provision pursuant to which the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with any patent, copyright or other intellectual property infringement claim by any third party with respect to the Company's products. Such provisions generally survive termination or expiration of the agreements. The potential amount of future payments the Company could be required to make under these indemnification provisions is, in some instances, unlimited.

In connection with the sale of the Company's former MIS business, the Company provided indemnification to the buyer of the business. The Company's indemnification obligations generally cover the buyer for damages resulting from breaches of representations, warranties and covenants contained in the purchase and sale agreement and generally cover pre-closing tax liabilities of the business. The Company's indemnification obligations regarding the MIS business are generally subject to caps.

## PURCHASE COMMITMENTS

As of June 30, 2016, the Company has entered into non-cancelable purchase commitments for certain inventory components and services used in its normal operations. The purchase commitments covered by these agreements are for less than one year and aggregate to \$32,195.

## LEASE COMMITMENTS

The Company leases certain facilities, machinery and equipment under various cancelable and non-cancelable operating leases that expire at various dates through fiscal 2029. The leases contain various renewal options. Rental charges are subject to escalation for increases in certain operating costs of the lessor. For tenant improvement allowances and rent holidays, the Company records a deferred rent liability on the consolidated balance sheets and amortizes the deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of operations. Rental expense during the fiscal years ended June 30, 2016, 2015, and 2014 was \$4,015, \$3,777 and \$4,213, respectively. Minimum lease payments under the Company's non-cancelable operating leases are as follows:

	Year Ending June 30,
2017	\$ 6,018
2018	4,960
2019	4,851
2020	4,683
2021	3,674
Thereafter	19,445
Total minimum lease payments	<u>\$ 43,631</u>

## OTHER

As part of the Company's strategy for growth, the Company continues to explore acquisitions or strategic alliances. The associated acquisition costs incurred in the form of professional fees and services may be material to the future periods in which they occur, regardless of whether the acquisition is ultimately completed.

The Company may elect from time to time to purchase and subsequently retire shares of common stock in order to settle an individual employees' tax liability associated with vesting of a restricted stock award or exercise of stock options. These transactions would be treated as a use of cash in financing activities in the Company's statement of cash flows.

## L. Debt

### TERM LOAN AND REVOLVING CREDIT FACILITIES

On May 2, 2016, the Company and certain of its subsidiaries, as guarantors, entered into a Credit Agreement (the "Credit Agreement") with a syndicate of commercial banks and Bank of America, N.A acting as the administrative agent. The Credit Agreement provides for a \$200,000 term loan facility ("Term Loan") and a \$100,000 revolving credit facility ("Revolver"). In connection with the issuance of Term Loan, the Company incurred \$8,026 of debt issuance costs, which are recorded as a direct reduction to long-term debt on the face of the consolidated balance sheets. The debt issuance costs will be amortized to non-cash interest expense using the effective interest method over the term of the Term Loan.

### *Maturity*

The Term Loan facility has a five year maturity subject to the amortization payments described below. The revolving credit facility has a five year maturity.

### *Interest Rates and Fees*

Borrowings under the Credit Agreement bear interest, at the Company's option, at floating rates tied to LIBOR or the prime rate plus an applicable percentage. The applicable percentage has initially been set at 2.0% and in future fiscal quarters will be established pursuant to a pricing grid based on the Company's total net leverage ratio. In addition to interest on the aggregate outstanding principal amounts of any borrowings, the Company will also pay a quarterly commitment fee on the unutilized commitments under the Revolver, which fee has initially been set at 0.3% per annum and in future fiscal quarters will be established pursuant to a pricing grid based on the Company's total net leverage ratio. The Company will also pay customary letter of credit and agency fees. The quarterly commitment fee, letter of credit and agency fees are reported as financing and other related cost in the accompanying consolidated financial statements. As of June 30, 2016, the stated interest rate of the Term Loan was 2.6%.

### *Prepayments*

The Credit Agreement provides for quarterly amortization payments on the Term Loan, beginning with 5.0% per annum amortization and increasing to 12.5% per annum amortization over the five year term of the Term Loan. The Company is required to make mandatory prepayments of the Term Loan with the proceeds of certain non-ordinary course asset sales or the proceeds of certain debt issuances. Subject to minimum notice requirements, borrowings under the Credit Agreement may be voluntarily prepaid at any time without premium or penalty.

### *Covenants and Events of Default*

The Credit Agreement provides for customary negative covenants, including, among other things and subject to certain significant exceptions, restrictions on the incurrence of debt or guarantees, the creation of liens, the making of certain investments, loans and acquisitions, mergers and dissolutions, the sale of assets including capital stock of subsidiaries, the payment of dividends, the repayment or amending of junior debt, altering the business conducted, engaging in transactions with affiliates and entering into agreements limiting subsidiary dividends and distributions. The Credit Agreement also requires the Company to comply with certain financial covenants, including a quarterly minimum consolidated cash interest charge ratio test and a quarterly maximum consolidated total net leverage ratio test. The Credit Agreement also provides for customary representations and warranties, affirmative covenants and events of default (including, among others, the failure to make required payments of principal and interest, certain insolvency events, and an event of default upon a change of control). If an event of default occurs, the lenders under the Credit Agreement will be entitled to take various actions, including the acceleration of amounts due under the Credit Agreement and all actions permitted to be taken by a secured creditor. As of June 30, 2016, the Company was in compliance with all covenants and conditions under the Credit Agreement.

### *Guarantees and Security*

The Company's obligations under the Credit Agreement are guaranteed by certain of the Company's material domestic wholly-owned restricted subsidiaries (the "Guarantors"). The obligations of both the Company and the Guarantors are secured by a perfected security interest in substantially all of the assets of the Company and the Guarantors, in each case, now owned or later acquired, including a pledge of all of the capital stock of substantially all of the Company's domestic wholly-owned restricted subsidiaries and 65% of the capital stock of certain of its foreign restricted subsidiaries, subject in each case to the exclusion of certain assets and additional exceptions. The foregoing description of the Credit Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Credit Agreement, a copy of which is filed as Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 2, 2016.

