



**INNOVATION
THAT
MATTERS**

FY20 RECORD YEAR EARNINGS

↑ **22%**
Revenue

↑ **14%**
Organic
Revenue

↑ **22%**
Bookings

↑ **83%**
GAAP Net
Income

↑ **21%**
Adjusted
EBITDA

MERCURY SYSTEMS BY THE NUMBERS

1,900+

Number of team members globally, >25% whom hold security clearances

4-5x

Research & Development relative investment compared to our industry

\$797M

FY20 Revenue reported

22

Global state-of-the-art facilities

300+

Installed base: number of A&D programs with Mercury embedded

28%

Revenue CAGR FY15-FY20

35+

Years of tech leadership in A&D industry

25+

Prime customers: including virtually all leaders in the A&D industry

11

Number of M&A transactions completed last 5 years

Cautionary Notice About Forward-Looking Statements

This annual report contains certain forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995, including those relating to the Company's overall business and markets. You can identify these statements by the use of the words "may," "will," "would," "should," "could," "plan," "expect," "anticipate," "continue," "estimate," "project," "intend," "likely," "forecast," "probable," "potential" and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of epidemics and pandemics such as COVID, effects of any U.S. Federal government shutdown or extended continuing resolution, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, federal export control or procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to cyber-security regulations and requirements, changes in tax rates or tax regulations, changes to interest rate swaps or other cash flow hedging arrangements, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as are discussed in the Company's filings with the U.S. Securities and Exchange Commission, including its Annual Report on Form 10-K for the fiscal year ended July 3, 2020, accompanying this report. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

INNOVATION THAT MATTERS

To Our Shareholders,
At Mercury Systems, we deliver Innovation That Matters[®]. We make mission-critical technologies profoundly more accessible and affordable for aerospace and defense.



RESULTS BUILT FROM TRUST

Our fiscal 2020 results demonstrate that our customers trust us more than ever to meet their current and emerging technology and business needs. Mercury delivered record bookings, revenue, net income, adjusted EBITDA and adjusted EPS in fiscal 2020 against a challenging coronavirus backdrop. We continued to invest organically in the business for future growth, improved our performance in operations and manufacturing, acquired American Panel Corporation (APC) and concluded the year with zero debt and nearly \$1 billion of financial capacity.

Mercury's footprint has increased in recent years to more than 300 programs across multiple platforms. Our top-line growth reflects this expansion. Total revenue for fiscal 2020 increased 22% year-over-year to a new company record of \$797 million. Our largest revenue programs were SEWIP, F-35, P8, Filthy Buzzard and ARCI.

Organic revenue, excluding recent acquisitions, was up 14% from fiscal 2019. Bookings grew 22% to \$954 million — our sixth straight record. Year-end backlog increased 33% to a record \$831 million, positioning us to continue delivering above industry average growth in fiscal 2021. It was also a record year for new design wins, which amounted to more than \$2 billion in total lifetime value.

Our business model continues to perform well, and Mercury delivered strong results on the bottom line in fiscal 2020. GAAP net income increased 83% from fiscal 2019, driven by improved operating performance and the positive impact of one-time, non-operating items. Adjusted EBITDA grew 21% to a record \$176 million. It also was a record year for free cash flow, defined as operating cash flow less capital expenditures, at \$72 million.

Mercury is beginning fiscal 2021 in an excellent position strategically. The team is doing an outstanding job managing through the virus pandemic. Although the public health and economic risks remain elevated, we are positive about the business outlook.

We continue to believe that Mercury is targeting the right parts of the market. The wave of modernization occurring in radar, EW and C4I continues to drive growth in the business. Demand in weapons systems, space, avionics processing and mission computing, as well as secure rugged servers, remains healthy.

Our bookings and design win activity reflect the impacts of three industry trends that I have discussed in past letters: 1) supply chain delayering by the government and the defense primes; 2) the primes' flight to quality suppliers; and 3) increased outsourcing by the primes at the subsystem level. A potential fourth trend is the government's drive to create a domestic supply chain for secure and trusted advanced electronics capabilities designed and built in the U.S.

ENSURING THE SAFETY OF OUR PEOPLE

Protecting the health, safety and livelihoods of our employees has been at the center of our decision-making since the earliest days of the COVID pandemic. In return, the Mercury team has performed superbly in maintaining their productivity and overcoming our operational challenges.

Early on, we were concerned about possible virus-related closures of our suppliers' facilities. Those did not occur, however, and the supply side of the business seems to be improving at the present time.

We were also concerned about our ability to add talent resources to support Mercury's growth, but those concerns proved to be unfounded as well. Although we have transitioned our employee recruiting and onboarding to a fully virtualized process, there has been no significant erosion in our time-to-hiring or productivity metrics.

“ Mercury delivered record bookings, revenue, net income, adjusted EBITDA and adjusted EPS in fiscal 2020 against a challenging coronavirus backdrop. ”

“ At Mercury, we have always been a WHY company, defined not only by what we make, but why we do what we do. ”

At this stage in the pandemic, we believe the risks related to Mercury's manufacturing operations are increasing, as a result of the economy's reopening and the coronavirus resurgence in large parts of the country. Everyone in the company who can work from home has been doing so since March 2020. We expect that they will continue to work remotely at least through the end of this calendar year.

All of our manufacturing facilities have remained open and operational. In addition to ensuring physical distancing, we have implemented COVID-19 symptom checking and temperature screening for all personnel entering those facilities, along with mandatory use of masks and face shields in certain areas.

In August 2020, we began rolling out weekly on-site virus testing for all employees, across various manufacturing locations. In addition, we have contracted a chief medical advisor to provide best-practice advice, given the evolving nature of the pandemic.

STRATEGIC OPPORTUNITIES

Risks related to defense spending have also increased as a result of the coronavirus. Chief among them is the potential for a delay in the approval of a defense appropriations bill due to an extended continuing resolution. There is also the prospect of another round of fiscal stimulus and the potential for those dollars, over time, to crowd out discretionary spending, including defense.

The counterbalance is that the national security environment is probably the most challenging it has been for quite some time, given China's militarization and heightened U.S.-China diplomatic and economic tensions. Most of the global intellectual property in defense microelectronics is generated in the U.S., but most of the packaging and manufacturing is done offshore, largely in China.

The Department of Defense has underscored this vulnerability by identifying U.S.-produced, trusted microelectronics as the government's top defense technology priority. Given our record of investment in secure processing and trusted microelectronics, this is a strategic opportunity for Mercury.

EYES ON THE FUTURE

Over the past 10 years, we have focused on pioneering a domestic, next-generation defense electronics company sitting at the intersection of high tech and defense. Our goal is to transition commercially developed technologies and to make them profoundly more accessible to the U.S. defense industry.

We also believe that processing in different formats, whether it be secure processing or edge processing at the semiconductor chip level, will enable the next generation of applications that are not currently feasible with existing technology. Mercury is making significant investments in this opportunity as well.

We are hearing great feedback from our semiconductor partners, customers and the DoD on our microelectronics strategy. Although our new business pursuits could potentially take longer due to pandemic-related travel difficulties and the realities associated with working from home, to date, we have seen no significant change in fundamental demand.

We are optimistic about Mercury's ability to continue delivering organic revenue growth at a rate that far exceeds the industry average, and confident that we can improve Mercury's financial performance by executing our plans in five areas:

- Deliver robust organic revenue growth, supplemented by growth from acquisitions.
- Invest in new secure and trusted technologies in our manufacturing assets, business systems and in our people.
- Enhance margins and drive working capital efficiencies through manufacturing insourcing and performance improvements.
- Create stronger operating leverage in the business by growing revenue faster than expenses.
- Fully integrate Mercury's acquired businesses to generate cost and revenue synergies.

This strategy has worked very well over the past six years. Given our ability to execute, we are confident that Mercury will extend this record of success. We anticipate another year of strong growth in revenue and adjusted EBITDA in fiscal 2021, driven by high single-digit to low double-digit organic revenue growth, in line with our long-term strategy.

BY AND FOR PEOPLE WHO MATTER

At Mercury, we have always been a WHY company, defined not only by what we make, but why we do what we do. I am so proud of our people and their commitment to make our customized products profoundly more accessible to make people's lives better, and to make the world a safer, more secure place for all. That is our purpose: Innovation That Matters by and for People Who Matter. In short, we use technology for good.

On behalf of everyone on the Mercury Systems team, I would like to extend our deep appreciation for your continuing support. We look forward to keeping you apprised of our progress.

Sincerely,



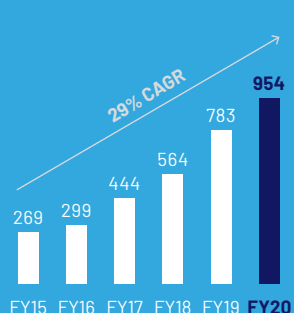
Mark Aslett
President and Chief Executive Officer

September 3, 2020

FY20 FINANCIAL HIGHLIGHTS

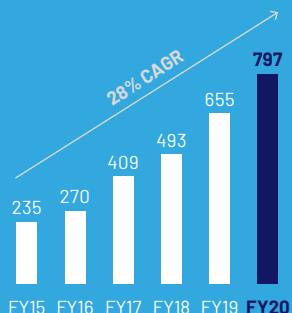
BOOKINGS (\$M)

▲
22%
YOY



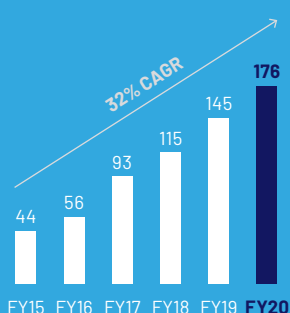
REVENUE (\$M)

▲
22%
YOY



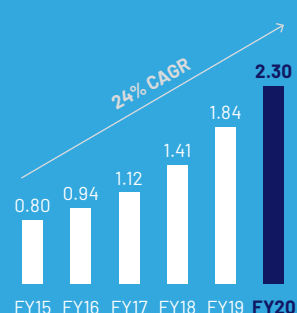
ADJ. EBITDA (\$M)

▲
21%
YOY



ADJ. EPS (\$)

▲
25%
YOY



Notes: For the fiscal year ended July 3, 2020. Bookings as reported in the Company's earnings announcement on August 4, 2020. Figures are based on fiscal year results as reported in the Company's Form 10-Ks. CAGR figures for the period FY15-FY20. Adjusted EBITDA and adjusted EPS are key measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"). Refer to "Non-GAAP Financial Measures" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for our definition of these measures, including reconciliations to our most directly comparable GAAP financial measures.

SELECTED FINANCIAL DATA

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

| | FISCAL YEARS | | | | |
|-------------------------------------|--------------------|-------------|-------------|-----------|-----------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| Statement of Operations Data | | | | | |
| Net revenues | \$796,610 | \$654,744 | \$493,184 | \$408,588 | \$270,154 |
| Income from operations | \$91,062 | \$76,584 | \$46,985 | \$37,403 | \$23,973 |
| Net income | \$85,712 | \$46,775 | \$40,883 | \$24,875 | \$19,742 |
| Net earnings per share | | | | | |
| Basic | \$1.57 | \$0.98 | \$0.88 | \$0.59 | \$0.58 |
| Diluted | \$1.56 | \$0.96 | \$0.86 | \$0.58 | \$0.56 |
| Adjusted EBITDA ⁽¹⁾ | \$176,242 | \$145,326 | \$114,567 | \$92,576 | \$56,137 |
| Adjusted EPS ⁽¹⁾ | \$2.30 | \$1.84 | \$1.41 | \$1.12 | \$0.94 |
| | AS OF FISCAL YEARS | | | | |
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| Balance Sheet Data | | | | | |
| Working capital | \$508,854 | \$484,140 | \$260,063 | \$173,351 | \$177,748 |
| Total assets | \$1,610,720 | \$1,416,977 | \$1,064,480 | \$815,745 | \$736,496 |
| Long-term obligations | \$100,021 | \$34,206 | \$220,909 | \$17,483 | \$195,808 |
| Total shareholders' equity | \$1,384,784 | \$1,284,739 | \$771,891 | \$725,417 | \$473,044 |

(1) Adjusted EBITDA and adjusted EPS are key measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"). Refer to "Non-GAAP Financial Measures" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for our definition of these measures, including reconciliations to our most directly comparable GAAP financial measures.

ABOUT MERCURY SYSTEMS

Founded in
1981

Business model at the
intersection of high tech
and defense

A leading commercial
provider of secure sensor
and mission processing
to the aerospace and
defense industry

Making commercial
technology profoundly
more accessible

Differentiators:

TRUSTED
SECURE
HIGH-PERFORMANCE

Solutions purpose-built
for all aerospace
and defense customers

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED July 3, 2020

OR

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

COMMISSION FILE NUMBER 0-23599

MERCURY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of incorporation or organization)

50 Minuteman Road

Andover MA

(Address of principal executive offices)

04-2741391

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

01810

(Zip Code)

978-256-1300

(Registrant's telephone number, including area code)

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

| Title of Each Class | Trading Symbol | Name of Each Exchange on Which Registered |
|--|----------------|---|
| Common Stock, Par Value \$0.01 Per Share | MRCY | Nasdaq Global Select Market |

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial report under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C.762(b)) by the registered public accounting firm that prepared or issued its audit report. Yes No

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant was approximately \$3.9 billion based upon the closing price of the Common Stock as reported on the Nasdaq Global Select Market on December 27, 2019, the last business day of the registrant's most recently completed second fiscal quarter.

Shares of Common Stock outstanding as of July 31, 2020: 55,642,844 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2020 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

Exhibit Index on Page 89

MERCURY SYSTEMS, INC.

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PART I

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ materially from those set forth in the forward-looking statements. The reader may find discussions containing such forward-looking statements in the material set forth under “Management’s Discussion and Analysis of Financial Conditions and Results of Operations” as well as elsewhere in this Annual Report on Form 10-K. Certain factors that might cause such a difference are discussed in this annual report on Form 10-K, including in the section entitled “Risk Factors.”

When used in this report, the terms “Mercury,” “we,” “our,” “us,” and “the Company” refer to Mercury Systems, Inc. and its consolidated subsidiaries, except where the context otherwise requires or as otherwise indicated.

Effective July 1, 2019, the Company's fiscal year has changed to the 52-week or 53-week period ending on the Friday closest to the last day in June. All references to fiscal 2020 are to the 53-week period from July 1, 2019 to July 3, 2020. All references to fiscal 2019 and 2018 are to the 52-week periods from July 1, 2018 to June 30, 2019 and July 1, 2017 to June 30, 2018, respectively. There have been no reclassifications of prior comparable periods due to this change.

ITEM 1. BUSINESS

Our Company

Mercury Systems, Inc. is a leading technology company serving the aerospace and defense industry, positioned at the intersection of high-tech and defense. Headquartered in Andover, Massachusetts, we deliver solutions that power a broad range of aerospace and defense programs, optimized for mission success in some of the most challenging and demanding environments. We envision, create and deliver innovative technology solutions purpose-built to meet our customers’ most pressing high-tech needs, including those specific to the defense community.

As a leading manufacturer of essential components, modules and subsystems, we sell to defense prime contractors, the U.S. government and original equipment manufacturers (“OEM”) commercial aerospace companies. Mercury has built a trusted, contemporary portfolio of proven product solutions purpose-built for aerospace and defense that it believes meets and exceeds the performance needs of our defense and commercial customers. Customers add their own applications and algorithms to our specialized, secure and innovative pre-integrated solutions. This allows them to complete their full system by integrating with their platform, the sensor technology and, in some cases, the processing from Mercury, with their platform. Our products and solutions are deployed in more than 300 programs with over 25 different defense prime contractors and commercial aviation customers.

