

MERCURY SYSTEMS INC

FORM 10-K (Annual Report)

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**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, 2017

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)

50 MINUTEMAN ROAD
ANDOVER, MA
(Address of principal executive offices)

04-2741391
(I.R.S. Employer
Identification No.)

01810
(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 \$1,241.0 million based upon the closing price of the Common Stock as reported on the Nasdaq Global Select Market on December 31, 2016, the last business day of the registrant's most recently completed second fiscal quarter.

Shares of Common Stock outstanding as of July 31, 2017 : 48,108,360 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.
Exhibit Index on Page 84

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 2017 refers to the period from July 1, 2016 to June 30, 2017.

ITEM 1. BUSINESS

Our Company

Mercury Systems, Inc. is a leading commercial provider of secure sensor and safety critical mission processing subsystems. 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 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, Reaper, F-16 SABR, E2D Hawkeye and Paveway. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise into electronic subsystem solutions primarily for the aerospace and defense sector.

Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, safety-critical avionics, radio frequency (“RF”) components, multi-function assemblies and subsystems. 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 while also addressing the packaging ruggedization and cooling challenges, often referred to as “SWaP” (size, weight, and power), that are common in military applications. We have design, development, and manufacturing capabilities in mission computing, safety-critical avionics and platform management solutions. In addition, we design and manufacture RF, microwave and millimeter wave components and subsystems to meet the needs of the radar, electronic warfare (“EW”), signals intelligence (“SIGINT”) and other high bandwidth communications requirements and applications.

We also provide significant capabilities relating to pre-integrated 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, build and manufacture 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 processing, radar, EW, SIGINT, and radar environment test and simulation.

Our revenues, income from continuing operations and adjusted EBITDA for fiscal 2017 were \$408.6 million, \$24.9 million and \$93.9 million, respectively. Our revenues, 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 of this annual report for a reconciliation of our adjusted EBITDA to income (loss) from continuing operations. Results of operations for fiscal 2016 do not include results for CES Creative Electronic Systems, S.A. (“CES”) and Delta Microwave, LLC (“Delta”) and only include the results for the custom microelectronics, RF and microwave solutions, and embedded security operations of Microsemi Corporation (the “Carve-Out Business”) from May 2, 2016. Accordingly, the information between periods are not directly comparable.

Our Business Strategy

Our strategy is built around our key strengths as a leading commercial provider of secure sensor and safety critical mission processing subsystems. 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 capabilities 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. We invest in scalable manufacturing operations in the U.S. to enable rapid, cost-effective deployment of our microelectronics and secure processing solutions to our customers. Our engagement model 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. Since July 2015, we have substantially added to our technology portfolio by adding capabilities in embedded security with the acquisitions of Lewis Innovative Technologies (“LIT”) and the Carve-Out Business, RF solutions and custom microelectronics solutions with the acquisitions of the Carve-Out Business and Delta, and mission computing, safety-critical avionics and platform management with the CES and Richland Technologies L.L.C. (“RTL”) acquisitions.

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® 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 and product solutions. We are also influential in the industry-standard organizations associated with our market segments. For example, we started the OpenVPXTM 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 one of our core skills, the size, weight, and power constraints that are encountered in connection with the high performance embedded processing applications create unique challenges. For example, to deal with the heat build-up involved in small subsystems, we introduced a key innovation designed to address this challenge. The technology is called Air-Flow-ByTM 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, our Liquid-Flow-ByTM technology 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 can be used in both commercial industrial applications, such as transportation, exploration, communications, 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 products into the following categories:

- *Components.* Components include technology elements typically performing a single, discrete technological function, which when physically combined with other components may be used to create a module or sub-assembly. Examples include but are not limited to power amplifiers and limiters, switches, oscillators, filters, equalizers, digital and analog converters, chips, MMICs (monolithic microwave integrated circuits), and memory and storage devices.
- *Modules and Sub-assemblies.* Modules and sub-assemblies include combinations of multiple functional technology elements and/or components that work together to perform multiple functions but are typically resident on or within a single board or housing. Modules and sub-assemblies may in turn be combined to form an integrated subsystem. Examples of modules and sub-assemblies include but are not limited to embedded processing modules, embedded processing boards, switch fabric boards, high speed input/output boards, digital receiver boards, graphics and video processing and Ethernet and IO (input-output) boards, multi-chip modules, integrated radio frequency and microwave multi-function assemblies, tuners, and transceivers.
- *Integrated Subsystems.* Integrated subsystems include multiple modules and/or subassemblies combined with a backplane or similar functional element and software to enable a solution. These are typically but not always integrated within a chassis and with cooling, power and other elements to address various requirements and are also often combined with additional technologies for interaction with other parts of a complete system or platform. Integrated subsystems also include spare and replacement modules and sub- assemblies sold as part of the same program for use in or with integrated subsystems sold by us.

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® 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.

Recent Acquisitions

Since 2011 we have successfully acquired and integrated eight businesses. The five acquisitions completed since July 1, 2015 are described below.

Acquisition of Lewis Innovative Technologies, Inc.

In December 2015, we acquired LIT. 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.

Acquisition of the Microsemi Carve-Out Business

On May 2, 2016, we acquired the custom microelectronics, RF and microwave solutions, and embedded security operations from Microsemi Corporation, resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the "Carve-Out Acquisition"). 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, and net income (loss) was \$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 aerospace and defense markets. The Carve-Out Business' defense electronics solutions include high-density rugged 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 embedded security 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-guided munitions, fighter and surveillance aircraft, airport security portals, and advanced electronic systems for radar and EW.

Acquisition of Creative Electronic Systems

In November 2016, we acquired CES. Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as several types of unmanned platforms.

The addition of CES adds important and complementary capabilities in mission computing, safety-critical avionics and platform management that are in demand from our customers. These new capabilities will also substantially expand our addressable market into commercial aerospace, defense platform management, C4I and mission computing markets that are aligned to our existing market focus. CES also expands our international presence and gives us better access to non-U.S. markets. Like Mercury, CES has exceptional technology, solid engineering talent and strong leadership, so we believe there is an excellent fit strategically, culturally and operationally between the CES business and Mercury.

Acquisition of Delta Microwave, LLC

In April 2017, we acquired Delta. Based in Oxnard, California, Delta is a leading designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace, and space markets.

The acquisition of Delta is an excellent fit for our market and content expansion strategy. Delta's strengths in high-power, high-frequency active and passive microwave components and subassemblies - particularly in GaN solid-state power amplifiers - are driving strong backlog and growth. These new capabilities add scale and breadth to our existing RF, microwave and millimeter wave portfolio, expand our addressable market into satellite communications, datalinks and space launch - markets that are well-

aligned with our existing market focus - and deepen our penetration into our core radar, EW, and precision-guided munitions markets.

Additionally, Delta has a strong position on a number of franchise U.S. and international defense programs such as F-35, Paveway, MALD, and Rivet Joint that complement our presence. Delta has strong relationships with space OEMs, supplying future manned spaceflight missions as well as military and commercial satellite programs, representing a new growth area for Mercury.

Acquisition of Richland Technologies L.L.C.

In July 2017, we acquired Richland Technologies L.L.C. (“RTL”). Based in Duluth, Georgia, RTL specializes in safety-critical and high integrity systems, software, and hardware development as well as safety-certification services for mission-critical applications. In addition, RTL is a leader in safety-certifiable embedded graphics software for commercial and military aerospace applications. The acquisition complements our acquisition of CES in November 2016 by providing additional capabilities in safety-critical markets as well as the opportunity to leverage RTL's U.S. presence and expertise. Together, the RTL and CES acquisitions position us uniquely as a leading provider of secure and safety-critical processing subsystems for aerospace and defense customers.

We gained a European footprint in safety-critical avionics with the acquisition of CES. The combination of RTL with CES strengthens our U.S. presence in the safety-critical avionics market, adding significant systems engineering, safety-critical software and hardware development and certification expertise to our existing mission computing portfolio. These new capabilities enhance our market penetration in commercial aerospace, defense platform management, C4I and mission computing - markets that are very closely aligned with our existing market focus.

Our Market Opportunity

Our market opportunity is defined by the growing demand for domestically designed and manufactured secure sensor and safety critical mission processing capabilities for critical aerospace, defense and intelligence applications. Historically, our primary market has been centered on bringing commercially available technologies to the defense sector, specifically C4I systems, sensor processing and EW systems; and commercial markets, which include commercial aerospace 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 acquisitions of the Carve-Out Business and Delta further improved our ability to compete successfully in these market segments by allowing us to offer an even more comprehensive set of closely related capabilities. Further, the CES and RTL acquisitions provided us new capabilities that substantially expand our addressable market into commercial aerospace, defense platform management and mission computing markets that are aligned to our existing market focus.

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 aerospace and defense electronics market is expected to grow in 2017 and beyond.* According to Renaissance Strategic Advisors (“RSA”), the global aerospace and defense electronics market is estimated to be \$97 billion in 2017, growing to \$108 billion by 2021. Within this global market, RSA estimates that the U.S. defense electronics market will be approximately \$43 billion in 2017, growing to \$47 billion in 2021. Within the context of the overall U.S. defense budget and spending for defense electronics specifically, we believe the ISR, EW, guided missiles and precision munitions, and ballistic missile defense market segments 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 these markets, and 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 persistence 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, a large ground-based radar, 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* . RSA estimates that in 2017 the U.S. defense tier 2 embedded computing and RF market addressable by suppliers such as Mercury is approximately \$13 billion. RSA estimates that the U.S. defense prime contractors currently outsource only a small percentage of their work. On a global basis the tier 2 embedded computing and RF market in 2017 is estimated by RSA to be over \$30 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 factors are providing incentives for defense prime contractors to outsource more work to subcontractors with significant expertise and cost-effective technology capabilities and solutions, 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 them from nefarious activities such as tampering, reverse engineering, and other forms of advanced attacks, including cyber. 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 embedded vulnerabilities, 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 computing applications 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 multicomputing, embedded sensor processing, with the addition of our RF microwave and millimeter subsystems and components, along with strategic investments in research and development to provide solutions across the sensor processing chain.

Our deep domain knowledge within our company rounds out our capabilities and services to our prime contractor and DoD customers. The acquisitions of the Carve-Out Business and Delta have added both depth and breadth to our capabilities and offerings, and also open new market opportunities such as missiles, precision guided munitions and homeland security. Further, the CES and RTL acquisitions provided us new capabilities that substantially expand our addressable market into commercial aerospace, defense platform management and mission computing markets that are aligned to our existing market focus.

- *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, guided missiles and precision munitions, airborne reconnaissance, EW, and have secured positions on mission-critical programs including Aegis, Predator and Reaper UAVs, F-35 Joint Strike Fighter, Patriot missile, SEWIP, and Paveway. In addition, we consistently

leverage our technology and capabilities across multiple programs, providing significant operating leverage and cost savings. Our recent acquisitions allow 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 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 customers' 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 also 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 Carve-Out Acquisition brought us new security technologies and also allowed us to provide enhanced security capabilities in areas such as memory and storage devices. The Carve-Out Acquisition also provided us with a DMEA ("Defense Micro-Electronics Association") certified trusted manufacturing facility for microelectronics in our Phoenix, Arizona facility.
- *We are pioneering a next generation business model .* The DoD and 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 calls for the continued drive for innovation and competition within the defense industrial base, while also driving down acquisition costs. 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 OSA for both embedded computing and RF.
 - 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 continuing shift toward 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 secure sensor and safety-critical 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 combine directly 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 RF 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 product lines. Our scalable microelectronics manufacturing operations at our AMCs enable rapid, cost-effective deployment of RF solutions to our customers. The acquisitions of the Carve-Out Business and Delta have provided us with west coast RF manufacturing locations providing similar advanced capabilities and better proximity to certain key customer locations.
- *United States Manufacturing Operations*. Our United States Manufacturing Operations (“USMO”) in Phoenix, Arizona is built around scalable, repeatable, secure, affordable, and predictable manufacturing. The facility is a DMEA certified secure trusted site, certified to AS9100 quality standards and it utilizes Lean Six Sigma methodologies throughout manufacturing. The USMO is designed for efficient manufacture, enabling our customers to access the best proven technology and high performing, secure processing solutions. This allows for the most repeatable product performance, while optimizing affordability and production responsiveness.
- *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, L3 Technologies, 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 our recently acquired businesses have 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 to continue growing and scaling our business.

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 rapid, 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 respond rapidly 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 component or 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.

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 and in mission computing, platform management and other safety-critical applications. Expenditures for research and development amounted to \$54.1 million , \$36.4 million , and \$36.5 million in fiscal 2017 , 2016 , and 2015 , respectively. As of June 30, 2017 , we had 352 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 subsystems, 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 Oxnard and Camarillo, California facilities manufacture radio frequency and microwave products in ISO 9001:2008 and AS9100 quality system certified facilities. Our Cypress, California, West Lafayette, Indiana, and Huntsville, Alabama facilities are AS9100 quality systems certified facilities as well. Our Andover, Massachusetts and Hudson, New Hampshire facilities design and assemble our processing products and are AS9100 and ISO 9001:2008 quality systems certified facilities. Our Andover, Massachusetts facility is also a DMEA certified trusted design facility and is primarily focused on advanced security features for the processing product line.

We rely on both vertical integration and subcontracting to contract manufacturers to meet our manufacturing needs. Our USMO has the manufacturing capabilities to complete the assembly and testing for certain of our embedded multi-computing products. We subcontract a portion of the assembly and testing for our other embedded multi-computing products to contract manufacturers in the U.S. to build to our specifications. Our printed circuit board assemblies and chassis subsystems' manufacturing operations also consist of materials planning and procurement, final assembly and test and logistics (inventory and traffic management). Our vertically integrated subsystem product solutions 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.

Our USMO in Phoenix, Arizona is built around scalable, repeatable, secure, affordable, and predictable manufacturing. The facility is a DMEA certified secure trusted site, certified to AS9100 quality standards and it utilizes Lean Six Sigma methodologies throughout manufacturing. The USMO is designed for efficient manufacture, enabling our customers to access the best proven technology and high performing, secure processing solutions. This allows for the most repeatable product performance, while optimizing affordability and production responsiveness.

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 one 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 EO/IR technologies for small UAV platforms as well as powerful onboard UAV processor systems for real-time Wide Area Motion Imagery.

Intellectual Property and Proprietary Rights

As of June 30, 2017, 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, 2017, we had a backlog of orders aggregating approximately \$357.0 million, of which \$290.8 million is expected to be delivered within the next twelve months. As of June 30, 2016, backlog was approximately \$287.7 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, 2017, we employed a total of 1,159 people excluding contractors, including 352 in research and development, 93 in sales and marketing, 552 in manufacturing and customer support and 162 in general and administrative functions. We have 80 employees located in Europe, one located in Japan, and 1,078 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. We also use contractors on an as needed basis.