There were no borrowings under the Revolver as of June 30, 2016. The following summarizes the future cash payment obligations (excluding interest) as of June 30, 2016:

	<b>Year Ending June 30,</b>
2017	\$ 10,000
2018	10,000
2019	15,000
2020	20,000
2021	145,000
Total remaining cash payment obligations	\$ 200,000
Unamortized debt issuance costs	(7,725)
Long-term debt, net	<u>\$ 192,275</u>

## **FORMER CREDIT AGREEMENT WITH KEYBANK**

On October 12, 2012, the Company entered into a credit agreement with a syndicate of commercial banks, with KeyBank National Association acting as the administrative agent. The credit agreement provided for a \$200,000 senior unsecured revolving line of credit. In connection with the closing of the acquisition of the Carve-Out Business and entering into the new term loan and revolving credit facilities discussed above, the Company terminated its existing revolving credit agreement with KeyBank on May 2, 2016. Deferred costs of \$230 associated with this agreement were recorded to other expenses upon termination of the credit agreement.

## **M. Shareholders' Equity**

### **PREFERRED STOCK**

The Company is authorized to issue 1,000 shares of preferred stock with a par value of \$0.01 per share.

### **EQUITY OFFERING**

On April 4, 2016, the Company commenced an offering of 4,500 shares of its common stock pursuant to an underwritten public offering (the "Offering"). In connection with the Offering, the Company granted the underwriters an over-allotment option for 30 days to purchase up to an additional 675 shares of its common stock. The Offering was made pursuant to a shelf registration statement previously filed with the SEC on August 15, 2014. On April 13, 2016, the Company closed the Offering, including the full over-allotment allocation, selling an aggregate of 5,175 shares of common stock for total net proceeds of \$92,788 after \$6,851 of expenses associated with the equity offering including underwriting fees and other related expenses.

## **N. Employee Benefit Plans**

The Company maintains a qualified 401(k) plan (the "401(k) Plan") for its U.S. employees. During fiscal 2016, 2015 and 2014, the Company matched employee contributions up to 3% of eligible compensation. The Company may also make optional contributions to the plan for any plan year at its discretion. Expense recognized by the Company for matching contributions related to the 401(k) plan was \$1,874, \$1,934 and \$1,896 during the fiscal years ended June 30, 2016, 2015, and 2014, respectively.

## **O. Stock-Based Compensation**

### **STOCK OPTION PLANS**

The number of shares authorized for issuance under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan"), is 15,252 shares at June 30, 2016. As reflected in the Company's registration statement on Form S-8 filed on February 4, 2016, the Company's number of shares authorized for issuance under the 2005 Plan increased by 2 shares as a result of forfeitures, cancellations and/or terminations from the Company's 1997 Stock Option Plan (the "1997 Plan"). The 2005 Plan will be increased by any future cancellations, forfeitures or terminations (other than by exercise) under the 1997 Plan. The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant and the options generally have a term of seven years. There were 2,811 shares available for future grant under the 2005 Plan at June 30, 2016.

The number of shares authorized for issuance under the 1997 Plan was 8,650 shares, of which 100 shares could be issued pursuant to restricted stock grants. The 1997 Plan provided for the grant of non-qualified and incentive stock options and restricted stock to employees and non-employees. All stock options were granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant. The options typically vest over periods of zero to four years and have a maximum term of 10 years. Following shareholder approval of the 2005 Plan on November 14, 2005, the Company's Board of Directors determined that no further grants of stock options or other awards would be made under the 1997 Plan, and the 1997 Plan subsequently expired in June 2007.

During fiscal 2015 and 2016, as part of the Company's ongoing annual equity grant program for employees, the Company granted performance-based restricted stock awards to certain executives pursuant to the 2005 Plan. These performance awards vest annually over a three year requisite service period subject to the achievement of specific financial performance targets related to adjusted EBITDA as a percentage of revenue. Based on the performance targets, these awards require graded vesting that results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company monitors the probability of achieving the performance targets on a quarterly basis and may adjust periodic compensation expense accordingly.

## EMPLOYEE STOCK PURCHASE PLAN

The number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,800 shares. Under the ESPP, rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six-month offering period. The ESPP permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the ESPP. The number of shares issued under the ESPP during fiscal years 2016, 2015, and 2014 was 88, 79 and 92, respectively. Shares available for future purchase under the ESPP totaled 398 at June 30, 2016.

## STOCK OPTION AND AWARD ACTIVITY

The following table summarizes activity of the Company's stock option plans since June 30, 2014:

	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of 6/30/2016
<b>Outstanding at June 30, 2014</b>	<b>1,435</b>	<b>\$ 11.76</b>	<b>2.23</b>	
Granted	—	—		
Exercised	(500)	7.43		
Cancelled	(105)	19.21		
<b>Outstanding at June 30, 2015</b>	<b>830</b>	<b>\$ 13.43</b>	<b>1.66</b>	
Granted	—	—		
Exercised	(524)	13.12		
Cancelled	(48)	17.25		
<b>Outstanding at June 30, 2016</b>	<b>258</b>	<b>\$ 13.34</b>	<b>1.06</b>	<b>\$ 2,972</b>
<b>Vested and expected to vest at June 30, 2016</b>	<b>258</b>	<b>\$ 13.34</b>	<b>1.06</b>	<b>\$ 2,972</b>
<b>Exercisable at June 30, 2016</b>	<b>258</b>	<b>\$ 13.34</b>	<b>1.06</b>	<b>\$ 2,972</b>

The intrinsic value of the options exercised during fiscal years 2016, 2015, and 2014 was \$1,976, \$3,373 and \$578, respectively. Non-vested stock options are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2016, there was \$0 of total unrecognized compensation cost related to non-vested options granted under the Company's stock plans. As of June 30, 2015, there was \$6 of total unrecognized compensation cost related to non-vested options granted under the Company's stock plans that was expected to be recognized over a weighted-average period of 0.13 years from June 30, 2015. There were no stock options granted during fiscal years 2016, 2015 or 2014.