Mercury’s transformational business model accelerates the process of making new technology profoundly more accessible to our customers by bridging the gap between commercial technology and aerospace and defense applications. Our long-standing deep relationships with leading high-tech companies, coupled with our high level of research and development (“R&D”) investments and industry-leading trusted and secure design and manufacturing capabilities, are the foundational tenets of this highly successful model.

Our capabilities, technology and R&D investment strategy combine to differentiate Mercury in our industry. Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, secure and rugged rack-mount servers, safety-critical avionics, radio frequency (“RF”) components, multi-function assemblies, subsystems and custom microelectronics. We maintain our technological edge by investing in critical capabilities and intellectual property (“IP” or “building blocks”) in processing and RF, leveraging open standards and open architectures to adapt quickly those building blocks into solutions for highly data-intensive applications, including emerging needs in areas such as artificial intelligence (“AI”).

Our mission critical solutions are deployed by our customers for a variety of applications including command, control, communications, computers, intelligence, surveillance and reconnaissance (“C4ISR”), electronic intelligence, avionics, electro-optical/infrared (“EO/IR”), electronic warfare, weapons and missile defense, hypersonics and radar.

Our consolidated revenues, acquired revenues, net income, diluted earnings per share (“EPS”), adjusted earnings per share (“adjusted EPS”) and adjusted EBITDA for fiscal 2020 were \$796.6 million, \$64.0 million, \$85.7 million, \$1.56, \$2.30 and \$176.2 million, respectively. Our consolidated revenues, acquired revenues, net income, EPS, adjusted EPS and adjusted EBITDA for fiscal 2019 were \$654.7 million, \$13.5 million, \$46.8 million, \$0.96, \$1.84 and \$145.3 million, respectively. See the Non-GAAP Financial Measures section of this annual report for a reconciliation of our acquired revenues, adjusted EPS and adjusted EBITDA to the most directly comparable GAAP measures.

Our Business Strategy

Mercury's business strategy is based on a differentiated market position: we make trusted, secure, mission critical technologies profoundly more accessible to the aerospace and defense industry. We leverage cutting edge commercial technology innovations to develop complex, secure and reliable product solutions and subsystems, purpose built for aerospace and defense. We create leading-edge technologies customized for aerospace and defense applications, through above average industry investment on a percentage basis in R&D. Our strategy is built to meet the aerospace and defense market's need for speed.

Our strategies for growth are as follows:

1. *Invest to grow organically*: Mercury invests in our people, processes, systems and trusted manufacturing assets to support continued organic growth.

2. *Expand capabilities, market access and penetration through mergers & acquisitions ("M&A")*: We supplement our organic growth by expanding capabilities, market access and penetration through a disciplined M&A process and full acquisition integration to drive cost and revenue synergies.

3. *Invest in trusted, secure Innovation that Matters®*: Mercury develops leading edge technologies, customized for aerospace and defense applications, through above-average industry investment on a percentage basis in R&D. Recently our investments have been centered on trusted, secure Innovation that Matters®.

4. *Continuously improve operational capability and scalability*: We deploy our Mercury operating system to drive transformational and sustainable business improvement and value creation across the enterprise.

5. *Attract and retain the right talent*: We strive to continuously improve operational capability and scalability by attracting, retaining and engaging the right talent and supporting and promoting our culture and values.

Our strategies are built around our key strengths as a leading technology company serving the aerospace and defense industry. Our strategies include innovation and investment in scaling existing capabilities, as well as augmenting our capabilities through an acquisition strategy designed to focus on adjacent technologies. We believe our investment in R&D is more than double that of our competitors on a percentage basis. Our consistent strategies allow us to assist our customers, mostly defense prime contractors, to reduce program cost, minimize technical risk, stay on schedule and on budget, and ensure trust and security in the supply chain. As a result we have successfully penetrated strategic programs including Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-35, Reaper, F-16 SABR, E2-D Hawkeye, Paveway, Filthy Buzzard, PGK, P-8, Advanced Integrated Defensive Electronic Warfare Suite ("AIDEWS"), Common Display System ("CDS") and WIN-T.

We are committed to continued investment and innovation in advanced new products and solutions development to maintain our competitive advantage, including in the fields of RF, analog-to-digital and digital-to-analog conversion, advanced multi- and many-core sensor processing systems including graphics processing units ("GPUs"), safety-critical design and engineering, processing for AI, embedded security, digital storage, and digital radio frequency memory ("DRFM") solutions, software defined communications capabilities, and advanced security technologies and capabilities. Concurrently, we leverage our engineering and development capabilities, including systems integration, to accelerate our strategy to become a commercial outsourcing partner to the large defense prime contractors as they seek the more rapid design, development and delivery of affordable, commercially-developed, open architecture solutions within the markets we serve. We invest in scalable manufacturing operations in the U.S. to enable rapid, cost-effective deployment of our microelectronics and secure processing solutions to our customers.

Our commercial business model positions us to be compensated for non-recurring engineering which supplements our own internal R&D investment. We typically team concurrently with multiple defense prime contractors as they pursue new business with solutions they develop and market to the government, and engage with our customers early in the design cycle. Our engagement model can lead to long-term production revenue that continues after the initial services are delivered.

We intend to add capabilities, through both M&A and investment in organic growth, both horizontally – in adjacent markets – and vertically – adding more content. For example:

- First, transition to pre-integrated subsystems: Mercury has expanded capabilities, particularly in integrated subsystems related to defense threats and increased system complexity, which in turn has driven greater outsourcing to us from our prime defense contractor and OEM customers.

- Second, expansion into new submarkets: Within the major markets Mercury serves we have moved, for example, into electronic warfare, weapons systems, acoustics submarkets and C4I.

- Third, vertical expansion: As we continue to add content, we seek to apply technology to all computers on aerospace and defense platforms that require trusted, safe and secure processing.

- Fourth, microelectronics: Our investment domestically in next-generation chiplet technology, from chip-scale to system scale.

Since July 2015, we have added substantial capabilities to our technology portfolio including: embedded security, with the acquisitions of Lewis Innovative Technologies Inc. (“LIT”), custom microelectronics, RF and microwave solutions, and embedded security, with the carve-out acquisition from Microsemi Corporation (the “Carve-Out Business”), The Athena Group, Inc. (“Athena”), Delta Microwave, LLC (“Delta”), and Syntonic Microwave LLC (“Syntonic”); mission computing, safety-critical avionics and platform management, and large area display technology with the CES Creative Electronic Systems, S.A. (“CES”), Richland Technologies, L.L.C. (“RTL”), GECO Avionics, LLC (“GECO”), and American Panel Corporation (“APC”) acquisitions; and rugged servers, computers and storage systems with the acquisitions of Themis Computer (“Themis”) and Germane Systems, LC (“Germane”).

We believe we have built the most trusted, proven, contemporary portfolio of solutions and sub-systems that are purpose-built to meet or exceed our customers’ most pressing high-tech needs. We are investing in six highly differentiated capabilities embedded into our pre-integrated subsystem solutions and products.

- *Silicon.* We adapt commercial Silicon Valley technology specifically for the aerospace and defense industry bringing cutting-edge commercial silicon technology to the Department of Defense (“DoD”) and our commercial customers, across platforms and programs, fast and affordably, from chip-scale to systems.

- *Speed.* We believe we have the highest performance and densest processing solutions available onboard military platforms. We also have some of the highest performing broadband RF capability targeting electronic warfare applications.

- *SWaP.* We have some of the best size, weight, power and cooling capabilities that ensure that our technology is able to run at the highest performance as well as the advanced ruggedization that is required to ensure that these technologies are able to operate consistently and effectively in the harsh environments in which they are required to operate.

- *Software.* We have some of the most advanced open middleware and software that allows customers to port their applications on top of open mission systems architecture.

- *Security.* We have industry-leading embedded security capabilities. We design, market and sell products intended to protect electronic systems that are critical to national security.

- *Safety.* We design safety-certifiable processing systems up to the highest design assurance levels. Our products are certifiable to the highest levels of software critically recognized by the Federal Aviation Administration (“FAA”), European Union Aviation Safety Agency (“EASA”), Transport Canada and Joint Aviation Authorities (“JAA”).

Our Solutions and Products

We deliver technology at the intersection of the high-tech and defense industries. The Mercury difference is driven by three key factors we promise to deliver to all of our customers: Trusted, Secure and Performance.

- *Trusted:* A trusted partner to aerospace and defense, delivering the most advanced and secure solutions to address accelerating global security challenges.

- *Secure:* Advanced embedded security capabilities – built-in, not bolted on – delivering uncompromised solutions in the face of growing cyber threats, and manufactured in Mercury facilities with superior ratings in industrial security.

- *High Performance:* Solutions that are among the highest performing available and optimized to meet the most rigorous demands of defense and commercial customers.

We offer a broad family of products designed to meet the full range of requirements in compute-intensive, signal processing, image processing and command and control applications. To maintain a competitive advantage, we seek to leverage technology investments across multiple product lines and product solutions. Examples of hardware products include small, custom microelectronics, embedded sensor processing subsystems, RF and microwave components, modules, and subsystems, rugged servers, and avionics mission computers.

Our products are typically compute-intensive and require extremely high bandwidth and high throughput. These systems often must also meet significant SWaP constraints for use in aircraft, unmanned aerial vehicles (“UAVs”), ships and other platforms and be ruggedized for use in harsh environments. They are primarily used in both commercial aerospace applications, such as communications and ground radar air traffic control, as well as advanced defense and intelligence applications, including space-time adaptive processing, synthetic aperture radar, airborne early warning, command, control, communication and information systems, mission planning, image intelligence and signal intelligence systems. Our products transform the massive streams of digital data created in these applications into usable information in real time. The systems can scale from a few processors to thousands of processors.

We group our products into the following categories:

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

By providing pre-integrated subsystems to our customers, we enable them to rapidly and cost-effectively port and adapt their applications to changing threats. This approach also saves our customers valuable time and expense, as their initial costs to integrate modules and components typically far exceed the costs of the individual product procurement. This benefit continues over time because we are continually investing R&D into our products. This allows us to provide our customers the latest technologies in our pre-integrated subsystems faster than they can typically do it themselves. We believe this is a better business and technology model to operate within, as it continues to provide value and benefits to us over time.

To address the current challenges facing the warfighter, our government and defense prime contractors, we have developed a new product architecture that supports a more dynamic, iterative, spiral development process by leveraging open architecture standards and leading-edge commercial technologies and products. Our open architecture is carried throughout our entire embedded computing product line from the very small form-factor subsystems to the high-end, where ultimate processing power and reliability is of paramount importance to the mission. Our commercially-developed product capabilities cover the entire intelligence, surveillance and reconnaissance (“ISR”) spectrum from acquisition and digitization of the signal, to processing of the signal, through the exploitation and dissemination of the information. We work continuously to improve our hardware technology with an eye toward optimization of SWaP demands.

Mercury partners with global tech leaders to align technology roadmaps and deliver cutting-edge computing in scalable, field-deployable form factors that are fully configurable to each unique workload. We use the latest Intel® server-class processing products, Field Programmable Gate Arrays (“FPGA”), as well as GPU products in our embedded high-performance processing technologies. While this multi-computing and embedded processing technology is one of our core skills, the SWaP constraints that are encountered in connection with the high-performance embedded processing applications create unique challenges. For example, to deal with the heat build-up involved in small subsystems, we introduced a key technology called Air-Flow-By™ that enables previously unattainable levels of processing power within a small footprint by effectively removing heat so the server-class processors can perform at maximum designed power limits. In rugged environments where air is limited, such as high-altitude operations, our Liquid-Flow-By™ technology has been successfully customer tested allowing maximum server-class processor performance. These innovative cooling techniques allow full performance server-class processing in rugged environments enabling new and advanced modes of operation that enhance the multi-intelligence, situational awareness and electronic warfare capabilities in military platforms.

Embedded systems security has become a requirement for new and emerging military programs, and our security solutions are a critical differentiator from our traditional competition. Our security solutions, combined with our next-generation secure Intel® server-class product line, together with increasingly frequent mandates from the government to secure electronic systems for domestic and foreign military sales, position us well to capitalize on DoD program protection security requirements. Finally, our built-in security framework creates higher product differentiation, and drives greater program velocity, while lowering risk.

Open Standards Support

Mercury has a long history of driving modular open systems architectures and has remained committed to creating, advancing, and adopting open standards for all our products, from our smallest components and connectors to our largest, high-performance, integrated multi-computer systems. With thirty-five years of technology leadership within the high-performance embedded computing industry, we have pioneered or contributed to the development of many of the defense industry’s current and emerging open standards, including standards such as RACEway, RapidIO, VXS, VPX, REDI and notably OpenVPX.

These open standards allow system integrators to benefit from the interoperability of modules produced by multiple vendors. We also continue to be influential in the industry-standards organizations associated with our market segments. As a member of the VMEbus International Trade Association (“VITA”), the Sensor Open Systems Architecture (“SOSA”) initiative, the Future Airborne Capability Environment (“FACE”) consortium, and the Vehicular Integration for C4ISR/EW Interoperability (“VICTORY”) consortium, among other standards bodies, Mercury is helping to guide the aerospace and defense industry toward greater openness and vendor interoperability, consistent with the DoD’s focus on using modular open systems architectures (“MOSA”) in major programs.

Our software is based on open standards and includes heterogeneous processor support with extensive highly-optimized math libraries, multi-computing switch fabric support, net-centric and system management enabling services, extended operating system services, board support packages and development tools. This software platform delivers on the performance required for highly tuned real-time operation with the flexibility of open standards that are an essential ingredient of technology insertion and software life-cycle support.

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

Recent Acquisitions

Since 2011 we have successfully acquired 14 businesses, successfully completing integration of the earlier acquired business with the integration of the more recent acquisitions progressing well. The 11 acquisitions completed since July 1, 2015 are shown below.

| Name of Acquired Entities | Date of Acquisition |
|--------------------------------------|----------------------------|
| Lewis Innovative Technologies, Inc. | December 16, 2015 |
| Microsemi Carve-Out Business | May 2, 2016 |
| CES Creative Electronic Systems S.A. | November 3, 2016 |
| Delta Microwave, LLC | April 3, 2017 |
| Richland Technologies L.L.C. | July 3, 2017 |
| Themis Computer | February 1, 2018 |
| Germane Systems, LC | July 31, 2018 |
| GECO Avionics, LLC | January 29, 2019 |
| The Athena Group, Inc. | April 18, 2019 |
| Syntonic Microwave LLC | April 18, 2019 |
| American Panel Corporation | September 23, 2019 |

Our Market Opportunity

Our market opportunity is defined by the growing demand for domestically designed and manufactured secure sensor and safety-critical mission processing capabilities for critical aerospace, defense and intelligence applications. Our primary market positioning is centered on making commercially available technologies profoundly more accessible to the aerospace and defense sector, specifically C4I systems, sensor processing and electronic warfare systems; and commercial markets, which include commercial aerospace communications and other commercial computing applications. We believe we are well-positioned in growing sustainable market segments of the aerospace and defense sector that rely on advanced technologies to improve warfighter capability and provide enhanced force protection capabilities. The acquisitions of the Carve-Out Business, Delta and Syntonic further improved our ability to compete successfully in these market segments by allowing us to offer an even more comprehensive set of closely related capabilities. The CES, RTL, GECO and APC acquisitions provided us new capabilities that substantially expanded our addressable market into defense platform management, mission computing and commercial aerospace markets that are aligned to our existing market focus. The additions of Themis and Germane provided us with new capabilities and positioned us with a significant footprint within the C2I rugged server business. Our organic investments as well as the acquisitions of LIT, the Carve-Out Business, and Athena added to our portfolio of embedded security

products that can be leveraged across our business. Finally, our CES addition, due to its location in Geneva, is helping to open more opportunities in international markets.