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, 2017, 2016 and 2015. These three defense prime contractors comprised an aggregate of 44%, 51% and 61% of our revenues in each of the years ended June 30, 2017, 2016 and 2015, respectively. While sales to each of these customers typically compose 10% or more of our revenue, the sales to these customers are spread across multiple programs and platforms.

Corporate Headquarters and Incorporation

We recently relocated our Corporate headquarters into a more modern facility in Andover, MA, investing in communications, media and collaborative capabilities, engineering labs and security infrastructure.

Mercury Systems, Inc. was incorporated in Massachusetts in 1981.

WEBSITE

We maintain a website at 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.

OTHER INFORMATION

EchoCore, Echotek, Ensemble, PowerStream, RACE++, and MultiCore Plus and ASSURE-Stor are registered trademarks, and Mercury Systems, Innovation that Matters, Air Flow-By, Liquid Flow-By, POET, CANGuard, WhiteboxCRYPTO, CodeSEAL, EnforcIT-S, and SecureBootFPGA are trademarks of Mercury Systems, Inc. OpenVPX is a trademark of the VMEbus International Trade Association. All other trademarks and registered trademarks are the property of their respective holders, and are hereby acknowledged.

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 96%, 98%, and 94% of our total net revenues in fiscal 2017, 2016, and 2015, 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, 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 2018 and beyond, the potential for further gridlock in Congress, another continuing budget resolution, or the defense industry operating under sequestration could 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 in 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 we contract with the U.S. government, we 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 us 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. 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 a rolling 12-month average of 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. We expect to lose our status as a small business during fiscal 2018.
- 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 smelted 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 conflict minerals regulations enacted pursuant to the Dodd Frank legislation may pose similar risks and increase our costs. The new DFARS cyber-security requirements may increase our costs or delay the award of contracts if we are unable to certify that we satisfy such cyber-security requirements by the implementation deadline for the security protocols, which is currently scheduled during our fiscal 2018.

- 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 2017, Lockheed Martin Corporation accounted for 20% of our total net revenues and Raytheon Company accounted for 16% of our total net revenues. In fiscal 2016, Lockheed Martin Corporation accounted for 23% of our total net revenues and Raytheon Company accounted for 20% of our total net revenues. In fiscal 2015, Raytheon Company accounted for 37% of our total net revenues and Lockheed Martin Corporation accounted for 20% of our total net revenues. 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 37%, 52%, and 61% of our total net revenues for fiscal 2017, 2016, and 2015, 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, 2017, no single program individually comprised ten percent or more of our revenues. For the fiscal year ended June 30, 2016, the Surface Electronic Warfare Improvement Program (“SEWIP”) program individually comprised 12% of our revenues. For the fiscal years ended June 30, 2016 and 2015, the Aegis program individually comprised 10% and 12% of our revenues, respectively. For the fiscal year ended June 30, 2015, Patriot and F-35 accounted for 18% and 16% of our revenue, respectively. Loss of a significant radar program could adversely affect our results of operations.

Going forward, we believe the SEWIP, AEGIS, F-35, F-16 and the Patriot missile defense programs 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 more brand-based providers of open-source architectures versus Mercury. 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 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 as 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 the commercial and defense 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. 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 engineering and 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 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 expect to continue to explore acquisitions or strategic alliances, which ultimately may not be completed or be 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;
- layering of integration activity due to multiple overlapping acquisitions;
- 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 acquisitions of the Carve-Out Business, CES, Delta and RTL because of integration difficulties and other challenges.

While we expect the Carve-Out Business, CES, Delta, and RTL acquisitions 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 acquisitions will depend, in part, on our ability to realize the anticipated benefits from integrating such businesses with our existing business. The integration process may be complex, costly and time consuming.

The difficulties of integrating the operations of the Carve-Out Business, CES, Delta, and RTL 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, CES, Delta, and RTL 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, CES, Delta, and RTL had achieved or might achieve separately. In addition, we may not accomplish the integration of these businesses 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 these acquisitions 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 our M&A activity.

The market price of our common stock may decline as a result of our merger and acquisition activity 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, CES, Delta, and RTL are not realized. The market price of our common stock also may decline if we do not achieve the perceived benefits of the acquisitions as rapidly or to the extent anticipated by financial or industry analysts or if the effect of the acquisitions on our financial results is not consistent with the expectations of financial or industry analysts.

We may incur substantial indebtedness.

In June 2017, we amended our revolving credit facility ("Revolving Credit Facility"), increasing and extending the facility into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining principal on our term loan using cash on hand. The Revolving Credit Facility remained undrawn at June 30, 2017, other than for outstanding letters of credit.

Subject to the limits contained in our Revolving Credit Facility, we may 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 debt could intensify. Specifically, our debt could have important consequences to our investors, including the following:

- making it more difficult for us to satisfy our obligations under our debt instruments, including, without limitation, the Revolving Credit Facility; 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, our Revolving Credit Facility contains restrictive covenants that may limit our ability to engage in activities that are 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 our Revolving Credit Facility could proceed against the collateral granted to them to secure that 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, which it has begun.

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, 2017, the carrying values of goodwill and identifiable intangible assets on our balance sheet were \$380.8 million and \$129.0 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 our recent acquisitions 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 acquisitions of Delta in fiscal 2017 and the Carve-Out Business in fiscal 2016, as well as our earlier 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 began to internally manufacture the impacted Huntsville, Alabama digital processing product line at our Phoenix, Arizona facility. With our build out of a surface mount technology manufacturing capability in our Phoenix, Arizona facility, which we refer to as our USMO, we are developing a second source for our digital processing product manufacturing needs to complement our contract manufacturing relationship with Benchmark Electronics. With a source of internal manufacturing to meet an increasing portion of our digital processing product manufacturing needs, we will need to effectively manage our relationship with our contract manufacturers to manage our order volumes, scale production to meet volume requirements, and maintain necessary inventory levels.

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

We market and sell products in international markets, and have established sales offices and subsidiaries in United Kingdom and Japan and, as part of the acquisition of CES in November 2016, we now have manufacturing and engineering facilities in Switzerland. Revenues from international operations accounted for 7%, 4%, and 2% of our total net revenues in fiscal 2017, 2016, and 2015, 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.

With the acquisition of CES in fiscal 2017, we acquired a pension plan (the "Plan") for Swiss employees, mandated by Swiss law. Since participants of the Plan are entitled to a defined rate of interest on contributions made, the Plan meets the criteria for a defined benefit plan under U.S. GAAP. The Plan, an independent pension fund, is part of a multi-employer plan with unrestricted joint liability for all participating companies and the economic interest in the Plan's overfunding or underfunding is allocated to each participating company based on an allocation key determined by the Plan. U.S. GAAP requires an employer to recognize the funded status of the defined benefit plan on the balance sheet, which we have presented in other long-term liabilities on our consolidated balance sheet at June 30, 2017. The funded status may vary from year to year due to changes in the fair value of Plan's assets and variations on the underlying assumptions in the Plan and we may have to record an increased liability as a result of fluctuations in the value of the Plan's assets. As of June 30, 2017, we had a liability of \$6.6 million in other non-current liabilities representing the net under-funded status of the Plan.

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 or increased 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.

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;
- changes in customer order patterns;
- 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;
- inability to realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits;
- 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 timely identify, attract, hire, train, retain and motivate highly skilled managerial and operational personnel as we continue our pace of growth. 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. Likewise, our international operations are subject to the export laws of the countries in which they conduct business. 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 could be delayed or prevented from selling our products in certain jurisdictions, which could adversely affect our business and financial results.

If we are unable to obtain or maintain appropriate government security clearances for our facilities or personnel, we may be precluded from bidding on certain opportunities.

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. Several of our facilities maintain

a facility security clearance and many of our employees maintain a personal security clearance in order to access sensitive information necessary to the performance of our work on certain government contracts and subcontracts. 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 subcontract, or potentially debarment as a government contractor.

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, we 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 our 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;
- our future results of operations, financial condition and cash flows; and
- prevailing interest rates.

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, 2017 :

| <u>Location</u> | <u>Size in Sq. Feet</u> | <u>Commitment</u> |
|-----------------|-----------------------------|-----------------------|
| Phoenix, AZ | 116,858 | Leased, expiring 2020 |
| Andover, MA | 114,198 | Leased, expiring 2029 |
| Hudson, NH | 100,111 | Leased, expiring 2024 |
| Cypress, CA | 42,770 | Leased, expiring 2021 |
| Oxnard, CA | 35,650 | Leased, expiring 2019 |
| Huntsville, AL | 25,950 | Leased, expiring 2018 |
| Camarillo, CA | 25,195 | Leased, expiring 2020 |

The company actively manages its facilities and is in pursuit of lease extensions or alternative locations for facilities with expiration dates in 2017, 2018 or 2019. 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 49, 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 59, joined Mercury in 2016 as Senior Vice President, General Counsel and Secretary and was appointed Executive Vice President, General Counsel, and Secretary in 2017. 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. Prior to L-3, Mr. Cambria was an Associate with Fried, Frank, Harris, Shriver & Jacobson and Cravath, Swaine & Moore.

Gerald M. Haines II, age 54, joined Mercury in 2010 as Senior Vice President of Corporate Development and General Counsel 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 58, 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 56, 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 |
|---------------------|-------------|------------|
| 2017 Fourth quarter | \$ 43.15 | \$ 36.09 |
| Third quarter | \$ 40.86 | \$ 29.31 |
| Second quarter | \$ 32.75 | \$ 22.31 |
| First quarter | \$ 26.37 | \$ 21.52 |
| 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 |

As of July 31, 2017, we had 291 record shareholders. As of July 17, 2017, we had 21,830 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, 2017 :

| Period of Net Share Settlement | Total Number of Shares Net Settled (1) | | Average Price Per Share |
|---------------------------------------|---|----|--------------------------------|
| July 1, 2016 - September 30, 2016 | 260 | \$ | 23.48 |
| October 1, 2016 - December 31, 2016 | 53 | \$ | 27.34 |
| January 1, 2017 - March 31, 2017 | 4 | \$ | 36.01 |
| April 1, 2017 - June 30, 2017 | 27 | \$ | 39.43 |
| Total | 344 | | |

(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 2017, 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, | | | | |
|---|------------------------------|------------|------------|------------|-------------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Statement of Operations Data: | | | | | |
| Net revenues | \$ 408,588 | \$ 270,154 | \$ 234,847 | \$ 208,729 | \$ 194,231 |
| Income (loss) from operations | \$ 37,403 | \$ 23,973 | \$ 18,355 | \$ (7,405) | \$ (24,810) |
| Income (loss) from continuing operations | \$ 24,875 | \$ 19,742 | \$ 14,429 | \$ (4,072) | \$ (13,782) |
| Adjusted EBITDA(1) | \$ 93,921 | \$ 57,274 | \$ 44,414 | \$ 23,522 | \$ 9,940 |
| Net earnings (loss) per share from continuing operations: | | | | | |
| Basic | \$ 0.59 | \$ 0.58 | \$ 0.45 | \$ (0.13) | \$ (0.46) |
| Diluted | \$ 0.58 | \$ 0.56 | \$ 0.44 | \$ (0.13) | \$ (0.46) |
| | As of June 30, | | | | |
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Balance Sheet Data: | | | | | |
| Working capital | \$ 173,351 | \$ 177,748 | \$ 142,472 | \$ 127,375 | \$ 115,483 |
| Total assets | \$ 815,745 | \$ 736,496 | \$ 386,880 | \$ 373,712 | \$ 374,431 |
| Long-term obligations | \$ 17,483 | \$ 195,808 | \$ 3,457 | \$ 13,635 | \$ 15,112 |
| Total shareholders' equity | \$ 725,417 | \$ 473,044 | \$ 350,138 | \$ 327,147 | \$ 328,501 |

- (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 sensor and safety critical mission processing subsystems. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, 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, F-16 SABR, E2D Hawkeye, Reaper and Paveway. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector.

As of June 30, 2017, we had 1,159 employees. Our revenue, income from continuing operations and adjusted EBITDA for fiscal 2017 were \$408.6 million, \$24.9 million, and \$93.9 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation of our income (loss) from continuing operations to adjusted EBITDA.

Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, safety-critical avionics, radio frequency ("RF") components, multi-function assemblies and subsystems. 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 while addressing the packaging challenges, often referred to as "SWaP" (size, weight, and power), that are common in military applications. We have design, development, and manufacturing capabilities in mission computing, safety-critical avionics and platform management. In addition, we design and manufacture RF, microwave and millimeter wave components and subsystems to meet the needs of the radar, electronic warfare ("EW"), signals intelligence ("SIGINT") and other high bandwidth communications requirements and applications.

We also provide significant capabilities relating to pre-integrated 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.

Since we 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.

B BUSINESS DEVELOPMENTS :

FISCAL 2017

On June 27, 2017, we amended our revolving credit facility ("Revolving Credit Facility"), increasing and extending the facility into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining principal on our term loan using cash on hand. The Revolving Credit Facility remained undrawn at June 30, 2017, other than for outstanding letters of credit.

On April 3, 2017, we acquired Delta Microwave, LLC ("Delta"). Delta is a leading designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace and space markets. The acquisition and transaction related expenses were funded with cash on hand.

On January 26, 2017, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On February 1, 2017, we closed the offering, including the full over-allotment allocation, selling an aggregate of 6.9 million shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215.7 million.

On November 4, 2016, we acquired CES Creative Electronic Systems, S.A. ("CES"). Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission-critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as several types of unmanned platforms.

FISCAL 2016

On May 2, 2016, we acquired the custom microelectronics, RF and microwave solutions, and embedded security operations of 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").

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.

On December 16, 2015, we acquired Lewis Innovative Technologies, Inc. ("LIT"). 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 acquisition integration plan primarily associated with the Micronetics, Inc. acquisition. 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.

RESULTS OF OPERATIONS:
FISCAL 2017 v S . FISCAL 2016

Results of operations for the twelve month period ended June 30, 2016 does not include results for CES and Delta since both businesses were acquired subsequent to June 30, 2016 and includes only two months results for the Carve-Out Business. Accordingly, the periods presented below are not directly comparable.