The following table summarizes the status of the Company's non-vested restricted stock awards since June 30, 2014:

	Non-Vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
<b>Outstanding at June 30, 2014</b>	<b>2,091</b>	<b>\$ 10.15</b>
Granted	849	11.99
Vested	(776)	10.56
Forfeited	(298)	10.73
<b>Outstanding at June 30, 2015</b>	<b>1,866</b>	<b>\$ 10.72</b>
Granted	556	16.26
Vested	(743)	10.93
Forfeited	(124)	11.70
<b>Outstanding at June 30, 2016</b>	<b>1,555</b>	<b>\$ 12.52</b>

The total fair value of restricted stock awards vested during fiscal year 2016, 2015, and 2014 was \$12,185, \$9,078 and \$6,543, respectively.

Non-vested restricted stock awards are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2016, there was \$10,938 of total unrecognized compensation cost related to non-vested restricted stock awards granted under the Company's stock plans that is expected to be recognized over a weighted-average period of 1.6 years from June 30, 2016. As of June 30, 2015, there was \$11,080 of total unrecognized compensation cost related to non-vested restricted stock awards

granted under the Company's stock plans that is expected to be recognized over a weighted-average period of 1.9 years from June 30, 2015.

#### STOCK-BASED COMPENSATION EXPENSE AND ASSUMPTIONS

The Company recognizes expense for its share-based payment plans in the consolidated statements of operations for the fiscal years 2016, 2015, and 2014 in accordance with FASB ASC 718. The Company had \$93 of capitalized stock-based compensation expense on the consolidated balance sheet as of June 30, 2016. In the prior years, the Company did not capitalize any such costs on the consolidated balance sheets, as such costs that qualified for capitalization were not material. Under the fair value recognition provisions of FASB ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period. The following table presents share-based compensation expenses from continuing operations included in the Company's consolidated statement of operations:

	Year Ended June 30,		
	2016	2015	2014
Cost of revenues	\$ 441	\$ 493	\$ 601
Selling, general and administrative	7,864	6,751	7,024
Research and development	1,269	1,396	1,374
Share-based compensation expense before tax	9,574	8,640	8,999
Income taxes	(3,727)	(3,332)	(3,420)
Share-based compensation expense, net of income taxes	\$ 5,847	\$ 5,308	\$ 5,579

#### P. Operating Segment, Geographic Information and Significant Customers

Operating segments are defined as components of an enterprise evaluated regularly by the Company's chief operating decision maker ("CODM") in deciding how to allocate resources and assess performance. Prior to the fourth quarter of fiscal 2016, the Company's operating segments were: Mercury Commercial Electronics and Mercury Defense Systems.

During fiscal 2016, the Company completed a series of important internal organizational structure changes to align and scale the Company into one business. In addition, over the past several years, the Company has completed several acquisitions to support its strategy of creating a better alternative for affordable, secure processing subsystems designed and made in the U.S.A. These acquisitions culminated with the \$300,000 acquisition of the Carve-Out Business on May 2, 2016. These strategic changes finalized the transformation of the CODM's management, evaluation and review of the business, including how he allocates resources and assesses performance. Therefore, during the fourth quarter ended June 30, 2016, the Company's previous MCE and MDS operating segments no longer continued to exist and the Company is now comprised of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with FASB ASC 280.

The geographic distribution of the Company's revenues is summarized as follows:

	US	Europe	Asia Pacific	Eliminations	Total
<b>YEAR ENDED JUNE 30, 2016</b>					
Net revenues to unaffiliated customers	\$ 259,781	\$ 5,464	\$ 4,909	\$ —	\$ 270,154
Inter-geographic revenues	7,911	447	—	(8,358)	—
Net revenues	<u>\$ 267,692</u>	<u>\$ 5,911</u>	<u>\$ 4,909</u>	<u>\$ (8,358)</u>	<u>\$ 270,154</u>
Identifiable long-lived assets	<u>\$ 28,187</u>	<u>\$ 127</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 28,337</u>
<b>YEAR ENDED JUNE 30, 2015</b>					
Net revenues to unaffiliated customers	\$ 229,849	\$ 2,076	\$ 2,922	\$ —	\$ 234,847
Inter-geographic revenues	2,806	475	—	(3,281)	—
Net revenues	<u>\$ 232,655</u>	<u>\$ 2,551</u>	<u>\$ 2,922</u>	<u>\$ (3,281)</u>	<u>\$ 234,847</u>
Identifiable long-lived assets	<u>\$ 13,127</u>	<u>\$ 68</u>	<u>\$ 31</u>	<u>\$ —</u>	<u>\$ 13,226</u>
<b>YEAR ENDED JUNE 30, 2014</b>					
Net revenues to unaffiliated customers	\$ 202,845	\$ 2,806	\$ 3,078	\$ —	\$ 208,729
Inter-geographic revenues	3,479	1,550	140	(5,169)	—
Net revenues	<u>\$ 206,324</u>	<u>\$ 4,356</u>	<u>\$ 3,218</u>	<u>\$ (5,169)</u>	<u>\$ 208,729</u>
Identifiable long-lived assets	<u>\$ 14,090</u>	<u>\$ 48</u>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$ 14,144</u>

Foreign revenue is based on the country in which the Company's legal subsidiary is domiciled. Identifiable long-lived assets exclude goodwill and intangible assets.

Customers comprising 10% or more of the Company's revenues for the periods are as follows:

	Year Ended June 30,		
	2016	2015	2014
Lockheed Martin Corporation	23%	20%	18%
Raytheon Company	20	37	13
Northrop Grumman Corporation	*	*	12
	<u>43%</u>	<u>57%</u>	<u>43%</u>

\* Indicates that the amount is less than 10% of the Company's revenues for the respective period.

