

MERCURY SYSTEMS INC
Form 10-Q
May 05, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____
COMMISSION FILE NUMBER: 0-23599

MERCURY SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

| | |
|--|---|
| MASSACHUSETTS (State or other jurisdiction of incorporation or organization) | 04-2741391 (I.R.S. Employer Identification No.) |
|--|---|

| | |
|--|---------------------|
| 201 RIVERNECK ROAD CHELMSFORD, MA (Address of principal executive offices) | 01824 (Zip Code) |
|--|---------------------|

978-256-1300
(Registrant's telephone number, including area code)

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

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

Shares of Common Stock outstanding as of April 30, 2016: 40,028,735 shares

MERCURY SYSTEMS, INC.
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCURY SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

| | March 31, 2016 | June 30, 2015 |
|---|-------------------|------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 84,245 | \$ 77,586 |
| Accounts receivable, net of allowance for doubtful accounts of \$102 and \$56 at March 31, 2016 and June 30, 2015, respectively | 39,314 | 31,765 |
| Unbilled receivables and costs in excess of billings | 29,376 | 22,021 |
| Inventory | 34,348 | 31,960 |
| Deferred income taxes | 12,788 | 12,407 |
| Prepaid income taxes | 1,912 | 3,747 |
| Prepaid expenses and other current assets | 4,652 | 8,678 |
| Total current assets | 206,635 | 188,164 |
| Restricted cash | 264 | 264 |
| Property and equipment, net | 13,512 | 13,226 |
| Goodwill | 173,741 | 168,146 |
| Intangible assets, net | 17,235 | 17,998 |
| Other non-current assets | 3,369 | 2,190 |
| Total assets | \$ 414,756 | \$ 389,988 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 12,412 | \$ 6,928 |
| Accrued expenses | 12,534 | 9,005 |
| Accrued compensation | 11,880 | 9,875 |
| Deferred revenues and customer advances | 5,166 | 7,477 |
| Total current liabilities | 41,992 | 33,285 |
| Deferred gain on sale-leaseback | 61 | 929 |
| Deferred income taxes | 2,391 | 3,108 |
| Income taxes payable | 1,513 | 1,459 |
| Other non-current liabilities | 1,056 | 1,069 |
| Total liabilities | 47,013 | 39,850 |
| Commitments and contingencies (Note I) | | |
| 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; 33,281,436 and 32,570,959 shares issued and outstanding at March 31, 2016 and June 30, 2015, respectively | 333 | 326 |
| Additional paid-in capital | 260,805 | 254,568 |
| Retained earnings | 105,747 | 94,468 |
| Accumulated other comprehensive income | 858 | 776 |
| Total shareholders' equity | 367,743 | 350,138 |
| Total liabilities and shareholders' equity | \$ 414,756 | \$ 389,988 |

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

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MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In thousands, except per share data)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | March 31, | | March 31, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net revenues | \$65,898 | \$59,578 | \$184,724 | \$170,728 |
| Cost of revenues | 35,407 | 31,660 | 98,126 | 91,776 |
| Gross margin | 30,491 | 27,918 | 86,598 | 78,952 |
| Operating expenses: | | | | |
| Selling, general and administrative | 12,687 | 11,842 | 37,396 | 36,809 |
| Research and development | 7,269 | 8,115 | 23,046 | 23,961 |
| Amortization of intangible assets | 1,754 | 1,744 | 5,105 | 5,268 |
| Restructuring and other charges | 409 | 27 | 968 | 2,457 |
| Impairment of long-lived assets | — | — | 231 | — |
| Acquisition costs and other related expenses | 1,553 | 33 | 3,533 | 33 |
| Total operating expenses | 23,672 | 21,761 | 70,279 | 68,528 |
| Income from operations | 6,819 | 6,157 | 16,319 | 10,424 |
| Interest income | 39 | 6 | 89 | 13 |
| Interest expense | (3 |) (7 |) (10 |) (23 |
| Other income, net | 144 | 7 | 298 | 399 |
| Income from continuing operations before income taxes | 6,999 | 6,163 | 16,696 | 10,813 |
| Tax provision | 2,473 | 1,469 | 5,417 | 2,516 |
| Income from continuing operations | 4,526 | 4,694 | 11,279 | 8,297 |
| Loss from discontinued operations, net of income taxes | — | (1,019 |) — | (3,858 |
| Net income | \$4,526 | \$3,675 | \$11,279 | \$4,439 |
| Basic net earnings (loss) per share: | | | | |
| Income from continuing operations | \$0.14 | \$0.14 | \$0.34 | \$0.26 |
| Loss from discontinued operations, net of income taxes | — | (0.03 |) — | (0.12 |
| Net income | \$0.14 | \$0.11 | \$0.34 | \$0.14 |
| Diluted net earnings (loss) per share: | | | | |
| Income from continuing operations | \$0.13 | \$0.14 | \$0.33 | \$0.25 |
| Loss from discontinued operations, net of income taxes | — | (0.03 |) — | (0.12 |
| Net income | \$0.13 | \$0.11 | \$0.33 | \$0.13 |
| Weighted-average shares outstanding: | | | | |
| Basic | 33,251 | 32,298 | 33,052 | 32,001 |
| Diluted | 33,991 | 33,233 | 33,830 | 32,953 |
| Comprehensive income: | | | | |
| Net income | \$4,526 | \$3,675 | \$11,279 | \$4,439 |
| Foreign currency translation adjustments | 93 | — | 82 | (208 |
| Total comprehensive income | \$4,619 | \$3,675 | \$11,361 | \$4,231 |

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

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

| | Nine Months Ended March 31, | |
|---|-----------------------------------|----------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net income | \$11,279 | \$4,439 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 9,878 | 10,446 |
| Stock-based compensation expense | 7,244 | 6,765 |
| Benefit for deferred income taxes | (1,257) | (817) |
| Impairment of goodwill and long-lived assets | 231 | 2,283 |
| Excess tax benefit from stock-based compensation | (1,384) | (834) |
| Loss on sale of discontinued operations | — | 892 |
| Other non-cash items | (614) | (234) |
| Changes in operating assets and liabilities, net of effects of businesses acquired: | | |
| Accounts receivable, unbilled receivables, and costs in excess of billings | (14,850) | (8,373) |
| Inventory | (2,351) | (969) |
| Prepaid income taxes | 1,836 | (2,499) |
| Prepaid expenses and other current assets | 4,024 | 49 |
| Other non-current assets | (1,008) | 428 |
| Accounts payable and accrued expenses | 8,965 | 7,019 |
| Deferred revenues and customer advances | (2,230) | 1,853 |
| Income taxes payable | 2,107 | (898) |
| Other non-current liabilities | (62) | (30) |
| Net cash provided by operating activities | 21,808 | 19,520 |
| Cash flows from investing activities: | | |
| Acquisition of business, net of cash acquired | (9,756) | — |
| Purchases of property and equipment | (4,908) | (3,467) |
| Proceeds from sale of discontinued operations | — | 885 |
| (Increase) decrease in other investing activities | (567) | 1 |
| Net cash used in investing activities | (15,231) | (2,581) |
| Cash flows from financing activities: | | |
| Proceeds from employee stock plans | 2,804 | 2,048 |
| Payments for retirement of common stock | (4,211) | — |
| Excess tax benefit from stock-based compensation | 1,384 | 834 |
| Payments of capital lease obligations | — | (481) |
| Net cash (used in) provided by financing activities | (23) | 2,401 |
| Effect of exchange rate changes on cash and cash equivalents | 105 | (107) |
| Net increase in cash and cash equivalents | 6,659 | 19,233 |
| Cash and cash equivalents at beginning of period | 77,586 | 47,287 |
| Cash and cash equivalents at end of period | \$84,245 | \$66,520 |
| Cash paid during the period for: | | |
| Interest | \$10 | \$23 |
| Income taxes | \$1,717 | \$5,749 |
| Supplemental disclosures—non-cash activities: | | |

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| | | |
|--|---------|---------|
| Issuance of restricted stock awards to employees | \$8,241 | \$9,514 |
|--|---------|---------|

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

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MERCURY SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share data)

(Unaudited)

A. Description of Business

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

The Company's goal is to grow and build on its position as a critical component of the defense industrial base and become the leading provider of affordable secure processing subsystems. The Mercury Commercial Electronics ("MCE") operating segment designs, develops and builds open sensor processing products and subsystems that include embedded processing modules and subsystems, radio frequency ("RF") and microwave multi-function assemblies as well as subsystems, and RF and microwave components. The Mercury Defense Systems ("MDS") operating segment provides significant capabilities relating to pre-integrated, open, affordable electronic warfare ("EW"), electronic attack ("EA") and electronic counter measure ("ECM") subsystems, significant capabilities in signals intelligence ("SIGINT"), electro-optical/infrared ("EO/IR") and secure processing technologies, and radar environment test and simulation systems.

In June 2014, the Company initiated a plan to divest the Mercury Intelligence Systems ("MIS") operating segment, based on the Company's strategic direction and investment priorities focusing on its core business. On January 23, 2015, the Company completed the sale of the MIS operating segment. See Note M to the consolidated financial statements.

B. Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to the Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures, normally included in annual consolidated financial statements have been condensed or omitted pursuant to those rules and regulations; however, in the opinion of management the financial information reflects all adjustments, consisting of adjustments of a normal recurring nature, necessary for fair presentation. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended June 30, 2015 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on August 13, 2015. The results for the three and nine months ended March 31, 2016 are not necessarily indicative of the results to be expected for the full fiscal year. The Company is comprised of the following operating segments: MCE and MDS. See Note L to consolidated financial statements for further discussion.

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

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 the 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.

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USE OF ESTIMATES

The preparation of financial statements in conformity with 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.

REVENUE RECOGNITION

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

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

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

The Company enters into multiple-deliverable arrangements that may include a combination of hardware components, related integration or other services. These arrangements generally do not include any performance-, cancellation-, termination- or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements was 39% and 41% of total revenues in the three and nine months ended March 31, 2016, respectively. Total revenue recognized under multiple-deliverable revenue arrangements was 26% and 27% of total revenues in the three and nine months ended March 31, 2015, respectively.

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 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. 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.

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).

WEIGHTED-AVERAGE SHARES

Weighted-average shares were calculated as follows:

| | Three Months | | Nine Months | |
|---|--------------|--------|-------------|--------|
| | Ended March | | Ended March | |
| | 31, | 31, | 31, | 31, |
| | 2016 | 2015 | 2016 | 2015 |
| Basic weighted-average shares outstanding | 33,251 | 32,298 | 33,052 | 32,001 |
| Effect of dilutive equity instruments | 740 | 935 | 778 | 952 |
| Diluted weighted-average shares outstanding | 33,991 | 33,233 | 33,830 | 32,953 |

Equity instruments to purchase 26 and 4 shares of common stock were not included in the calculation of diluted net earnings per share for the three and nine months ended March 31, 2016 because the equity instruments were anti-dilutive. Equity instruments to purchase 147 and 428 shares of common stock were not included in the calculation of diluted net earnings per share for the three and nine months ended March 31, 2015 because the equity instruments were anti-dilutive.

C.Acquisitions

LEWIS INNOVATIVE TECHNOLOGIES ACQUISITION

On December 16, 2015, the Company entered into a share purchase agreement (the “Share Purchase Agreement”) with Lewis Innovative Technologies, Inc. (“LIT”) and the holders of the equity interests of LIT. Pursuant to the Share Purchase Agreement, the Company completed its purchase of all of the equity interests in LIT, and LIT became a wholly-owned subsidiary of the Company. Based in Decatur, Alabama, LIT provides advanced security technology and development services necessary for protecting systems critical to national security while meeting strict Department of Defense (“DoD”) program protection requirements. LIT is included in the MDS operating segment. The Company acquired LIT for a cash purchase price of \$9,756. The Company funded the purchase with cash on hand. The purchase price was subject to a post-closing adjustment based on a determination of LIT's closing net working capital. In accordance with the Share Purchase Agreement, \$1,000 of the purchase price was placed into escrow to support the post-closing working capital adjustment and the sellers' indemnification obligations. The escrow is available for indemnification claims through June 16, 2017. The Company acquired LIT free of bank debt.

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

| | Amounts |
|--|-----------|
| Consideration transferred | |
| Cash paid at closing | \$ 10,290 |
| Working capital adjustment | (244) |
| Less cash and cash equivalents acquired | (290) |
| Net purchase price | \$9,756 |
| Estimated fair value of tangible assets acquired and liabilities assumed | |
| Cash and cash equivalents | \$ 290 |
| Accounts receivable and cost in excess of billings | 290 |
| Other current and non-current assets | 175 |
| Current liabilities | (264) |
| Estimated fair value of net tangible assets acquired | 491 |
| Estimated fair value of identifiable intangible assets | 3,960 |
| Estimated fair value of goodwill | 5,595 |
| Estimated fair value of assets acquired | 10,046 |
| Less cash and cash equivalents acquired | (290) |
| Net purchase price | \$9,756 |

The amounts above represent the preliminary fair value estimates as of March 31, 2016 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimates include completed technology of \$3,240, customer relationships of \$590 and backlog of \$130. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill or income, as applicable.

The goodwill of \$5,595 arising from the LIT acquisition largely reflects the potential synergies and expansion of the Company's service offerings across product segments and markets complementary to the Company's existing products and markets. The LIT acquisition provides the Company with additional capabilities and expertise related to secure embedded processing applications. The acquisition is directly aligned with the Company's strategy of assembling critical and differentiated capabilities across the entire sensor processing chain. The goodwill from the LIT acquisition is included in the Company's MDS reporting unit.

The Company and the shareholders of LIT have agreed to treat the acquisition of LIT as an asset purchase for tax purposes by filing the required election forms under IRC Section 338(h)(10). The Company has estimated the tax value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. As of March 31, 2016, the Company had \$5,595 of goodwill deductible for tax purposes.

The Company's consolidated results for the three months ended March 31, 2016 include \$759 and \$(286) of LIT's revenue and net loss, respectively. The Company's consolidated results for the nine months ended March 31, 2016

include \$789 and \$(326)

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of revenue and net loss, respectively, for LIT's operating results between the acquisition date and March 31, 2016. Pursuant to the completion of the LIT acquisition, the Company incurred \$231 of impairment expense related to a pre-existing relationship. LIT acquisition costs and other related expenses were immaterial during the three and nine months ended March 31, 2016. Additionally, the Company has not furnished pro forma financial information relating to LIT because such information is not material to the Company's financial results.

CARVE-OUT BUSINESS ACQUISITION

On March 23, 2016, the Company and Microsemi Corporation ("Microsemi") entered into a Stock Purchase Agreement, pursuant to which, Microsemi agreed to sell all the membership interests in its custom microelectronics, RF and microwave solutions and embedded security operations of the Power and Microelectronics Group within Microsemi ("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. The Company has not completed its preliminary purchase price allocation for the Carve-Out Business as not all information required for the analysis was available. See Note N "Subsequent Events" to the consolidated financial statements for further discussion.

D. Fair Value of Financial Instruments

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at March 31, 2016:

| | Fair Value Measurements | | | |
|---------------------------|-------------------------|----------|----------|---------|
| | March | | | |
| | 31, | Level 1 | Level 2 | Level 3 |
| | 2016 | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$54,196 | \$54,196 | \$— | \$— |
| Certificates of deposit | 30,049 | — | 30,049 | — |
| Restricted cash | 264 | 264 | — | — |
| Cost-method investment | 500 | — | — | 500 |
| Total | \$85,009 | \$54,460 | \$30,049 | \$ 500 |

The carrying values of cash and cash equivalents, including all U.S. Treasury bills and money market funds, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The value of the certificates of deposit is based on the quoted price for identical or similar instruments in markets that are not active or are directly or indirectly observable. The cost-method investment does not have a readily determinable fair value, as such the Company recorded the investment as a long term asset at cost and will continue to evaluate the asset for impairment.

The change of the fair value of the Company's cost-method investment is as follows:

| | Fair Value |
|---------------------------|------------|
| Balance at June 30, 2015 | \$ 500 |
| Changes in fair value | — |
| Balance at March 31, 2016 | \$ 500 |

E. Inventory

Inventory is stated at the lower of cost (first-in, first-out) or market value, and consists of materials, labor and overhead. On a quarterly basis, the Company uses consistent methodologies to evaluate 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 inventory in excess of estimated usage. The excess and obsolete inventory evaluation is based upon assumptions about future demand, history, product mix and possible alternative uses. Inventory was comprised of the following:

| | March 31, 2016 | June 30, 2015 |
|-----------------|----------------------|------------------|
| Raw materials | \$14,827 | \$15,864 |
| Work in process | 14,817 | 11,190 |
| Finished goods | 4,704 | 4,906 |
| Total | \$34,348 | \$31,960 |

There are no amounts in inventory relating to contracts having production cycles longer than one year.

F. Goodwill

The following table sets forth the changes in the carrying amount of goodwill by reporting unit for the nine months ended March 31, 2016:

| | MCE | MDS | Total |
|---|-----------|----------|-----------|
| Balance at June 30, 2015 | \$134,378 | \$33,768 | \$168,146 |
| Goodwill arising from the LIT acquisition | — | 5,595 | 5,595 |
| Balance at March 31, 2016 | \$134,378 | \$39,363 | \$173,741 |

In the nine months ended March 31, 2016, there were no triggering events, as defined by FASB ASC 350, which required an interim goodwill impairment test. The Company performs its annual goodwill impairment test in the fourth quarter of each fiscal year.

The Company determines its reporting units in accordance with FASB ASC 350 by assessing whether discrete financial information is available and if management regularly reviews the operating results of that component. Following this assessment, the Company determined that its reporting units are the same as its operating segments, MCE and MDS.

G. Restructuring

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

| | Severance & Facilities Related | & Other | Total |
|---|-----------------------------------|----------|----------|
| Restructuring liability at June 30, 2015 | \$ 657 | \$ 1,335 | \$ 1,992 |
| MCE restructuring and other charges | 699 | 287 | 986 |
| MDS restructuring and other charges | 54 | — | 54 |
| Cash paid | (867) | (798) | (1,665) |
| Reversals(*) | (72) | — | (72) |
| Restructuring liability at March 31, 2016 | \$ 471 | \$ 824 | \$ 1,295 |

(*) Reversals result from unused outplacement services.

During the three and nine months ended March 31, 2016, the Company incurred net restructuring and other charges of \$409 and \$968, respectively. In the event that the Company is unable to sublease the unoccupied portion of its headquarters complex in Chelmsford, Massachusetts, it will incur nominal, periodic restructuring charges through fiscal 2017 in its MCE reportable segment.