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

| (In thousands) | Fiscal 2017 | As a % of Total Net Revenue | Fiscal 2016 | As a % of Total Net Revenue |
|---|-------------|-----------------------------------|-------------|-----------------------------------|
| Net revenues | \$ 408,588 | 100.0 % | \$ 270,154 | 100.0 % |
| Cost of revenues | 217,045 | 53.1 | 142,535 | 52.8 |
| Gross margin | 191,543 | 46.9 | 127,619 | 47.2 |
| Operating expenses: | | | | |
| Selling, general and administrative | 76,491 | 18.7 | 52,952 | 19.6 |
| Research and development | 54,086 | 13.2 | 36,388 | 13.4 |
| Amortization of intangible assets | 19,680 | 4.8 | 8,842 | 3.2 |
| Restructuring and other charges | 1,952 | 0.5 | 1,240 | 0.5 |
| Impairment of long-lived assets | — | — | 231 | 0.1 |
| Acquisition costs and other related expenses | 1,931 | 0.5 | 3,993 | 1.5 |
| Total operating expenses | 154,140 | 37.7 | 103,646 | 38.3 |
| Income from operations | 37,403 | 9.2 | 23,973 | 8.9 |
| Interest income | 462 | 0.1 | 131 | — |
| Interest expense | (7,568) | (1.9) | (1,172) | (0.4) |
| Other income, net | 771 | 0.2 | 2,354 | 0.9 |
| Income from continuing operations before income taxes | 31,068 | 7.6 | 25,286 | 9.4 |
| Tax provision | 6,193 | 1.5 | 5,544 | 2.1 |
| Net income | \$ 24,875 | 6.1 % | \$ 19,742 | 7.3 % |

R EVENUES

| (In thousands) | Fiscal 2017 | As a % of Total Net Revenue | Fiscal 2016 | As a % of Total Net Revenue | \$ Change | % Change |
|------------------|----------------|-----------------------------------|----------------|-----------------------------------|------------|----------|
| Organic revenue | \$ 277,699 | 68% | \$ 253,516 | 94% | \$ 24,183 | 10% |
| Acquired revenue | 130,889 | 32% | 16,638 | 6% | 114,251 | 687% |
| Total revenues | \$ 408,588 | 100% | \$ 270,154 | 100% | \$ 138,434 | 51% |

Total revenues increased \$138.4 million, or 51%, to \$408.6 million during fiscal 2017 compared to \$270.2 million during fiscal 2016 including "Acquired revenue" which represents net revenue from acquired businesses that have been part of Mercury for completion of four full quarters or less (which excludes any intercompany transactions). After the completion of four fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenues is primarily attributed to higher revenues associated with a large ground based radar program and ProVision program and the increase of \$114.3 million of Acquired revenue. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, increased by \$17.0 million to \$66.9 million during fiscal 2017 compared to \$49.9 million during fiscal 2016 . International revenues represented 16% and 19% of total revenues during fiscal 2017 and 2016 , respectively.

G ROSS M ARGIN

Gross margin was 46.9% for fiscal 2017 , a decrease of 30 basis points from the 47.2% gross margin achieved in fiscal 2016 . The lower gross margin in fiscal 2017 was primarily due to inventory step-up amortization related to the Carve-Out Business, CES and Delta of \$2.8 million, \$0.7 million, and \$0.2 million, respectively, partially offset by production cost efficiencies and acquisition

integration synergies, as well as the continuing ramp up of our insourced U.S. manufacturing operations. The remaining \$0.6 million of inventory step-up will be amortized into cost of goods sold over the first 4 months of fiscal 2018.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$23.5 million, or 44%, to \$76.5 million during fiscal 2017 as compared to \$53.0 million during fiscal 2016. The increase was primarily due to increased headcount driven by the full year impact of the Carve-Out Business, as well as the acquisitions of CES and Delta in the second and fourth quarters of fiscal 2017, respectively, and higher compensation related costs. Selling, general and administrative expenses decreased as a percentage of revenue to 18.7% during fiscal 2017 from 19.6% during fiscal 2016 due to higher revenues in fiscal 2017.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$17.7 million, or 49%, to \$54.1 million during fiscal 2017 compared to \$36.4 million for fiscal 2016. The increase was primarily due to increased headcount from the full year impact of the Carve-Out Business, as well as the acquisitions of CES and Delta in the second and fourth quarters of fiscal 2017, respectively. The increase was also due to higher compensation related costs, partially offset by increased customer funded development. Research and development expenses accounted for 13.2% and 13.4% of our revenues during fiscal 2017 and fiscal 2016, respectively.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased \$10.9 million to \$19.7 million during fiscal 2017 compared to \$8.8 million for fiscal 2016, primarily due to the full year impact of amortization from the acquisition of the Carve-Out Business, as well as the amortization from CES and Delta acquisitions.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges increased \$0.7 million, or 58%, to \$1.9 million during fiscal 2017 compared to \$1.2 million in fiscal 2016. The increase was driven by the severance related activities associated with the planned closure of our Manteca, California facility in early fiscal 2018. We also incurred facility related charges through April 2017, as we were unable to sublease the unoccupied portion of our former Chelmsford, Massachusetts headquarters facility. We have relocated our headquarters to Andover, Massachusetts in March 2017. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

IMPAIRMENT OF LONG-LIVED ASSETS

We had no impairment charges during fiscal 2017, compared to an impairment charge of \$0.2 million related to a pre-existing LIT relationship during fiscal 2016.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$1.9 million of acquisition costs and other related expenses during fiscal 2017, compared to \$4.0 million during fiscal 2016. The acquisition costs and other related expenses incurred during fiscal 2017 relate to the acquisitions of both CES and Delta. \$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 \$0.5 million in fiscal 2017, compared to \$0.1 million in fiscal 2016 due to higher average balances of cash on hand throughout the year.

INTEREST EXPENSE

Interest expense for fiscal 2017 increased \$6.4 million to \$7.6 million compared to \$1.2 million in fiscal 2016. The increase was driven by \$5.8 million cash interest expense and \$1.8 million of amortization of debt issuance costs related to our term loan, which was entered into during the fourth quarter of fiscal 2016, and repaid during June 2017 as noted above.

OTHER INCOME, NET

Other income decreased \$1.6 million to \$0.8 million during fiscal 2017 compared to \$2.4 million in fiscal 2016. During fiscal 2016 we realized \$1.9 million gain on the settlement of escrow litigation, which was associated with our fiscal 2012 acquisition of KOR Electronics. Other income includes \$0.9 million and \$1.2 million related to the amortization of the gain on the sale leaseback of our former corporate headquarters during fiscal 2017 and fiscal 2016, respectively. In fiscal 2017, we realized \$0.3 million foreign exchange gain compared to \$0.2 million loss during the same period in fiscal 2016. We incurred bank operating fees of \$0.6 million and \$0.4 million during fiscal 2017 and 2016, respectively.

INCOME TAXES

We recorded an income tax provision of \$6.2 million in fiscal 2017 compared to \$5.5 million in fiscal 2016. The effective tax rates for fiscal 2017 and fiscal 2016 were 19.9% and 21.9%, respectively.

Our effective tax rate for fiscal 2017 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 2017 and fiscal 2016 is mainly driven by additional excess tax benefits for equity compensation, 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.

FISCAL 2016 V S . FISCAL 2015

Results of operations for the twelve month period ended June 30, 2016 include two months results for the Carve-Out Business. Accordingly, the periods presented below are not directly comparable.

The following tables set forth, for the periods indicated, financial data from the consolidated statement 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 | 142,535 | 52.8 | 120,647 | 51.4 |
| Gross margin | 127,619 | 47.2 | 114,200 | 48.6 |
| Operating expenses: | | | | |
| Selling, general and administrative | 52,952 | 19.6 | 49,010 | 20.9 |
| Research and development | 36,388 | 13.4 | 36,535 | 15.6 |
| 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 | 103,646 | 38.3 | 95,845 | 40.8 |
| Income from operations | 23,973 | 8.9 | 18,355 | 7.8 |
| Interest income | 131 | — | 21 | — |
| Interest expense | (1,172) | (0.4) | (34) | — |
| Other income, net | 2,354 | 0.9 | 453 | 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

| (In thousands) | Fiscal 2016 | As a % of Total Net Revenue | Fiscal 2015 | As a % of Total Net Revenue | \$ Change | % Change |
|------------------|----------------|-----------------------------------|----------------|-----------------------------------|-----------|----------|
| Organic revenue | \$ 253,516 | 94% | \$ 234,847 | 100% | \$ 18,669 | 8% |
| Acquired revenue | 16,638 | 6% | — | —% | 16,638 | 100% |
| Total revenues | \$ 270,154 | 100% | \$ 234,847 | 100% | \$ 35,307 | 15% |

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 in total revenues is primarily attributed to higher SEWIP and F16/SABR program revenues and the inclusion of \$16.6 million of Acquired revenue from the Carve-Out Business. Acquired revenue represents net revenue from acquisitions for the first four full quarters since the entities' acquisition date (which excludes any intercompany transactions).

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 .

G ROSS M ARGIN

Gross margin was 47.2% for fiscal 2016 , a decrease of 140 basis points from the 48.6% 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.

S ELLING , G ENERAL AND A DMINISTRATIVE

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 increased headcount driven by the acquisition of the Carve-Out Business and higher compensation related costs. 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.

R ESEARCH AND D EVELOPMENT

Research and development expenses decreased \$0.1million, or less than 1%, to \$36.4 million during fiscal 2016 compared to \$36.5 million for fiscal 2015 . The decrease was primarily due to increased customer funded development. Research and development expenses accounted for 13.4% and 15.6% of our revenues during fiscal 2016 and fiscal 2015 , respectively.

A MORTIZATION OF I NTANGIBLE A SSETS

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.

R ESTRUCTURING AND O THER C HARGES

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 former Chelmsford, Massachusetts headquarters consolidation and related severance activities. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

A CQUISITION C OSTS AND O THER R ELATED E XPENSES

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.

I NTEREST I NCOME

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

I NTEREST E XPENSE

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.

O THER I NCOME, N ET

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.

I NCOME T AXES

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.

LIQUIDITY AND CAPITAL RESOURCES

During fiscal 2017, our primary sources of liquidity came from existing cash and cash generated from operations and our follow on equity offering. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments with our contract manufacturers. 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 amounts under the 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 \$173.0 million of availability remaining under the shelf registration statement.

Follow-on Equity Offerings

On January 26, 2017, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On February 1, 2017, we closed the offering, including the full over-allotment allocation, selling an aggregate of 6.9 million shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215.7 million.

On April 4, 2016, we announced the commencement an underwritten public offering of our common stock, par value \$0.01 per share. 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 at a price to the public of \$19.25 for total net proceeds of \$94.4 million.

Revolving Credit Facilities

In June 2017, we amended our revolving credit facility ("Revolving Credit Facility"), increasing and extending the facility into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining outstanding principal of and interest on our term loan using cash on hand. The Revolving Credit Facility remained undrawn at June 30, 2017, other than for outstanding letters of credit. See Note L in the accompanying consolidated financial statements for further discussion of the Revolving Credit Facility.

CASH FLOWS**(In thousands)**

| As of and for the fiscal year ended | June 30, 2017 | June 30, 2016 | June 30, 2015 |
|--|----------------------|----------------------|----------------------|
| Net cash provided by operating activities | \$ 59,146 | \$ 36,940 | \$ 32,207 |
| Net cash used in investing activities | \$ (111,087) | \$ (318,208) | \$ (5,598) |
| Net cash provided by financing activities | \$ 11,338 | \$ 284,894 | \$ 3,905 |
| Net (decrease) increase in cash and cash equivalents | \$ (40,054) | \$ 4,105 | \$ 30,299 |
| Cash and cash equivalents at end of year | \$ 41,637 | \$ 81,691 | \$ 77,586 |

Our cash and cash equivalents decreased by \$40.1 million during fiscal 2017 as a result of \$200.0 million in payments against our term loan and \$77.8 million invested in two business acquisitions, \$32.8 million invested in purchases of property and equipment, and \$8.8 million used in the retirement of common stock used to settle individual employees' tax liabilities associated with vesting of restricted stock awards, partially offset by \$215.7 million in net proceeds from our follow on equity offering and \$59.1 million in cash generated from operating activities.

Operating Activities

During fiscal 2017, we generated \$59.1 million in cash from operating activities, an increase of \$22.2 million when compared to \$36.9 million in cash generated from operating activities in fiscal 2016. The increase in cash generated by operating activities was primarily a result of \$5.1 million of higher comparable net income, \$16.5 million additional depreciation and amortization expense, \$11.3 million increase in accounts receivable collections, and a \$9.4 million increase in income taxes payable. The increase in cash generated from operating activities was partially offset by a \$15.4 million increase in cash used for accounts payable and accrued expenses and \$8.5 million in higher inventory purchases. 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 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.

Investing Activities

During fiscal 2017, we used cash of \$111.1 million in investing activities compared to \$318.2 million used during fiscal 2016. The decrease is primarily due to the acquisition of the Carve-Out Business for \$300.0 million during fiscal 2016 as compared to the acquisitions of CES and Delta for \$38.8 million and \$40.5 million, respectively, during fiscal 2017. The decrease in cash used for investing activities was partially offset by increased purchases of property and equipment of \$25.0 million.

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.

Financing Activities

During fiscal 2017, the Company closed a follow on offering which generated \$215.7 million of cash. The company utilized a portion of these proceeds to pay down the remaining principal balance of the term loan. As a result of these activities, the Company generated net cash of \$11.3 million from financing activities during fiscal 2017.

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, both in connection to the Carve-Out Business acquisition.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following is a schedule of our commitments and contractual obligations outstanding at June 30, 2017 :

| (In thousands) | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
|----------------------|-------------------|---------------------|------------------|-----------------|----------------------|
| Operating leases | \$ 43,517 | \$ 6,139 | \$ 10,803 | \$ 7,678 | \$ 18,897 |
| Purchase obligations | 59,173 | 59,173 | — | — | — |
| | <u>\$ 102,690</u> | <u>\$ 65,312</u> | <u>\$ 10,803</u> | <u>\$ 7,678</u> | <u>\$ 18,897</u> |

We have a liability at June 30, 2017 of \$0.8 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. 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 \$59.2 million at June 30, 2017 .

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.

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 2017 and 2016 , 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, adjusted earnings per share ("adjusted EPS") and free cash flow.

Adjusted EBITDA is defined as income 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 from continuing operations, the most directly comparable GAAP financial measure, to our adjusted EBITDA:

| (In thousands) | Year Ended June 30, | | |
|---|---------------------|-----------|-----------|
| | 2017 | 2016 | 2015 |
| Income from continuing operations | \$ 24,875 | \$ 19,742 | \$ 14,429 |
| Interest expense, net | 7,106 | 1,041 | 13 |
| Tax provision | 6,193 | 5,544 | 4,366 |
| Depreciation | 12,589 | 6,900 | 6,332 |
| Amortization of intangible assets | 19,680 | 8,842 | 7,008 |
| Restructuring and other charges (1) | 1,952 | 1,240 | 3,175 |
| Impairment of long-lived assets | — | 231 | — |
| Acquisition and financing costs | 2,389 | 4,701 | 451 |
| Fair value adjustments from purchase accounting (2) | 3,679 | 1,384 | — |
| Litigation and settlement expense (income), net | 117 | (1,925) | — |
| Stock-based compensation expense | 15,341 | 9,574 | 8,640 |
| Adjusted EBITDA | \$ 93,921 | \$ 57,274 | \$ 44,414 |

(1) Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities. The Company believes these items are non-routine and may not be indicative of ongoing operating results.

(2) Fair value adjustments from purchase accounting for fiscal year 2017 relate to the Carve-Out Business, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2016 relate to the Carve-Out Business inventory step-up amortization.