While the Company typically has customers from which it derives 10% or more of its revenue, the sales to each of these customers are spread across multiple programs and platforms. Programs comprising 10% or more of the Company's revenues for the periods are as follows:

	Year Ended June 30,		
	2016	2015	2014
SEWIP	12%	*	*
Aegis	10%	12%	15%
Patriot	*	18%	*
F-35	*	16%	*
	<u>22%</u>	<u>46%</u>	<u>15%</u>

\* Indicates that the amount is less than 10% of the Company's revenues for the respective period.

## Q. Discontinued Operations

During the fourth quarter of fiscal 2014, the Company conducted a strategic review of the Mercury Intelligence Systems ("MIS") business which encompassed an assessment of MIS' financial performance and contemporaneous future financial projections. The Company, with Board of Director's approval, concluded that a plan to divest the MIS business would be in the best interests of the Company and its shareholders. On January 23, 2015, the Company completed the sale of MIS.

In fiscal 2014, the Company's MIS business met the "held for sale" criteria in accordance with FASB ASC 205. As the Company did not anticipate continuing involvement in the operations of MIS after its divestiture, the MIS operating results have been reported as a discontinued operation for all periods presented.

The classification as "held for sale" was considered a triggering event for impairment testing under FASB ASC 350 and FASB ASC 360. However, since the Company conducted its annual goodwill impairment testing in its fourth quarter of fiscal 2014, which coincided with the plan to divest the MIS business, the "held for sale" triggering event did not constitute a separate goodwill impairment test under FASB ASC 350 (see Note G). The triggering event, however, did require separate impairment testing of the MIS asset group's long-lived assets under FASB ASC 360.

The goodwill impairment testing conducted in the fourth quarter of fiscal 2014 determined the MIS reporting unit's carrying value of goodwill exceeded its implied fair value, resulting in a \$6,687 impairment charge. The impairment charge is reflected within discontinued operations of the Company's accompanying consolidated financial statements. The failure of the first step of the goodwill impairment test was driven by a decline in forecasted results of the MIS reporting unit. The fair value of the MIS reporting unit from the first step of the goodwill impairment test exceeded the fair value of the assets and liabilities of the MIS reporting unit, as determined by the second step of the goodwill impairment test. Testing of the valuation of long-lived assets of the MIS asset group indicated no impairment, as the estimated undiscounted cash flows of the MIS asset group, less estimated costs to sell, significantly exceeded its carrying value.

As MIS became a discontinued operation in the fourth quarter of fiscal 2014, the revenues, costs of revenue, and operating expenses of MIS have been reported separately as discontinued operations in the Consolidated Statements of Operations and Comprehensive Income (Loss) for all periods presented. The results of discontinued operations do not reflect interest expense or the allocation of the Company's corporate general and administrative expenses.

During the second quarter of fiscal 2015, the Company determined that the MIS reporting unit's carrying value of goodwill exceeded its implied fair value, resulting in a further goodwill impairment charge of 2,283. This impairment charge is reflected within discontinued operations of the Company's accompanying fiscal 2015 consolidated financial statements.

On January 23, 2015, the Company completed the sale of MIS for approximately \$1,600. The sale resulted in net proceeds of \$885 and a loss on disposal of \$892, which is reflected within discontinued operations of the Company's accompanying consolidated financial statements. The Company does not have continuing involvement in the operations of MIS after its divestiture.

The amounts reported in loss from discontinued operations, net of income taxes were as follows:

	<b>For the Years Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>
Net revenues of discontinued operations	\$ 3,493	\$ 9,414
Costs of discontinued operations:		
Cost of revenues	2,385	6,356
Selling, general and administrative	1,958	3,029
Research and development	305	585
Amortization of intangible assets	279	495
Restructuring and other charges	—	26
Impairment of goodwill	2,283	6,687
Loss from discontinued operations before income taxes	(3,717)	(7,764)
Loss on disposal of discontinued operations before income taxes	(892)	—
Tax benefit	(549)	(411)
Loss from discontinued operations, net of income taxes	<u>\$ (4,060)</u>	<u>\$ (7,353)</u>

There were no balances for the assets and liabilities of the discontinued operations at June 30, 2016 and 2015.

The depreciation, amortization, capital expenditures and significant operating and investing non-cash items of the discontinued operations were as follows:

	For the Years Ended June 30,	
	2015	2014
Depreciation	\$ 100	\$ 160
Amortization of intangible assets	\$ 279	\$ 495
Capital expenditures	\$ —	\$ 78
Impairment of goodwill	\$ 2,283	\$ 6,687
Stock-based compensation expense	\$ 88	\$ 245

**R. Subsequent Events**

The Company has evaluated subsequent events from the date of the consolidated balance sheet through the date the consolidated financial statements were issued.

## SUPPLEMENTARY INFORMATION (UNAUDITED)

The following sets forth certain unaudited consolidated quarterly statements of operations data for each of the Company's last eight quarters. In management's opinion, this quarterly information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation for the periods presented. Such quarterly results are not necessarily indicative of future results of operations and should be read in conjunction with the audited consolidated financial statements of the Company and the notes thereto included elsewhere herein.