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

H. Income Taxes

The Company recorded an income tax provision of \$2,473 and \$1,469 on income from continuing operations before income taxes of \$6,999 and \$6,163 for the three months ended March 31, 2016 and 2015, respectively. The Company recorded an income tax provision of \$5,417 and \$2,516 on income from continuing operations before income taxes of \$16,696 and \$10,813 for the nine months ended March 31, 2016 and 2015, respectively. The effective tax rates for the three and nine months ended March 31, 2016 differed from the federal statutory rate primarily due to federal research and development credits, domestic manufacturing deduction, stock compensation, and state taxes. The effective tax rates for the three and nine months ended March 31, 2015 differed from the federal statutory rate primarily due to the impact of federal research and development credits, domestic manufacturing deduction, stock compensation, state taxes, and the realization of previously unrecognized tax benefits.

On December 18, 2015, the Protecting Americans from Tax Hikes Act of 2015 was enacted, which retroactively reinstated and made permanent the federal research and development tax credit effective January 1, 2015. Based on the indefinite extension, the Company estimates that there was an additional \$1,572 credit earned during the period January 1, 2015 through June 30, 2016, of which \$572 relating to fiscal year 2015 was recognized as a discrete benefit in the nine months ended March 31, 2016.

No material changes in the Company's unrecognized tax positions occurred during the nine months ended March 31, 2016. The Company is currently under audit by the Internal Revenue Service for fiscal year 2013. There have been no significant changes to the status of this examination during the nine months ended March 31, 2016. It is reasonably possible that within the next 12 months the Company's unrecognized tax benefits, exclusive of interest, may decrease by up to \$757 at the conclusion of the audit. The Company expects that the decrease, if recognized, would not affect the effective tax rate.

I. Commitments and Contingencies

LEGAL CLAIMS

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

INDEMNIFICATION OBLIGATIONS

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

On January 26, 2016, the Company received cash of \$175 based on the lapse of the indemnity escrow period associated with the sale of the Company's former MIS operating segment in January of 2015.

PURCHASE COMMITMENTS

As of March 31, 2016, the Company has entered into non-cancelable purchase commitments for certain inventory components and services used in its normal operations. The purchase commitments covered by these agreements are for less than one year and aggregate to \$31,002.

LEASE COMMITMENTS

On September 1, 2015, the Company entered into a lease agreement for a new headquarters location in Andover, Massachusetts. The Company expects to occupy the new office space by May 2017. The Company's total obligation for the base rent is \$21,070 based on utilization of not less than 114 square feet over the twelve year term of the lease. The Company has an option to expand its footprint to 145 square feet, or the entire facility, which would increase its corresponding total base rent obligation. This option must be exercised by the Company on or before December 31, 2018. For accounting purposes the lease commencement date is anticipated to be in August 2016, which will trigger

the recognition of rental expense for the Company, although actual cash rent payments will not commence until May 2017 at the stated commencement date of the lease.

OTHER

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

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

J. Debt

SENIOR UNSECURED CREDIT FACILITY

As of March 31, 2016, there was \$168,445 of borrowing capacity available under the Company's credit agreement with a syndicate of commercial banks, with Key Bank National Association acting as the administrative agent. The Company can borrow up to \$200,000 based on the Company's consolidated EBITDA for the trailing four quarters and subject to compliance with the financial covenants in the credit agreement. There were no borrowings outstanding on the credit agreement; however, there were outstanding letters of credit of \$4,850. The Company was in compliance with all covenants and conditions under the credit agreement. In connection with the closing of the acquisition of the Carve-Out Business and entering into the new term loan A and revolving credit facilities discussed above, the Company terminated its existing revolving credit agreement with KeyBank on May 2, 2016.

TERM LOAN A AND REVOLVING CREDIT FACILITIES

On March 23, 2016, the Company entered into a debt commitment letter in connection with the acquisition of the Carve-Out Business. On May 2, 2016, the Company entered into a \$200,000 senior secured term loan A and \$100,000 revolving credit facility with a syndicate of commercial banks which replaced the debt commitment letter signed on March 23, 2016. See Note N "Subsequent Events" to the consolidated financial statements for further discussion.

K. 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 March 31, 2016. On October 21, 2015, the Company's number of shares authorized for issuance under the 2005 Plan increased 2 shares as a result of cancellations, forfeitures or terminations under the 1997 Plan. The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant and the options generally have a term of seven years. There were 2,888 shares available for future grant under the 2005 Plan at March 31, 2016.

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. These performance awards vest over a three or four year requisite service period subject to the achievement of specific financial performance targets related to adjusted EBITDA as a percentage of revenue. Based on the performance targets, these awards require graded vesting that results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company monitors the probability of achieving the performance targets on a quarterly basis and may adjust periodic stock compensation expense accordingly.

EMPLOYEE STOCK PURCHASE PLAN

The number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,800 shares. On December 8, 2015, the Company's shareholders approved an increase in the number of shares authorized for issuance under the ESPP to 1,800, an increase of 400. 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. There were 46 and 41 shares issued under the ESPP during the nine months ended March 31, 2016 and 2015, respectively. Shares available for future purchase under the ESPP totaled 440 at March 31, 2016.

STOCK OPTION AND AWARD ACTIVITY

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

| | Options Outstanding | | Weighted Average |
|-------------------------------|---------------------|---------------------------------|------------------------------------|
| | Number of Shares | Weighted Average Exercise Price | Remaining Contractual Term (Years) |
| Outstanding at June 30, 2015 | 830 | \$ 13.43 | 1.66 |
| Granted | — | — | |
| Exercised | (212) | 10.96 | |
| Cancelled | (48) | 17.25 | |
| Outstanding at March 31, 2016 | 570 | \$ 14.03 | 1.29 |

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 | 518 | 15.90 |
| Vested | (719) | 10.87 |
| Forfeited | (124) | 11.70 |
| Outstanding at March 31, 2016 | 1,541 | \$ 12.31 |

STOCK-BASED COMPENSATION EXPENSE

The Company recognized the full expense of its share-based payment plans in the consolidated statements of operations for the three and nine months ended March 31, 2016 and 2015 in accordance with FASB ASC 718. The Company had \$114 of capitalized stock-based compensation expense on the consolidated balance sheets as of March 31, 2016. In the prior years, the Company did not capitalize any such costs on the consolidated balance sheets, as such costs 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, net of estimated forfeitures. The following table presents share-based compensation expenses from continuing operations included in the Company's consolidated statements of operations:

| | Three Months Ended March 31, | | Nine Months Ended March 31, | |
|---|------------------------------|---------|-----------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of revenues | \$152 | \$110 | \$307 | \$375 |
| Selling, general and administrative | 1,802 | 1,446 | 5,993 | 5,190 |
| Research and development | 196 | 314 | 944 | 1,111 |
| Share-based compensation expense before tax | 2,150 | 1,870 | 7,244 | 6,676 |
| Income tax benefit | (805) | (682) | (2,838) | (2,442) |
| Share-based compensation expense, net of income taxes | \$1,345 | \$1,188 | \$4,406 | \$4,234 |

L. 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 utilizes the management approach for determining reportable segments in accordance with the authoritative guidance. The following operating segments were determined based upon the nature of the products offered to customers, the market characteristics of each operating segment and the Company's management structure:

Mercury Commercial Electronics ("MCE"): this operating segment provides affordable, innovative, commercially designed and developed, specialized processing subsystems for critical defense and intelligence applications. MCE's technologies and capabilities include secure embedded processing modules and subsystems, RF and microwave multi-function assemblies and subsystems, as well as RF and microwave components. MCE utilizes leading edge, high performance computing technologies and open standards and open architectures to address highly data-intensive applications that include data signal, sensor and image processing, while simultaneously addressing the packaging challenges, often referred to as "SWaP" (size, weight, and power) that are common in military applications. In addition, MCE designs and builds RF and microwave components and subsystems to meet the needs of the EW, SIGINT and other high bandwidth communications requirements and applications.

Mercury Defense Systems ("MDS"): this operating segment provides significant capabilities relating to pre-integrated, open and affordable EW, EA and ECM subsystems, SIGINT, EO/IR and secure processing technologies, and radar environment test and simulation systems. Recently, MDS gained additional advanced security technology and development services capabilities related to secure embedded processing applications. MDS deploys these solutions on behalf of defense prime contractors and the Department of Defense ("DoD"), leveraging commercially available technologies and solutions (or "building blocks") from the MCE business and other commercial suppliers. MDS leverages 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. MDS brings significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

The Company's operating segments were evaluated in accordance with FASB ASC 280 "Segment Reporting" in order to determine which operating segments qualified as reportable segments. The Company determined that both MCE and MDS met the quantitative thresholds for reporting.

The accounting policies of the reportable segments are the same as those described in "Note B: Summary of Significant Accounting Policies." The profitability measure employed by the Company and its CODM as the basis for allocating resources to segments and assessing segment performance is adjusted EBITDA. The Company believes the adjusted EBITDA financial measure assists in providing an enhanced understanding of its underlying operational measures to manage its business, to evaluate its performance compared to prior periods and the marketplace, and to establish operational goals.