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 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 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 expense, and stock-based compensation expense. The impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision. Adjusted EPS expresses adjusted income 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.

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The following table reconciles income from continuing operations and diluted earnings 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, | | | | | |
|--|----------------------------|---------|-------------|---------|-------------|---------|
| | 2017 | | 2016 | | 2015 | |
| Income from continuing operations and diluted earnings per share | \$ 24,875 | \$ 0.58 | \$ 19,742 | \$ 0.56 | \$ 14,429 | \$ 0.44 |
| Amortization of intangible assets | 19,680 | | 8,842 | | 7,008 | |
| Restructuring and other charges (1) | 1,952 | | 1,240 | | 3,175 | |
| Impairment of long-lived assets | — | | 231 | | — | |
| Acquisition and financing costs | 2,389 | | 4,701 | | 451 | |
| Fair value adjustments from purchase accounting (2) | 3,679 | | 1,384 | | — | |
| Litigation and settlement expense (income), net | 117 | | (1,925) | | — | |
| Stock-based compensation expense | 15,341 | | 9,574 | | 8,640 | |
| Impact to income taxes (3) | (18,602) | | (9,975) | | (6,733) | |
| Adjusted income from continuing operations and adjusted earnings per share | \$ 49,431 | \$ 1.15 | \$ 33,814 | \$ 0.96 | \$ 26,970 | \$ 0.82 |
| Diluted weighted-average shares outstanding | | 43,018 | | 35,097 | | 32,939 |

(1) Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities. The Company believes these items are non-routine and may not be indicative of ongoing operating results.

(2) Fair value adjustments from purchase accounting for fiscal year 2017 relate to the Carve-Out Business, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2016 relate to the Carve-Out Business inventory step-up amortization.

(3) Impact to income taxes is calculated by recasting income before income taxes to include the add-backs involved in determining adjusted income and recalculating the income tax provision using this adjusted income from operations before income taxes. The impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision.

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures. 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, | | |
|---------------------------------------|----------------------------|-------------|-------------|
| | 2017 | 2016 | 2015 |
| Cash provided by operating activities | \$ 59,146 | \$ 36,940 | \$ 32,207 |
| Capital expenditures | (32,844) | (7,885) | (5,984) |
| Free cash flow | \$ 26,302 | \$ 29,055 | \$ 26,223 |

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 44%, 33%, and 23% of total Company revenues in fiscal 2017, 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, 2017, approximately \$0.5 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.

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, we utilized a discount rate for each of our reporting units, as defined by FASB ASC 350, *Intangibles-Goodwill and Other*, 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 Sensor and Mission Processing (“SMP”), Advanced Microelectronic Solutions (“AMS”) and Mercury Defense Systems (“MDS”) were 8.0%, 7.5%, and 7.5%. The annual testing indicated that the fair values of our SMP, AMS, and MDS reporting units significantly exceeded their carrying values, and thus no further testing was required.

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.

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.

B 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 GAAP when it becomes effective. The new standard is effective for the Company on July 1, 2018, and we do not plan to early adopt this ASU. The standard permits the use of either the retrospective or cumulative effect transition method. We currently intend to use the retrospective transition method upon adoption of the standard. During fiscal 2017, we have made significant investments in our data reporting infrastructure in order to support the reporting requirements of the standard. Throughout fiscal 2018, we will continue enhancing our infrastructure to capture each of the specific disclosure requirements detailed in the standard. We are continuing to evaluate the future impact that the adoption of the standard will have on our consolidated financial statements. However, we do anticipate that the additional disclosure requirements will represent a significant change from current practices.

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. The new standard is effective for the Company on July 1, 2019. 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.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. We are evaluating the effect that ASU 2016-15 will have on our consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU No. 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory). Under current U.S. GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or annual). We are evaluating the effect that ASU 2016-16 will have on our consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement to measure the implied fair value of goodwill by assigning the fair value of a reporting unit to all assets and liabilities within that unit (“the Step 2 test”) from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized in an amount equal to that excess, limited by the amount of goodwill in that reporting unit. For public business entities, the new standard is effective for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The ASU requires prospective adoption and permits early adoption for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We do not expect this guidance to have a material impact to our consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. We are evaluating the effect that ASU 2017-07 will have on our consolidated financial statements and related disclosures.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2016, we adopted FASB 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 GAAP more closely with International Financial Reporting Standards. We 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. Such adoption did not have any impact to our consolidated financial statements.

Effective June 30, 2017, we adopted FASB 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). There was not a going concern uncertainty in the foreseeable future, and therefore this guidance did not have an impact to our consolidated financial statements.

Effective July 1, 2017, we adopted 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. Such adoption will not have any impact to our consolidated financial statements.

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 and our 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.

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 borrowings and no swaps outstanding at June 30, 2017.

C ONCENTRATION O F C REDIT R ISK

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 with high credit quality. At June 30, 2017 and 2016, we had \$41,637 and \$81,691, 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, 2017, five customers accounted for 53% of our receivables, unbilled receivables and costs in excess of billings. At June 30, 2016, five customers accounted for 50% of our receivables, unbilled receivables and costs in excess of billings.

F OREIGN C URRENCY R ISK

We operate primarily in the United States; however, we conduct business outside the United States through our foreign subsidiaries in Switzerland, the United Kingdom, 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 non-U.S. subsidiaries. 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.

R E P O R T O F I N D E P E N D E N T R E G I S T E R E D P U B L I C A C C O U N T I N G F I R M

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, 2017 and 2016, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2017. 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, 2017, 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, 2017 and 2016, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2017, 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, 2017, 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 CES Creative Electronic Systems, S.A. (CES) and Delta Microwave, LLC (Delta) during fiscal year 2017, and management excluded from its assessment of the effectiveness of Mercury Systems, Inc. and subsidiaries' internal control over financial reporting as of June 30, 2017, CES' and Delta's internal control over financial reporting associated with 12 percent of total consolidated assets (of which 8 percent represented goodwill and intangible assets included within the scope of the assessment) and 5 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, 2017. 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 CES and Delta.

/s/ KPMG LLP

Boston, Massachusetts

August 18, 2017

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MERCURY SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| | June 30, | |
|---|------------|------------|
| | 2017 | 2016 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 41,637 | \$ 81,691 |
| Accounts receivable, net of allowance for doubtful accounts of \$83 and \$92 at June 30, 2017 and 2016, respectively | 76,341 | 73,427 |
| Unbilled receivables and costs in excess of billings | 37,332 | 22,467 |
| Inventory | 81,071 | 58,284 |
| Prepaid income taxes | 1,434 | 3,401 |
| Prepaid expenses and other current assets | 8,381 | 6,122 |
| Total current assets | 246,196 | 245,392 |
| Restricted cash | — | 264 |
| Property and equipment, net | 51,643 | 28,337 |
| Goodwill | 380,846 | 344,027 |
| Intangible assets, net | 129,037 | 116,673 |
| Other non-current assets | 8,023 | 1,803 |
| Total assets | \$ 815,745 | \$ 736,496 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 27,485 | \$ 26,723 |
| Accrued expenses | 20,594 | 10,273 |
| Accrued compensation | 18,406 | 13,283 |
| Deferred revenues and customer advances | 6,360 | 7,365 |
| Current portion of long-term debt | — | 10,000 |
| Total current liabilities | 72,845 | 67,644 |
| Deferred income taxes | 4,856 | 11,842 |
| Income taxes payable | 855 | 700 |
| Long-term debt | — | 182,275 |
| Other non-current liabilities | 11,772 | 991 |
| Total liabilities | 90,328 | 263,452 |
| 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; 46,303,075 and 38,675,340 shares issued and outstanding at June 30, 2017 and 2016, respectively | 463 | 387 |
| Additional paid-in capital | 584,795 | 357,500 |
| Retained earnings | 139,085 | 114,210 |
| Accumulated other comprehensive income | 1,074 | 947 |
| Total shareholders' equity | 725,417 | 473,044 |
| Total liabilities and shareholders' equity | \$ 815,745 | \$ 736,496 |

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

MERCURY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In thousands, except per share data)

| | For the Years Ended June 30, | | |
|--|------------------------------|------------|------------|
| | 2017 | 2016 | 2015 |
| Net revenues | \$ 408,588 | \$ 270,154 | \$ 234,847 |
| Cost of revenues | 217,045 | 142,535 | 120,647 |
| Gross margin | 191,543 | 127,619 | 114,200 |
| Operating expenses: | | | |
| Selling, general and administrative | 76,491 | 52,952 | 49,010 |
| Research and development | 54,086 | 36,388 | 36,535 |
| Amortization of intangible assets | 19,680 | 8,842 | 7,008 |
| Restructuring and other charges | 1,952 | 1,240 | 3,175 |
| Impairment of long-lived assets | — | 231 | — |
| Acquisition costs and other related expenses | 1,931 | 3,993 | 117 |
| Total operating expenses | 154,140 | 103,646 | 95,845 |
| Income from operations | 37,403 | 23,973 | 18,355 |
| Interest income | 462 | 131 | 21 |
| Interest expense | (7,568) | (1,172) | (34) |
| Other income, net | 771 | 2,354 | 453 |
| Income from continuing operations before income taxes | 31,068 | 25,286 | 18,795 |
| Tax provision | 6,193 | 5,544 | 4,366 |
| Income from continuing operations | 24,875 | 19,742 | 14,429 |
| Loss from discontinued operations, net of income taxes | — | — | (4,060) |
| Net income | \$ 24,875 | \$ 19,742 | \$ 10,369 |
| Basic net earnings (loss) per share: | | | |
| Income from continuing operations | \$ 0.59 | \$ 0.58 | \$ 0.45 |
| Loss from discontinued operations, net of income taxes | — | — | (0.13) |
| Net income | \$ 0.59 | \$ 0.58 | \$ 0.32 |
| Diluted net earnings (loss) per share: | | | |
| Income from continuing operations | \$ 0.58 | \$ 0.56 | \$ 0.44 |
| Loss from discontinued operations, net of income taxes | — | — | (0.13) |
| Net income | \$ 0.58 | \$ 0.56 | \$ 0.31 |
| Weighted-average shares outstanding: | | | |
| Basic | 41,986 | 34,241 | 32,114 |
| Diluted | 43,018 | 35,097 | 32,939 |
| Comprehensive income: | | | |
| Net income | \$ 24,875 | \$ 19,742 | \$ 10,369 |
| Foreign currency translation adjustments | (93) | 171 | (235) |
| Pension benefit plan, net of tax | 220 | — | — |
| Total other comprehensive income, net of tax | 127 | 171 | (235) |
| Total comprehensive income | \$ 25,002 | \$ 19,913 | \$ 10,134 |

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, 2017, 2016 and 2015
(In thousands)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|--------------|--------|----------------------------------|----------------------|---|----------------------------------|
| | Shares | Amount | | | | |
| 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 shortfall 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 |
| Issuance of common stock under employee stock incentive plans | 976 | 9 | 2,747 | — | — | 2,756 |
| Issuance of common stock under employee stock purchase plan | 96 | 1 | 2,213 | — | — | 2,214 |
| Retirement of common stock | (344) | (3) | (8,763) | — | — | (8,766) |
| Follow-on public stock offering | 6,900 | 69 | 215,656 | — | — | 215,725 |
| Stock-based compensation | — | — | 15,442 | — | — | 15,442 |
| Net income | — | — | — | 24,875 | — | 24,875 |
| Foreign currency translation adjustments | — | — | — | — | (93) | (93) |
| Pension benefit plan, net of tax | — | — | — | — | 220 | 220 |
| Balance at June 30, 2017 | 46,303 | \$ 463 | \$ 584,795 | \$ 139,085 | \$ 1,074 | \$ 725,417 |

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, | | |
|---|------------------------------|------------------|------------------|
| | 2017 | 2016 | 2015 |
| Cash flows from operating activities: | | | |
| Net income | \$ 24,875 | \$ 19,742 | \$ 10,369 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization expense | 32,269 | 15,742 | 13,840 |
| Stock-based compensation expense | 15,341 | 9,574 | 8,728 |
| Deferred income taxes | (7,841) | (3,061) | (1,038) |
| Impairment of goodwill and long-lived assets | — | 231 | 2,283 |
| Excess tax benefit from stock-based compensation | — | — | (943) |
| Loss on sale of discontinued operations | — | — | 892 |
| Non-cash interest expense | 1,810 | 301 | — |
| Other non-cash items | (626) | (722) | (495) |
| Changes in operating assets and liabilities, net of effects of businesses acquired: | | | |
| Accounts receivable, unbilled receivables, and costs in excess of billings | (14,054) | (25,396) | 5,935 |
| Inventory | (9,318) | (865) | (345) |
| Prepaid income taxes | 1,978 | 346 | (2,265) |
| Prepaid expenses and other current assets | (1,270) | 2,964 | (4,964) |
| Other non-current assets | 372 | (778) | 565 |
| Accounts payable and accrued expenses | 3,520 | 18,871 | (475) |
| Deferred revenues and customer advances | (1,621) | (194) | 1,138 |
| Income taxes payable | 9,622 | 253 | (938) |
| Other non-current liabilities | 4,089 | (68) | (80) |
| Net cash provided by operating activities | <u>59,146</u> | <u>36,940</u> | <u>32,207</u> |
| Cash flows from investing activities: | | | |
| Acquisition of businesses, net of cash acquired | (77,757) | (309,756) | — |
| Purchases of property and equipment | (32,844) | (7,885) | (5,984) |
| Proceeds from sale of discontinued operations | — | — | 885 |
| Other investing activities | (486) | (567) | (499) |
| Net cash used in investing activities | <u>(111,087)</u> | <u>(318,208)</u> | <u>(5,598)</u> |
| Cash flows from financing activities: | | | |
| Proceeds from equity offering, net | 215,725 | 92,778 | — |
| Proceeds from employee stock plans | 4,970 | 8,097 | 4,548 |
| Payment for retirement of common stock | (8,766) | (7,955) | (944) |
| Excess tax benefit from stock-based compensation | — | — | 943 |
| Proceeds from issuance of term debt, net | — | 194,900 | — |
| Payments of debt issuance costs | (591) | (2,926) | — |
| Payments of term debt | (200,000) | — | — |
| Payments of capital lease obligations | — | — | (642) |
| Net cash provided by financing activities | <u>11,338</u> | <u>284,894</u> | <u>3,905</u> |
| Effect of exchange rate changes on cash and cash equivalents | 549 | 479 | (215) |
| Net (decrease) increase in cash and cash equivalents | (40,054) | 4,105 | 30,299 |
| Cash and cash equivalents at beginning of year | 81,691 | 77,586 | 47,287 |
| Cash and cash equivalents at end of year | <u>\$ 41,637</u> | <u>\$ 81,691</u> | <u>\$ 77,586</u> |
| Cash paid during the period for: | | | |
| Interest | \$ 5,758 | \$ 1,041 | \$ 34 |
| Income taxes | \$ 2,834 | \$ 7,975 | \$ 7,875 |
| Supplemental disclosures—non-cash activities: | | | |
| Share-based business combination consideration | \$ — | \$ 407 | \$ — |

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 sensor and safety critical mission processing subsystems. Optimized for customer and mission success, its solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, 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-16, F-35, E2D Hawkeye, Reaper and Paveway. The Company's organizational structure allows it to deliver capabilities that combine technology building blocks and deep domain expertise in the aerospace defense sector.