2016 (In thousands, except per share data)	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Net revenues	\$ 58,409	\$ 60,417	\$ 65,898	\$ 85,430
Gross margin	\$ 27,529	\$ 28,578	\$ 30,491	\$ 38,176
Income from operations	\$ 3,131	\$ 6,369	\$ 6,819	\$ 7,654
Income from continuing operations before income taxes	\$ 3,224	\$ 6,473	\$ 6,999	\$ 8,590
Income tax provision (1)	\$ 368	\$ 1,433	\$ 2,642	\$ 1,101
Income from continuing operations	\$ 2,856	\$ 5,040	\$ 4,357	\$ 7,489
Loss from discontinued operations, net of income taxes	—	—	—	—
Net income	\$ 2,856	\$ 5,040	\$ 4,357	\$ 7,489
Net income per share:				
Basic net income per share:				
Income from continuing operations	\$ 0.09	\$ 0.15	\$ 0.13	\$ 0.20
Loss from discontinued operations	\$ —	\$ —	\$ —	\$ —
Net income	\$ 0.09	\$ 0.15	\$ 0.13	\$ 0.20
Diluted net income per share:				
Income from continuing operations	\$ 0.08	\$ 0.15	\$ 0.13	\$ 0.19
Loss from discontinued operations	\$ —	\$ —	\$ —	\$ —
Net income	\$ 0.08	\$ 0.15	\$ 0.13	\$ 0.19
2015 (In thousands, except per share data)	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Net revenues	\$ 54,061	\$ 57,089	\$ 59,578	\$ 64,119
Gross margin	\$ 23,999	\$ 27,035	\$ 27,918	\$ 31,267
Income from operations	\$ 728	\$ 3,539	\$ 6,157	\$ 7,931
Income from continuing operations before income taxes	\$ 717	\$ 3,933	\$ 6,163	\$ 7,982
Income tax provision	\$ —	\$ 1,047	\$ 1,469	\$ 1,850
Income from continuing operations	\$ 717	\$ 2,886	\$ 4,694	\$ 6,132
Loss from discontinued operations, net of income taxes	\$ (218)	\$ (2,621)	\$ (1,019)	\$ (202)
Net income	\$ 499	\$ 265	\$ 3,675	\$ 5,930
Net income per share:				
Basic net income (loss) per share:				
Income from continuing operations	\$ 0.02	\$ 0.09	\$ 0.14	\$ 0.19
Loss from discontinued operations	\$ —	\$ (0.08)	\$ (0.03)	\$ (0.01)
Net income	\$ 0.02	\$ 0.01	\$ 0.11	\$ 0.18
Diluted net income (loss) per share:				
Income from continuing operations	\$ 0.02	\$ 0.09	\$ 0.14	\$ 0.18
Loss from discontinued operations	\$ —	\$ (0.08)	\$ (0.03)	\$ —
Net income	\$ 0.02	\$ 0.01	\$ 0.11	\$ 0.18

(1) Upon adoption of FASB ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, the Company recognized \$1,100 of excess tax benefits in the fourth quarter as a benefit to income taxes in its consolidated statements of operations and comprehensive income (loss) for the year ended June 30, 2016. The tax benefit (provision) impacts were restated above to show the effect of this adoption as if it had occurred at the beginning of fiscal 2016. The tax benefit (provision) impacts were \$896, \$247, \$(169), and \$126 for the 1<sup>st</sup> quarter, 2<sup>nd</sup> quarter, 3<sup>rd</sup> quarter and 4<sup>th</sup> quarter, respectively. Income from continuing operations, net income, and net income amounts per share were also updated as a result of the adjustment to the income tax provision.

Due to the effects of rounding, the sum of the four quarters does not equal the annual total.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

(a) EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

We conducted an evaluation as of June 30, 2016 under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), and concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, the “Exchange Act”) were effective as of June 30, 2016 and designed to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that it is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

(c) MANAGEMENT’S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of the Chief Executive Officer and Chief Financial Officer, management conducted an assessment of the effectiveness of our internal control over financial reporting as of June 30, 2016 based on the framework in *Internal Control-Integrated Framework* (2013) published by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of this assessment, management concluded that our internal control over financial reporting was effective as of June 30, 2016. The effectiveness of our internal control over financial reporting as of June 30, 2016 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report.

The audited consolidated financial statements of the Company include the results of the acquired Carve-Out Business on and after May 2, 2016, as described in Note C to the Consolidated Financial Statements. Upon consideration of the date of the acquisition and the time constraints under which our management’s assessment would have to be made, management determined that it would not be possible to conduct a sufficiently comprehensive assessment of the Carve-Out Business’ internal control over financial reporting as allowable under section 404 of the Sarbanes-Oxley Act of 2002. Accordingly, these operations have been excluded from the scope of management’s assessment of internal controls for fiscal year 2016. However, management is in the process of integrating the Carve-Out Business into the overall internal control over financial reporting environment for fiscal year 2017. The Company’s consolidated financial statements reflect revenues and total assets from the Carve-Out Business of approximately 6 percent and 46 percent (of which 37 percent represented goodwill and intangible assets included within the scope of the Company’s assessment), respectively, as of and for the year ended June 30, 2016.

(d) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of fiscal 2016 identified in connection with our Chief Executive Officer’s and Chief Financial Officer’s evaluation that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, management is in the process of integrating the Carve-Out Business into our overall internal control over financial reporting environment.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this item is incorporated herein by reference to our Proxy Statement for our 2016 Annual Meeting of Shareholders (the “Shareholders Meeting”), except that information required by this item concerning our executive officers appears in Part I, Item 4.1. of this Annual Report on Form 10-K.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is incorporated by reference to our Proxy Statement for the Shareholders Meeting.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) FINANCIAL STATEMENTS, SCHEDULES AND EXHIBITS**

The financial statements, schedule, and exhibits listed below are included in or incorporated by reference as part of this report:

1. Financial statements:

- Report of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets as of June 30, 2016 and 2015
- Consolidated Statements of Operations and Comprehensive Income (loss) for the fiscal years ended June 30, 2016, 2015, and 2014
- Consolidated Statements of Shareholders' Equity for the fiscal years ended June 30, 2016, 2015, and 2014
- Consolidated Statements of Cash Flows for the years ended June 30, 2016, 2015, and 2014
- Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

II. Valuation and Qualifying Accounts

**MERCURY SYSTEMS, INC.**

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS  
FOR FISCAL YEARS ENDED JUNE 30, 2016, 2015 AND 2014  
(In thousands)