We believe there are a number of evolving trends that are reshaping our target markets and accordingly provide us with attractive growth opportunities. We expect these to endure despite the COVID-19 pandemic. These trends include:

- *The aerospace and defense electronics market is expected to grow in 2020 and beyond.* According to Renaissance Strategic Advisors (“RSA”), as of November 2019, the global aerospace and defense electronics market is estimated to be \$130 billion in 2020, growing to \$146 billion by 2024. Within this global market, RSA estimates that the U.S. defense electronics market will be approximately \$71 billion in 2020, growing to \$77 billion in 2024. The aerospace and defense electronics marketplace consists of two primary subsegments: (i) C4I and (ii) sensor and effector mission systems. C4I encompasses platform and mission management, which include avionics and vetronics, C2I, which includes command and control and intelligence, and dedicated communications processing. Sensor and effector mission systems are primarily different types of sensor modalities such as electronic warfare, radar, EO/IR, and acoustics as well as weapons systems such as missiles and munitions. Within the global Tier 2 C4I market in which we participate, RSA estimates the market for 2020 to be \$7.8 billion for platform and mission management, \$8.1 billion for C2I, and \$8.2 billion for dedicated communications. RSA estimates the compound annual growth rate (“CAGR”) from 2019-2024 for these markets to be 4.8% for platform and mission management, 3.7% for C2I, and 3.8% for dedicated communications. Within the global Tier 2 sensor and effector mission systems market in which we participate, RSA estimates the market for 2020 to be \$5.6 billion for electronic warfare, \$5.5 billion for radar, \$1.9 billion for EO/IR, \$1.1 billion for acoustics, and \$3.2 billion for weapons systems. RSA estimates the 2019-2024 CAGR for these markets to be 4.3% for electronic warfare, 3.6% for radar, 4.8% for EO/IR, 6.0% for acoustics, and 4.4% for weapons systems. Within the context of the overall U.S. defense budget and spending for defense electronics specifically, we believe the C4ISR, electronic warfare, guided missiles and precision munitions, and ballistic missile defense market segments have a high priority for future DoD spending. We continue to build on our strengths in the design and development of performance optimized electronic subsystems for these markets, and often team with multiple defense prime contractors as they bid for projects, thereby increasing our chance of a successful outcome. We expect to continue our above industry-average growth.
- *The rapidly expanding demand for tactical ISR is leading to significant growth in sensor data being generated, leading to even greater demand for the capability of our products to securely store and process data onboard platforms.* An increase in the prevalence and resolution of ISR sensors is generating significant growth in the associated data that needs to be stored and turned into information for the warfighter in a timely manner. In addition, several factors are driving the defense and intelligence industries to demand greater capability to collect, store, and process data onboard the aircraft, UAVs, ships and other vehicles, which we refer to collectively as platforms. These factors include the limited communications bandwidth of existing platforms, the need for platforms that can operate more autonomously and possibly in denied communications environments, the need for platforms with increased persistence to enable them to remain in or fly above the battlefield for extended periods, and the need for greater onboard processing capabilities. In addition, the advent of sophisticated AI algorithms is beginning to revolutionize the ability of sensor processing systems to intelligently and efficiently process and act upon these large data sets. Standard computing architectures and computing platforms currently do not offer the level of performance needed to optimize existing AI algorithms, creating an additional opportunity for advanced processing capabilities onboard the platform.
- *Rogue nations’ missile programs and threats from peer nations are causing greater investment in advanced new radar, electronic warfare and ballistic missile defense capabilities.* There are a number of new and emerging threats, such as peer nations developing stealth technologies, including stealth aircraft, new anti-ship ballistic missiles and a variety of other advanced missile capabilities. Additionally, U.S. armed forces require enhanced signals intelligence and jamming capabilities. In response to these emerging threats, we have participated in key DoD programs, including Aegis, Patriot, SEWIP, LTAMDS, F-22, Raptor, F-35 Joint Strike Fighter and upgrade programs for the F-15 and F-16.
- *The long-term DoD budget pressure is pushing more dollars toward upgrades of the electronic subsystems on existing platforms, which may increase demand for our products.* The DoD is moving from major new weapons systems developments to upgrades of the electronic subsystems on existing platforms. These upgrades are expected to include more sensors, signal processing, ISR algorithms, multi-intelligence fusion and exploitation, computing and communications. We believe that upgrades to provide new urgent war fighting capability, driven by combatant commanders, are occurring more rapidly than traditional defense prime contractors can easily react to. We believe these trends will cause defense prime contractors to increasingly seek out our high-performance, cost-effective open architecture products.
- *Defense procurement reform is causing the defense prime contractors to outsource more work to commercial companies and we believe that prime contractor outsourcing is our largest secular growth opportunity.* RSA estimates

that in 2020 the U.S. defense Tier 2 embedded computing and RF market addressable by suppliers such as Mercury is approximately \$21 billion. RSA estimates that the U.S. defense prime contractors currently outsource only a small percentage of their work. On a global basis the Tier 2 embedded computing and RF market in 2020 is estimated by RSA to be \$41 billion. The U.S. government is intensely focused on making systems more affordable and shortening their development time. In addition, the U.S. government is challenging defense prime contractors to leverage commercial technology wherever possible. This trend, along with a scarcity of technical and engineering talent in the market, is causing defense prime contractors to outsource to companies like Mercury, which we believe is our largest secular growth opportunity. As a merchant supplier of commercial technologies to the defense industry, we believe our products and subsystem solutions are often more affordable than solutions with the same functionality developed by a defense prime contractor. In addition, we believe our size, scale, and stability in addition to the investments we have made in our domestic manufacturing capabilities and infrastructure, make us a more reliable and attractive outsourcing partner for our customers relative to smaller sub-scale providers. These factors are providing incentives for defense prime contractors to outsource more work to subcontractors with significant expertise and cost-effective technology capabilities and solutions, and we have transformed our business model over the last several years to address these long-term outsourcing trends and other needs.

- *DoD security and program protection requirements are creating new opportunities for domestic sourcing and our advanced secure processing capabilities.* The government is focused on ensuring that the U.S. military protects its defense electronic systems and the information held within them from nefarious activities such as tampering, reverse engineering, and other forms of advanced attacks, including cyber. The requirement to add security comes at a time when the commercial technology world continues to offshore more of the design, development, manufacturing, and support of such capabilities, making it more difficult to protect against embedded vulnerabilities, tampering, reverse engineering and other undesired activities. The DoD has a mandate to ensure both the provenance and integrity of the technology and its associated supply chain. These factors have created a unique opportunity for us to expand beyond sensor processing into the provision of technologies ranging from advanced secure processing subsystems to miniaturized custom microelectronics devices and capabilities for other on-board critical computing applications designed, developed, manufactured, and supported in the U.S.A. In addition, advanced systems sold to foreign military buyers also require protection so that the technologies, techniques and data associated with them do not become more widely available, which further enhances our market opportunity.
- *Mercury is well-positioned to help address the need for DoD to access the latest commercial silicon, combined with the desire to ensure a trusted domestic supply of silicon technologies.* In June 2020, DoD elevated microelectronics to its number one technology priority. This decision was based primarily on the proliferation and advances in commercial silicon but also the realization that DoD needs to be able to access these technologies in a trusted, secure, and domestic manner. We believe Mercury is the leading provider of commercially-developed silicon purpose-built for the specific requirements of aerospace & defense. This capability began with our 2016 acquisition of the Carve-Out Business, which included capabilities in trusted and secure microelectronics. Since the acquisition, we have made additional investments in security and advanced packaging, most notably our announced \$15 million capital investment in fiscal year 2020 to expand our trusted custom microelectronics business in Phoenix, Arizona, to bring cutting-edge commercial silicon to the DoD. This initiative is specifically intended to bridge DoD technologies from monolithic ASIC designs, which are purpose-built for DoD but are deployed on legacy silicon designs, to heterogeneous “chiplet” architectures, which leverage best-of-breed silicon from commercial providers and packages the silicon for defense-specific applications, including the ability to embed security into the device itself.

Our Competitive Strengths

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

- *Subsystem Solutions Provider for the C4ISR and Electronic Warfare Markets.* Through our commercially developed, specialized processing subsystem solutions, we address the challenges associated with the collection and processing of massive, continuous streams of data and dramatically shorten the time that it takes to give information to U.S. armed forces at the tactical edge. Our solutions are specifically designed for flexibility and interoperability, allowing our products to be easily integrated into larger system-level solutions. Our ability to integrate subsystem-level capabilities allows us to provide solutions that most effectively address the mission-critical challenges within the C4ISR market, including multi-intelligence data fusion and AI processing onboard the platform. We leverage our deep expertise in embedded multicomputing, embedded sensor processing, with the addition of our RF microwave and millimeter subsystems and components, along with strategic investments in research and development to provide solutions across the sensor processing chain.
- *Diverse Mix of Stable, Growth Programs Aligned with DoD Funding Priorities.* Our products and solutions have been deployed on more than 300 different programs and over 25 different defense prime contractors. We serve high priority

markets for the DoD and foreign militaries, such as UAVs, ballistic missile defense, guided missiles and precision munitions, airborne reconnaissance, electronic warfare, and have secured positions on mission-critical programs including Aegis, Predator and Reaper UAVs, F-35 Joint Strike Fighter, LTAMDS, Patriot missile, SEWIP, and Paveway. In addition, we consistently leverage our technology and capabilities across multiple programs, providing significant operating leverage and cost savings. Our recent acquisitions allow us to participate in a broader array of programs, many with key strategic customers of ours.

- *We are a leading technology company serving the aerospace and defense industry.* We have a portfolio of Open Standards Architecture (“OSA”) technology building blocks across the entire sensor processing chain. We offer embedded secure processing capabilities with advanced packaging and cooling technologies that ruggedize commercial technologies while allowing them to stay cool for reliable operation. These capabilities allow us to help our customers meet the demanding SWaP requirements of today’s defense platforms. Our pre-integrated subsystems improve affordability by substantially reducing customer system integration costs and time-to-market for our solutions. System integration costs are one of the more substantial costs our customers bear in developing and deploying technologies in defense programs and platforms. Our pre-integrated solutions approach allows for more rapid and affordable modernization of existing platforms and faster deployment of new platforms.

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

As more commercial technology companies move the design, development, manufacturing, and support of their technologies offshore, the DoD is looking to domestic technology providers to develop a sustainable, U.S.-based trusted supply chain. Over several years we have been building out our capacity for domestic manufacturing through our Advanced Microelectronics Centers (“AMCs”). These facilities provide significant scale and capacity for our defense prime customers, who have been increasingly willing to outsource to partners with the scale needed to meet large program production requirements. In addition, our Phoenix, Arizona AMC is a Defense Microelectronics Activity (“DMEA”)–certified, trusted manufacturing facility, which represents a significant competitive advantage. Our Phoenix AMC also includes a surface mount technology manufacturing capability which we refer to as our U.S. Manufacturing Operations (“USMO”).

- *We provide advanced, integrated security features for our products and subsystems, addressing an increasingly prevalent requirement for DoD program security.* We offer secure processing expertise that is built-in to our pre-integrated subsystems. By doing this we are able to provide secure building blocks that allow our customers to also incorporate their own security capabilities. This assists our customers in ensuring program protection as they deploy critical platforms and programs, all in support of DoD missions. The acquisition of the Carve-Out Business brought us new security technologies and also allowed us to provide enhanced security capabilities in areas such as memory and storage devices. Our acquisitions of the Carve-Out Business, LIT, and Athena also added to our portfolio of sophisticated firmware and software specifically designed to secure microelectronic devices that can be leveraged across our product portfolio.
- *We are pioneering a next generation business model.* The DoD and the defense industrial base is currently undergoing a major transformation. Domestic political and budget uncertainty, geopolitical instability and evolving global threats have become constants. The defense budget remains under pressure and R&D and technology spending are often in budgetary competition with the increasing costs of military personnel requirements, health care costs, and other important elements within the DoD and the Federal budget generally. Finally, defense acquisition reform calls for the continued drive for innovation and competition within the defense industrial base, while also driving down acquisition costs. Our approach is built around a few key pillars:
 - We continue to leverage our expertise in building pre-integrated subsystems in support of critical defense programs, driving out procurement costs by lowering integration expenses of our customers.
 - We have been a pioneer in driving OSA for both embedded computing and RF.
 - The DoD has asked defense industry participants to invest their own resources into R&D. This approach is a pillar of our business model.
 - Security and program protection are now critical considerations for both program modernizations as well as for new program deployment. We are now in our third generation of building secure embedded processing solutions.

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

- *Value-Added Subsystem Solution Provider for Defense Prime Contractors.* Because of the DoD’s continuing shift toward a firm fixed price contract procurement model, an increasingly uncertain budgetary and procurement environment, and increased budget pressures from both the U.S. and allied governments, defense prime contractors are accelerating their move toward outsourcing opportunities to help mitigate the increased program and financial risk. Our differentiated secure sensor and safety-critical processing solutions offer meaningful capabilities upgrades for our customers and enable the rapid, cost-effective deployment of systems to the end customer. We believe our open architecture subsystems offer differentiated sensor processing and data analytics capabilities that cannot be easily replicated. Our solutions minimize program risk, maximize application portability, and accelerate customers’ time to market, all within a fixed-pricing contracting environment.
- *Delivery of Platform-Ready Solutions for Classified Programs.* We believe our integration work through our Cypress, California facility provides us with critical insights as we implement and incorporate key classified government intellectual property, including critical intelligence and signal processing algorithms, into advanced systems. This integration work provides us the opportunity to combine directly and integrate our technology building blocks along with our intellectual property into our existing embedded processing products and solutions, enabling us to deliver more affordable, platform-ready integrated ISR subsystems that leverage our OSA and address key government technology and procurement concerns. Our operations in this environment also help us identify emerging needs and opportunities to influence our future product development, so that critical future needs can be met in a timely manner with commercially-developed products and solutions.
- *We have invested in advanced, domestic design and manufacturing capabilities.* Over the past several years we have prioritized investments to build our internal capabilities and capacity for defense electronics design and manufacturing in the U.S. These investments include the consolidation of a number of sub-scale microelectronics manufacturing facilities into our modern AMCs as well as the establishment of our USMO in Phoenix, Arizona. In addition to the consolidation of facilities into scalable engineering and manufacturing centers of excellence, we have made the necessary investments to outfit these facilities with modern, scalable, and redundant tools and equipment to promote quality, efficiency, throughput, and redundancy. In addition we invested in our information technology (“IT”) infrastructure and business systems to meet Defense Federal Acquisition Regulation Supplement (“DFARS”) requirements for cybersecurity. These investments taken together are intended to demonstrate our commitment to meeting DoD expectations for a trusted and secure defense industrial base. Our AMCs in Hudson, New Hampshire, West Caldwell, New Jersey, Oxnard, California, Huntsville, Alabama and Phoenix, Arizona are strategically located near key customers and are purpose-built for the design, build and test of RF components and subsystems in support of a variety of key customer programs. Our USMO is built around scalable, repeatable, secure, affordable, and predictable manufacturing. The USMO is a DMEA certified secure trusted site, certified to AS9100 quality standards and it utilizes Lean Six Sigma methodologies throughout manufacturing. The USMO is designed for efficient manufacturing, enabling our customers to access the best proven technology and high performing, secure processing solutions. This allows for the most repeatable product performance, while optimizing affordability and production responsiveness.
- *Long-Standing Industry Relationships.* We have established long-standing relationships with defense prime contractors, the U.S. government and other key organizations in the defense industry over our 30 years in the defense electronics industry. Our customers include Airbus, BAE Systems, Boeing, General Atomics, General Dynamics, L3Harris Technologies, Leonardo, Lockheed Martin Corporation, Northrop Grumman, and Raytheon Technologies. Over this period, we have become recognized for our ability to develop new technologies and meet stringent program requirements. We believe we are well-positioned to maintain these high-level customer engagements and enhance them through the additional relationships that our recently acquired businesses have with many of the same customers.
- *Proven Management Team.* Our senior management team has developed a long-term compelling strategy for the aerospace and defense markets. Our senior management team has a history of identifying and evaluating successful business acquisition opportunities, performing in-depth due diligence, negotiating with owners and management, structuring, financing, and closing transactions and then integrating the acquired business resulting in the creation of synergies and enhanced overall returns. Having completed these critical steps with a senior management team with significant experience in growing, scaling and acquiring businesses, we believe that we have demonstrated our operational capabilities and we are well-positioned to continue growing and scaling our business.
- *Leading M&A Origination and Execution Capability.* We have a strong track-record of identifying and executing strategic acquisitions. Since July 1, 2015 we have acquired 11 businesses, which are strategically aligned with Mercury, successfully completing integration of the earlier acquired businesses with the integration of the more recent acquisitions progressing well. We have established an internal team that brings decades of experience across more than 100 transactions. We have developed internal processes to identify and source strategic acquisitions on a proprietary basis and negotiated directly with owners on a number of acquisitions. In addition, we have developed relationships with a number of investment banks and other sell-side advisors, as well as a reputation as a preferred acquirer, which

allow us access to targeted or widely-marketed M&A processes. Our internal capabilities include financial, legal, and other transaction diligence, deal valuation, and deal negotiations. Where appropriate, we leverage third party advisors to supplement our internal diligence. We have a proven ability to execute numerous transactions simultaneously effectively and efficiently.