On April 3, 2017, the Company acquired Delta Microwave, LLC (“Delta”) on a cash-free, debt-free basis for a total purchase price of \$40,500, subject to net working capital and net debt adjustments. Based in Oxnard, California, Delta is a leading designer and manufacturer of high-value radio frequency (“RF”), microwave and millimeter wave sub-assemblies and components for the military, aerospace, and space markets. See Note C to consolidated financial statements.

On November 3, 2016, the Company acquired CES Creative Electronic Systems, S.A. (“CES”) for a total purchase price of approximately \$39,123, subject to net working capital and net debt adjustments. Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and input-output (“IO”). CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as several types of unmanned platforms. See Note C to consolidated financial statements.

On May 2, 2016, the Company acquired the custom microelectronics, RF and microwave solutions, and embedded security operations of 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 “Carve-Out Acquisition”). Under the terms of the 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.

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 Generally Accepted Accounting Principles (“GAAP”) 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.

RECLASSIFICATION

The Company included costs related to the sustainment of its product portfolio as research and development expense, which was previously included as costs of revenues on the Consolidated Statements of Operations and Comprehensive Income. For comparative purposes, for the fiscal years ended June 30, 2016 and 2015, the Company has reclassified \$2,845 and \$3,981, respectively, from costs of revenues to research and development expense.

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.

R E V E N U E R E C O G N I T I O N

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 2018. 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, 2017 or 2016.

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).

C ASH AND C ASH E QUIVALENTS

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.

F AIR V ALUE OF F INANCIAL I NSTRUMENTS

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.

C ONCENTRATION OF C REDIT R ISK

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 of high credit quality. At June 30, 2017 and 2016, the Company had \$41,637 and \$81,691, 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, 2017, five customers accounted for 53% of the Company's accounts receivable, unbilled receivables and costs in excess of billings. At June 30, 2016, five customers accounted for 50% of the Company's accounts receivable, unbilled receivables and costs in excess of billings.

I NVENTORY

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.

S EGMEN T I NFORMATION

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 sensor and safety critical mission processing subsystems for critical defense and intelligence applications.

G OODWILL AND I NTANGIBLE A SSETS

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 (see Note G). 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.

L ONG - LIVED A SSETS

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 2017, 2016 and 2015, the Company capitalized \$508, \$0 and \$0 of software development costs.

D EFERRED R EVENUES AND C USTOMER A DVANCES

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.

I NCOME T AXES

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.

P RODUCT W ARRANTY A CCRUAL

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 2017 | Fiscal 2016 | Fiscal 2015 |
|--|-----------------|-----------------|-----------------|
| Beginning balance at July 1, | \$ 1,523 | \$ 1,974 | \$ 2,078 |
| Warranty assumed from CES | 176 | — | — |
| Warranty assumed from Delta | 30 | — | — |
| Warranty assumed from Carve-Out Business | — | 114 | — |
| Accruals for warranties issued during the period | 1,328 | 1,976 | 1,465 |
| Settlements made during the period | (1,366) | (2,541) | (1,569) |
| Ending balance at June 30, | <u>\$ 1,691</u> | <u>\$ 1,523</u> | <u>\$ 1,974</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 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, | | |
|---|----------------------|---------------|---------------|
| | 2017 | 2016 | 2015 |
| Basic weighted-average shares outstanding | 41,986 | 34,241 | 32,114 |
| Effect of dilutive equity instruments | 1,032 | 856 | 825 |
| Diluted weighted-average shares outstanding | <u>43,018</u> | <u>35,097</u> | <u>32,939</u> |

Equity instruments to purchase 16, 7 and 453 shares of common stock were not included in the calculation of diluted net earnings per share for the fiscal years ended June 30, 2017, 2016 and 2015, respectively, because the equity instruments were anti-dilutive.

ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes foreign currency translation adjustments and pension benefit plan adjustments. The components of accumulated other comprehensive income included \$(93) and \$171 of accumulated foreign currency translation adjustments for the years ended June 30, 2017 and 2016. In addition, pension benefit plan adjustments totaled \$220 for the year ended June 30, 2017. There were no material accumulated net unrealized gains on investments at June 30, 2017 and 2016.

FOREIGN CURRENCY

Local currencies are the functional currency for the Company's subsidiaries in Switzerland, United Kingdom 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 non-U.S. currency transactions are included in other income (expense), net in the Consolidated Statements of Operations and Comprehensive Income 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 GAAP when it becomes effective. The new standard is effective for the Company on July 1, 2018, and it does not plan to early adopt this ASU. The standard permits the use of either the retrospective or cumulative effect transition method. The Company currently intends to use the retrospective transition method upon adoption of the standard. During fiscal 2017, the Company has made significant investments in its data reporting infrastructure in order to support the reporting requirements of the standard. Throughout fiscal 2018, the Company will continue enhancing its infrastructure to capture each of the specific disclosure requirements detailed in the standard. The Company is continuing to evaluate the future impact that the adoption of the standard will have on its consolidated financial statements. However, the Company does anticipate that the additional disclosure requirements will represent a significant change from current practices.

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. The new standard is effective for the Company on July 1, 2019. 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.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company is evaluating the effect that ASU 2016-15 will have on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU No. 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory). Under current GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or annual). The Company is evaluating the effect that ASU 2016-16 will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement to measure the implied fair value of goodwill by assigning the fair value of a reporting unit to all assets and liabilities within that unit ("the Step 2 test") from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized in an amount equal to that excess, limited by the amount of goodwill in that reporting unit. For public business entities, the new standard is effective for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The ASU requires prospective adoption and permits early adoption for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect this guidance to have a material impact to its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public

entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The Company is evaluating the effect that ASU 2017-07 will have on its consolidated financial statements and related disclosures.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2016, the Company adopted FASB 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 GAAP more closely with International Financial Reporting Standards. The Company 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. Such adoption did not have any impact to the Company's consolidated financial statements.

Effective June 30, 2017, the Company adopted FASB 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 an entity's ability to continue as a going concern. Substantial doubt exists if it is probable (the "probable" threshold under GAAP has generally been interpreted to be between 75 and 80 percent) that the entity 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). There was not a going concern uncertainty in the current year or in the foreseeable future, and therefore this guidance did not have an impact to the Company's consolidated financial statements.

Effective July 1, 2017, the Company adopted 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. Such adoption did not have any impact to the Company's consolidated financial statements.

C. Acquisitions

DELTA ACQUISITION

On April 3, 2017, the Company entered into a membership interest purchase agreement with Delta, pursuant to which, the Company acquired Delta on a cash-free, debt-free basis for a total purchase price of \$40,500, subject to net working capital and net debt adjustments. Delta is a designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace and space markets. The acquisition and transaction related expenses were funded with cash on hand.

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

| | <u>Amounts</u> |
|--|----------------|
| Consideration transferred | |
| Cash paid at closing | \$ 40,500 |
| Net purchase price | \$ 40,500 |
| Estimated fair value of tangible assets acquired and liabilities assumed | |
| Accounts receivable and cost in excess of billings | \$ 957 |
| Inventory | 4,452 |
| Fixed assets | 1,918 |
| Other current and non-current assets | 67 |
| Current liabilities | (1,854) |
| Estimated fair value of net tangible assets acquired | 5,540 |
| Estimated fair value of identifiable intangible assets | 17,000 |
| Estimated goodwill | 17,960 |
| Estimated fair value of net assets acquired | 40,500 |
| Net purchase price | \$ 40,500 |

The amounts above represent the preliminary fair value estimates as of June 30, 2017 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period. The preliminary identifiable intangible asset estimates include customer relationships of \$8,000 with a useful life of 9 years, developed technology of \$5,900 with a useful life of 7 years and backlog of \$3,100 with a useful life of 2 years. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$17,960 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 Delta acquisition expands scale and breadth of the Company's RF, microwave and millimeter wave capabilities, provides highly complementary program portfolio in missiles and munitions, deepens market penetration in core radar, electronic warfare ("EW"), and precision-guided munitions markets, and opens new growth opportunities in space launch, GPS, satellite communications and datalinks. The goodwill from this acquisition was initially reported under the MCE reporting unit.

The Company and the shareholders of Delta have agreed to treat the acquisition of Delta 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, 2017, the Company had \$18,029 of goodwill deductible for tax purposes.

The revenues and income before income taxes from Delta included in the Company's consolidated results for the fiscal year ended June 30, 2017 were \$5,435 and \$805, respectively. The Company has not furnished pro forma financial information relating to Delta because such information is not material to the Company's financial results.

CES ACQUISITION

On November 4, 2016, the Company and the shareholders of CES entered into a Stock Purchase Agreement, pursuant to which, Mercury acquired CES for a total purchase price of \$39,123, subject to net working capital and net debt adjustments. The acquisition and associated transaction expenses were funded with cash on hand. Based in Geneva, Switzerland, CES is a provider of embedded solutions for military and aerospace mission-critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as the several types of unmanned platforms.

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

| | <u>Amounts</u> |
|--|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 39,123 |
| Working capital adjustment | (330) |
| Net purchase price | <u>\$ 38,793</u> |
| Estimated fair value of tangible assets acquired and liabilities assumed | |
| Accounts receivable and cost in excess of billings | \$ 2,698 |
| Inventory | 8,950 |
| Fixed assets | 1,480 |
| Other current and non-current assets | 748 |
| Current liabilities | (3,154) |
| Non-current liabilities | (6,140) |
| Deferred tax liabilities | (857) |
| Estimated fair value of net tangible assets acquired | <u>3,725</u> |
| Estimated fair value of identifiable intangible assets | 14,722 |
| Estimated goodwill | 20,346 |
| Estimated fair value of net assets acquired | <u>38,793</u> |
| Net purchase price | <u>\$ 38,793</u> |

The amounts above represent the preliminary fair value estimates as of June 30, 2017 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period. The preliminary identifiable intangible asset estimates include customer relationships of \$9,060 with a useful life of 9 years and developed technology of \$5,662 with a useful life of 7 years. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$20,346 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. CES provides the Company with capabilities in mission computing, safety-critical avionics and platform management that are in demand from its customers. These new capabilities will also substantially expand Mercury's addressable market into commercial aerospace, defense platform management, command, control, communications, computers, and intelligence ("C4I") and mission computing markets that are aligned to Mercury's existing market focus. 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 was initially reported under the MCE reporting unit.

The revenues and income before income taxes from CES included in the Company's consolidated results for the fiscal year ended June 30, 2017 were \$17,008 and \$1,196, respectively. The Company has not furnished pro forma financial information relating to CES because such information is not material to the Company's financial results.

CARVE-OUT BUSINESS ACQUISITION

On March 23, 2016, the Company and Microsemi entered into a Stock Purchase Agreement, pursuant to which, Microsemi agreed to sell all the membership interests in 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 invested 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 N).

The following table presents the net purchase price and the 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 |
| Working capital adjustment | (1,838) |
| Net purchase price | <u>\$ 298,569</u> |
| Fair value of tangible assets acquired and liabilities assumed | |
| Accounts receivable and cost in excess of billings | \$ 17,157 |
| Inventory | 25,477 |
| Fixed assets | 13,996 |
| Other current and non-current assets | 524 |
| Current liabilities | (4,692) |
| Non-current deferred tax liabilities | (25,449) |
| Fair value of net tangible assets acquired | <u>27,013</u> |
| Fair value of identifiable intangible assets | 102,800 |
| Goodwill | <u>168,756</u> |
| Fair value of assets acquired | <u>298,569</u> |
| Net purchase price | <u>\$ 298,569</u> |

On May 2, 2017, the measurement period for the Carve-Out Business expired. The identifiable intangible assets include customer relationships of \$70,900, completed technology of \$29,700 and backlog of \$2,200.

The goodwill of \$ 168,756 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 AMS and MDS reporting units. As of June 30, 2016, the Company had \$26,494 of goodwill deductible for tax purposes.

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, 2017 :

| | <u>Fair Value Measurements</u> | | | |
|-------------------------|--------------------------------|----------------|-----------------|----------------|
| | <u>June 30, 2017</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Assets: | | | | |
| Certificates of deposit | \$ 1,043 | \$ — | \$ 1,043 | \$ — |
| Total | <u>\$ 1,043</u> | <u>\$ —</u> | <u>\$ 1,043</u> | <u>\$ —</u> |

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 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, 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 Company determined the face value of its long-term debt approximated fair value at June 30, 2016 due to the recent issuance and stability of interest rates during that period.

E. Inventory

Inventory was comprised of the following:

| | June 30, | |
|-----------------|-----------|-----------|
| | 2017 | 2016 |
| Raw materials | \$ 48,645 | \$ 31,205 |
| Work in process | 22,567 | 15,967 |
| Finished goods | 9,859 | 11,112 |
| Total | \$ 81,071 | \$ 58,284 |

The \$22,787 increase in inventory was primarily due to the inclusion of inventory from CES and Delta. 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, | |
|---------------------------------|---|-----------|-----------|
| | | 2017 | 2016 |
| Computer equipment and software | 3-4 | \$ 64,374 | \$ 62,409 |
| Furniture and fixtures | 5 | 4,810 | 8,547 |
| Leasehold improvements | lesser of estimated useful life or lease term | 19,092 | 8,515 |
| Machinery and equipment | 5-10 | 42,193 | 29,078 |
| | | 130,469 | 108,549 |
| Less: accumulated depreciation | | (78,826) | (80,212) |
| | | \$ 51,643 | \$ 28,337 |

The \$23,306 increase in property and equipment was primarily due to the build-out of the Company's new corporate headquarters, integration activities associated with the Carve-Out Business, and the acquisition of CES and Delta. In fiscal 2017 and 2016, the Company retired \$14,310 and \$32, respectively, of computer equipment and software, furniture, and fixtures, leasehold improvements, and machinery and equipment that were no longer in use by the Company.

Depreciation expense related to property and equipment for the fiscal years ended June 30, 2017, 2016 and 2015 was \$12,589, \$6,900 and \$6,332, 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 former 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 was ten years and included two five year options to renew, which the Company did not 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 was amortized to other income on a straight-line basis over the initial lease term.

The unamortized deferred gain of \$929 at June 30, 2016 was included in accrued expenses and in the accompanying consolidated balance sheets and has been fully amortized as of June 30, 2017.