**Allowance for Doubtful Accounts**

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS	REVERSALS	WRITE- OFFS	BALANCE AT END OF PERIOD
2016	\$ 56	\$ 425	\$ —	\$ 389	\$ 92
2015	\$ 34	\$ 44	\$ 1	\$ 21	\$ 56
2014	\$ 33	\$ 133	\$ 14	\$ 118	\$ 34

**Deferred Tax Asset Valuation Allowance**

	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS & EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS	BALANCE AT END OF PERIOD
2016	\$ 18,864	\$ (392)	\$ —	\$ —	\$ 18,472
2015	\$ 10,844	\$ 8,020	\$ —	\$ —	\$ 18,864
2014	\$ 9,032	\$ 1,812	\$ —	\$ —	\$ 10,844

3. Exhibits:

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index on page 83, which is incorporated herein by reference.



## EXHIBIT INDEX

<u>ITEM NO.</u>	<u>DESCRIPTION OF EXHIBIT</u>
1.1	Underwriting Agreement, dated April 7, 2016, among Mercury Systems, Inc. as issuer and Citigroup Global Markets Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated as representatives of the several underwriters named therein (incorporated herein by reference to Exhibit 1.1 of the Company's current report on Form 8-K filed on April 8, 2016)
3.1.1	Articles of Organization (incorporated herein by reference to Exhibit 3.1.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009)
3.1.2	Articles of Amendment (incorporated herein by reference to Exhibit 3.1.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010)
3.1.3	Articles of Amendment (incorporated herein by reference to Exhibit 1 of the Company's registration statement on Form 8-A filed on December 15, 2005)
3.1.4	Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on November 13, 2012)
3.1.5	Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on June 30, 2015)
3.2	Bylaws, amended and restated effective as of May 4, 2011 (incorporated herein by reference to Exhibit 3.2 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2011)
4.1	Form of Stock Certificate (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.1.1*	1997 Stock Option Plan, as amended and restated (incorporated herein by reference to Exhibit 10.1.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010)
10.1.2*	Form of Stock Option Agreement under the 1997 Stock Option Plan (incorporated herein by reference to Exhibit 10.1.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010)
10.1.3*	Form of Restricted Stock Award Agreement under the 1997 Stock Option Plan (incorporated herein by reference to Exhibit 10.1.3 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010)
10.2*	1997 Employee Stock Purchase Plan, as amended and restated (incorporated herein by reference to Appendix B to the Company's definitive proxy statement filed on October 29, 2015)
10.3*	Form of Indemnification Agreement between the Company and each of its current directors (incorporated herein by reference to Exhibit 10.4 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009)
10.4*	Annual Executive Bonus Plan – Corporate Financial Performance (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on August 30, 2013)
10.5*	Annual Executive Bonus Plan – Individual Performance (incorporated herein by reference to Exhibit 10.7 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009)
10.6*	2005 Stock Incentive Plan, as amended and restated (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on October 29, 2015)
10.7.1*	Form of Stock Option Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
10.7.2*	Form of Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)

ITEM NO.	DESCRIPTION OF EXHIBIT
10.7.3*	Form of Deferred Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.3 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
10.7.4*	Form of Stock Option Agreement for performance stock options under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on September 28, 2007)
10.7.5*	Form of Amended and Restated Performance-Based Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2014)
10.8.1*	Form of Change in Control Severance Agreement between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.9.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
10.8.2*	Form of Change in Control Severance Agreement between the Company and Non-CEO Executives (incorporated herein by reference to Exhibit 10.9.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
10.9*	Compensation Policy for Non-Employee Directors (incorporated herein by reference to Exhibit 10.10 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2012)
10.10.1*	Employment Agreement, dated as of November 19, 2007, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on November 20, 2007)
10.10.2*	First Amendment to Employment Agreement, dated as of December 20, 2008, by and between the Company and Mark Aslett (incorporated by reference to Exhibit 10.2 of the Company's quarterly report on Form 10-Q for the quarter ended December 31, 2008)
10.10.3*	Second Amendment to Employment Agreement, dated as of September 30, 2009, by and between the Company and Mark Aslett (incorporated by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2009)
10.11*	Agreement, dated March 1, 2010, by and between the Company and Gerald M. Haines II (incorporated herein by reference to Exhibit 10.13 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
10.12	Micronetics, Inc. 2006 Equity Incentive Plan (incorporated herein by reference to Exhibit 99.1 to the Company's registration statement on Form S-8 filed on August 10, 2012)
10.13	Stock Purchase Agreement by and between Mercury Systems, Inc. and Microsemi Corporation, dated as of March 23, 2016 (incorporated by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on April 4, 2016)
10.14	Credit Agreement, dated May 2, 2016, among Mercury Systems, Inc., the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent and Collateral Agent (incorporated by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on May 2, 2016)

ITEM NO.	DESCRIPTION OF EXHIBIT
12.1†	Computation of Ratio of Earnings to Fixed Charges
21.1†	Subsidiaries of the Company
23.1†	Consent of KPMG LLP
23.2†	Consent of PricewaterhouseCoopers LLP, independent accountants for the Carve-Out Business
31.1†	Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2†	Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1+	Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Carve-Out Business audited consolidated balance sheets as of September 27, 2015 and September 28, 2014, and the related consolidated statements of operations and comprehensive income, consolidated statements of changes of invested equity and consolidated statements of cash flows for the years ended September 27, 2015, September 28, 2014 and September 29, 2013 (incorporated by reference to Exhibit 99.2 of the Company's Current Report on Form 8-K filed with the Securities Exchange Commission on April 4, 2016)
99.2	Carve-Out Business unaudited interim consolidated balance sheets as of January 3, 2016 and December 28, 2014 and the related unaudited consolidated statements of operations and comprehensive income and consolidated statements of cash flows for three months ended January 3, 2016 and December 28, 2014 (incorporated by reference to Exhibit 99.3 of the Company's Current Report on Form 8-K filed with the Securities Exchange Commission on April 4, 2016)
99.3	Mercury Systems, Inc. unaudited pro forma condensed consolidated balance sheet as of December 31, 2015, the unaudited pro forma condensed consolidated statements of operations for the six months ended December 31, 2015 and the unaudited pro forma condensed consolidated statement of operations for the year ended June 30, 2015 (incorporated by reference to Exhibit 99.4 of the Company's Current Report on Form 8-K filed with the Securities Exchange Commission on April 4, 2016)
101†	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Statement of Operations, (ii) Consolidated Balance Sheet, (iii) Consolidated Statement of Shareholders' Equity, (iv) Consolidated Statement of Cash Flows, and (v) Notes to Consolidated financial Statements