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 expenses, and stock-based compensation expense. Additionally, asset information by reportable segment is not reported because the Company and its CODM utilize consolidated asset information when making business decisions. The following is a summary of the performance of the Company's operations by reportable segment:

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| | MCE | MDS | Eliminations | Total |
|--|-----------|----------|--------------|-----------|
| THREE MONTHS ENDED MARCH 31, 2016 | | | | |
| Net revenues to unaffiliated customers | \$57,499 | \$8,608 | \$ (209) | \$65,898 |
| Intersegment revenues | 1,652 | 40 | (1,692) | — |
| Net revenues | \$59,151 | \$8,648 | \$ (1,901) | \$65,898 |
| Adjusted EBITDA | \$13,948 | \$768 | \$ (150) | \$14,566 |
| THREE MONTHS ENDED MARCH 31, 2015 | | | | |
| Net revenues to unaffiliated customers | \$52,748 | \$6,714 | \$ 116 | \$59,578 |
| Intersegment revenues | 2,325 | 32 | (2,357) | — |
| Net revenues | \$55,073 | \$6,746 | \$ (2,241) | \$59,578 |
| Adjusted EBITDA | \$12,073 | \$614 | \$ (1,172) | \$11,515 |
| NINE MONTHS ENDED MARCH 31, 2016 | | | | |
| Net revenues to unaffiliated customers | \$160,520 | \$24,572 | \$ (368) | \$184,724 |
| Intersegment revenues | 6,012 | 145 | (6,157) | — |
| Net revenues | \$166,532 | \$24,717 | \$ (6,525) | \$184,724 |
| Adjusted EBITDA | \$38,278 | \$831 | \$ (123) | \$38,986 |
| NINE MONTHS ENDED MARCH 31, 2015 | | | | |
| Net revenues to unaffiliated customers | \$153,110 | \$16,860 | \$ 758 | \$170,728 |
| Intersegment revenues | 3,750 | 244 | (3,994) | — |
| Net revenues | \$156,860 | \$17,104 | \$ (3,236) | \$170,728 |
| Adjusted EBITDA | \$29,872 | \$1,384 | \$ (1,032) | \$30,224 |

The following table reconciles the Company's income from continuing operations, the most directly comparable GAAP financial measure, to its adjusted EBITDA:

| | Three Months | | Nine Months | |
|---|-----------------|----------|-----------------|----------|
| | Ended March 31, | | Ended March 31, | |
| | 2016 | 2015 | 2016 | 2015 |
| Income from continuing operations | \$4,526 | \$4,694 | \$11,279 | \$8,297 |
| Interest (income) expense, net | (36) | 1 | (79) | 10 |
| Income taxes | 2,473 | 1,469 | 5,417 | 2,516 |
| Depreciation | 1,565 | 1,510 | 4,773 | 4,800 |
| Amortization of intangible assets | 1,754 | 1,744 | 5,105 | 5,268 |
| Restructuring and other charges | 409 | 27 | 968 | 2,457 |
| Impairment of long-lived assets | — | — | 231 | — |
| Acquisition and financing costs | 1,725 | 200 | 4,048 | 200 |
| Fair value adjustments from purchase accounting | — | — | — | — |
| Litigation and settlement expenses | — | — | — | — |
| Stock-based compensation expense | 2,150 | 1,870 | 7,244 | 6,676 |
| Adjusted EBITDA | \$14,566 | \$11,515 | \$38,986 | \$30,224 |

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

| | US | Europe | Asia Pacific | Eliminations | Total |
|--|-----------|---------|--------------|--------------|-------------|
| THREE MONTHS ENDED MARCH 31, 2016 | | | | | |
| Net revenues to unaffiliated customers | \$62,675 | \$1,742 | \$ 1,481 | \$ — | \$65,898 |
| Inter-geographic revenues | 1,598 | 18 | — | (1,616) |) — |
| Net revenues | \$64,273 | \$1,760 | \$ 1,481 | \$ (1,616) |) \$65,898 |
| THREE MONTHS ENDED MARCH 31, 2015 | | | | | |
| Net revenues to unaffiliated customers | \$58,307 | \$439 | \$ 832 | \$ — | \$59,578 |
| Inter-geographic revenues | 1,200 | 54 | — | (1,254) |) — |
| Net revenues | \$59,507 | \$493 | \$ 832 | \$ (1,254) |) \$59,578 |
| NINE MONTHS ENDED MARCH 31, 2016 | | | | | |
| Net revenues to unaffiliated customers | \$178,249 | \$2,852 | \$ 3,623 | \$ — | \$184,724 |
| Inter-geographic revenues | 4,800 | 420 | — | (5,220) |) — |
| Net revenues | \$183,049 | \$3,272 | \$ 3,623 | \$ (5,220) |) \$184,724 |
| NINE MONTHS ENDED MARCH 31, 2015 | | | | | |
| Net revenues to unaffiliated customers | \$167,017 | \$1,140 | \$ 2,571 | \$ — | \$170,728 |
| Inter-geographic revenues | 2,747 | 233 | — | (2,980) |) — |
| Net revenues | \$169,764 | \$1,373 | \$ 2,571 | \$ (2,980) |) \$170,728 |

Foreign revenue is based on the country in which the Company's legal subsidiary is domiciled.

The geographic distribution of the Company's long-lived assets is summarized as follows:

| | US | Europe | Asia Pacific | Eliminations | Total |
|----------------|----------|--------|--------------|--------------|----------|
| March 31, 2016 | \$13,422 | \$ 66 | \$ 24 | \$ — | \$13,512 |
| June 30, 2015 | \$13,127 | \$ 68 | \$ 31 | \$ — | \$13,226 |

Identifiable long-lived assets exclude goodwill and intangible assets.

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

| | Three Months Ended | | Nine Months Ended | |
|------------------------------|--------------------|----------------|-------------------|----------------|
| | March 31, 2016 | March 31, 2015 | March 31, 2016 | March 31, 2015 |
| Raytheon Company | 17% | 37% | 28% | 36% |
| Lockheed Martin Corporation | 26% | 19% | 23% | 22% |
| Northrop Grumman Corporation | 14% | * | * | * |
| | 57% | 56% | 51% | 58% |

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:

| | Three Months Ended | | Nine Months Ended | |
|---------|--------------------|----------------|-------------------|----------------|
| | March 31, 2016 | March 31, 2015 | March 31, 2016 | March 31, 2015 |
| SEWIP | 12 % | * | 12 % | * |
| F-35 | * | 16 % | * | 13 % |
| Patriot | * | 20 % | 11 % | 19 % |
| Aegis | * | 13 % | * | 11 % |
| | 12 % | 49 % | 23 % | 43 % |

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

M.Discontinued Operations

During the third quarter of fiscal 2015, the Company completed the sale of the MIS operating segment. The MIS operating results have been reported as a discontinued operation for all periods presented. 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:

| | Three Months Ended March 31, 2015 | Nine Months Ended March 31, 2015 |
|---|--|---|
| Net revenues of discontinued operations | \$333 | \$3,493 |
| Costs of discontinued operations: | | |
| Cost of revenues | 209 | 2,385 |
| Selling, general and administrative | 715 | 1,961 |
| Research and development | 29 | 305 |
| Amortization of intangible assets | 32 | 279 |
| Acquisition costs and other related expenses | (109) | — |
| Impairment of goodwill | — | 2,283 |
| Loss from discontinued operations before income taxes | (543) | (3,720) |
| Loss on disposal of discontinued operations before income taxes | (892) | (892) |
| Tax benefit | (416) | (754) |
| Loss from discontinued operations, net of income taxes | \$(1,019) | \$(3,858) |

There were no balances for the assets and liabilities of the discontinued operations for the periods ending March 31, 2016 and June 30, 2015.

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

| | Three Months Ended March 31, 2015 | Nine Months Ended March 31, 2015 |
|-----------------------------------|--|---|
| Depreciation | \$ 11 | \$ 100 |
| Amortization of intangible assets | \$ 32 | \$ 279 |
| Impairment of goodwill | \$ — | \$ 2,283 |
| Stock-based compensation expense | \$ (38) | \$ 89 |

N. Subsequent Events

CARVE-OUT BUSINESS ACQUISITION AND RELATED FINANCING ACTIVITIES

CARVE-OUT BUSINESS ACQUISITION

On May 2, 2016, the Company closed its previously announced acquisition of the Carve-Out Business from Microsemi Corporation on a cash-free, debt-free basis for aggregate cash consideration of \$300,000, subject to a working capital adjustment.

The acquisition and associated transaction and bank financing related fees and expenses were funded with a combination of a new \$200,000 bank term loan A facility and cash on hand, which included net proceeds of approximately \$94,392 from the Company's issuance of 5,175 shares of common stock in an underwritten public offering concluded on April 13, 2016 (See Term Loan A and Revolving Credit Facilities and Equity Offering below). The Company anticipates aggregate transaction and bank financing related fees and expenses to be approximately \$9,600.

CARVE-OUT BUSINESS ACQUISITION RELATED FINANCING ACTIVITIES

TERM LOAN A AND REVOLVING CREDIT FACILITIES

On May 2, 2016, the Company entered into a \$200,000 senior secured term loan A and \$100,000 revolving credit facility with a syndicate of commercial banks, with Bank of America, N.A. acting as the administrative agent. The proceeds of the senior secured term loan A facility were used to partially fund the acquisition of the Carve-Out Business, and the revolving credit facility was undrawn at closing. Pursuant to the revolving credit facility the Company can, subject to compliance with the applicable financial covenants, borrow up to \$100,000 for working capital acquisitions, and general corporate purposes of the Company and its subsidiaries. A copy of the Credit Agreement relating to the term loan A and revolving credit facility was filed as exhibit 10.1 to the Company's Current Report on Form 8-K dated May 2, 2016.