G. Goodwill

Throughout fiscal 2017, the Company undertook a series of integration activities related to the Carve-Out Business. These integration activities included system conversions, the build-out of our U.S. Manufacturing Organization in Phoenix, insourcing of embedded sensor products manufacturing previously outsourced, retirement of legacy internal controls related to the Carve-Out Business, and integration of the acquired sites into the legacy control environment. Significant work was done through the fourth quarter of fiscal 2017 to complete these integration activities. The conclusion of these integration efforts resulted in a reorganization of the Company's reporting unit structure from MCE, MDS and the Carve-Out Business to: Sensor and Mission Processing ("SMP"), Advanced Microelectronic Solutions ("AMS") and Mercury Defense Systems ("MDS"). This change had no effect on the Company's operating segment, as the Chief Operating Decision Maker ("CODM") continues to evaluate and manage the Company on the basis of one reportable segment.

The following table summarizes the changes in goodwill at the Company's three reporting units for the year ended June 30, 2016, prior to the reorganization of the Company's reporting unit structure in fiscal 2017:

| | MCE | MDS | Carve-Out Business | Total |
|--|-------------------|------------------|--------------------|-------------------|
| Balance at June 30, 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> |

The following table summarizes the changes in goodwill at the Company's three reporting units from June 30, 2016 through May 31, 2017, immediately before the reorganization of the Company's reporting unit structure:

| | MCE | MDS | Carve-Out Business | Total |
|--|-------------------|------------------|--------------------|-------------------|
| Balance at June 30, 2016 | \$ 134,378 | \$ 39,406 | \$ 170,243 | \$ 344,027 |
| Goodwill adjustment for the Carve-Out Business acquisition | — | — | (1,487) | (1,487) |
| Goodwill arising from the CES acquisition | 20,346 | — | — | 20,346 |
| Goodwill arising from the Delta acquisition | 17,960 | — | — | 17,960 |
| Balance at May 31, 2017 | <u>\$ 172,684</u> | <u>\$ 39,406</u> | <u>\$ 168,756</u> | <u>\$ 380,846</u> |

In accordance with FASB ASC 350, *Intangibles-Goodwill and Other* ("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.

The Company reviewed its analysis of its internally reorganized business in order to determine its reporting units in accordance with ASC 350. Component level financial information is now reviewed by management at SMP, AMS and MDS. Accordingly, these were determined to be the Company's new reporting units.

In fiscal 2017, after its reorganization, the Company reassigned goodwill to the businesses in the affected reporting units based on their relative fair values in accordance with ASC 350. There were no changes in the total carrying amount of goodwill for the one month ended June 30, 2017 after reallocation. The carrying amounts of goodwill by reporting unit at June 30, 2017 are \$116,003, \$217,956, and \$46,887 for SMP, AMS and MDS, respectively.

The change in reporting units qualified as a triggering event and required goodwill to be tested for impairment. As required by ASC 350, the Company analyzed goodwill for impairment immediately prior to and immediately subsequent to the reorganization. As a result of these analyses, it was determined that goodwill was not impaired either prior to or subsequent to the reorganization.

H. Intangible Assets

Intangible assets consisted of the following:

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|----------------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------------------|
| June 30, 2017 | | | | |
| Customer relationships | \$ 117,630 | \$ (31,533) | \$ 86,097 | 10.0 years |
| Licensing agreements and patents | 1,131 | (277) | 854 | 3.7 years |
| Completed technologies | 44,503 | (6,079) | 38,424 | 7.9 years |
| Backlog | 5,430 | (1,768) | 3,662 | 2.0 years |
| | <u>\$ 168,694</u> | <u>\$ (39,657)</u> | <u>\$ 129,037</u> | |
| June 30, 2016 | | | | |
| 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> | |

Estimated future amortization expense for intangible assets remaining at June 30, 2017 is as follows:

| | Year Ending June 30, |
|-----------------------------------|-------------------------|
| 2018 | \$ 21,722 |
| 2019 | 17,542 |
| 2020 | 14,767 |
| 2021 | 14,165 |
| 2022 | 14,165 |
| Thereafter | 46,676 |
| Total future amortization expense | <u>\$ 129,037</u> |

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the Delta acquisition. These assets are included in the Company's gross and net carrying amounts as of June 30, 2017.

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------------------|
| Customer relationships | \$ 8,000 | \$ (225) | \$ 7,775 | 9.1 years |
| Completed technologies | 5,900 | (148) | 5,752 | 10.0 years |
| Backlog | 3,100 | (388) | 2,712 | 2.0 years |
| | <u>\$ 17,000</u> | <u>\$ (761)</u> | <u>\$ 16,239</u> | |

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the CES acquisition. These assets are included in the Company's gross and net carrying amounts as of June 30, 2017.

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------------------|
| Customer relationships | \$ 9,060 | \$ (681) | \$ 8,379 | 9.0 years |
| Completed technologies | 5,662 | (547) | 5,115 | 7.0 years |
| | <u>\$ 14,722</u> | <u>\$ (1,228)</u> | <u>\$ 13,494</u> | |

The following table summarizes the 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, 2017.

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------------------|
| Customer relationships | \$ 70,900 | \$ (7,856) | \$ 63,044 | 11.5 years |
| Completed technologies | 29,700 | (4,690) | 25,010 | 7.8 years |
| Backlog | 2,200 | (1,283) | 917 | 2.0 years |
| | <u>\$ 102,800</u> | <u>\$ (13,829)</u> | <u>\$ 88,971</u> | |

I. Restructuring

During the fourth quarter of fiscal 2017, the Company initiated a plan to close its Manteca, California facility as a result of the acquisition of Delta. The Company incurred \$910 of severance and related expenses in conjunction with the elimination of 33 positions primarily in operations related to the planned closure of the facility. Additionally, the Company incurred \$1,042 in restructuring expenses related to other various restructuring events during fiscal 2017.

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 primarily associated with the Micronetics, Inc. acquisition. Additionally, during the fourth quarter of fiscal 2015, the Company eliminated 16 positions, primarily in operations.

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, 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 | 190 | 736 | 926 |
| Restructuring charges | 1,706 | 253 | 1,959 |
| Cash paid | (524) | (989) | (1,513) |
| Reversals (*) | (7) | — | (7) |
| Restructuring liability at June 30, 2017 | <u>\$ 1,365</u> | <u>\$ —</u> | <u>\$ 1,365</u> |

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

J. Income Taxes

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

| | Year Ended June 30, | | |
|--|---------------------|------------------|------------------|
| | 2017 | 2016 | 2015 |
| Income from continuing operations before income taxes: | | | |
| United States | \$ 30,499 | \$ 25,194 | \$ 18,443 |
| Foreign | 569 | 92 | 352 |
| | <u>\$ 31,068</u> | <u>\$ 25,286</u> | <u>\$ 18,795</u> |
| Tax provision (benefit): | | | |
| Federal: | | | |
| Current | \$ 11,476 | \$ 6,707 | \$ 4,267 |
| Deferred | (7,645) | (2,627) | (458) |
| | <u>\$ 3,831</u> | <u>\$ 4,080</u> | <u>\$ 3,809</u> |
| State: | | | |
| Current | \$ 3,650 | \$ 1,839 | \$ 1,372 |
| Deferred | (1,684) | (424) | (921) |
| | <u>\$ 1,966</u> | <u>\$ 1,415</u> | <u>\$ 451</u> |
| Foreign: | | | |
| Current | \$ 240 | \$ 59 | \$ 58 |
| Deferred | 156 | (10) | 48 |
| | <u>396</u> | <u>49</u> | <u>106</u> |
| | <u>\$ 6,193</u> | <u>\$ 5,544</u> | <u>\$ 4,366</u> |

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

| | Year Ended June 30, | | |
|---|---------------------|---------------|---------------|
| | 2017 | 2016 | 2015 |
| Tax provision at federal statutory rates | 35.0 % | 35.0 % | 35.0 % |
| State income tax, net of federal tax benefit | 4.9 | 5.0 | 4.9 |
| Research and development credits | (6.1) | (8.4) | (4.8) |
| Excess tax benefits on stock compensation | (13.1) | (4.4) | — |
| Domestic manufacturing deduction | (3.9) | (3.5) | (3.2) |
| Income from legal settlement excluded from taxable income | — | (2.8) | — |
| Deemed repatriation of foreign earnings | (0.1) | (0.2) | (0.4) |
| Foreign income tax rate differential | 0.2 | — | — |
| Equity compensation | 0.6 | 0.3 | (0.1) |
| Officers' compensation | 1.2 | 2.3 | 2.8 |
| Deferred tax asset and liability adjustments | — | — | (4.2) |
| Change in state tax rates | — | — | (3.1) |
| Acquisition costs | 0.9 | — | — |
| Reserves for tax contingencies | (0.6) | (3.2) | (5.0) |
| Other | 0.9 | 1.8 | 1.3 |
| | <u>19.9 %</u> | <u>21.9 %</u> | <u>23.2 %</u> |

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

| | June 30, | |
|---|-------------------|--------------------|
| | 2017 | 2016 |
| Deferred tax assets: | | |
| Inventory valuation and receivable allowances | \$ 13,845 | \$ 12,768 |
| Accrued compensation | 4,555 | 3,267 |
| Equity compensation | 4,858 | 3,201 |
| Federal and state research and development tax credit carryforwards | 13,415 | 15,870 |
| Gain on sale-leaseback | — | 371 |
| Other accruals | 2,125 | 1,570 |
| Deferred compensation | 1,606 | — |
| Capital loss carryforwards | 3,562 | 3,562 |
| Other temporary differences | 1,500 | 4,011 |
| | <u>45,466</u> | <u>44,620</u> |
| Valuation allowance | (16,570) | (18,472) |
| Total deferred tax assets | <u>28,896</u> | <u>26,148</u> |
| Deferred tax liabilities: | | |
| Prepaid expenses | (481) | (773) |
| Property and equipment | (3,749) | (2,451) |
| Intangible assets | (28,163) | (33,826) |
| Tax method of accounting change | (285) | (570) |
| Other temporary differences | (441) | (370) |
| Total deferred tax liabilities | <u>(33,119)</u> | <u>(37,990)</u> |
| Net deferred tax (liabilities) assets | <u>\$ (4,223)</u> | <u>\$ (11,842)</u> |
| As reported: | | |
| Deferred tax assets | \$ 633 | \$ — |
| Deferred tax liabilities | (4,856) | (11,842) |
| | <u>\$ (4,223)</u> | <u>\$ (11,842)</u> |

At June 30, 2017, 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 capital loss carryforwards and certain state research and development credits as of June 30, 2017 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 \$406, which will expire in 2033. The Company had state research and development credit carryforwards of \$13,008, which will expire from 2017 through 2032.

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 \$794 in undistributed foreign 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, | |
|--|---------------------|-----------------|
| | 2017 | 2016 |
| Unrecognized tax benefits, beginning of period | \$ 1,566 | \$ 2,190 |
| Increases for previously recognized positions | 46 | 79 |
| Settlements of previously recognized positions | (793) | — |
| Reductions as a result of a lapse of the applicable statute of limitations | (273) | — |
| Increases for currently recognized positions | 384 | 302 |
| Reductions for previously recognized positions deemed effectively settled | — | (681) |
| Reductions for previously recognized positions | (126) | (324) |
| Unrecognized tax benefits, end of period | <u>\$ 804</u> | <u>\$ 1,566</u> |

The \$804 of unrecognized tax benefits as of June 30, 2017, if released, would reduce income tax expense.

The Company's major tax jurisdiction is the U.S. and the open tax years are fiscal 2014 through 2017.

The Internal Revenue Service (the "IRS") accepted the final examination report during the fourth quarter of fiscal year 2017 in connection with the IRS's examination of the Company's consolidated federal income tax returns for the fiscal year 2013, which resolved various tax matters for the Company. As a result of the acceptance, the Company recorded a \$273 income tax benefit attributable to the reversal of tax reserves and \$793 for amounts previously reserved that were settled through the examination process. The Company received a refund of \$1,598 during July 2017 in connection with the conclusion of the IRS examination.

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of June 30, 2017 and 2016, the total amount of gross interest and penalties accrued was \$54 and \$258, respectively. In connection with tax matters, the Company recognized interest and penalty expense in fiscal 2017, 2016 and 2015 of \$30, \$204 and \$26, respectively.

K. Commitments and Contingencies

L EGAL C LAIMS

The Company is subject to litigation, claims, investigations and audits arising from time to time in the ordinary course of 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.

I NDEMNIFICATION O BLIGATIONS

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.

P URCHASE C OMMITMENTS

As of June 30, 2017, 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 \$59,173.

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, 2017, 2016, and 2015 was \$7,774, \$4,015 and \$3,777, respectively. Minimum lease payments under the Company's non-cancelable operating leases are as follows:

| | Year Ending June 30, |
|-------------------------------------|---------------------------------|
| 2018 | \$ 6,139 |
| 2019 | 5,595 |
| 2020 | 5,208 |
| 2021 | 4,291 |
| 2022 | 3,387 |
| Thereafter | 18,897 |
| Total minimum lease payments | \$ 43,517 |

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 employee's 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**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 provided for a \$200,000 term loan facility ("the 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 were recorded as a direct reduction to long-term debt on the face of the consolidated balance sheets. The debt issuance costs were amortized to non-cash interest expense using the effective interest method over the term of the Term Loan.

On June 27, 2017, the Company amended the Credit Agreement to increase and extend the borrowing capacity of the Revolver to \$400,000 expiring in June 2022 ("the Amended Credit Agreement"). In connection with the amendment, the Company also repaid the remaining principal and accrued and unpaid interest outstanding on the Term Loan using cash on hand. The Company evaluated the amended Credit Agreement under FASB ASC 470, *Debt*, and determined that the amendment represented a modification of the Credit Agreement. Accordingly, the remaining \$6,522 in unamortized debt issuance costs at June 27, 2017, in addition to \$591 in new fees paid to the syndicate of lenders in connection with the amendment, will be amortized to non-cash interest expense on a straight line basis over the new term of the Revolver. The Revolver remained undrawn at June 30, 2017, other than \$5,897 of outstanding letters of credit.

Maturity

The Revolver has a five year maturity.

Interest Rates and Fees

Borrowings under the Revolver 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 LIBOR plus 1.375% 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 0.25% 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.

Covenants and Events of Default

The Amended Credit Agreement provides for customary negative covenants. The Amended 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 Amended Credit Agreement also provides for customary representations and warranties, affirmative covenants and events of default. If an event of default occurs, the lenders under the Amended Credit Agreement will be entitled to take various actions, including the termination of unutilized commitments, the acceleration of amounts outstanding under the Amended Credit Agreement and all actions permitted to be taken by a secured creditor. As of June 30, 2017, the Company was in compliance with all covenants and conditions under the Amended Credit Agreement.

Guarantees and Security

The Company's obligations under the Amended Credit Agreement are guaranteed by certain of its 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 its 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.