\* Identifies a management contract or compensatory plan or arrangement in which an executive officer or director of the Company participates.

† Filed with this Form 10-K.

+ Furnished herewith. This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

**MERCURY SYSTEMS, INC.**  
**COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**  
**(dollars in thousands)**

	Year Ended June 30, 2016	Year Ended June 30, 2015	Year Ended June 30, 2014	Year Ended June 30, 2013	Year Ended June 30, 2012
Income (loss) from continuing operations before income taxes	\$ 25,286	\$ 18,795	\$ (5,913)	\$ (24,283)	\$ 31,771
Fixed charges:					
Interest expense	\$ 1,172	\$ 34	\$ 49	\$ 38	\$ 40
Portion of rental expense representative of interest factor (1)	1,325	1,246	1,390	1,375	1,255
Total fixed charges	\$ 2,497	\$ 1,280	\$ 1,439	\$ 1,413	\$ 1,295
Income (loss) from continuing operations before income taxes plus fixed charges	\$ 27,783	\$ 20,075	\$ (4,474)	\$ (22,870)	\$ 33,066
Ratio of earnings to fixed charges (2)	11.1	15.7	(3.1)	(16.2)	25.5
Coverage deficiency	\$ —	\$ —	\$ 5,913	\$ 24,283	\$ —

(1) The portion of rental expense which management believes is representative of the interest component of rent expense (assumed to be 33%).

(2) The ratio of earnings to fixed charges is calculated by dividing (a) income from continuing operations before income taxes plus fixed charges by (b) fixed charges. Fixed charges include interest expense (including amortization of debt issuance costs) and an estimate of the interest within rental expense.

## CERTIFICATION

I, Mark Aslett, certify that:

1. I have reviewed this annual report on Form 10-K of Mercury Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2016

/s/ MARK ASLETT

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Mark Aslett

PRESIDENT AND CHIEF EXECUTIVE OFFICER  
[PRINCIPAL EXECUTIVE OFFICER]

## CERTIFICATION

I, Gerald M. Haines II, certify that:

1. I have reviewed this annual report on Form 10-K of Mercury Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2016

/s/ GERALD M. HAINES II

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Gerald M. Haines II

EXECUTIVE VICE PRESIDENT,  
CHIEF FINANCIAL OFFICER, AND TREASURER  
[PRINCIPAL FINANCIAL OFFICER]

Mercury Systems, Inc.

Certification Pursuant To  
18 U.S.C. Section 1350,  
As Adopted Pursuant To  
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report of Mercury Systems, Inc. (the "Company") on Form 10-K for the fiscal year ended June 30, 2016 as filed with the Securities and Exchange Commission (the "Report"), we, Mark Aslett, President and Chief Executive Officer of the Company, and Gerald M. Haines II, Executive Vice President, Chief Financial Officer, and Treasurer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that to our knowledge the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 16, 2016

/s/ MARK ASLETT

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**Mark Aslett**  
**PRESIDENT AND CHIEF EXECUTIVE OFFICER**

/s/ GERALD M. HAINES II

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**Gerald M. Haines II**  
**EXECUTIVE VICE PRESIDENT,**  
**CHIEF FINANCIAL OFFICER, AND TREASURER**

## SHAREHOLDER RETURN PERFORMANCE GRAPH

Set forth below is a line graph comparing the cumulative total shareholder return of our common stock against the cumulative total return of the Spade Defense Index and a peer group of 29 companies for the period of June 30, 2011 through June 30, 2016. The graph and table assume that \$100 was invested on June 30, 2011 in each of our common stock, the Spade Defense Index, and a peer group and that all dividends were reinvested. The peer group consists of the following companies:

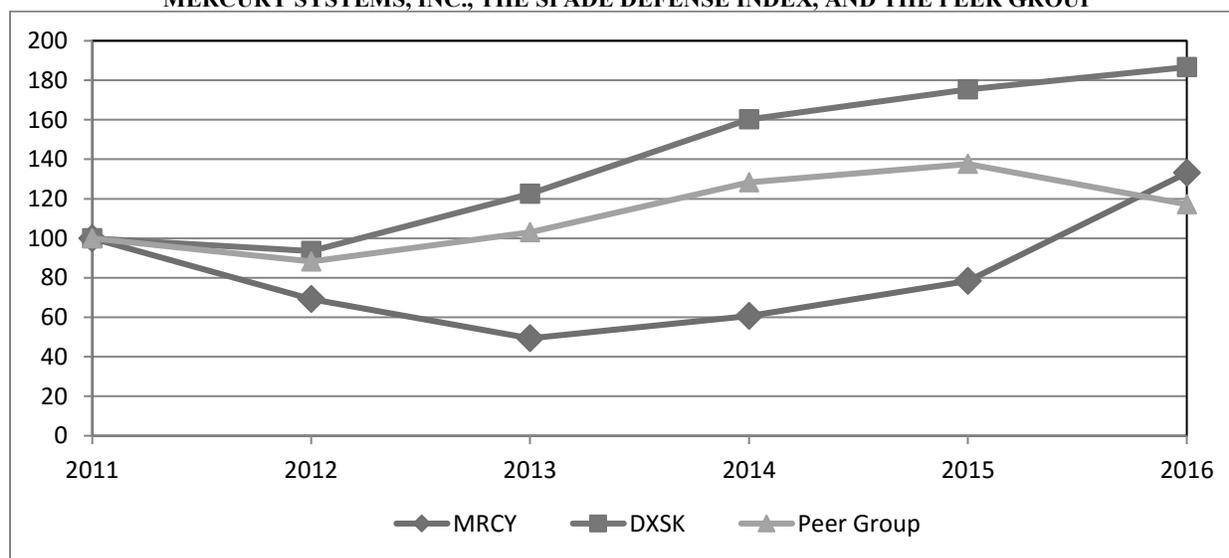
ADTRAN, Inc.	Ducommun Incorporated	Netgear Inc.
AeroVironment, Inc.	Gigamon, Inc.	NetScout Systems, Inc.
Analogic Corporation	GSI Group Inc.	Progress Software Corporation
Astronics Corporation	Infinera Corporation	Qualys, Inc.
Brooks Automation, Inc.	InvenSense, Inc.	Ruckus Wireless, Inc.
CalAmp Corp.	iRobot Corporation	Shore Tel, Inc.
Cognex Corporation	Ixia	Sonus Networks, Inc.
Comtech Telecommunications Corp.	Kratos Defense & Security Solutions, Inc.	Sparton Corp.
Cray, Inc.	M/A-COM Technology Solutions Holdings, Inc.	Vicor Corp.
Digi International Inc.	MKS Instruments, Inc.	

We retained the same peer group used in fiscal 2015 with the following exceptions: (i) we removed American Science and Engineering, Inc., API Technologies Corp., DigitalGlobe, Inc., Electro Scientific Industries, Inc., KVH Industries, Inc., NCI, Inc., RadiSys Corporation, and KEYW Holding Corporation from our peer group; and (ii) we added ADTRAN, Inc., Astronics Corporation, Brooks Automation, Inc., Cognex Corporation, Gigamon, Inc., GSI Group Inc., Infinera Corporation, InvenSense, Inc., Ixia, Kratos Defense & Security Solutions, Inc., MKS Instruments, Inc., Netgear Inc., NetScout Systems, Inc., Progress Software Corporation, Qualys, Inc., Ruckus Wireless, Inc., Shore Tel, Inc., Sparton Corp., and Vicor Corp. to our peer group.

### COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN AMONG MERCURY SYSTEMS, INC., THE SPADE DEFENSE INDEX, AND THE PEER GROUP

<u>Measurement Point</u>	<u>Mercury Systems, Inc.</u>	<u>Spade Defense Index (DXSK)</u>	<u>Peer Group</u>
6/30/11	100.0	100.0	100.0
6/30/12	69.22	93.52	88.26
6/30/13	49.36	122.50	103.04
6/30/14	60.71	160.21	128.36
6/30/15	78.37	175.32	137.59
6/30/16	133.08	186.67	117.16

### COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN AMONG MERCURY SYSTEMS, INC., THE SPADE DEFENSE INDEX, AND THE PEER GROUP



ASSUMES \$100 INVESTED ON JUNE 30, 2011  
ASSUMES DIVIDEND REINVESTED  
FISCAL YEAR ENDED JUNE 30, 2016

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# DIRECTORS & MANAGEMENT

## EXECUTIVE OFFICERS

**Mark Aslett**

President and Chief Executive Officer

**Christopher C. Cambria**

Senior Vice President, General Counsel, and Secretary

**Gerald M. Haines II**

Executive Vice President, Chief Financial Officer and Treasurer

**Charles A. Speicher**

Vice President, Controller, Chief Accounting Officer, and Assistant Treasurer

**Didier M.C. Thibaud**

Executive Vice President, Chief Operating Officer

## BOARD OF DIRECTORS

**Vincent Vitto**

Chairman of the Board  
Retired President and CEO  
The Charles Stark Draper Laboratory, Inc.

**Mark Aslett**

President and Chief Executive Officer  
Mercury Systems, Inc.

**James K. Bass**

Retired President and CEO  
Piper Aircraft, Inc.

**Michael A. Daniels**

Retired Chairman and CEO  
Mobile 365, Inc. and  
Network Solutions, Inc.

**George K. Muellner**

Retired Executive  
The Boeing Company

**Mark S. Newman**

Retired Chairman and CEO  
DRS Technologies, Inc.

**William K. O'Brien**

Retired Chairman and CEO  
Enterasys Networks

# CORPORATE INFORMATION

## CORPORATE OFFICE

MERCURY SYSTEMS, INC.  
201 Riverneck Road  
Chelmsford, MA 01824-2820  
Tel 978.256.1300  
866.411.MRCY  
ir.mrcy.com  
NASDAQ: MRCY

## AUDITOR

KPMG LLP  
Two Financial Center  
60 South Street  
Boston, MA 02111

## TRANSFER AGENT AND REGISTRAR

Computershare Investor Services  
P.O. Box 43023  
Providence, RI 02940-4023  
Tel 781.575.2879  
[www.computershare.com/investor](http://www.computershare.com/investor)

## COMMON STOCK

Mercury Systems, Inc. common stock is traded on the Nasdaq Global Select Market under the symbol MRCY.

## STOCKHOLDER INFORMATION

The Company's Form 10-K and other published information is available on request, free of charge, by writing or calling Investor Relations as listed below.

## INVESTOR RELATIONS

Mercury Systems, Inc.  
201 Riverneck Road  
Chelmsford, MA 01824-2820  
Tel 866.411.MRCY



INNOVATION THAT MATTERS™

Mercury Systems, Inc. is an Equal Opportunity/Affirmative Action Employer.  
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We've invested in open innovations that matter to deliver full sensor processing solutions engineered and made in the USA.