- *Proven M&A Integration Capability.* We have developed the internal processes and capability to integrate acquired businesses to deliver value through revenue and cost synergies. We leverage our common cultures and values as well as common processes, business systems, tools, channels and manufacturing infrastructure to accelerate growth and improve profitability in our acquired businesses.

Competition

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

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

Research and Product Development

Our R&D efforts are focused on developing new products and systems as well as enhancing existing hardware and software products in mission, signal and image processing. Our R&D goal is to fully exploit and maintain our technological lead in the high-performance, real-time sensor processing industry and in mission computing, platform management and other safety-critical applications. Expenditures for research and development amounted to \$98.5 million, \$68.9 million, and \$58.8 million in fiscal years 2020, 2019, and 2018, respectively. As of July 3, 2020, we had 643 employees, including hardware and software architects and design engineers, primarily engaged in engineering and research and product development activities. These individuals, in conjunction with our sales team, also devote a portion of their time to assisting customers in utilizing our products, developing new uses for these products and anticipating customer requirements for new products.

Manufacturing

The majority of our sales are produced in AS9100 quality system-certified facilities. The current scope of delivered hardware products includes commercial and industrial class printed circuit board assemblies (modules), complex chassis subsystems, and RF and microwave components and subsystems.

Our Phoenix, Arizona AMC manufactures our custom microelectronics products in an AS9100 quality system-certified facility. Our Phoenix, Arizona facility also contains our USMO, which is an IPC1791 and DMEA-certified trusted manufacturing facility and is primarily focused on advanced secure system-on-chip design, assembly, packaging, and test. Our Oxnard, California facility manufactures radio frequency and microwave products in an AS9100 quality system-certified facility. Our Cypress, California, West Lafayette, Indiana, Huntsville, Alabama and Mesa, Arizona facilities are AS9100 quality systems-certified facilities as well. Our Fremont, California and Alpharetta, Georgia facilities are ISO 9001:2015 quality systems-certified. Our Chantilly, Virginia facility is an AS9100 quality systems-certified facility. Our Andover, Massachusetts and Hudson, New Hampshire facilities design and assemble our processing products and are AS9100 quality systems-certified facilities. Our Andover, Massachusetts facility is also a DMEA-certified trusted design facility and is primarily focused on advanced security features for the processing product line. Our Geneva, Switzerland facility, the headquarters of Mercury's European operations, provides electronic design and manufacturing, maintenance and support services and is AS9001 and EASA Part 145 quality systems-certified. Our Silchester, England facility provides engineering, development and integration services and is AS9100 quality systems-certified.

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

Our AMC in Phoenix, Arizona is built around scalable, repeatable, secure, affordable, and predictable manufacturing. The high mix, low volume and high complexity/density nature of our products require speed and seamless interaction with all internal functions (as opposed to with an external contract manufacturer) which is a key value proposition of the USMO. The USMO is also designed for efficient showcasing to customers who at any point wish to access the best proven technology and high performing, secure electronics and processing manufacturing solutions within a broader product company such as Mercury. Proximity and interaction with our internal engineering organization is a significant benefit. This allows for the most repeatable product performance, while optimizing affordability and production responsiveness. The Phoenix AMC also provides manufacturing and assembly for SWaP-optimized multi-chip modules and system-in-package devices. We combine surface-mount, flip chip, die attach, wire bond and rugged 3D packaging on the same devices to provide a swap-optimized solution for our customers.

The Hudson, New Hampshire, West Caldwell, New Jersey, and Oxnard, California facilities are specifically aimed at providing scalable manufacturing within our critical businesses. We leverage best practices in design, development, manufacturing and materials handling at these production and sub-systems integration facilities. These facilities include the design, build and test of both RF and microwave components and subsystems in support of a variety of key customer programs. Our most recent acquisition of APC in Alpharetta, Georgia enables further integrated offerings to customers whereby products from other facilities are deployed to the end user by active matrix liquid crystal display systems which enhances the highly sophisticated man/machine interface.

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

We also design, develop, and manufacture DRFM units for a variety of modern electronic warfare applications, as well as radar environment simulation and test systems for defense and intelligence applications. We develop high performance signals intelligence payloads and EO/IR technologies for small UAV platforms as well as powerful onboard UAV processor systems for real-time wide area motion imagery.

Intellectual Property and Proprietary Rights

As of July 3, 2020, we held 88 patents of varying duration issued in the United States. We file U.S. patent applications and, where appropriate, foreign patent applications. We also file continuations to cover both new and improved designs and products. At present, we have several U.S. and foreign patent applications in process.

We also rely on a combination of trade secret, copyright, and trademark laws, as well as contractual agreements, to safeguard our proprietary rights in technology and products. In seeking to limit access to sensitive information to the greatest practical extent, we routinely enter into confidentiality and assignment of invention agreements with each of our employees and consultants and nondisclosure agreements with our key customers and vendors.

Mercury Systems, Innovation that Matters, Armor, ASSURE-Stor, EchoCore, Echotek, Ensemble, MultiCore Plus, NanoATR, NanoPAK, NanoSWITCH, PowerBlock, PowerStream, RACE, RACE Series, Race++ Series, Themis, TRRUST-Stor, and TRRUST-Purge are registered trademarks; and Air Flow-By, BuiltSAFE, BuiltSECURE, CANGuard, CodeSEAL, EnforcIT-S, EnsembleSeries, EnterpriseSeries, Liquid Flow-By, OpenRFM, POET, SecureBootFPGA, SpectrumSeries, and WhiteboxCRYPTO are trademarks of Mercury Systems, Inc. OpenVPX is a trademark of the VMEbus International Trade

Association. All other trademarks and registered trademarks are the property of their respective holders, and are hereby acknowledged.

Backlog

As of July 3, 2020, we had a backlog of orders aggregating approximately \$831.1 million, of which \$567.7 million is expected to be delivered within the next twelve months. As of June 30, 2019, backlog was approximately \$625.4 million. We include in our backlog customer orders for products and services for which we have accepted signed purchase orders, as long as that order is scheduled to ship or invoice in whole, or in part, within the next 24 months. Orders included in backlog may be canceled or rescheduled by customers, although the customer may incur cancellation penalties depending on the timing of the cancellation. A variety of conditions, both specific to the individual customer and generally affecting the customer's industry, may cause customers to cancel, reduce or delay orders that were previously made or anticipated. We cannot assure the timely replacement of canceled, delayed or reduced orders.

Employees

At July 3, 2020, we employed a total of 1,947 people excluding contractors, including 643 in research and development, 151 in sales and marketing, 867 in manufacturing and customer support and 286 in general and administrative functions. We have 141 employees located in Europe, six located in Canada, and one located in Japan, and 1,799 located in the United States. We do not have any employees represented by a labor organization, and we believe that our relations with our employees are good. We also use contractors on an as-needed basis.

Customers

Our revenues are concentrated in two defense prime contractors including Lockheed Martin Corporation and Raytheon Technologies for the fiscal years ended 2020, 2019 and 2018. These two defense prime contractors comprised an aggregate of 32%, 37% and 38% of our revenues in each of the fiscal years 2020, 2019 and 2018, respectively. While sales to each of these customers that typically comprise 10% or more of our revenue, the sales to these customers are spread across multiple programs and platforms. For the fiscal years ended 2020, 2019 and 2018, we had no single program that represented 10% or more of our revenues.

Corporate Headquarters and Incorporation

Our corporate headquarters is located in Andover, Massachusetts. In 2017, we relocated our corporate headquarters into a more modern facility, investing in communications, media and collaborative capabilities, engineering labs and security infrastructure.

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

Financial Information about Geographic Scope

Information about revenue we receive within and outside the U.S. can be found in Note Q - Operating Segment, Geographic Information and Significant Customers - to the accompanying Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K.

WEBSITE

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

Investors and others should note that we announce material financial information using our website (www.mrcy.com), SEC filings, press releases, public conference calls, webcasts, and social media, including Twitter (twitter.com/mrcy and twitter.com/mrcy_CEO) and LinkedIn (www.linkedin.com/company/mercury-systems). Therefore, we encourage investors and others interested in Mercury to review the information we post on the social media and other communication channels listed on our website.

ITEM 1A. RISK FACTORS:

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

Sales of our products and related services, primarily as an indirect subcontractor or team member with defense prime contractors, and in some cases directly, to the U.S. government and its agencies, as well as foreign governments and agencies, accounted for approximately 95% of our total net revenues in fiscal 2020 and 2019, and 96% of our total net revenues in fiscal 2018, respectively. Our products and services are incorporated into many different domestic and international defense programs. Over the lifetime of a defense program, the award of many different individual contracts and subcontracts may impact our products' requirements. The funding of U.S. government programs is subject to Congressional appropriations. Although multiple-year contracts may be planned in connection with major procurements, Congress generally appropriates funds on a fiscal year basis even though a program may continue for many years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations and prime contracts receive such funding. The reduction or delay in funding or termination of a government program in which we are involved could result in a loss of or delay in receiving anticipated future revenues attributable to that program and contracts or orders received. The U.S. government could reduce or terminate a prime contract under which we are a subcontractor or team member irrespective of the quality of our products or services. The termination of a program or the reduction in or failure to commit additional funds to a program in which we are involved could negatively impact our revenues and have a material adverse effect on our financial condition and results of operations. The U.S. defense budget frequently operates under a continuing budget resolution, which increases revenue uncertainty and volatility. During fiscal 2014, gridlock in Congress, a continuing budget resolution, and the implementation of defense budget sequestration impacted our revenues and increased uncertainty in our business and financial planning. For fiscal 2021 and beyond, the potential for further gridlock in Congress, the November 2020 Presidential election, another continuing budget resolution, the defense industry operating under sequestration, or the crowding out of defense funding due to historically high budget deficits could adversely impact our revenues and increase uncertainty in our business and financial planning. In addition, delays in the funding for new or existing programs, or in defense appropriation generally could negatively impact our revenues and have a material adverse effect on our financial condition and results of operations for the period in which such revenues were originally anticipated.

We face various risks related to health epidemics, pandemics and similar outbreaks, which may have material adverse effects on our business, financial position, results of operations and/or cash flows.

We face various risks related to health epidemics, pandemics, and similar outbreaks, including the outbreak of coronavirus disease 2019 and any future variants of the disease ("COVID"). The continued spread of COVID has resulted in a global health crisis that is adversely affecting the economies and financial markets of many countries, resulting in a severe economic downturn that may negatively affect demand for our products. In response to COVID, we implemented a work-from-home program for all of our employees who could perform their duties from home, limited domestic and international travel and required self-quarantines following travel, limited customer and supplier visits to our sites, implemented social distancing measures, temperature and COVID testing within our facilities, and created a \$1 million employee relief fund as well as a COVID sick leave policy providing up to 120 hours of paid leave. The extent to which COVID could further impact our business, results of operations and financial condition is highly uncertain. Despite our efforts to manage the adverse impacts of this pandemic, its ultimate impact may depend on various factors beyond our knowledge or control, including the duration and severity of the outbreak and actions taken to contain its spread and mitigate its public health effects. Examples of the actual and potential adverse impacts of COVID on our business include, but are not limited to:

- significant portions of our workforce being unable to work effectively, including because of illness, quarantines, government actions, temporary facility closures or other restrictions on our operations such as the loss of our essential business designation in the event of tighter restrictions on operations of companies in the defense industrial base;
- disruptions in our supply chain;
- the inability to perform fully on our contracts because of workforce or supply chain constraints;
- cost increases that may not be recoverable or adequately covered by our insurance, resulting in lower profitability;
- delays or limits on the ability of our customers to perform on their contracts, including in making timely payments to us;
- increased volume and effectiveness of cyber-attacks and phishing attempts designed to exploit the pandemic and the large numbers of employees working remotely;
- disruption and volatility in capital markets, increasing the cost of capital and adversely impacting our access to capital;
- slowdowns in M&A market activity, limiting our ability to execute on our M&A growth strategy;
- increased deficit spending in governmental recovery efforts leading to the crowding out of defense spending in future governmental budgets;

- additional costs to protect the health and safety of our employees, including, among others, costs to monitor and test for COVID, to reformat facilities to provide for increased social distancing, to enhance employees' ability to work from home, additional medical costs; and
- litigation related to any of the foregoing.

The uncertainties associated with the global outbreak of COVID, the foregoing impacts and other unforeseen impacts not referenced herein, as well as the ultimate impact of the COVID pandemic, are difficult to predict and could have a material adverse effect on our business, financial position, results of operations and/or cash flows.

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

The world's financial markets have, at times, experienced turmoil which could have material adverse impacts on our financial condition or our ability to achieve targeted results of operations due to:

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

Further, the funding of the defense programs that incorporate our products and services is subject to the overall U.S. government budget and appropriation decisions and processes, which are driven by numerous factors beyond our control, including geo-political, macroeconomic, public health, and political conditions. Increased Federal budget deficits could result in reduced Congressional appropriations, such as defense budget sequestration, for the defense programs that use our products and services. Reduced baseline defense budgets could reduce the number of funded programs in which we participate. In addition, the effects of any U.S. Federal government shutdown or extended continuing resolution could potentially reduce or delay the demand for our products. We are unable to predict the likely duration and severity of adverse economic conditions in the United States and other countries, but the longer the duration or the greater the severity, the greater the risks we face in operating our business.

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

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

- Changes in government administration and national and international priorities, including developments in the geo-political environment, could have a significant impact on national or international defense spending priorities and the efficient handling of routine contractual matters. These changes could have a negative impact on our business in the future.
- Our contracts with the U.S. and foreign governments and their defense prime contractors and subcontractors are subject to termination either upon default by us or at the convenience of the government or contractor if, among other reasons, the program itself has been terminated. Termination for convenience provisions generally entitles us to recover costs incurred, settlement expenses, and profit on work completed prior to termination, but there can be no assurance in this regard.
- Because we contract to supply goods and services to the U.S. and foreign governments and their prime and subcontractors, we compete for contracts in a competitive bidding process. We may compete directly with other suppliers or align with a prime or subcontractor competing for a contract. We may not be awarded the contract if the pricing or product offering is not competitive, either at our level or the prime or subcontractor level. In addition, in the event we are awarded a contract, we are subject to protests by losing bidders of contract awards that can result in the reopening of the bidding process and changes in governmental policies or regulations and other political factors. In addition, we may be subject to multiple rebid requirements over the life of a defense program in order to continue to participate in such program, which can result in the loss of the program or significantly reduce our revenue or margin from the program. The government's requirements for more frequent technology refreshes on defense programs may lead to increased costs and lower long term revenues.
- Consolidation among defense industry contractors has resulted in a few large contractors with increased bargaining power relative to us. The increased bargaining power of these contractors may adversely affect our ability to compete for contracts and, as a result, may adversely affect our business or results of operations in the future.