M. Employee Benefit Plans

Pension Plan

With the acquisition of CES on November 4, 2016, the Company assumed a pension plan (the "Plan") for its Swiss employees, which is administered by an independent pension fund. The Plan is mandated by Swiss law and meets the criteria for a defined benefit plan under ASC 715, *Compensation—Retirement Benefits* ("ASC 715"), since participants of the Plan are entitled to a defined rate of return on contributions made. The independent pension fund is a multi-employer plan with unrestricted joint liability for all participating companies for which the Plan's overfunding or underfunding is allocated to each participating company based on an allocation key determined by the Plan.

The Company recognizes a net asset or liability for the Plan equal to the difference between the projected benefit obligation of the Plan and the fair value of the Plan's assets as required by ASC 715. The funded status may vary from year to year due to changes in the fair value of the Plan's assets and variations on the underlying assumptions of the projected benefit obligation of the Plan.

On January 1, 2017, the Company changed pension providers. The Company's results contain the effects of the change in pension provider as prior service costs. These prior service costs will be amortized from other comprehensive income to net periodic benefit costs over approximately 10 years. At June 30, 2017, the accumulated benefit obligation of the Plan equals the fair value of the Plan's assets. The Plan's funded status at June 30, 2017 was a net liability of \$6,601, which is recorded in other non-current liabilities on the consolidated balance sheets. The Company recorded a net gain of \$220 in accumulated other comprehensive income during the year ended June 30, 2017. The Company's total expected employer contributions to the Plan during fiscal 2018 are \$539.

The following table reflects the total pension benefits expected to be paid from the Plan, which is funded from contributions by participants and the Company.

| | Year Ended June 30, |
|---------------------------|--------------------------------|
| 2018 | \$ 526 |
| 2019 | 678 |
| 2020 | 800 |
| 2021 | 497 |
| 2022 | 622 |
| Thereafter (next 5 years) | 3,928 |
| Total | \$ 7,051 |

The following table outlines the components of net periodic benefit cost of the Plan for the year ended June 30, 2017 :

| | Year Ended June 30, 2017 |
|------------------------------------|-------------------------------------|
| Service cost | \$ 557 |
| Interest cost | 73 |
| Expected return on assets | (105) |
| Amortization of prior service cost | 20 |
| Net periodic benefit cost | \$ 545 |

The following table reflects the related actuarial assumptions used to determine net periodic benefit cost of the Plan for the year ended June 30, 2017:

| | Year Ended June 30, 2017 |
|--|-------------------------------------|
| Discount rate | 0.70% |
| Expected rate of return on Plan assets | 1.50% |
| Expected inflation | 1.00% |
| Rate of compensation increases | 1.00% |

The calculation of the projected benefit obligation ("PBO") utilized BVG 2015 Generational data for assumptions related to the mortality rates, disability rates, turnover rates, and early retirement ages. Assumptions used to determine the year-end pension benefit obligation is the discount rate of 0.70% and rate of compensation increases of 1.00% .

The PBO represents the present value of Plan benefits earned through the end of the year, with an allowance for future salary and pension increases as well as turnover rates. The following table presents the change in projected benefit obligation for the period presented:

| | Year Ending June 30, 2017 |
|--|--------------------------------------|
| Projected benefit obligation at November 4, 2016 | \$ 17,086 |
| Service cost | 557 |
| Interest cost | 73 |
| Employee contributions | 581 |
| Actuarial gain | (598) |
| Benefits paid | (563) |
| Plan amendment | 390 |
| Projected benefit obligation at end of year | \$ 17,526 |

The following table presents the change in Plan assets for the period presented:

| | Year Ending June 30, 2017 |
|---|--------------------------------------|
| Fair value of plan assets at November 4, 2016 | \$ 10,459 |
| Actual return on Plan assets | 100 |
| Company contributions | 348 |
| Employee contributions | 581 |
| Benefits paid | (563) |
| Fair value of plan assets at end of year | \$ 10,925 |

The following table presents the Company's reconciliation of funded status for the period presented:

| | Year Ended June 30, 2017 | |
|---|-------------------------------------|----------------|
| Projected benefit obligation at end of year | \$ | 17,526 |
| Fair value of plan assets at end of year | | 10,925 |
| Funded status | \$ | <u>(6,601)</u> |

The Company did not recognize any (gain) loss from other comprehensive income ("OCI") in its consolidated results of operations during the year ended June 30, 2017. The Company does not expect to recognize any (gain) loss from OCI for the year ended June 30, 2018.

The fair value of Plan assets were \$10,925 at June 30, 2017. The Plan is denominated in a foreign currency, the Swiss Franc, which can have an impact on the fair value of Plan assets. The Plan was not subject to material fluctuations during year ended June 30, 2017. The Plan's assets are administered by an independent pension fund foundation (the "foundation"). As of June 30, 2017, the foundation has invested the assets of the Plan in various investments vehicles, including cash, real estate, equity securities, and bonds. The investments are measured at fair value using a mix of Level 1, Level 2 and Level 3 inputs.

401(k) Plan

The Company maintains a qualified 401(k) plan (the "401(k) Plan") for its U.S. employees. During fiscal 2017, 2016 and 2015, 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 \$3,206, \$1,874 and \$1,934 during the fiscal years ended June 30, 2017, 2016, and 2015, respectively.

N. 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.

FOLLOW-ON EQUITY OFFERINGS

On January 26, 2017, the Company announced the commencement of an underwritten public offering of its common stock, par value \$0.01 per share. On February 1, 2017, the Company closed the offering, including the full over-allotment allocation, selling an aggregate of 6,900 shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215,725.

On April 4, 2016, the Company announced the commencement of an underwritten public offering of its common stock, par value \$0.01 per share. 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 at a price to the public of \$19.25 for total net proceeds of \$92,788.

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, 2017. 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 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 2,559 shares available for future grant under the 2005 Plan at June 30, 2017.

As part of the Company's ongoing annual equity grant program for employees, the Company grants performance-based restricted stock awards to certain executives pursuant to the 2005 Plan. Performance awards vest based on the requisite service period subject to the achievement of specific financial performance targets. Based on the performance targets, some of these awards require graded vesting which 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 stock compensation expense accordingly. The performance targets include: (i) the achievement of internal performance targets only, and (ii) the achievement of internal performance targets in relation to a peer group of companies.

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 2017, 2016, and 2015 was 96, 88 and 79, respectively. Shares available for future purchase under the ESPP totaled 302 at June 30, 2017.

STOCK OPTION AND AWARD ACTIVITY

The following table summarizes activity of the Company’s stock option plans since June 30, 2015:

| | Options Outstanding | | | |
|---|---------------------|---------------------------------|---|---|
| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value as of 6/30/2017 |
| Outstanding at June 30, 2015 | 830 | \$ 13.43 | 1.66 | |
| Granted | — | — | | |
| Exercised | (524) | 13.12 | | |
| Cancelled | (48) | 17.25 | | |
| Outstanding at June 30, 2016 | 258 | \$ 13.34 | 1.06 | |
| Granted | — | — | | |
| Exercised | (207) | 13.29 | | |
| Cancelled | — | — | | |
| Outstanding at June 30, 2017 | 51 | \$ 13.53 | 0.60 | \$ 1,442 |
| Vested and expected to vest at June 30, 2017 | 51 | \$ 13.53 | 0.60 | \$ 1,442 |
| Exercisable at June 30, 2017 | 51 | \$ 13.53 | 0.60 | \$ 1,442 |

The intrinsic value of the options exercised during fiscal years 2017, 2016, and 2015 was \$3,762, \$1,976 and \$3,373, respectively. Non-vested stock options are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2017 and 2016, there was \$0 of total unrecognized compensation cost related to non-vested options granted under the Company’s stock plans. There were no stock options granted during fiscal years 2017, 2016 or 2015.

The following table summarizes the status of the Company’s non-vested restricted stock awards since June 30, 2015:

| | Non-Vested Restricted Stock Awards | |
|-------------------------------------|------------------------------------|--|
| | Number of Shares | Weighted Average Grant Date Fair Value |
| Outstanding at June 30, 2015 | 1,866 | \$ 10.72 |
| Granted | 667 | 16.26 |
| Vested | (743) | 10.93 |
| Forfeited | (124) | 11.70 |
| Outstanding at June 30, 2016 | 1,666 | \$ 13.09 |
| Granted | 718 | 24.72 |
| Vested | (769) | 11.94 |
| Forfeited | (51) | 15.02 |
| Outstanding at June 30, 2017 | 1,564 | \$ 18.93 |

The total fair value of restricted stock awards vested during fiscal year 2017, 2016, and 2015 was \$19,402, \$12,185 and \$9,078, respectively.

Non-vested restricted stock awards are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2017, there was \$12,160 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 1.5 years from June 30, 2017. 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.

STOCK - BASED COMPENSATION EXPENSE

The Company recognizes expense for its share-based payment plans in the consolidated statements of operations for the fiscal years 2017, 2016, and 2015 in accordance with FASB ASC 718. The Company had \$194 and \$93 of capitalized stock-based compensation expense on the Consolidated Balance Sheet as of June 30, 2017 and 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, | | |
|---|---------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Cost of revenues | \$ 531 | \$ 441 | \$ 493 |
| Selling, general and administrative | 13,212 | 7,864 | 6,751 |
| Research and development | 1,598 | 1,269 | 1,396 |
| Share-based compensation expense before tax | 15,341 | 9,574 | 8,640 |
| Income taxes | (5,874) | (3,727) | (3,332) |
| Share-based compensation expense, net of income taxes | <u>\$ 9,467</u> | <u>\$ 5,847</u> | <u>\$ 5,308</u> |

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. The Company is comprised of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with FASB ASC 280, *Segment Reporting*.

The geographic distribution of the Company's revenues as determined by order origination based on the country in which the Company's legal subsidiary is domiciled is summarized as follows:

| | US | Europe | Asia Pacific | Eliminations | Total |
|--|-------------------|------------------|-----------------|-------------------|-------------------|
| YEAR ENDED JUNE 30, 2017 | | | | | |
| Net revenues to unaffiliated customers | \$ 380,538 | \$ 22,242 | \$ 5,808 | \$ — | \$ 408,588 |
| Inter-geographic revenues | 7,637 | 44 | — | (7,681) | — |
| Net revenues | <u>\$ 388,175</u> | <u>\$ 22,286</u> | <u>\$ 5,808</u> | <u>\$ (7,681)</u> | <u>\$ 408,588</u> |
| Identifiable long-lived assets (1) | \$ 50,340 | \$ 1,288 | \$ 15 | \$ — | \$ 51,643 |
| YEAR ENDED JUNE 30, 2016 | | | | | |
| 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 (1) | \$ 28,187 | \$ 127 | \$ 23 | \$ — | \$ 28,337 |
| YEAR ENDED JUNE 30, 2015 | | | | | |
| 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 (1) | \$ 13,127 | \$ 68 | \$ 31 | \$ — | \$ 13,226 |

(1) Identifiable long-lived assets exclude goodwill and intangible assets.

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In recent years, the Company completed a series of acquisitions that changed its technological capabilities, applications and end markets. As these acquisitions and changes occurred, the Company increased the proportion of its revenue derived from the sale of components in different technological areas, and also increased the amount of revenue associated with combining technologies into more complex and diverse products including modules, sub-assemblies and integrated subsystems. The following tables present revenue consistent with the Company's strategy of expanding its technological capabilities and program content.

The following table presents the Company's net revenue by end market for the periods presented:

| | Year Ended June 30, | | |
|--|---------------------|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Domestic (1) | \$ 341,699 | \$ 220,253 | \$ 189,596 |
| International/Foreign Military Sales (2) | 66,889 | 49,901 | 45,251 |
| Total Net Revenue | \$ 408,588 | \$ 270,154 | \$ 234,847 |

- (1) Domestic revenues consist of sales where the end user is within the U.S., as well as sales to prime defense contractor customers where the ultimate end user location is not defined.
(2) International/Foreign Military Sales consist of sales to U.S. prime defense contractor customers where the end user is outside the U.S., foreign military sales through the U.S. government, and direct sales to non-U.S. based customers intended for end use outside of the U.S.

The following table presents the Company's net revenue by end application for the periods presented:

| | Year Ended June 30, | | |
|--------------------------|---------------------|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Radar (1) | \$ 150,441 | \$ 140,289 | \$ 143,475 |
| Electronic Warfare (2) | 106,446 | 72,118 | 51,419 |
| Other (3) | 151,701 | 57,747 | 39,953 |
| Total Net Revenue | \$ 408,588 | \$ 270,154 | \$ 234,847 |

- (1) Radar includes end-use applications where radio frequency signals are utilized to detect, track, and identify objects.
(2) Electronic Warfare includes end-use applications comprising the offensive and defensive use of the electromagnetic spectrum.
(3) Other products include all end markets other than Radar and Electronic Warfare. Examples include but are not limited to various commercial and other end-use applications and technologies, as well as various component and other sales where the end use is not specified.

The following table below the Company's net revenue by product grouping for the periods presented:

| | Year Ended June 30, | | |
|--------------------------------|---------------------|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Components (1) | \$ 105,669 | \$ 31,252 | \$ 15,543 |
| Modules and Sub-assemblies (2) | 161,973 | 126,777 | 107,922 |
| Integrated Subsystems (3) | 140,946 | 112,125 | 111,382 |
| Total Net Revenue | \$ 408,588 | \$ 270,154 | \$ 234,847 |

- (1) Components include technology elements typically performing a single, discrete technological function, which when physically combined with other components may be used to create a module or sub-assembly. Examples include but are not limited to power amplifiers and limiters, switches, oscillators, filters, equalizers, digital and analog converters, chips, MMICs (monolithic microwave integrated circuits), and memory and storage devices.
(2) Modules and Sub-assemblies include combinations of multiple functional technology elements and/or components that work together to perform multiple functions but are typically resident on or within a single board or housing. Modules and sub-assemblies may in turn be combined to form an integrated subsystem. Examples of modules and sub-assemblies include but are not limited to embedded processing modules, embedded processing boards, switch fabric boards, high speed input/output boards, digital receiver boards, graphics and video processing and Ethernet and IO boards, multi-chip modules, integrated radio frequency and microwave multi-function assemblies, tuners, and transceivers.
(3) Integrated Subsystems include multiple modules and/or sub-assemblies combined with a backplane or similar functional element and software to enable a solution. These are typically but not always integrated within a chassis and with cooling, power and other elements to address various requirements and are also often combined with additional technologies for interaction with other parts of a complete system or platform. Integrated subsystems also include spare and replacement modules and sub-assemblies sold as part of the same program for use in or with integrated subsystems sold by the Company.

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

| | Year Ended June 30, | | |
|-----------------------------|---------------------|------------|------------|
| | 2017 | 2016 | 2015 |
| Lockheed Martin Corporation | 20% | 23% | 20% |
| Raytheon Company | 16 | 20 | 37 |
| | <u>36%</u> | <u>43%</u> | <u>57%</u> |

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 shown below are as follows:

| | Year Ended June 30, | | |
|---------|---------------------|------------|------------|
| | 2017 | 2016 | 2015 |
| SEWIP | * | 12% | * |
| Aegis | * | 10% | 12% |
| Patriot | * | * | 18% |
| F-35 | * | * | 16% |
| | <u>—%</u> | <u>22%</u> | <u>46%</u> |

* Indicates that the amount is less than 10% of the Company's revenues for the respective period. No programs were in excess of 10% of the Company's revenues for fiscal 2017.