EQUITY OFFERING

On April 4, 2016, the Company commenced an offering of 4,500 shares of its common stock pursuant to an underwritten public offering (the "Offering"). In connection with the Offering, the Company granted the underwriters an over-allotment option for 30 days to purchase up to an additional 675 shares of its common stock. The Offering was made pursuant to a shelf registration statement previously filed with the SEC on August 15, 2014. On April 13, 2016, the Company closed the Offering, including the full over-allotment allocation, selling an aggregate of 5,175 shares of common stock for total net proceeds of \$94,392 after underwriting fees of \$5,230. The Company anticipates additional fees and expenses associated with the equity offering of approximately \$1,700.

EXISTING CREDIT FACILITY

In connection with the closing of the acquisition of the Carve-Out Business and entering into the new term loan A and revolving credit facilities discussed above, the Company terminated its existing revolving credit agreement with KeyBank on May 2, 2016.

GENERAL

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

ITEM 2. 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," "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 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, 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 the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2015. 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

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

As of March 31, 2016, we had 678 employees. Our consolidated revenues, income from continuing operations, adjusted earnings per share ("adjusted EPS"), and adjusted EBITDA for the three months ended March 31, 2016 were \$65.9 million, \$4.5 million, \$0.25, and \$14.6 million, respectively. Our revenue, income from continuing operations, adjusted EPS, and adjusted EBITDA for the nine months ended March 31, 2016 were \$184.7 million, \$11.3 million, \$0.67, and \$39.0 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

Our operations are organized in the following two reportable segments: (i) Mercury Commercial Electronics ("MCE") and (ii) Mercury Defense Systems ("MDS").

Mercury Commercial Electronics, or MCE, provides affordable, innovative, commercially designed and developed, specialized processing subsystems for critical defense and intelligence applications. Our technologies and capabilities include secure embedded processing modules and subsystems, RF and microwave multi-function assemblies and subsystems, as well as RF and microwave components. MCE utilizes leading edge, high performance computing technologies and open standards and open architectures to address highly data-intensive applications that include data signal, sensor and image processing, while simultaneously addressing the packaging challenges, often referred to as “SWaP” (size, weight, and power) that are common in military applications. In addition, MCE designs and builds RF and microwave components and subsystems to meet the needs of the electronic warfare (“EW”), signals intelligence (“SIGINT”) and other high bandwidth communications requirements and applications.

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For the nine months ended March 31, 2016, MCE accounted for 87% of our total net revenues.

Mercury Defense Systems, or MDS, provides significant capabilities relating to pre-integrated, open and affordable EW, electronic attack (“EA”) and electronic counter measure (“ECM”) subsystems, SIGINT, electro-optical/infrared (“EO/IR”) and secure processing technologies, and radar environment test and simulation systems. Recently, MDS gained additional advanced security technology and development services capabilities related to secure embedded processing applications. MDS deploys 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 MCE business and other commercial suppliers. MDS leverages 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. MDS brings significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

For the nine months ended March 31, 2016, MDS accounted for 13% of our total net revenues.

Our two operating segments allow us to deliver capabilities that combine our technology building blocks, deep domain expertise in the defense sector and critical solution area, and specialized skills serving the DoD and the intelligence community.

Since 2011 we have acquired and successfully integrated four businesses, most recently in December 2015 with the acquisition of 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 competitors. LIT’s solutions combined with our next generation secure Intel server-class product line, together with increasingly frequent mandates from government to secure electronic systems for domestic and foreign military sales, positions us well to capitalize on DoD program protection security requirements.

RESULTS OF OPERATIONS:

Three months ended March 31, 2016 compared to the three months ended March 31, 2015

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

| (In thousands) | March 31, 2016 | As a % of Total Net Revenue | March 31, 2015 | As a % of Total Net Revenue |
|--|----------------------|-----------------------------------|-------------------|-----------------------------------|
| Net revenues | \$65,898 | 100.0 % | \$59,578 | 100.0 % |
| Cost of revenues | 35,407 | 53.7 | 31,660 | 53.1 |
| Gross margin | 30,491 | 46.3 | 27,918 | 46.9 |
| Operating expenses: | | | | |
| Selling, general and administrative | 12,687 | 19.2 | 11,842 | 19.9 |
| Research and development | 7,269 | 11.0 | 8,115 | 13.6 |
| Amortization of intangible assets | 1,754 | 2.7 | 1,744 | 2.9 |
| Restructuring and other charges | 409 | 0.6 | 27 | — |
| Impairment of long-lived assets | — | — | — | — |
| Acquisition costs and other related expenses | 1,553 | 2.4 | 33 | 0.1 |
| Total operating expenses | 23,672 | 35.9 | 21,761 | 36.5 |
| Income from operations | 6,819 | 10.4 | 6,157 | 10.4 |
| Other income, net | 180 | 0.3 | 6 | — |
| Income from continuing operations before income taxes | 6,999 | 10.7 | 6,163 | 10.4 |
| Tax provision | 2,473 | 3.8 | 1,469 | 2.5 |
| Income from continuing operations | 4,526 | 6.9 | 4,694 | 7.9 |
| Loss from discontinued operations, net of income taxes | — | 0.0 | (1,019) | (1.7) |
| Net income | \$4,526 | 6.9 % | \$3,675 | 6.2 % |

REVENUES

| (In thousands) | March 31, 2016 | March 31, 2015 | \$ Change | % Change |
|----------------|-------------------|----------------------|-----------|----------|
| MCE | \$57,499 | \$52,748 | \$4,751 | 9 % |
| MDS | 8,608 | 6,714 | 1,894 | 28 % |
| Eliminations | (209) | 116 | (325) | (280)% |
| Total revenues | \$65,898 | \$59,578 | \$6,320 | 11 % |

Total revenues increased \$6.3 million, or 11%, to \$65.9 million during the three months ended March 31, 2016 as compared to the same period in fiscal 2015. The increase in total revenues is primarily attributed to higher revenues from the SEWIP, SABR, E2D Hawkeye and DEWS programs, partially offset by lower F-35 and Patriot revenues.

International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, increased \$3.8 million to \$13.8 million during the three months ended March 31, 2016, compared to \$10.0 million in the same period in the prior fiscal year. The increase was primarily driven by higher revenues from the SABR program. International revenues represented 21% and 17% of total revenues during the three months ended March 31, 2016 and 2015, respectively.

Net MCE revenues increased \$4.7 million, or 9%, during the three months ended March 31, 2016 as compared to the same period in the prior fiscal year. This increase was primarily driven by higher SEWIP, SABR, E2D Hawkeye and DEWS program revenues, partially offset by lower F-35 and Patriot revenues.

Net MDS revenues increased \$1.9 million, or 28%, during the three months ended March 31, 2016 as compared to the same period in the prior fiscal year. This increase was primarily driven by growth in the Filthy Buzzard program in the most recent quarter.

Eliminations revenue is attributable to development programs where the revenue is recognized in each segment under contract accounting, and reflects the reconciliation to our consolidated results.

GROSS MARGIN

Gross margin was 46.3% for the three months ended March 31, 2016, a decrease of 60 basis points from the 46.9% gross margin achieved during the same period in fiscal 2015. The lower gross margin between years was driven by changes in product mix, with a slight decline in certain higher-margin programs in the three months ended March 31, 2016 as compared to the same period in the prior fiscal year.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$0.9 million, or 7%, to \$12.7 million during the three months ended March 31, 2016, compared to \$11.8 million in the same period in fiscal 2015. The increase was primarily due to higher compensation expense due to increased headcount. Selling, general and administrative expenses decreased as a percentage of revenues to 19.2% during the three months ended March 31, 2016 from 19.9% during the same period in fiscal 2015. The decrease was due to higher revenues in the third quarter of fiscal 2016, as compared to the same period in fiscal 2015.

RESEARCH AND DEVELOPMENT

Research and development expenses decreased approximately \$0.8 million, or 10%, to \$7.3 million during the three months ended March 31, 2016, compared to \$8.1 million during the same period in fiscal 2015. The decrease was primarily driven by higher customer funded development.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges increased approximately \$0.4 million, to \$0.4 million during the three months ended March 31, 2016, compared to less than \$0.1 million during the same period in fiscal 2015. We will incur nominal, periodic restructuring charges through fiscal 2017 in our MCE reportable segment if we are unable to sublease the unoccupied portion of our Chelmsford, Massachusetts headquarters.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$1.6 million of acquisition costs and other related expenses during the three months ended March 31, 2016, compared to less than \$0.1 million during the same period in fiscal 2015. The acquisition costs and other related expenses we incurred during the three months ended March 31, 2016 related to the acquisition of the custom

microelectronics, RF and microwave solutions and embedded security operations of the Power and Microelectronics Group within Microsemi Corporation ("the Carve-Out Business") which was completed on May 2, 2016. We expect to incur acquisition costs and other related expenses in connection

with completing the acquisition of the Carve-Out Business in the quarter ended June 30, 2016, and periodically in the future as we continue to seek acquisition opportunities to expand our capabilities within the entire sensor processing chain.