- Our customers include U.S. government contractors who must comply with and are affected by laws and regulations relating to the formation, administration, and performance of U.S. government contracts. In addition, when we contract with the U.S. government, we must comply with these laws and regulations, including the organizational conflict-of-interest regulations. A violation of these laws and regulations could result in the imposition of fines and penalties to us or our customers or the termination of our or their contracts with the U.S. government. As a result, there could be a delay in our receipt of orders from our customers, a termination of such orders, or a termination of contracts between us and the U.S. government.
- We sell certain products and services to U.S. and international defense contractors or directly to the U.S. government on a commercial item basis, eliminating the requirement to disclose and certify cost data. To the extent that there are interpretations or changes in the Federal Acquisition Regulations (“FAR”) regarding the qualifications necessary to sell commercial items, there could be a material impact on our business and operating results. For example, there have been legislative proposals to narrow the definition of a “commercial item” (as defined in the FAR) or to require cost and pricing data on commercial items that could limit or adversely impact our ability to contract under commercial item terms. Changes could be accelerated due to changes in our mix of business, in Federal regulations, or in the interpretation of Federal regulations, which may subject us to increased oversight by the Defense Contract Audit Agency (“DCAA”) for certain of our products or services. Such changes could also trigger contract coverage under the Cost Accounting Standards (“CAS”), further impacting our commercial operating model and requiring compliance with a defined set of business systems criteria. Growth in the value of certain of our contracts has increased our compliance burden, requiring us to implement new business systems to comply with such requirements. Failure to comply with applicable CAS requirements could adversely impact our ability to win future CAS-type contracts.
- We are subject to the Defense Federal Acquisition Regulation Supplement (“DFARS”), in connection with our defense work for the U.S. government and defense prime contractors. Amendments to the DFARS, such as the DFARS cybersecurity requirements, may increase our costs or delay the award of contracts if we are unable to certify that we satisfy such cybersecurity requirements at our Company level and into our supply chain.
- We are subject to the Department of Defense Cybersecurity Maturity Model Certification (“CMMC”) in connection with our defense work for the U.S. government and defense prime contractors. Amendments to the CMMC may increase our costs or delay the award of contracts if we are unable to certify that we satisfy such cybersecurity requirements at our Company level and into our supply chain.
- The U.S. government or a defense prime contractor customer could require us to relinquish data rights to a product in connection with performing work on a defense contract, which could lead to a loss of valuable technology and intellectual property in order to participate in a government program.
- The U.S. government or a defense prime contractor customers could require us to enter into cost reimbursable contracts that could offset our cost efficiency initiatives.
- We are subject to various U.S. Federal export-control statutes and regulations, which affect our business with, among others, international defense customers. In certain cases the export of our products and technical data to foreign persons, and the provision of technical services to foreign persons related to such products and technical data, may require licenses from the U.S. Department of Commerce or the U.S. Department of State. The time required to obtain these licenses, and the restrictions that may be contained in these licenses, may put us at a competitive disadvantage with respect to competing with international suppliers who are not subject to U.S. Federal export control statutes and regulations. In addition, violations of these statutes and regulations can result in civil and, under certain circumstances, criminal liability as well as administrative penalties which could have a material adverse effect on our business and operating results.
- We anticipate that sales to our U.S. prime defense contractor customers as part of foreign military sales (“FMS”) programs will be an increasing part of our business going forward. These FMS sales combine several different types of risks and uncertainties highlighted above, including risks related to government contracts, risks related to defense contracts, timing and budgeting of foreign governments, and approval from the U.S. and foreign governments related to the programs, all of which may be impacted by macroeconomic and geopolitical factors outside of our control.
- Certain of our employees with appropriate security clearances may require access to classified information in connection with the performance of a U.S. government contract. We must comply with security requirements pursuant to the National Industrial Security Program Operating Manual, or NISPOM, and other U.S. government security protocols when accessing sensitive information. Failure to comply with the NISPOM or other security requirements may subject us to civil or criminal penalties, loss of access to sensitive information, loss of a U.S. government contract, or potentially debarment as a government contractor. Further, the Defense Counterintelligence and Security Agency (“DCSA”) has transitioned its review of a contractor's security program to focus on the protection of critical

unclassified information and assets. Failure to meet DCSA's new, broader requirements could adversely impact the ability to win new business as a government contractor.

- We may need to invest additional capital to build out higher level security infrastructure at certain of our facilities to capture new design wins on defense programs with higher level security requirements. Failure to invest in such infrastructure may limit our ability to obtain new design wins on defense programs. In addition, we may need to invest in additional secure laboratory space to integrate efficiently subsystem level solutions and maintain quality assurance on current and future programs.

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

We are dependent on a small number of customers for a large portion of our revenues. A significant decrease in the sales to or loss of any of our major customers would have a material adverse effect on our business and results of operations. In fiscal 2020, both Lockheed Martin Corporation and Raytheon Technologies accounted for 16% of our total net revenues. In fiscal 2019, Raytheon Technologies accounted for 20% of our total net revenues and Lockheed Martin Corporation accounted for 17% of our total net revenues. In fiscal 2018, both Raytheon Technologies and Lockheed Martin Corporation accounted for 19% of our total net revenues. Customers in the defense market generally purchase our products in connection with government programs that have a limited duration, leading to fluctuating sales to any particular customer in this market from year to year. In addition, our revenues are largely dependent upon the ability of customers to develop and sell products that incorporate our products. No assurance can be given that our customers will not experience financial, technical or other difficulties that could adversely affect their operations and, in turn, our results of operations. Additionally, on a limited number of programs the customer has co-manufacturing rights which could lead to a shift of production on such a program away from us which in turn could lead to lower revenues.

Going forward, we believe the SEWIP, Filthy Buzzard, F-35, LTAMDS and a classified radar program could be a large portion of our future revenues in the coming years, and the loss or cancellation of these programs could adversely affect our future results. Further, new programs may yield lower margins than legacy programs, which could result in an overall reduction in gross margins.

If we are unable to respond adequately to our competition or to changing technology, we may lose existing customers and fail to win future business opportunities. The emergence of commodity-type products as acceptable substitutes for certain of our products may cause customers to delay purchases or seek alternative solutions.

The markets for our products are highly competitive and are characterized by rapidly changing technology, frequent product performance improvements, and evolving industry standards. Competitors may be able to offer more attractive pricing or develop products that could offer performance features that are superior to our products, resulting in reduced demand for our products. We may be unable to keep pace with competitors' marketing and the lack of visibility in the marketplace may negatively impact design wins, bookings, and revenues. Customers may also decide to reduce costs and accept the least costly technically acceptable alternative to our products or services. In addition, customers may decide to insource products that they have traditionally outsourced to us. Due to the rapidly changing nature of technology, we may not become aware in advance of the emergence of new competitors into our markets. The emergence of new competitors into markets targeted by us could result in the loss of existing customers and may have a negative impact on our ability to win future business opportunities. Perceptions of Mercury as a high-cost provider could cause us to lose existing customers or fail to win new business. Further, our lack of strong engagements with important government-funded laboratories (e.g. DARPA, MIT Lincoln Labs, MITRE) may inhibit our ability to become subsystem solution design partners with our defense prime customers.

Our products are often designed for operating under physical constraints such as limited space, weight, and electrical power. Furthermore, these products are often designed to be "rugged," that is, to withstand enhanced environmental stress such as extended temperature range, shock, vibration, and exposure to sand or salt spray. Historically these requirements have often precluded the use of less expensive, readily available commodity-type systems typically found in more benign non-military settings. With continued microprocessor evolution, low-end systems could become adequate to meet the requirements of an increased number of the lesser-demanding applications within our target markets. Workstation or blade center computer manufacturers and other low-end single-board computer, or new competitors, may attempt to penetrate the high-performance market for defense electronics systems. Factors that may increase the acceptability of commodity-type products in some defense platforms that we serve include improvements in the physical properties and durability of such alternative products, combined with the relaxation of physical and ruggedness requirements by the military due to either a reevaluation of those requirements or the installation of products in a more highly environmentally isolated setting. These developments could negatively impact our revenues and have a material adverse effect on our business and operating results.

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

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

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

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

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

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

- our ability to create demand for products in new markets;
- our ability to respond to changes in our customers' businesses by updating existing products and introducing, in a timely fashion, new products which meet the needs of our customers;
- our ability to increase our market visibility and penetration with the prime defense contractors;
- the quality of our new products;
- our ability to respond rapidly to technological change;
- our ability to increase our in-house manufacturing capacity and utilization; and
- our ability to successfully identify and integrate any acquisitions that we make and achieve revenue and cost synergies and economies of scale.

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

Growing our business, in particular by providing services and products such as sophisticated subsystems for major defense programs could strain our operational capacity and working capital demands if not properly anticipated and managed. Pursuing such growth could result in our operational and infrastructure resources being spread too thin, which could negatively impact our ability to deliver quality product on schedule and on budget. Providing innovative subsystem level products is a key driver of our growth strategy and the failure to properly scale our capabilities to support our customers at a subsystem level

could result in lost opportunities and revenues. Failure to implement consistent enterprise resource planning and management systems across our entire platform, to increase the level of automation to scale our operations and to establish a uniform program management process for lifecycle management could negatively impact our ability to generate efficiencies to achieve cost reduction objectives.

Future acquisitions may adversely affect our financial condition.

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

Acquisitions may pose risks to our operations, including:

- problems and increased costs in connection with the integration of the personnel, operations, technologies, IT infrastructure, or products of the acquired businesses;
- layering of integration activity due to multiple overlapping acquisitions;
- unanticipated costs;
- failure to achieve anticipated increases in revenues and profitability;
- diversion of management's attention from our organic business;
- adverse effects on business relationships with suppliers and customers and those of the acquired company;
- acquired assets becoming impaired as a result of technical advancements or worse-than-expected performance by the acquired company;
- failure to rationalize manufacturing capacity, locations, and operating models to achieve anticipated economies of scale, or disruptions to manufacturing and product design operations during the combination of facilities;
- failure to rationalize business and information systems and to expand the IT infrastructure and security protocols throughout the enterprise;
- volatility associated with accounting for earn-outs in a given transaction;
- entering markets in which we have no, or limited, prior experience;
- poor export control programs pre-acquisition at acquired companies, which may lead to liabilities for export violation, or impact the business acquired when placed under our export compliance program;
- potential loss of key employees; and
- adverse effects on our internal control over financial reporting before the acquiree's complete integration into our control environment.

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

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

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

We may not realize the expected benefits, including synergies, of our recent acquisitions because of integration difficulties and other challenges.

While we expect our recent acquisitions to result in synergies and other financial and operational benefits, we may be unable to realize these synergies or other benefits in the timeframe that we expect or at all. The success of the acquisitions will depend, in part, on our ability to realize the anticipated benefits from integrating such businesses with our existing business. The integration process may be complex, costly and time consuming.

The difficulties of integrating the operations of these companies include, among others:

- failure to implement our business plan for the combined business;
- unanticipated issues in integrating manufacturing, logistics, business systems, information and communications systems, and other infrastructure items;
- unanticipated changes in applicable laws and regulations;
- failure to retain key employees;
- failure to retain key customers;
- failure to rationalize our supply chain;
- operating risks inherent in these companies and our organic business;
- the impact of any assumed legal proceedings;
- the impact of our export compliance program on these companies;
- the impact on our internal controls and compliance with the regulatory requirements under the Sarbanes-Oxley Act of 2002; and
- unanticipated issues, expenses, charges, and liabilities related to the acquisitions.

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

The market price of our common stock may decline as a result of our M&A activity.

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

We may incur substantial indebtedness.

On September 28, 2018, we amended our existing revolving credit facility (“the Revolver”) to increase and extend the borrowing capacity to a \$750.0 million, 5-year revolving credit line, with the maturity extended to September 28, 2023. As of July 3, 2020, we had no outstanding borrowings on the Revolver. The Revolver accrues interest, at our option, at floating rates tied to LIBOR or the prime rate plus an applicable percentage. The applicable percentage is set at LIBOR plus 1.25% and is established pursuant to a pricing grid based on our total net leverage ratio. We may be exposed to the impact of interest rate changes primarily through our borrowing activities. Subject to the limits contained in the Revolver, we may incur substantial additional debt from time to time to finance working capital, capital expenditures, investments or acquisitions, or for other purposes. If we do so, the risks related to our debt could intensify. Specifically, our debt could have important consequences to our investors, including the following:

- making it more difficult for us to satisfy our obligations under our debt instruments, including, without limitation, the Revolver; 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 may 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 Revolver contains restrictive covenants that may limit our ability to engage in activities that are in our long term best interest. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all our debt. And, if we were unable to repay the amounts due and payable, the lenders under the Revolver could proceed against the collateral granted to them to secure that indebtedness.

In addition, increases in interest rates would increase the cost of servicing our financial instruments with exposure to interest rate risk and could materially reduce our profitability and cash flows. While we had no borrowings on our Revolver at July 3, 2020, assuming that we had \$100.0 million of floating rate debt outstanding, our annual interest expense would change by approximately \$1.0 million for each 100 basis point increase in interest rates.

We may also incur costs related to interest rate hedges, including the termination of any such hedges. As of July 3, 2020, we did not have any interest rate hedge instruments in effect. During the fourth quarter of fiscal 2019, in conjunction with the net proceeds generated by a follow-on equity offering, we repaid all of our then outstanding borrowings on the Revolver, including \$175.0 million with a fixed interest rate hedge, with the termination of the interest rate hedge resulting in \$5.4 million in settlement costs.

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

At July 3, 2020, the carrying values of goodwill and identifiable intangible assets on our balance sheet were \$614.1 million and \$208.7 million, respectively. We evaluate indefinite lived intangible assets and goodwill for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Indefinite lived intangible assets are impaired and goodwill impairment is indicated when their book value exceeds fair value. We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our long-lived assets decline because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary. The value of goodwill and intangible assets from the allocation of purchase price from our recent acquisitions will be derived from our business operating plans and is susceptible to an adverse change in demand, input costs or general changes in our business or industry and could require an impairment charge in the future.

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

Several components used in our products are currently obtained from sole-source suppliers. We are dependent on key vendors such as Xilinx, Inc., Intel Corporation and Microsemi for Field Programmable Gate Arrays (“FPGA”), on Semiconductor for Application-Specific Integrated Circuits (“ASICs”), Intel Corporation and NXP Semiconductor for processors, Micron Technology, Inc. for specific memory products and in general any sole-source microelectronics suppliers. Generally, suppliers may terminate their contracts with us without cause upon 30 days’ notice and may cease offering their products upon 180 days’ notice. If any of our sole-source suppliers limits or reduces the sale of these components, we may be unable to fulfill customer orders in a timely manner or at all. In addition, if these or other component suppliers, some of which are small companies, experienced financial difficulties or other problems that prevented them from supplying us with the necessary components, we could experience a loss of revenues due to our inability to fulfill orders. These sole-source and other suppliers are each subject to quality and performance issues, materials shortages, excess demand, reduction in capacity and other factors that may disrupt the flow of goods to us or to our customers, which would adversely affect our business and customer relationships. We have no guaranteed supply arrangements with our suppliers and there can be no assurance that these suppliers will continue to meet our requirements. If supply arrangements are interrupted, we may not be able to find another supplier on a timely or satisfactory basis. We may incur significant set-up costs and delays in manufacturing should it become necessary to replace any key vendors due to work stoppages, shipping delays, financial difficulties, natural or manmade disasters or other factors.