Q. Discontinued Operations

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. 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:

| | For the Year Ended June 30, 2015 |
|---|--|
| Net revenues of discontinued operations | \$ 3,493 |
| Costs of discontinued operations: | |
| Cost of revenues | 2,385 |
| Selling, general and administrative | 1,958 |
| Research and development | 305 |
| Amortization of intangible assets | 279 |
| Restructuring and other charges | — |
| Impairment of goodwill | 2,283 |
| Loss from discontinued operations before income taxes | (3,717) |
| Loss on disposal of discontinued operations before income taxes | (892) |
| Tax benefit | (549) |
| Loss from discontinued operations, net of income taxes | <u>\$ (4,060)</u> |

There were no balances for the assets and liabilities of the discontinued operations at June 30, 2017 and 2016.

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

| | For the Year Ended June 30, 2015 |
|-----------------------------------|---|
| Depreciation | \$ 100 |
| Amortization of intangible assets | \$ 279 |
| Capital expenditures | \$ — |
| Impairment of goodwill | \$ 2,283 |
| Stock-based compensation expense | \$ 88 |

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.

| 2017 (In thousands, except per share data) | 1ST QUARTER | 2ND QUARTER | 3RD QUARTER | 4TH QUARTER |
|---|--------------------|--------------------|--------------------|--------------------|
| Net revenues | \$ 87,649 | \$ 98,014 | \$ 107,317 | \$ 115,608 |
| Gross margin | \$ 39,444 | \$ 47,389 | \$ 50,783 | \$ 53,927 |
| Income from operations | \$ 3,742 | \$ 8,958 | \$ 11,695 | \$ 13,008 |
| Income from continuing operations before income taxes | \$ 2,560 | \$ 6,983 | \$ 10,218 | \$ 11,307 |
| Income tax (benefit) provision | \$ (1,259) | \$ 1,779 | \$ 3,170 | \$ 2,503 |
| Income from continuing operations | \$ 3,819 | \$ 5,204 | \$ 7,048 | \$ 8,804 |
| Net income | \$ 3,819 | \$ 5,204 | \$ 7,048 | \$ 8,804 |
| Net income per share: | | | | |
| Basic net income per share: | \$ 0.10 | \$ 0.13 | \$ 0.16 | \$ 0.19 |
| Diluted net income per share: | \$ 0.10 | \$ 0.13 | \$ 0.16 | \$ 0.19 |
| 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 (1) | \$ 28,302 | \$ 29,739 | \$ 31,402 | \$ 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 (2) | \$ 368 | \$ 1,433 | \$ 2,642 | \$ 1,101 |
| Income from continuing operations | \$ 2,856 | \$ 5,040 | \$ 4,357 | \$ 7,489 |
| Net income | \$ 2,856 | \$ 5,040 | \$ 4,357 | \$ 7,489 |
| Net income per share: | | | | |
| Basic net income per share | \$ 0.09 | \$ 0.15 | \$ 0.13 | \$ 0.20 |
| Diluted net income per share | \$ 0.08 | \$ 0.15 | \$ 0.13 | \$ 0.19 |

(1) During 2017, the Company included costs related to the sustainment of its product portfolio as research and development expense, which was previously included as costs of revenues on the Consolidated Statements of Operations and Comprehensive Income. For comparative purposes, for the fiscal year ended June 30, 2016, the Company has reclassified \$2,845, from costs of revenues to research and development expense. The quarterly amounts reclassified were \$773, \$1,161 and \$911 for the 1st quarter, 2nd quarter and 3rd quarter, respectively.

(2) 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 1st quarter, 2nd quarter, 3rd quarter and 4th 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, 2017 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, 2017 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) **I NHERENT L IMITATIONS ON E FFECTIVENESS OF C ONTROLS**

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) **M ANAGEMENT ' S A NNUAL R EPORT ON I NTERNAL C ONTROL O VER F INANCIAL R EPORTING**

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, 2017 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, 2017. The effectiveness of our internal control over financial reporting as of June 30, 2017 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 CES and Delta businesses on and after November 3, 2016 and April 3, 2017, respectively, as described in Note C to the Consolidated Financial Statements. Upon consideration of the date of the fiscal 2017 acquisitions 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 CES and Delta 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 2017. However, management is in the process of integrating CES and Delta into the overall internal control over financial reporting environment for fiscal year 2018. The Company's consolidated financial statements reflect revenues and total assets from the acquired CES and Delta businesses of approximately 5 percent and 12 percent (of which 8 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, 2017.

(d) **C HANGES IN I NTERNAL C ONTROL O VER F INANCIAL R EPORTING**

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 2017 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. Although management has completed the integration of the Carve-Out Business, it is in the process of integrating the CES and Delta into our overall internal control over financial reporting environment.

ITEM 9B. OTHER INFORMATION

On August 14, 2017, the Compensation Committee approved (and with respect to matters for the Company's Chief Executive Officer, the independent directors on the Company's Board of Directors approved) the following executive compensation matters:

- an increase for the annual perquisite for the Company's executive officers from up to \$2,000 annually for personal tax and financial planning to a \$4,000 annual allowance for personal tax and financial planning;
- an amendment to Mr. Aslett's employment agreement to provide that he is entitled to continue to participate in the Company's group health, dental, and vision programs for 24 months following a termination of his employment by the Company without "cause" or by him for "good reason" (as defined in his employment agreement); and
- an agreement for each of the Company's non-CEO named executive officers that provides for termination and severance benefits in the case of a termination of the executive's employment by the Company without "cause" or by the executive for "good reason."

For the agreements for the Company's non-CEO named executive officers, the following terms and conditions apply.

"Cause" is defined in the agreement to include: (1) the willful and continued failure by the executive to perform substantially the duties and responsibilities of his position with the Company after written demand; (2) the conviction of the executive by a court of competent jurisdiction for felony criminal conduct or a plea of nolo contendere to a felony; or (3) the willful engaging by the executive in fraud, dishonesty, or other misconduct which is demonstrably and materially injurious to the Company or its reputation, monetarily, or otherwise. No act, or failure to act, on the executive's part will be deemed

“willful” unless committed or omitted by the executive in bad faith and without reasonable belief that his act or failure to act was in, or not opposed to, the best interest of the Company.

“Good Reason” is defined in the agreement to include: (1) a material diminution in the executive's responsibilities, authority, or duties as in effect on the date of the agreement; (2) a material diminution in the executive's annual base salary, except for across-the-board salary reductions based on the Company's financial performance similarly affecting all or substantially all senior management employees of the Company; or (3) a material change in the geographic location at which the executive provides services to the Company.

Under the agreement, if the Company terminates the executive's employment without “cause” or the executive his employment for “good reason,” then the Company will pay the executive a severance amount equal to one times his annual base salary. In such event, the Company also will pay for certain insurance benefits and outplacement services.

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 2017 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, 2017 and 2016
Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended June 30, 2017 , 2016 , and 2015
Consolidated Statements of Shareholders' Equity for the fiscal years ended June 30, 2017 , 2016 , and 2015
Consolidated Statements of Cash Flows for the years ended June 30, 2017 , 2016 , and 2015
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, 2017 , 2016 AND 2015
(In thousands)****Allowance for Doubtful Accounts**

| | BALANCE AT BEGINNING OF PERIOD | | ADDITIONS | | REVERSALS | | WRITE- OFFS | | BALANCE AT END OF PERIOD |
|------|---|----|------------------|----|------------------|----|------------------------|----|---|
| 2017 | \$ 92 | \$ | 22 | \$ | — | \$ | 31 | \$ | 83 |
| 2016 | \$ 56 | \$ | 425 | \$ | — | \$ | 389 | \$ | 92 |
| 2015 | \$ 34 | \$ | 44 | \$ | 1 | \$ | 21 | \$ | 56 |

Deferred Tax Asset Valuation Allowance

| | BALANCE AT BEGINNING OF PERIOD | | CHARGED TO COSTS & EXPENSES | | CHARGED TO OTHER ACCOUNTS | | DEDUCTIONS | | BALANCE AT END OF PERIOD |
|------|---|----|--|----|--|----|-------------------|----|---|
| 2017 | \$ 18,472 | \$ | (1,902) | \$ | — | \$ | — | \$ | 16,570 |
| 2016 | \$ 18,864 | \$ | (392) | \$ | — | \$ | — | \$ | 18,472 |
| 2015 | \$ 10,844 | \$ | 8,020 | \$ | — | \$ | — | \$ | 18,864 |

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) |
| 1.2 | Underwriting Agreement, dated January 26, 2017, among the Company as issuer and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC 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 January 27, 2017) |
| 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 January 17, 2017 (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on January 20, 2017) |
| 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* | 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) |
| 10.2* | 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) |
| 10.3* | 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) |
| 10.4* | 2005 Stock Incentive Plan, as amended and restated (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on September 20, 2016) |
| 10.5.1* | 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) |
| 10.5.2* | 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) |
| 10.5.3* | 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) |
| 10.5.4* | 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) |
| 10.5.5* | 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) |
| 10.6.1* | 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) |
| 10.6.2* | 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) |
| 10.7† | Compensation Policy for Non-Employee Directors |

| ITEM NO. | DESCRIPTION OF EXHIBIT |
|-----------------|---|
| 10.8.1* | 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) |
| 10.8.2* | 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) |
| 10.8.3* | 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) |
| 10.9* | 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) |
| 10.10 | 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) |
| 10.11 | 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) |
| 10.12.1 | 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) |
| 10.12.2 | Amendment No. 1 to Credit Agreement, dated June 27, 2017, 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 June 27, 2017) |
| 12.1† | Computation of Ratio of Earnings to Fixed Charges |
| 21.1† | Subsidiaries of the Company |
| 23.1† | Consent of KPMG LLP |
| 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 |
| 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.
Compensation Policy for Non-Employee Directors

Objective

It is the objective of Mercury to compensate non-employee directors in a manner which will enable recruitment and retention of highly qualified directors and fairly compensate them for their services as a director.

Philosophy

Board of Director compensation includes cash and equity. It is annually reviewed by the Compensation Committee with recommendations to the Board. This review includes:

- a market survey of Board compensation to peer companies at the 50th and 75th percentiles;
- a review of Board and Committee meeting frequency;
- Board member personal preparation time for Board and Committee meetings; and
- Board member responsibilities.

The Board targets its annual cash and equity compensation to the 75th percentile of the market.

Cash Compensation

Annual retainer for non-employee directors: \$55,000 per annum, paid quarterly

Additional annual retainers:

Independent Chairman: \$45,000 per annum, paid quarterly

Chairman of the Audit Committee: \$25,000 per annum, paid quarterly

Chairman of the Compensation Committee: \$20,000 per annum, paid quarterly

Chairman of the N&G Committee: \$12,000 per annum, paid quarterly

Directors are entitled to be reimbursed for their reasonable expenses incurred in connection with attendance at Board and committee meetings.

Quarterly retainer payments shall be paid in arrears within 30 days following the end of each quarter. The full quarterly retainer shall be paid to each director who served on the Board during all or a portion of a quarter.

Equity Compensation

New non-employee directors will be granted equity awards in connection with their first election to the Board. These awards will be granted by the Board of Directors and will consist of shares of restricted stock for the number of shares of common stock equal to \$225,000 divided by the average closing price of the Company's common stock during the 30 calendar days prior to the date of grant. These awards will vest as to 50% of the covered shares on each of the first two anniversaries of the date of grant.

Non-employee directors may also receive annual restricted stock awards for the number of shares of common stock equal to \$150,000 divided by the average closing price of the Company's common stock during the 30 calendar days prior to the date of grant. These awards will vest as to 50% of the covered shares on the date of grant and as to the remaining covered shares on the first anniversary of the date of grant.

Non-employee directors will not be eligible to receive an annual restricted stock award for the fiscal year in which they are first elected. Non-employee directors who are first elected to the Board during the first half of Company's fiscal year will be eligible to receive an annual restricted stock award for the next fiscal year; otherwise, non-employee directors will not be eligible to receive their first annual restricted stock award until the second fiscal year following the fiscal year in which they are first elected to the Board.

Approved by the Board of Directors, as amended, on April 19, 2017 (effective as of July 1, 2017).

SUBSIDIARIES OF THE REGISTRANT

| NAME | JURISDICTION OF ORGANIZATION |
|---|------------------------------|
| Mercury Defense Systems, Inc. | California |
| Mercury Mission Systems, LLC | Delaware |
| Delta Microwave, LLC | California |
| Mercury Corp. - Security Solutions | Delaware |
| Arxan Research, Inc. | Delaware |
| Nihon Mercury Computer Systems K.K. | Japan |
| Mercury Computer Systems Limited. | United Kingdom |
| Mercury Mission Systems Canada, Inc. | Canada |
| Mercury Mission Systems Holding SA | Switzerland |
| Mercury Mission Systems SA | Switzerland |
| Creative Electronic Systems SL | Spain |
| CES do Brasil Creative Electronic Systems Participacoes Ltda. | Brazil |

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Mercury Systems, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-53291, 333-129929, 333-139019, 333-139020, 333-149046, 333-156364, 333-163705, 333-163707, 333-172775, 333-177770, 333-177771, 333-183240, 333-184756, 333-192161, 333-199917, 333-209383, 333-209384, 333-212672 and 333-217735) on Form S-8 and the registration statement (No. 333-198180) on Form S-3 of Mercury Systems, Inc. of our report dated August 18, 2017, with respect to the consolidated balance sheets of Mercury Systems, Inc. and subsidiaries as of June 30, 2017 and 2016, and the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows, for each of the years in the three-year period ended June 30, 2017, and the related financial statement schedule, and the effectiveness of internal control over financial reporting as of June 30, 2017, which report appears in the June 30, 2017 annual report on Form 10-K of Mercury Systems, Inc.

Our report dated August 18, 2017 on the effectiveness of internal control over financial reporting as of June 30, 2017, contains an explanatory paragraph that states that management excluded from its assessment of the effectiveness of Mercury Systems, Inc. and subsidiaries' internal control over financial reporting as of June 30, 2017, CES' and Delta's internal control over financial reporting associated with 12 percent of total consolidated assets (of which 8 percent represented goodwill and intangible assets included within the scope of the assessment) and 5 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, 2017. 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 CES and Delta.

/s/ KPMG LLP

Boston, Massachusetts
August 18, 2017

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 18, 2017

/s/ M ARK A SLETT

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 18, 2017

/s/ G ERALD M. H AINES II

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, 2017 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 18, 2017

/s/ MARK A SLETT

Mark Aslett
PRESIDENT AND CHIEF EXECUTIVE OFFICER

/s/ GERALD M. HAINES II

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