OTHER INCOME, NET

Other income, net increased \$0.2 million during the three months ended March 31, 2016, as compared to the same period in fiscal 2015. Both periods include \$0.3 million related to the amortization of the gain on the sale leaseback of our corporate headquarters partially offset by \$0.2 million in bank fees. The increase was driven by a small foreign exchange gain during the three months ended March 31, 2016 as compared to a small foreign exchange loss in the same period of fiscal 2015.

INCOME TAXES

We recorded an income tax provision of \$2.5 million during the three months ended March 31, 2016 as compared to \$1.5 million for the same period in fiscal 2015. Our effective tax rates for the three months ended March 31, 2016 differed from the federal statutory tax rate of 35% primarily due to federal research and development credits, domestic manufacturing deduction, stock compensation, and state taxes. Our effective tax rate for the three months ended March 31, 2015 differed from the federal statutory tax rate of 35% primarily due to federal research and development tax credits, domestic manufacturing deduction, stock compensation, state taxes, and the realization of previously unrecognized tax benefits.

DISCONTINUED OPERATIONS

We completed the sale of our MIS operating segment during the third quarter of fiscal 2015 and have ceased continuing involvement in the operations of MIS after its divestiture. The loss from discontinued operations during the three months ended March 31, 2015 included a \$0.9 million loss on disposal of discontinued operations before income taxes from the sale of MIS operating segment.

SEGMENT OPERATING RESULTS

We use adjusted EBITDA as the profitability measure for our segment reporting. Adjusted EBITDA for MCE increased \$1.8 million during the three months ended March 31, 2016 to \$13.9 million as compared to \$12.1 million for the same period in fiscal 2015. The increase in adjusted EBITDA was driven by higher revenues of \$4.7 million primarily from the SEWIP and SABR programs.

Adjusted EBITDA for MDS increased \$0.2 million to \$0.8 million during the three months ended March 31, 2016 as compared to \$0.6 million for the same period in fiscal 2015. The increase in adjusted EBITDA was driven by a \$1.9 million increase in revenue primarily from the Filthy Buzzard program.

See Note L to our consolidated financial statements included in this report for more information regarding our operating segments.

Nine months ended March 31, 2016 compared to the nine months ended March 31, 2015

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

| (In thousands) | March 31, 2016 | As a % of Total Net Revenue | March 31, 2015 | As a % of Total Net Revenue |
|--|-------------------|-----------------------------------|-------------------|-----------------------------------|
| Net revenues | \$184,724 | 100.0 % | \$170,728 | 100.0 % |
| Cost of revenues | 98,126 | 53.1 | 91,776 | 53.8 |
| Gross margin | 86,598 | 46.9 | 78,952 | 46.2 |
| Operating expenses: | | | | |
| Selling, general and administrative | 37,396 | 20.3 | 36,809 | 21.6 |
| Research and development | 23,046 | 12.5 | 23,961 | 14.0 |
| Amortization of intangible assets | 5,105 | 2.8 | 5,268 | 3.1 |
| Restructuring and other charges | 968 | 0.5 | 2,457 | 1.4 |
| Impairment of long-lived assets | 231 | 0.1 | — | — |
| Acquisition costs and other related expenses | 3,533 | 1.9 | 33 | — |
| Total operating expenses | 70,279 | 38.1 | 68,528 | 40.1 |
| Income from operations | 16,319 | 8.8 | 10,424 | 6.1 |
| Other income, net | 377 | 0.2 | 389 | 0.2 |
| Income from continuing operations before income taxes | 16,696 | 9.0 | 10,813 | 6.3 |
| Tax provision | 5,417 | 2.9 | 2,516 | 1.4 |
| Income from continuing operations | 11,279 | 6.1 | 8,297 | 4.9 |
| Loss from discontinued operations, net of income taxes | — | — | (3,858) | (2.3) |
| Net income | \$11,279 | 6.1 % | \$4,439 | 2.6 % |

REVENUES

| (In thousands) | March 31, 2016 | March 31, 2015 | \$ Change | % Change |
|----------------|-------------------|-------------------|-----------|----------|
| MCE | \$160,520 | \$153,110 | \$7,410 | 5 % |
| MDS | 24,572 | 16,860 | 7,712 | 46 % |
| Eliminations | (368) | 758 | (1,126) | (149)% |
| Total revenues | \$184,724 | \$170,728 | \$13,996 | 8 % |

Total revenues increased \$14.0 million, or 8%, to \$184.7 million during the nine months ended March 31, 2016 as compared to the same period in fiscal 2015. The increase in total revenues is primarily attributed to increases in the P8, DEWS, E2D Hawkeye, SEWIP and Reaper programs, partially offset by lower revenues from the Patriot and F-35 programs. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, were \$34.9 million during the nine months ended March 31, 2016 and 2015. International revenues represented 19% and 21% of total revenues during the nine months ended March 31, 2016 and 2015, respectively.

Net MCE revenues increased \$7.4 million, or 5%, during the nine months ended March 31, 2016 as compared to the same period in fiscal 2015. This increase was primarily driven by higher sales in the P8, DEWS, E2D Hawkeye, SEWIP and Reaper programs, partially offset by lower sales in Patriot and F-35 programs.

Net MDS revenues increased \$7.7 million, or 46%, during the nine months ended March 31, 2016 as compared to the same period in fiscal 2015. This increase was primarily driven by higher revenues related to Filthy Buzzard, PAC3 and an airborne surveillance program.

Eliminations revenue is attributable to development programs where the revenue is recognized in each segment under contract accounting, and reflects the reconciliation to our consolidated results.

GROSS MARGIN

Gross margin was 46.9% for the nine months ended March 31, 2016, an increase of 70 basis points from the 46.2% gross margin during the same period in fiscal 2015. The higher gross margin year over year was due to a favorable product mix, primarily driven by stronger revenues in our higher margin digital processing programs and products within MCE.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$0.6 million, or 2%, to \$37.4 million during the nine months ended March 31, 2016, compared to \$36.8 million in the same period in fiscal 2015. The increase was primarily due to higher compensation expense due to increased headcount. Selling, general and administrative expenses decreased as a percentage of revenues to 20.3% during the nine months ended March 31, 2016 from 21.6% during the same period in fiscal 2015. The decrease was due to higher revenues in the first nine months of fiscal 2016, as compared to the same period in fiscal 2015.

RESEARCH AND DEVELOPMENT

Research and development expenses decreased \$1.0 million, to \$23.0 million during the nine months ended March 31, 2016, compared to \$24.0 million during the same period in fiscal 2015. The decrease was primarily due to higher customer funded development partially offset by increased compensation expenses during fiscal 2016.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges were \$1.0 million for the nine months ended March 31, 2016, as compared to \$2.5 million during the same period in fiscal 2015. The decrease was driven by lower facility costs in the nine months ended March 31, 2016 as our acquisition integration activities were completed during fiscal 2015. Fiscal 2015 restructuring and other charges included the second and final phases of the Chelmsford, Massachusetts headquarters consolidation and related severance activities. We will incur nominal, periodic restructuring charges through fiscal 2017 in our MCE reportable segment if we are unable to sublease the unoccupied portion of our Chelmsford, Massachusetts headquarters.

IMPAIRMENT OF LONG-LIVED ASSETS

We recorded an impairment charge of \$0.2 million during the nine months ended March 31, 2016, compared to \$0.0 million during the same period in fiscal 2015. Pursuant to the completion of the LIT acquisition, we incurred \$0.2 million of impairment expense related to a pre-existing relationship.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$3.5 million of acquisition costs and other related expenses during the nine months ended March 31, 2016, compared to less than \$0.1 million during the same period in fiscal 2015. We incurred \$1.6 million of acquisition costs and other related expenses related to the acquisition of the Carve-Out Business in fiscal 2016. We expect to incur acquisition costs and other related expenses in connection with completing the acquisition of the Carve-Out Business in the quarter ended June 30, 2016, and periodically in the future as we continue to seek acquisition opportunities to expand our capabilities within the entire sensor processing chain.

OTHER INCOME, NET

Other income, net were \$0.4 million during the nine months ended March 31, 2016 and 2015, respectively. Both periods include \$0.9 million related to the amortization of the gain on the sale leaseback of our corporate headquarters. These gains were partially offset by \$0.5 million in bank fees during the nine months ended March 31, 2016 and by \$0.2 million in bank fees and a \$0.3 million write off of an escrow receivable during the same period in fiscal 2015.

INCOME TAXES

We recorded an income tax provision of \$5.4 million during the nine months ended March 31, 2016 as compared to \$2.5 million for the same period in fiscal 2015. Our effective tax rates for the nine months ended March 31, 2016 differed from the federal statutory tax rate of 35% primarily due to federal research and development tax credits, domestic manufacturing deduction, stock compensation, and state taxes. Our effective tax rate during the nine months ended March 31, 2015 differed from the federal statutory tax rate of 35% primarily due to federal research and development tax credits, domestic manufacturing deduction, stock compensation, state taxes and the realization of previously unrecognized tax benefits.

DISCONTINUED OPERATIONS

We completed the sale of our MIS operating segment during the third quarter of fiscal 2015 and have ceased continuing involvement in the operations of MIS after its divestiture. The loss from discontinued operation during the nine months ended

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March 31, 2015 included a \$2.3 million goodwill impairment of our MIS operating segment and a \$0.9 million loss on disposal of discontinued operations before income taxes from the sale of MIS operating segment.