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

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

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

With the expansion of our product lines in recent years, primarily related to the acquisition of APC in fiscal 2020, Athena, Syntonic, GECCO and Germane in fiscal 2019, as well as our earlier acquisitions of Themis, RTL, Delta, CES, the Carve-Out Business, LIT, Micronetics, Inc., KOR Electronics, and LNX Corporation, the mix and volume of products that we manufacture in-house has increased. With the building of our Advanced Microelectronics Center in Hudson, New Hampshire and the expansion of our Phoenix, Arizona facility, we have become more vertically integrated in our product lines. This vertical integration has led to higher capital intensity and labor utilization rate volatility which could affect our profitability, and higher fixed costs. Also, the changes to business processes and IT systems required to combine two locations into a single site like our Advanced Microelectronics Center in Oxnard, California may interrupt our operations for a period of time resulting in higher costs, lower revenues and missed opportunities for design wins. In addition, Benchmark Electronics, Inc. notified us in 2016 that they would no longer contract manufacture certain of our digital processing products at their Huntsville, Alabama facility due to internal integration planning at Benchmark. As a result, we began to internally manufacture the impacted Huntsville, Alabama digital processing product line at our Phoenix, Arizona facility. With our build out of the USMO, we are developing a second source for our digital processing product manufacturing needs to complement our contract manufacturing relationship with Benchmark Electronics. With a source of internal manufacturing to meet an increasing portion of our digital processing product manufacturing needs, we will need to manage effectively our relationship with our contract manufacturers to manage our order volumes, scale production to meet volume requirements, and maintain necessary inventory levels.

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

We market and sell products in international markets, have sales offices and subsidiaries in the United Kingdom and Japan and we have manufacturing and/or engineering facilities and subsidiaries in Switzerland, Spain, Canada, and France. Revenues from international operations accounted for 7%, 8%, and 9%, of our total net revenues in fiscal 2020, 2019, and 2018, respectively. We also ship directly from our U.S. operations to international customers. There are inherent risks in transacting business internationally, including:

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

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

We have a pension plan (the "Plan") for Swiss employees, mandated by Swiss law. Since participants of the Plan are entitled to a defined rate of interest on contributions made, the Plan meets the criteria for a defined benefit plan under U.S. GAAP. The Plan, an independent pension fund, is part of a multi-employer plan with unrestricted joint liability for all participating companies and the economic interest in the Plan's overfunding or underfunding is allocated to each participating company based on an allocation key determined by the Plan. U.S. GAAP requires an employer to recognize the funded status of the defined benefit plan on the balance sheet, which we have presented in other long-term liabilities on our Consolidated

Balance Sheets at July 3, 2020. The funded status may vary from year to year due to changes in the fair value of the Plan's assets and variations on the underlying assumptions in the Plan and we may have to record an increased liability as a result of fluctuations in the value of the Plan's assets. As of July 3, 2020, we had a liability of \$11.9 million in Other non-current liabilities representing the net under-funded status of the Plan.

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

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

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

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

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

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

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

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

losses by pursuing products liability claims against us which, even if unsuccessful, would likely be time-consuming and costly to defend and could adversely affect our reputation.

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

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

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

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

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

Our need for continued or increased investment in R&D may increase expenses and reduce our profitability.

Our industry is characterized by the need for continued investment in R&D. If we fail to invest sufficiently in R&D, our products could become less attractive to potential customers and our business and financial condition could be materially and adversely affected. As a result of the need to maintain or increase spending levels in this area and the difficulty in reducing costs associated with R&D, our operating results could be materially harmed if our R&D efforts fail to result in new products or if revenues fall below expectations. As a result of our commitment to invest in R&D, spending levels of R&D expenses as a percentage of revenues may fluctuate in the future. In addition, defense prime contractors could increase their requirement for sub-contractors, like us, to increase their share in the R&D costs for new programs and design wins.

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

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

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

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

- delays in completion of internal product development projects;

- delays in shipping hardware and software;
- delays in acceptance testing by customers;
- a change in the mix of products sold to our served markets;
- changes in customer order patterns;
- production delays due to quality problems with outsourced components;
- inability to scale quick reaction capability products due to low product volume;
- shortages and costs of components;
- delays due to the implementation of new tariffs or other trade barriers;
- the timing of product line transitions;
- declines in quarterly revenues from previous generations of products following announcement of replacement products containing more advanced technology;
- inability to realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits;
- potential asset impairment, including goodwill and intangibles, or restructuring charges; and
- changes in estimates of completion on fixed price service engagements.

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

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

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

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

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

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

Our future success also depends on our ability to identify, attract, hire, train, retain, and motivate highly skilled managerial and operational personnel on a timely basis as we continue our pace of growth. In addition, our ability to maintain growth as a portion of our workforce nears retirement is dependent upon our ability to adapt to the pending changes in our workforce demographics. If we fail to attract, integrate, and retain the necessary personnel, our ability to maintain and grow our business could suffer significantly. Further, improvements in the economy and labor markets could impact our ability to attract and retain key personnel.

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

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

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

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

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

We must comply with security requirements pursuant to the National Industrial Security Program Operating Manual, or NISPOM, and other U.S. government security protocols when accessing sensitive information. Most of our facilities maintain a facility security clearance and many of our employees maintain a personal security clearance in order to access sensitive information necessary to the performance of our work on certain U.S. government contracts and subcontracts. Failure to comply with the NISPOM or other security requirements may subject us to civil or criminal penalties, loss of access to sensitive information, loss of a U.S. government contract or subcontract, or potentially debarment as a government contractor.

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

Our business is subject to heightened risks of cyber intrusion as nation-state hackers seek access to technology used in U.S. defense programs. We are also targeted by spear phishing attacks in which an email directed at a specific individual or department is disguised to appear to be from a trusted source to obtain sensitive information. Like all DoD contractors that process, store, or transmit controlled unclassified information, we must meet DFARS minimum security standards or risk losing our DoD contracts. We securely store our designs, schematics, and source code for our products as they are created. A breach, whether physical, electronic or otherwise, of the systems on which this sensitive data is stored could lead to damage or piracy of our products. If we experience a data security breach from an external source or from an insider threat, we may have a loss in sales or increased costs arising from the restoration or implementation of additional security measures, either of which could adversely affect our business and financial results. Other potential costs could include damage to our reputation, loss of brand value, incident response costs, loss of stock market value, regulatory inquiries, litigation, and management distraction. A security breach that involves classified information could subject us to civil or criminal penalties, loss of a government contract, loss of access to classified information, or debarment as a government contractor. Similarly, a breach that involves loss of customer-provided data could subject us to loss of a customer, loss of a contract, litigation costs and legal damages, and reputational harm.

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

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

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

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

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

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

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

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

The Massachusetts Business Corporation Act permits directors to look beyond the interests of shareholders and consider other constituencies in discharging their duties. In determining what the director of a Massachusetts corporation reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors, and customers, the economy of the state, the region, and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation. This provision of Massachusetts law could reduce the likelihood that we may be acquired in a transaction that our shareholders consider to be attractive.

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

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

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

Our stock price, like that of other technology and aerospace and defense companies, can be volatile. The stock market in general and technology companies in particular may continue to experience volatility. The stock prices for companies in the aerospace and defense industry may continue to remain volatile given uncertainty and timing of funding for defense programs. This volatility may or may not be related to our operating performance. Our operating results, from time to time, may be below the expectations of public market analysts and investors, which could have a material adverse effect on the market price of our common stock. Market rumors or the dissemination of false or misleading information may impact our stock price. When the market price of a stock has been volatile, holders of that stock will sometimes file securities class action litigation against the company that issued the stock. If any shareholders were to file a lawsuit, we could incur substantial costs defending the lawsuit. Also, the lawsuit could divert the time and attention of management.

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

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

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

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

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

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

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

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

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

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following table sets forth our significant properties as of July 3, 2020:

| Location | Size in Sq. Feet | Commitment |
|-----------------|-------------------------|--------------------------|
| Andover, MA | 145,262 | Leased, expiring 2032 |
| Phoenix, AZ | 125,756 | Leased, expiring 2031 |
| Hudson, NH | 121,553 | Leased, expiring 2024 |
| Oxnard, CA | 72,673 | Leased, expiring 2025 |
| Fremont, CA | 53,713 | Leased, expiring 2023 |
| Cypress, CA | 42,770 | Leased, expiring 2028 |
| Alpharetta, GA | 35,005 | Leased, expiring 2028 |
| Chantilly, VA | 32,789 | Leased, expiring 2025 |
| Mesa, AZ | 31,820 | Leased, expiring 2022 |
| Geneva, CH | 27,287 | Leased, expiring 2027 |
| Cypress, CA | 25,990 | Subleased, expiring 2020 |

We actively manage our facilities and are in pursuit of lease extensions or alternative locations for facilities with expiration dates in 2020 and 2021. In addition, we lease a number of smaller offices around the world primarily for sales. Effective July 1, 2019, the Company adopted ASC 842, *Leases*, (“ASC 842”). We adopted ASC 842 using the optional transition method and, as a result, there have been no reclassifications of prior comparable periods due to this adoption. See

Note B and Note J to the consolidated financial statements for more information regarding our obligations under leases and the adoption of this standard.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 4.1. INFORMATION ABOUT OUR EXECUTIVE OFFICERS

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

Mark Aslett, age 52, joined Mercury in 2007 and has served as the President and Chief Executive Officer and as a member of the Board since 2007. Prior to joining Mercury, he was Chief Operating Officer and Chief Executive Officer of Enterasys Networks from 2003 to 2006, and held various positions with Marconi plc and its affiliated companies, including Executive Vice President of Marketing, Vice President of Portfolio Management, and President of Marconi Communications-North America, from 1998 to 2002. Mr. Aslett has also held positions at GEC Plessey Telecommunications, as well as other telecommunications-related technology firms.

Christopher C. Cambria, age 62, joined Mercury in 2016 as Senior Vice President, General Counsel, and Secretary and was appointed Executive Vice President, General Counsel, and Secretary in 2017. Prior to joining Mercury, he was Vice President, General Counsel, and Secretary of Aerojet Rocketdyne Holdings, Inc. from 2012 to 2016 and Vice President, General Counsel from 2011 to 2012. He was with L-3 Communications Holdings, Inc. from 1997 through 2009 serving as Senior Vice President and Senior Counsel, Mergers and Acquisitions from 2006 to 2009, Senior Vice President, Secretary and General Counsel from 2001 to 2006, and Vice President, General Counsel and Secretary from 1997 to 2001. Prior to L-3, Mr. Cambria was an Associate with Fried, Frank, Harris, Shriver & Jacobson and Cravath, Swaine & Moore.

Michael D. Ruppert, age 46, joined Mercury in 2014 as Senior Vice President, Strategy and Corporate Development and in 2017 was named Executive Vice President, Strategy and Corporate Development. In 2018, Mr. Ruppert was appointed the Company's Executive Vice President, Chief Financial Officer and Treasurer. Prior to joining Mercury, from 2013 to 2014, Mr. Ruppert was Co-Founder and Managing Partner of RS Partners, LLC, a boutique advisory firm focused on the aerospace & defense industries. Prior to that, he was a Managing Director at UBS Investment Bank where he led the defense investment banking practice from 2011 to 2013. Mr. Ruppert also held positions in the investment banking divisions at Lazard Freres & Co from 2008 to 2011 and at Lehman Brothers from 2000 to 2008.

Didier M.C. Thibaud, age 59, joined Mercury in 1995, and has served as our Executive Vice President, Chief Operating Officer since 2016. He served as the President of our Mercury Commercial Electronics business unit from 2012 to 2016 and the President of our Advanced Computing Solutions business unit from 2007 to 2012. Prior to that, he was Senior Vice President, Defense & Commercial Businesses from 2005 to 2007 and Vice President and General Manager, Imaging and Visualization Solutions Group, from 2000 to 2005 and served in various capacities in sales and marketing from 1995 to 2000.

PART II

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

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

| | High | Low |
|---------------------|----------|----------|
| 2020 Fourth quarter | \$ 92.80 | \$ 68.26 |
| Third quarter | \$ 86.47 | \$ 57.10 |
| Second quarter | \$ 81.17 | \$ 68.41 |
| First quarter | \$ 88.75 | \$ 68.31 |
| 2019 Fourth quarter | \$ 79.83 | \$ 63.39 |
| Third quarter | \$ 67.85 | \$ 43.01 |
| Second quarter | \$ 55.82 | \$ 41.16 |
| First quarter | \$ 57.26 | \$ 37.55 |

As of July 31, 2020, we had 482 record shareholders and 34,461 nominee holders.

Dividend Policy

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

Net Share Settlement Plans

The following table includes information with respect to net share settlements we made of our common stock during the fiscal year ended July 3, 2020:

| <u>Period of Net Share Settlement</u> | <u>Total Number of Shares Net Settled(1)</u> | <u>Average Price Per Share</u> |
|--|--|--------------------------------|
| July 1, 2019 - September 27, 2019 | 178 | \$ 82.50 |
| September 28, 2019 - December 27, 2019 | 5 | \$ 73.26 |
| December 28, 2019 - March 27, 2020 | 6 | \$ 79.54 |
| March 28, 2020 - July 3, 2020 | 8 | \$ 81.54 |
| Total | 197 | |

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

Share Repurchase Plans

During fiscal 2020, we had no active share repurchase programs.

Equity Compensation Plans

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

ITEM 6. SELECTED FINANCIAL DATA

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

| | Fiscal Years | | | | |
|--------------------------------------|--------------|------------|------------|------------|------------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| Statement of Operations Data: | | | | | |
| Net revenues | \$ 796,610 | \$ 654,744 | \$ 493,184 | \$ 408,588 | \$ 270,154 |
| Income from operations | \$ 91,062 | \$ 76,584 | \$ 46,985 | \$ 37,403 | \$ 23,973 |
| Net income | \$ 85,712 | \$ 46,775 | \$ 40,883 | \$ 24,875 | \$ 19,742 |
| Net earnings per share: | | | | | |
| Basic | \$ 1.57 | \$ 0.98 | \$ 0.88 | \$ 0.59 | \$ 0.58 |
| Diluted | \$ 1.56 | \$ 0.96 | \$ 0.86 | \$ 0.58 | \$ 0.56 |
| Adjusted EBITDA ⁽¹⁾ | \$ 176,242 | \$ 145,326 | \$ 114,567 | \$ 92,576 | \$ 56,137 |
| Adjusted EPS ⁽¹⁾ | \$ 2.30 | \$ 1.84 | \$ 1.41 | \$ 1.12 | \$ 0.94 |

| | As of Fiscal Years | | | | |
|--------------------------------------|--------------------|--------------|--------------|------------|------------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| Balance Sheet Data: | | | | | |
| Working capital | \$ 508,854 | \$ 484,140 | \$ 260,063 | \$ 173,351 | \$ 177,748 |
| Total assets ⁽²⁾ | \$ 1,610,720 | \$ 1,416,977 | \$ 1,064,480 | \$ 815,745 | \$ 736,496 |
| Long-term obligations ⁽²⁾ | \$ 100,021 | \$ 34,206 | \$ 220,909 | \$ 17,483 | \$ 195,808 |
| Total shareholders' equity | \$ 1,384,784 | \$ 1,284,739 | \$ 771,891 | \$ 725,417 | \$ 473,044 |

- (1) Adjusted EBITDA and adjusted EPS are key measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"). Refer to "Non-GAAP Financial Measures" in Management's Discussion and Analysis of Financial Condition and Results of Operations for our definition of these measures, including reconciliations to our most directly comparable GAAP financial measures.
- (2) Effective July 1, 2019, the Company has adopted ASC 842 using the optional transition method and, as a result, there have been no reclassifications of prior comparable periods due to this adoption. As of July 3, 2020, the Company has Right-of-use assets of \$60,613 and total Lease liabilities of \$73,931, of which \$66,981 is included in Long-term obligations.

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

FORWARD-LOOKING STATEMENTS

From time to time, information provided, statements made by our employees or information included in our filings with the Securities and Exchange Commission ("SEC") may contain statements that are not historical facts but that are "forward-looking statements," which involve risks and uncertainties. You can identify these statements by the use of the words "may," "will," "could," "should," "would," "plans," "expects," "anticipates," "continue," "estimate," "project," "intend," "likely," "forecast," "probable," "potential," and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of epidemics and pandemics such as COVID, effects of any U.S. Federal government shutdown or extended continuing resolution, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, Federal export control or procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to interest rate swaps or other cash flow hedging arrangements, changes to industrial security and cyber-security regulations and requirements, changes in tax rates or tax regulations, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as set forth under Part I-Item 1A (Risk Factors) in this Annual Report on Form 10-K. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

OVERVIEW

Mercury Systems, Inc. is a leading technology company serving the aerospace and defense industry, positioned at the intersection of high-tech and defense. Headquartered in Andover, Massachusetts, we deliver solutions that power a broad range of aerospace and defense programs, optimized for mission success in some of the most challenging and demanding environments. We envision, create and deliver innovative technology solutions purpose-built to meet our customers' most-pressing high-tech needs, including those specific to the defense community.

As a leading manufacturer of essential components, modules and subsystems, we sell to defense prime contractors, the U.S. government and OEM commercial aerospace companies. Mercury has built a trusted, contemporary portfolio of proven product solutions purpose-built for aerospace and defense that it believes meets and exceeds the performance needs of our defense and commercial customers. Customers add their own applications and algorithms to our specialized, secure and innovative pre-integrated solutions. This allows them to complete their full system by integrating with their platform, the sensor technology and, in some cases, the processing from Mercury, with their platform. Our products and solutions are deployed in more than 300 programs with over 25 different defense prime contractors and commercial aviation customers.

Mercury's transformational business model accelerates the process of making new technology profoundly more accessible to our customers by bridging the gap between commercial technology and aerospace and defense applications. Our long-standing deep relationships with leading high-tech companies, coupled with our high level of R&D investments and industry-leading trusted and secure design and manufacturing capabilities, are the foundational tenets of this highly successful model.

Our capabilities, technology and R&D investment strategy combine to differentiate Mercury in our industry. Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, secure and rugged rack-mount servers, safety-critical avionics, RF components, multi-function assemblies, subsystems and custom microelectronics. We maintain our technological edge by investing in critical capabilities and IP in processing and RF, leveraging open standards and open architectures to adapt quickly those building blocks into solutions for highly data-intensive applications, including emerging needs in areas such as AI.

Our mission critical solutions are deployed by our customers for a variety of applications including C4ISR, electronic intelligence, avionics, EO/IR, electronic warfare, weapons and missile defense, hypersonics and radar.

Since we conduct much of our business with our defense customers via commercial items, requests by customers are a primary driver of revenue fluctuations from quarter to quarter. Customers specify delivery date requirements that coincide with

their need for our products. Because these customers may use our products in connection with a variety of defense programs or other projects of different sizes and durations, a customer's orders for one quarter generally do not indicate a trend for future orders by that customer. Additionally, order patterns do not necessarily correlate amongst customers and, therefore, we generally cannot identify sequential quarterly trends.

As of July 3, 2020, we had 1,947 employees. During fiscal 2018, the growth in our headcount resulted in us exceeding the threshold for qualifying as a "small business" for government contract purposes. The revenues received as a result of small business set aside funding are not considered material.

Our consolidated revenues, acquired revenues, net income, EPS, adjusted EPS, and adjusted EBITDA for fiscal 2020 were \$796.6 million, \$64.0 million, \$85.7 million, \$1.56, \$2.30 and \$176.2 million, respectively. Our consolidated revenues, acquired revenues, net income, EPS, adjusted EPS and adjusted EBITDA for fiscal 2019 were \$654.7 million, \$13.5 million, \$46.8 million, \$0.96, \$1.84 and \$145.3 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

OUR RESPONSE TO COVID

The COVID pandemic continues to impact people and countries around the world. This is a time of extraordinary uncertainty. It is also a time when the work we do in support of strategic national priorities is recognized as critical.

At Mercury, we remain focused on the four goals we established at the outset of the COVID crisis: to protect the health, safety, and livelihoods of our people; to mitigate or reduce operational and financial risks to the Company; to continue to deliver on our commitments to customers and shareholders; and to continue the mission-critical work Mercury does every day to support the ongoing security of our nation, our brave men and women in uniform, and the communities in which we all live.

To protect the health, safety, and livelihoods of our employees, we took immediate action on several fronts, instituting a variety of new policies and programs including, but not limited to, additional sick leave for COVID-related circumstances, a work-from-home policy for all employees who can perform their duties remotely as well as increasing overtime pay for eligible employees. We also established a relief fund, with an initial \$1 million budget, to assist eligible Mercury employees, including temporary agency employees, experiencing unexpected financial burdens as a result of the COVID crisis. The intent of the Mercury COVID Relief Fund is to provide financial assistance to employees who may otherwise be unable to pay for basic necessities, unexpected care for immediate family members, or other urgent needs that promote their health and safety during the current COVID crisis.

As we have been designated an "essential business" as a part of the defense industrial base, during the year, our facilities continued to operate while complying with social distancing requirements consistent with Centers for Disease Control and Prevention ("CDC") guidelines and requirements. We implemented numerous preventive measures to maximize the safety of our facilities, including but not limited to, establishing physical segregation areas, implementing environmental cleaning and disinfection protocols in compliance with CDC guidelines and requirements, temperature and COVID testing at our manufacturing facilities, and limiting non-essential site visits by internal and external visitors.

We will continue to monitor and assess our response to protect the health, safety and livelihoods of our people.

BUSINESS DEVELOPMENTS:

FISCAL 2020

During the third quarter ended March 27, 2020, we drew \$200.0 million on our \$750.0 million Revolver to provide access to capital and flexibility in managing operations during this time of uncertainty due to the outbreak of COVID. We paid down the \$200.0 million draw during our fourth quarter ended July 3, 2020 based on reduced turbulence in the capital markets.

On September 23, 2019, we acquired American Panel Corporation ("APC") on a cash-free, debt-free basis for a total purchase price of \$100,000, prior to net working capital and net debt adjustments. Based in Alpharetta, Georgia, APC is a leading innovator in large area display technology for the aerospace and defense market. APC's capabilities are deployed on a wide range of next-generation platforms. The acquisition was funded with cash on hand.

Effective July 1, 2019, our fiscal year has changed to the 52-week or 53-week period ending on the Friday closest to the last day in June. All references to fiscal 2020 are to the 53-week period from July 1, 2019 to July 3, 2020. All references to fiscal 2019 is to the 52-week period from July 1, 2018 to June 30, 2019. There have been no reclassifications of prior comparable periods due to this change.

FISCAL 2019

On May 20, 2019, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On May 31, 2019 we closed the offering, including the full over-allotment allocation, selling an aggregate of 6.9 million shares of common stock at a price to the public of \$69.00 for total net proceeds of \$454.3 million.

On April 18, 2019, we acquired The Athena Group, Inc. (“Athena”) and Syntonic Microwave LLC (“Syntonic”). Athena was a privately-held company based in Gainesville, Florida and a leading provider of cryptographic and countermeasure IP vital to securing defense computing systems. Syntonic was a privately held company based in Campbell, California and a leading provider of advanced synthesizers, wideband phase coherent tuners and microwave converters optimized for signals intelligence and electronic intelligence applications demanding frequency coverage up to 40 GHz with 2 GHz instantaneous bandwidth. The acquisition and transaction related expenses were funded with borrowings obtained under the Revolver.

On January 29, 2019, we acquired GECO Avionics, LLC (“GECO”). Based in Mesa, Arizona, GECO has over twenty years of experience designing and manufacturing affordable safety-critical avionics and mission computing solutions. The acquisition and transaction related expenses were funded with borrowings obtained under the Revolver.

On September 28, 2018, we amended the Revolver to increase and extend the borrowing capacity to a \$750.0 million, 5-year revolving credit line, with the maturity extended to September 2023. During fiscal 2019, we drew additional borrowings of \$129.5 million to facilitate the acquisitions of Germane, GECO, Athena and Syntonic in the first, third and fourth quarters of fiscal 2019, respectively. In conjunction with the net proceeds generated by our follow-on equity offering, we paid down the balance on the Revolver during the fourth quarter of fiscal 2019 and terminated our hedge facility.

On July 31, 2018, we acquired Germane Systems, LC (“Germane”). Based in Chantilly, Virginia, Germane is an industry leader in the design, development and manufacturing of rugged servers, computers and storage systems for command, control and intelligence (“C2I”) applications. The acquisition and transaction related expenses were funded with borrowings obtained under the Revolver.

RESULTS OF OPERATIONS:

FISCAL 2020 VS. FISCAL 2019

Results of operations for fiscal 2020 include full period results from the acquisitions of Germane, GECO, Athena, Syntonic and only the results from acquisition date for APC, which was acquired subsequent to fiscal 2019. Results of operations for fiscal 2019 include only results from the acquisition date for Germane, GECO, Athena and Syntonic. Accordingly, the periods presented below are not directly comparable. There was also an additional three days of operations in fiscal 2020 which did not have a material impact on our results of operations. The Company has applied the FAST Act Modernization and Simplification of Regulation S-K, which limits the discussion to the two most recent fiscal years. Refer to Item 7 of the Company’s Form 10-K issued on August 15, 2019 for prior year discussion related to fiscal 2018.

The following tables set forth, for the periods indicated, financial data from the Consolidated Statements of Operations and Comprehensive Income:

| (In thousands) | Fiscal 2020 | As a % of Total Net Revenue | Fiscal 2019 | As a % of Total Net Revenue |
|--|-------------|-----------------------------------|-------------|-----------------------------------|
| Net revenues | \$ 796,610 | 100.0 % | \$ 654,744 | 100.0 % |
| Cost of revenues | 439,766 | 55.2 | 368,588 | 56.3 |
| Gross margin | 356,844 | 44.8 | 286,156 | 43.7 |
| Operating expenses: | | | | |
| Selling, general and administrative | 132,253 | 16.6 | 110,717 | 16.9 |
| Research and development | 98,485 | 12.4 | 68,925 | 10.5 |
| Amortization of intangible assets | 30,560 | 3.8 | 27,914 | 4.3 |
| Restructuring and other charges | 1,805 | 0.2 | 560 | 0.1 |
| Acquisition costs and other related expenses | 2,679 | 0.4 | 1,456 | 0.2 |
| Total operating expenses | 265,782 | 33.4 | 209,572 | 32.0 |
| Income from operations | 91,062 | 11.4 | 76,584 | 11.7 |
| Interest income | 2,151 | 0.3 | 932 | 0.1 |
| Interest expense | (1,006) | (0.1) | (9,109) | (1.4) |
| Other income (expense), net | 1,726 | 0.2 | (8,880) | (1.3) |
| Income before income taxes | 93,933 | 11.8 | 59,527 | 9.1 |
| Tax provision | 8,221 | 1.0 | 12,752 | 2.0 |
| Net income | \$ 85,712 | 10.8 % | \$ 46,775 | 7.1 % |

REVENUES

Total revenues increased \$141.9 million, or 22%, to \$796.6 million during fiscal 2020 compared to \$654.7 million during fiscal 2019 including “acquired revenue” which represents net revenue from acquired businesses that have been part of Mercury for completion of four full quarters or less (and excludes any intercompany transactions). After the completion of four fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenue was primarily due to \$91.4 million and \$50.5 million of organic revenues and acquired revenues, respectively. These increases were driven by higher demand throughout all product groupings, especially integrated subsystems, across all end applications and, in particular, radar, within the airborne, naval and land platforms. The increase in total revenues is primarily attributed to higher revenues associated with the P8, SEWIP and AIDEWS programs. Acquired revenue represents activity from the Germane, GECCO, Athena, Syntonic and APC acquired businesses. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

International revenues, which consist of foreign military sales through the U.S. government, sales to prime defense contractor customers where the end user is known to be outside of the U.S., and direct sales to non-U.S. based customers, increased \$18.1 million to \$91.9 million during fiscal 2020 compared to \$73.8 million during fiscal 2019. International revenues represented 11.5% and 11.3% of total revenues during fiscal 2020 and 2019, respectively.

GROSS MARGIN

Gross margin was 44.8% for fiscal 2020, an increase of 110 basis points from 43.7% in fiscal 2019. The higher gross margin was primarily driven by program mix, including a higher volume of secure processing programs, and operational efficiencies, including higher utilization. These gross margin improvements were partially offset by a higher volume of Customer Funded Research and Development (“CRAD”), COVID related expenses and \$1.1 million of additional inventory step-up amortization, as compared to fiscal 2019. CRAD primarily represents engineering labor associated with long-term contracts for customized development, production and service activities. These products are predominately grouped within integrated subsystems and, to a lesser extent, modules and sub-assemblies.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$21.6 million, or 20.0%, to \$132.3 million during fiscal 2020 as compared to \$110.7 million during fiscal 2019. The increase was primarily related to additional headcount from organic growth and our recent acquisitions as well as COVID related expenses. Selling, general and administrative expenses decreased as a percentage of revenue to 16.6% during fiscal 2020 from 16.9% during fiscal 2019 evidencing improved operating leverage.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$29.6 million, or 43.0%, to \$98.5 million during fiscal 2020, as compared to \$68.9 million for fiscal 2019. The increase was primarily related to additional headcount from organic growth and our recent acquisitions as well as COVID related expenses, which was partially offset by a higher volume of CRAD. Research and development expenses accounted for 12.4% and 10.5% of our revenues during fiscal 2020 and fiscal 2019, respectively. The increase as a percentage of revenue was primarily driven by the continued investment in internal R&D during fiscal 2020 to promote the future growth of the business.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased \$2.7 million to \$30.6 million during fiscal 2020, as compared to \$27.9 million for fiscal 2019, primarily due to the acquisition of APC and the full year impact of amortization from our fiscal 2019 acquisitions.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges were \$1.8 million during fiscal 2020, as compared to \$0.6 million in fiscal 2019. The increase was primarily driven by severance costs for separation of 20 employees during fiscal 2020. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

Acquisition costs and other related expenses were \$2.7 million during fiscal 2020, as compared to \$1.5 million during fiscal 2019. The acquisition costs and other related expenses incurred during fiscal 2020 were related to the acquisition of APC, as well as costs associated with our evaluation of other acquisition opportunities. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our technological capabilities and especially within the sensor and effector and C4I markets. Transaction costs incurred by the acquiree prior to the consummation of an acquisition would not be reflected in our historical results of operations.

INTEREST INCOME

Interest income increased to \$2.2 million in fiscal 2020 from \$0.9 million in fiscal 2019, due to higher average balances of cash on hand, as compared to fiscal 2019.