SEGMENT OPERATING RESULTS

We use adjusted EBITDA as the profitability measure for our segment reporting. Adjusted EBITDA for MCE increased \$8.4 million during the nine months ended March 31, 2016 to \$38.3 million as compared to \$29.9 million for the same period in fiscal 2015. The increase in adjusted EBITDA is primarily driven by higher revenues of \$7.4 million primarily from the P8, DEWS, E2D Hawkeye, SEWIP and Reaper programs, coupled with higher gross margins from a change in product mix.

Adjusted EBITDA for MDS decreased \$0.6 million during the nine months ended March 31, 2016 to \$0.8 million as compared to \$1.4 million for the same period in fiscal 2015. The decrease in adjusted EBITDA was primarily due to a \$1.5 million increase in inventory reserves, partially offset by higher revenues related to Filthy Buzzard, PAC3 and an airborne surveillance program.

See Note L to our consolidated financial statements included in this report for more information regarding our operating segments.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity comes from existing cash and cash generated from operations. Our near-term fixed operating commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments with our contract manufacturers. We currently do not have any material commitments for capital expenditures.

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.

CARVE-OUT BUSINESS ACQUISITION AND RELATED FINANCING ACTIVITIES

CARVE-OUT BUSINESS ACQUISITION

On May 2, 2016, we closed our previously announced acquisition of the Carve-Out Business from Microsemi Corporation on a cash-free, debt-free basis for aggregate cash consideration of \$300.0 million, subject to a working capital adjustment.

The acquisition and associated transaction and bank financing related fees and expenses were funded with a combination of a new \$200.0 million bank term loan A facility and cash on hand, which included net proceeds of approximately \$94.4 million from our issuance of 5.2 million shares of common stock in an underwritten public offering concluded on April 13, 2016 (See Term Loan A and Revolving Credit Facilities and Equity Offering below). We anticipate aggregate transaction and bank financing related fees and expenses to be approximately \$9.6 million.

CARVE-OUT BUSINESS ACQUISITION RELATED FINANCING ACTIVITIES

TERM LOAN AND REVOLVING CREDIT FACILITIES

On May 2, 2016, we entered into a \$200.0 million senior secured term loan A and \$100.0 million revolving credit facility with a syndicate of commercial banks, with Bank of America, N.A. acting as the administrative agent. The proceeds of the senior secured term loan A facility were used to partially fund the acquisition of the Carve-Out Business, and the revolving credit facility was undrawn at closing. Pursuant to the revolving credit facility we can, subject to compliance with the applicable financial covenants, borrow up to \$100.0 million for working capital acquisitions, and general corporate purposes of ours and our subsidiaries. A copy of the Credit Agreement relating to the term loan A and revolving credit facility was filed as exhibit 10.1 to our Current Report on Form 8-K dated May 2, 2016.

EQUITY OFFERING

On April 4, 2016, we commenced an offering of 4.5 million shares of our common stock pursuant to an underwritten public offering (the "Offering"). In connection with the Offering, we granted the underwriters an over-allotment option for 30 days to purchase up to an additional 0.7 million shares of its common stock. The Offering was made pursuant to a shelf registration statement previously filed with the SEC on August 15, 2014. On April 13, 2016, we closed the Offering, including the full over-allotment allocation, selling an aggregate of 5.2 million shares of common stock for total net proceeds of \$94.4 million after underwriting fees of \$5.2 million. The Company anticipates additional fees and expenses associated with the equity offering of approximately \$1.7 million.

Existing Credit Facility with KeyBank

As of March 31, 2016, there was \$168.4 million of borrowing capacity available under our credit agreement with a syndicate of commercial banks, with Key Bank National Association acting as the administrative agent. The credit agreement provides for borrowing up to a maximum \$200.0 million based on the Company's consolidated EBITDA for the trailing four quarters and subject to compliance with the financial covenants in the credit agreement. There were no borrowings outstanding on the credit agreement; however, there were outstanding letters of credit of \$4.9 million. We were in compliance with all covenants and conditions under the credit agreement. In connection with the closing of the acquisition of the Carve-Out Business and entering into the new term loan A and revolving credit facilities discussed above, we terminated our existing revolving credit agreement with KeyBank on May 2, 2016. Based on our current plans and business conditions, we believe that existing cash, cash equivalents, available line of credit, cash generated from operations, and financing capabilities will be sufficient to satisfy our anticipated cash requirements for at least the next twelve months.

CASH FLOWS

| | As Of and For the Nine Month Period Ended March 31, | |
|---|--|-----------|
| (In thousands) | 2016 | 2015 |
| Net cash provided by operating activities | \$21,808 | \$19,520 |
| Net cash used in investing activities | \$(15,231) | \$(2,581) |
| Net cash (used in) provided by financing activities | \$(23) | \$2,401 |
| Net increase in cash and cash equivalents | \$6,659 | \$19,233 |
| Cash and cash equivalents at end of period | \$84,245 | \$66,520 |

Our cash and cash equivalents increased by \$6.7 million from June 30, 2015 to March 31, 2016, primarily as a result of \$21.8 million in cash generated from operating activities, partially offset by \$9.8 million used for the acquisition of LIT, \$4.9 million in capital expenditure and \$4.2 million in payments for the retirement of common stock.

Operating Activities

During the nine months ended March 31, 2016, we generated \$21.8 million in cash from operating activities, an increase of \$2.3 million when compared to \$19.5 million in cash generated from operating activities during the same period in fiscal 2015. During the nine months ended March 31, 2016, we generated \$6.8 million in higher comparable net income, used \$8.3 million less cash for prepaid expenses and other current assets, and generated \$5.0 million more cash from the timing of payables as compared to the same period in the prior year. These increases were partially offset by \$6.5 million growth in accounts receivable, \$4.1 million less cash generated from deferred revenues and customer advances, \$4.4 million less in non-cash activities, and \$1.4 million higher inventory purchases as compared to the same period in fiscal 2015. 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.

Investing Activities

During the nine months ended March 31, 2016, we used \$15.2 million in investing activities compared to \$2.6 million during the same period in fiscal 2015. The increase was primarily driven by \$9.8 million used for the acquisition of LIT and \$1.4 million of higher capital expenditures in fiscal 2016.

Financing Activities

During the nine months ended March 31, 2016, we used less than \$0.1 million in financing activities compared to \$2.4 million generated from financing activities during the same period in fiscal 2015. The \$2.4 million increase in cash used in financing activities was primarily due to \$4.2 million used for the retirement of common stock, partially offset by a \$0.8 million increase in proceeds from our employee stock plan and a \$0.6 million increase in excess tax benefits from stock-based compensation during the nine months ended March 31, 2016.

COMMITMENTS, CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The following is a schedule of our commitments and contractual obligations outstanding at March 31, 2016:

| (In thousands) | Total | Less Than 1 Year | 2-3 Years | 4-5 Years | More Than 5 Years |
|----------------------|----------|---------------------|--------------|--------------|----------------------|
| Purchase obligations | \$31,002 | \$ 31,002 | \$— | \$— | \$— |
| Operating leases | 38,999 | 4,683 | 7,551 | 6,805 | 19,960 |
| | \$70,001 | \$ 35,685 | \$ 7,551 | \$ 6,805 | \$ 19,960 |

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 approximately \$31.0 million at March 31, 2016.

We have a liability at March 31, 2016 of \$2.3 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. It is reasonably possible that within the next 12 months this liability, exclusive of interest, may decrease by up to \$0.8 million upon the conclusion of the Internal Revenue Service audit of fiscal year 2013. We do not know the ultimate resolution on 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.

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 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 or exercise of stock options. 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.

NON-GAAP FINANCIAL MEASURES

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

Adjusted EBITDA, the profitability measure for our segment reporting, 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 expenses and stock-based compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We exclude the above-described items from our internal forecasts and models when establishing internal operating budgets,

supplementing the financial results and forecasts reported to our board of directors, determining the

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portion of bonus compensation for executive officers and other key employees based on operating performance, evaluating short-term and long-term operating trends in our operations, and allocating resources to various initiatives and operational requirements. We believe the adjusted EBITDA financial measure permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of charges that may vary from period to period without any correlation to underlying operating performance. 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. We believe that trends in our adjusted EBITDA are valuable indicators of our operating performance.

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) | Three Months | | Nine Months | |
|---|--------------|----------|-------------|----------|
| | Ended | | Ended | |
| | March 31, | | March 31, | |
| | 2016 | 2015 | 2016 | 2015 |
| Income from continuing operations | \$4,526 | \$4,694 | \$11,279 | \$8,297 |
| Interest (income) expense, net | (36) | 1 | (79) | 10 |
| Income taxes | 2,473 | 1,469 | 5,417 | 2,516 |
| Depreciation | 1,565 | 1,510 | 4,773 | 4,800 |
| Amortization of intangible assets | 1,754 | 1,744 | 5,105 | 5,268 |
| Restructuring and other charges | 409 | 27 | 968 | 2,457 |
| Impairment of long-lived assets | — | — | 231 | — |
| Acquisition and financing costs | 1,725 | 200 | 4,048 | 200 |
| Fair value adjustments from purchase accounting | — | — | — | — |
| Litigation and settlement expenses | — | — | — | — |
| Stock-based compensation expense | 2,150 | 1,870 | 7,244 | 6,676 |
| Adjusted EBITDA | \$14,566 | \$11,515 | \$38,986 | \$30,224 |

Free 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) | Three Months | | Nine Months | |
|---------------------------------------|--------------|----------|-------------|----------|
| | Ended | | Ended | |
| | March 31, | | March 31, | |
| | 2016 | 2015 | 2016 | 2015 |
| Cash provided by operating activities | \$4,330 | \$9,113 | \$21,808 | \$19,520 |
| Purchase of property and equipment | (1,752) | (1,344) | (4,908) | (3,467) |

Free cash flow \$2,578 \$7,769 \$16,900 \$16,053

Adjusted income from continuing operations and adjusted EPS exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. We believe that exclusion of these items assists in providing a more complete understanding of our underlying continuing operations results and trends and allows for comparability with our peer company

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

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

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

| | Three Months Ended March 31, | | | |
|--|---------------------------------|---------|----------|---------|
| (In thousands, except per share data) | 2016 | | 2015 | |
| Income from continuing operations and earnings per share | \$4,526 | \$ 0.13 | \$4,694 | \$ 0.14 |
| Amortization of intangible assets | 1,754 | | 1,744 | |
| Restructuring and other charges | 409 | | 27 | |
| Impairment of long-lived assets | — | | — | |
| Acquisition and financing costs | 1,725 | | 200 | |
| Fair value adjustments from purchase accounting | — | | — | |
| Litigation and settlement expenses | — | | — | |
| Stock-based compensation expense | 2,150 | | 1,870 | |
| Impact to income taxes | (2,148) | | (1,088) | |
| Adjusted income from continuing operations and adjusted earnings per share | \$8,416 | \$ 0.25 | \$7,447 | \$ 0.22 |
| Diluted weighted-average shares outstanding | | 33,991 | | 33,233 |
| | Nine Months Ended March 31, | | | |
| (In thousands, except per share data) | 2016 | | 2015 | |
| Income from continuing operations and earnings per share | \$11,279 | \$ 0.33 | \$8,297 | \$ 0.25 |
| Amortization of intangible assets | 5,105 | | 5,268 | |
| Restructuring and other charges | 968 | | 2,457 | |
| Impairment of long-lived assets | 231 | | — | |
| Acquisition and financing costs | 4,048 | | 200 | |
| Fair value adjustments from purchase accounting | — | | — | |
| Litigation and settlement expenses | — | | — | |
| Stock-based compensation expense | 7,244 | | 6,676 | |
| Impact to income taxes | (6,193) | | (4,703) | |
| Adjusted income from continuing operations and adjusted earnings per share | \$22,682 | \$ 0.67 | \$18,195 | \$ 0.55 |
| Diluted weighted-average shares outstanding | | 33,830 | | 32,953 |

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers.

The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for us on July 1, 2018 and can be early adopted for the fiscal year beginning July 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

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

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

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

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, an amendment of the FASB Accounting Standards Codification. This ASU simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as non-current on the balance sheet. The ASU is effective for us on July 1, 2016 and can be early adopted as of the beginning of an interim or annual reporting period. The ASU allows prospective or retrospective applications. We intend to early adopt the ASU in the period beginning April 1, 2016, and do not expect this guidance to have a material impact to our consolidated financial statements.

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

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, an amendment of the FASB Accounting Standards Codification. This ASU was issued as part of the FASB's simplification initiative, and intends to improve the accounting for share-based payment transactions. The ASU changes several aspects of the accounting for share-based payment award transactions, including: (1) Accounting and

Cash Flow Classification for Excess Tax Benefits and Deficiencies, (2) Forfeitures, and (3) Tax Withholding Requirements and Cash Flow Classification. ASU 2016-09 is effective for public business entities in annual and interim periods in fiscal years beginning after December 15, 2016. Early adoption is permitted in any interim or annual period provided that the entire ASU is adopted. If an entity early adopts the ASU in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. We have not determined the effect of the standard on our ongoing financial reporting.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective October 1, 2015, we adopted FASB ASU No. 2014-17, Pushdown Accounting (a consensus of the FASB Emerging Issues Task Force), an amendment of the FASB Accounting Standards Codification. This ASU allows an acquired entity to elect to apply pushdown accounting in its separate financial statements on a change-in-control event. The acquired entity elects whether

to apply pushdown accounting individually for each change-in-control event, and may apply pushdown accounting during the reporting period in which the change-in-control event occurs. Such adoption did not have any impact to our consolidated financial statements.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in our exposure to market risk from June 30, 2015 to March 31, 2016.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), regarding the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2016. We continue to review our disclosure controls and procedures and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our Company’s business. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

(b) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13c-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. 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 1A. RISK FACTORS

You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended June 30, 2015. In addition, you should note that risks below related to the acquisition of the Carve-Out Business.

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

While we expect the acquisition of the Carve-Out Business (“Acquisition”) to result in synergies and other financial and operational benefits, we may be unable to realize these synergies or other benefits in the timeframe that we expect or at all. The success of the Acquisition will depend, in part, on our ability to realize the anticipated benefits from integrating the Carve-Out Business with our existing businesses. The integration process may be complex, costly and time-consuming. The difficulties of integrating the operations of the Carve-Out Business include, among others:

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

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

We will incur significant transaction and acquisition-related costs in connection with the Acquisition.

We will incur significant costs in connection with the Acquisition. The substantial majority of these costs will be non-recurring transaction expenses and costs, which may impact our results of operations. We may incur additional costs to maintain employee morale and to retain key employees. We also expect to incur significant costs related to integrating the Carve-Out Business.

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

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

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

Following the acquisition of the Carve-Out Business, we will have a significant amount of indebtedness, including a \$200 million term loan and a \$100 million undrawn (other than \$4.9 million of outstanding letters of credit as of March 31, 2016) revolver. Our ability to make scheduled payments on or refinance our debt obligations depends on our financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business, legislative, regulatory and other factors beyond our control. The combined company may be unable to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness.

In addition, increases in interest rates will increase the cost of servicing our financial instruments with exposure to interest rate risk and could materially reduce our profitability and cash flows. In December 2015, the U.S. Federal Reserve announced that it would gradually raise short-term interest rates over the next three years. Each one percentage point change in interest rates would result in an approximate \$2.0 million change in the annual cash interest expense before any principal payment on our financial instruments with exposure to interest rate risk. Additionally, there can be no assurance that the amount of indebtedness we intend to incur in connection with the Acquisition will not impact the rating of our indebtedness.

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

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

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

We have a significant amount, and will have an additional amount following the Acquisition, of goodwill and intangible assets on our consolidated financial statements that is subject to impairment based upon future adverse changes in our business or prospects.

At March 31, 2016, the carrying values of goodwill and identifiable intangible assets on our balance sheet were \$173.7 million and \$17.2 million, respectively. We expect to have a material increase in goodwill and identifiable intangible assets as a result of the Acquisition. We evaluate indefinite lived intangible assets and goodwill for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Indefinite lived intangible assets are impaired and goodwill impairment is indicated when their book value exceeds fair value. We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our long-lived assets decline because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary. The value of goodwill and intangible assets from the allocation of purchase price from the Acquisition will be derived from our business operating plans and is susceptible to an adverse change in demand, input costs or general changes in our business or industry and could require an impairment charge in the future.

Risks Related to the Carve-Out Business.

The Carve-Out Business have substantially the same risks as described by the Company in Part I, Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended June 30, 2015 and our other reports filed from time to time with the SEC including the following risks discussed in the Annual Report on Form 10-K for the year ended June 30, 2015: "-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," "-Economic conditions could adversely affect our business, results of operations and financial condition," "-We face other risks and uncertainties associated with defense-related contracts, which may have a material adverse effect on our business," "-The loss of one or more of our largest customers, programs, or applications could adversely affect our results of operations," "-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," "-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," "-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," "-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," "-Implementation of our growth strategy may not be successful, which could affect our ability to increase revenues," "-Future acquisitions may adversely affect our financial condition," "-We may be unable to obtain critical components from suppliers, which could disrupt or delay our ability to deliver products to our customers," "-We are exposed to risks associated with international operations and markets," "-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," "-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 products are complex, and undetected defects may increase our costs, harm our reputation with customers or lead to costly litigation," "-We may be unsuccessful in protecting our intellectual property rights which could result in the loss of a competitive advantage," "-If we become subject to intellectual property infringement claims, we could incur significant expenses and could be prevented from selling specific products," "-Our need for continued investment in research and development may increase expenses and reduce our profitability," "-Our results of operations are subject to fluctuation from period to period and may not be an accurate indication of future performance," "-Changes in regulations could materially adversely affect us," "-Changes in generally accepted accounting principles may adversely affect us," "-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," "-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 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,” “-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 may need to invest in new information technology systems and infrastructure to scale our operations,” “-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,” and “-Our profits may decrease and/or we may incur significant unanticipated costs if we do not accurately estimate the costs of fixed-price engagements.”

ITEM 6. EXHIBITS

The following Exhibits are filed or furnished, as applicable, herewith:

- 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 The following materials from the Company's Quarterly Report on the Form 10-Q for the quarter ended March 31, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Cash Flows; and (iv) notes to the Consolidated Financial Statements

Furnished herewith. This certificate 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.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Chelmsford, Massachusetts, on May 5, 2016.

MERCURY SYSTEMS, INC.

By: /S/ GERALD M. HAINES II
Gerald M. Haines II
Executive Vice President,
Chief Financial Officer, and Treasurer