INTEREST EXPENSE

Interest expense for fiscal 2020 decreased \$8.1 million to \$1.0 million, as compared to \$9.1 million in fiscal 2019. We drew \$200.0 million against the Revolver during the third quarter of fiscal 2020 to provide access to capital and flexibility in managing operations during this time of uncertainty due to the outbreak of COVID. We paid down the \$200.0 million draw during the fourth quarter of fiscal 2020 as a result of the reduced turbulence in capital markets. Fiscal 2019 included interest expense related to borrowings on the Revolver from our acquisitions, prior to the pay down of the balance on the Revolver with the net proceeds generated by our follow-on equity offering during the fourth quarter of fiscal 2019.

OTHER INCOME (EXPENSE), NET

Other income (expense), net was \$1.7 million of other income during fiscal 2020, as compared to \$8.9 million of other expense in fiscal 2019. The increase was primarily due to \$6.4 million of other investment income partially offset by \$0.6 million of additional litigation and settlement expenses. Fiscal 2019 included \$5.4 million in other expense associated with the termination of the interest rate swap in conjunction with the pay down of the balance on the Revolver with the net proceeds generated by our follow-on equity offering to during the fourth quarter of fiscal 2019.

INCOME TAXES

We recorded an income tax provision of \$8.2 million and \$12.8 million on income before income taxes of \$93.9 million and \$59.5 million for fiscal years 2020 and 2019, respectively. We recognized a discrete tax benefit of \$7.3 million and \$2.7 million related to excess tax benefits on stock-based compensation for fiscal years 2020 and 2019, respectively. We also recognized a tax benefit of \$6.3 million and a tax reserve of \$2.2 million related to research and development tax credits claimed on prior year Federal and state tax returns and recognized a tax benefit for other favorable provision to return adjustments of \$2.9 million.

The effective tax rate for fiscal 2020 and 2019 differed from the Federal statutory rate of 21% primarily due to Federal and state research and development tax credits, excess tax benefits related to stock compensation, a modified territorial tax system and a minimum tax on certain foreign earnings, and state taxes.

Within the calculation of our annual effective tax rate we have used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service. These changes could have a material impact on our future U.S. tax expense.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity come from existing cash and cash generated from operations, our Revolver and our ability to raise capital under our universal shelf registration statement. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments. We plan to continue to invest in the modernization of our facilities, including the expansion of our trusted custom microelectronics business during fiscal 2021.

Based on our current plans, business conditions, including the COVID pandemic, and essential business status, we believe that existing cash and cash equivalents, our available Revolver, cash generated from operations, and our financing capabilities will be sufficient to satisfy our anticipated cash requirements for at least the next twelve months. Refer to Item 1A - "Risk Factors" for risk factors concerning the Company, including a risk factor related to health epidemics, pandemics and similar outbreaks.

Shelf Registration Statement

On August 28, 2017, we filed a shelf registration statement on Form S-3ASR with the SEC. The shelf registration statement, which was effective upon filing with the SEC, registered each of the following securities: debt securities, preferred stock, common stock, warrants and units. We intend to use the proceeds from financings using the shelf registration statement for general corporate purposes, which may include the following:

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

We have an unlimited amount available under the shelf registration statement. Additionally, as part of the shelf registration statement, we have entered into an equity distribution agreement which allows us to sell an aggregate of up to \$200.0 million of our common stock from time to time through our agents. The actual dollar amount and number of shares of common stock we sell pursuant to the equity distribution agreement will be dependent on, among other things, market conditions and our fund raising requirements. The agents may sell the common stock by any method deemed to be an “at the market offering” as defined in Rule 415 of the Securities Act of 1933, as amended, including without limitation sales made directly on Nasdaq, on any other existing trading market for the common stock or to or through a market maker. In addition, our common stock may be offered and sold by such other methods, including privately negotiated transactions, as we and the agents may agree. As of July 3, 2020, we have not sold any stock using our at the market offering feature. We intend to file a new shelf registration statement to replace the current registration that is expiring at the end of August 2020.

Follow-on Equity Offerings

On May 20, 2019, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On May 28, 2019, we closed the offering, selling an aggregate of 6.0 million shares of common stock at a price to the public of \$69.00. On May 29, 2019, the underwriters executed their over-allotment option. At the closing of the over-allotment, we issued 0.9 million additional shares of common stock. Total net proceeds, including the over-allotment, from the offering of 6.9 million shares were \$454.3 million.

Revolving Credit Facilities

On September 28, 2018, we amended the Revolver to increase and extend the borrowing capacity to a \$750.0 million, 5-year revolving credit line, with the maturity extended to September 2023. We drew \$200.0 million against the Revolver during the third quarter of fiscal 2020 to provide access to capital and flexibility in managing operations during this time of uncertainty due to the outbreak of COVID. We paid down the \$200.0 million draw during the fourth quarter of fiscal 2020 as a result of reduced turbulence in the capital markets. As of July 3, 2020, we had no outstanding balance on the Revolver. See Note M in the accompanying consolidated financial statements for further discussion of the Revolver.

CASH FLOWS

| (In thousands) | For the Fiscal Years Ended | | |
|--|-----------------------------------|----------------------|----------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Net cash provided by operating activities | \$ 115,184 | \$ 97,517 | \$ 43,321 |
| Net cash used in investing activities | \$ (135,486) | \$ (153,774) | \$ (200,877) |
| Net cash (used in) provided by financing activities | \$ (10,932) | \$ 247,765 | \$ 182,937 |
| Net (decrease) increase in cash and cash equivalents | \$ (31,094) | \$ 191,411 | \$ 24,884 |
| Cash and cash equivalents at end of year | \$ 226,838 | \$ 257,932 | \$ 66,521 |

Our cash and cash equivalents decreased by \$31.1 million during fiscal 2020 primarily as the result of \$96.5 million of cash on hand used to fund the acquisition of APC, \$43.3 million invested in purchases of property and equipment, and \$16.2 million used in the retirement of common stock used to settle individual employees' tax liabilities associated with vesting of restricted stock awards. These decreases were partially offset by \$115.2 million provided by operating activities.

Operating Activities

During fiscal 2020, we generated \$115.2 million in cash from operating activities, an increase of \$17.7 million, as compared to fiscal 2019. The increase in cash generated by operating activities was primarily the result of higher comparable net income, deferred revenues and customer advances partially offset by higher inventory purchases intended to mitigate potential disruptions to the supply chain resulting from the COVID pandemic and support the growth of the business, unbilled receivables and additional cash paid for income taxes.

Investing Activities

During fiscal 2020, we invested \$135.5 million, a decrease of \$18.3 million, as compared to \$153.8 million during fiscal 2019. The decrease was primarily driven by lower cash used for acquisitions, partially offset by a \$16.6 million increase in purchases of property and equipment. During fiscal 2020, we used \$96.5 million of cash on hand to fund the acquisition of APC, as compared to \$127.1 million used for the acquisitions of Germane, GECO, Athena and Syntonic during fiscal 2019.

Financing Activities

During fiscal 2020, we used \$10.9 million of cash in financing activities, as compared to \$247.8 million in cash provided by financing activities during fiscal 2019. The \$258.7 million decrease was primarily due to \$454.3 million provided by our follow-on equity offering during fiscal 2019, which was used to pay down the Revolver balance of \$324.5 million subsequent

to the additional \$129.5 million of borrowings during the year used to fund the acquisitions completed during fiscal 2019. During fiscal 2020 we drew \$200.0 million against the Revolver during the third quarter of fiscal 2020 to provide access to capital and flexibility in managing operations during this time of uncertainty due to the outbreak of COVID. We paid down the \$200.0 million draw during the fourth quarter of fiscal 2020 as a result of reduced turbulence in the capital markets. Fiscal 2020 also includes \$16.2 million of payments related to the retirement of common stock used to settle individual employees' tax liabilities associated with the vesting of restricted stock awards, an increase of \$8.2 million from fiscal 2019.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following is a schedule of our commitments and contractual obligations outstanding at July 3, 2020:

| (In thousands) | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
|----------------------|-------------------|---------------------|------------------|------------------|----------------------|
| Operating leases | \$ 94,037 | \$ 9,572 | \$ 21,013 | \$ 18,689 | \$ 44,763 |
| Purchase obligations | 103,548 | 103,548 | — | — | — |
| | <u>\$ 197,585</u> | <u>\$ 113,120</u> | <u>\$ 21,013</u> | <u>\$ 18,689</u> | <u>\$ 44,763</u> |

Effective July 1, 2019, the Company adopted ASC 842. We adopted ASC 842 using the optional transition method and, as a result, there have been no reclassifications of prior comparable periods due to this adoption. See Note B and Note J to the consolidated financial statements for more information regarding our obligations under leases and the adoption of this standard.

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 \$103.5 million at July 3, 2020.

We had a liability at July 3, 2020 of \$4.1 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. Our liability increased by an additional \$2.2 million reserve related to research and development credits claimed on amended Federal and state returns during the fiscal year ended July 3, 2020. We do not know the ultimate resolution of these uncertain tax positions and as such, do not know the ultimate timing of payments related to this liability. Accordingly, these amounts are not included in the above table.

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 employees' tax liabilities 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 Consolidated Statements of Cash Flows.

OFF-BALANCE SHEET ARRANGEMENTS

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

RELATED PARTY TRANSACTIONS

During fiscal 2020 and 2019, we did not engage in any related party transactions.

NON-GAAP FINANCIAL MEASURES

In our periodic communications, we discuss certain important measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"), including adjusted EBITDA, adjusted income, adjusted EPS, free cash flow, organic revenue and acquired revenue.

Adjusted EBITDA is defined as net income before other non-operating adjustments, interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense,

COVID related expenses, and stock-based and other non-cash compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining the 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 that adjusted EBITDA 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 net income, the most directly comparable GAAP financial measure, to our adjusted EBITDA:

| (In thousands) | For the Fiscal Years Ended | | |
|--|----------------------------|-------------------|-------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Net income | \$ 85,712 | \$ 46,775 | \$ 40,883 |
| Other non-operating adjustments, net ⁽¹⁾ | (5,636) | 364 | (795) |
| Interest (income) expense, net | (1,145) | 8,177 | 2,818 |
| Tax provision | 8,221 | 12,752 | 1,690 |
| Depreciation | 18,770 | 18,478 | 16,273 |
| Amortization of intangible assets | 30,560 | 27,914 | 26,004 |
| Restructuring and other charges ⁽²⁾ | 1,805 | 560 | 3,159 |
| Impairment of long-lived assets | — | — | — |
| Acquisition and financing costs ⁽³⁾ | 5,645 | 9,628 | 4,928 |
| Fair value adjustments from purchase accounting ⁽⁴⁾ | 1,801 | 713 | 1,992 |
| Litigation and settlement expense, net | 944 | 344 | — |
| COVID related expenses ⁽⁵⁾ | 2,593 | — | — |
| Stock-based and other non-cash compensation expense | 26,972 | 19,621 | 17,615 |
| Adjusted EBITDA | <u>\$ 176,242</u> | <u>\$ 145,326</u> | <u>\$ 114,567</u> |

(1) As of July 1, 2018, we revised our definition of adjusted EBITDA to incorporate other non-operating adjustments, net, which includes gains or losses on foreign currency remeasurement, investments and fixed asset sales or disposals among other adjustments. Adjusted EBITDA for prior periods has been recast for comparative purposes. Other non-operating adjustments for fiscal 2020 includes \$6.4 million of other non-operating investment income.

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

(3) Acquisition and financing costs includes \$5.4 million associated with the termination of the interest rate swap for fiscal year 2019.

(4) Fair value adjustments from purchase accounting for fiscal year 2020 relate to APC inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2019 relate to Germane and GECCO inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2018 relate to Themis, CES and Delta inventory step-up amortization.

(5) Effective as of the third quarter of fiscal 2020, the Company has added back incremental COVID related expenses, which relate primarily to enhanced compensation and benefits for employees as well as incremental supplies and services to support social distancing and mitigate the spread of COVID.

Adjusted income and adjusted EPS exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. We believe that exclusion of these items assists in providing a more complete understanding of our underlying results and trends and allows for comparability with our peer company index and industry. These non-GAAP financial measures may not be computed in the same manner as similarly titled measures used by other companies. 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 as net income before other non-operating adjustments, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, COVID related expenses, and stock-based and other non-cash compensation expense. The impact to income taxes includes the

impact to the effective tax rate, current tax provision and deferred tax provision. Adjusted EPS expresses adjusted income on a per share basis using weighted average diluted shares outstanding.

Adjusted income 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. We expect to continue to incur expenses similar to the adjusted income 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 tables reconcile net income and diluted earnings per share, the most directly comparable GAAP financial measures, to adjusted income and adjusted EPS:

| (In thousands, except per share data) | For the Fiscal Years Ended | | | | | |
|--|----------------------------|----------------|------------------|----------------|------------------|----------------|
| | July 3, 2020 | | June 30, 2019 | | June 30, 2018 | |
| Net income and diluted earnings per share | \$ 85,712 | \$ 1.56 | \$ 46,775 | \$ 0.96 | \$ 40,883 | \$ 0.86 |
| Other non-operating adjustments, net ⁽¹⁾ | (5,636) | | 364 | | (795) | |
| Amortization of intangible assets | 30,560 | | 27,914 | | 26,004 | |
| Restructuring and other charges ⁽²⁾ | 1,805 | | 560 | | 3,159 | |
| Impairment of long-lived assets | — | | — | | — | |
| Acquisition and financing costs ⁽³⁾ | 5,645 | | 9,628 | | 4,928 | |
| Fair value adjustments from purchase accounting ⁽⁴⁾ | 1,801 | | 713 | | 1,992 | |
| Litigation and settlement expense, net | 944 | | 344 | | — | |
| COVID related expenses ⁽⁵⁾ | 2,593 | | — | | — | |
| Stock-based and other non-cash compensation expense | 26,972 | | 19,621 | | 17,615 | |
| Impact to income taxes ⁽⁶⁾ | (23,634) | | (16,630) | | (27,044) | |
| Adjusted income and adjusted earnings per share | <u>\$126,762</u> | <u>\$ 2.30</u> | <u>\$ 89,289</u> | <u>\$ 1.84</u> | <u>\$ 66,742</u> | <u>\$ 1.41</u> |
| Diluted weighted-average shares outstanding | | <u>55,115</u> | | <u>48,500</u> | | <u>47,471</u> |

(1) Effective as of the third quarter of fiscal 2020, the Company has revised its definition of adjusted income and adjusted earnings per share to incorporate other non-operating adjustments, net, which includes gains or losses on foreign currency remeasurement, investments and fixed asset sales or disposals among other adjustments. Adjusted EPS for prior periods has been recast for comparative purposes. Other non-operating adjustments for fiscal 2020 includes \$6.4 million of other non-operating investment income.

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

(3) Acquisition and financing costs includes \$5.4 million associated with the termination of the interest rate swap for fiscal year 2019.

(4) Fair value adjustments from purchase accounting for fiscal year 2020 relate to APC inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2019 relate to Germane and GECO inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2018 relate to Themis, CES and Delta inventory step-up amortization.

(5) Effective as of the third quarter of fiscal 2020, the Company has added back incremental COVID related expenses, which relate primarily to enhanced compensation and benefits for employees as well as incremental supplies and services to support social distancing and mitigate the spread of COVID.

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

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures for property and equipment, which includes capitalized software development costs. We believe free cash flow provides investors with an important perspective on cash available for investments and acquisitions after making capital investments required to support ongoing business operations and long-term value creation. We believe that trends in our free cash flow can be 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) | For the Fiscal Years Ended | | |
|---------------------------------------|----------------------------|---------------|---------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Cash provided by operating activities | \$ 115,184 | \$ 97,517 | \$ 43,321 |
| Purchase of property and equipment | (43,294) | (26,691) | (15,106) |
| Free cash flow | \$ 71,890 | \$ 70,826 | \$ 28,215 |

Organic revenue and acquired revenue are non-GAAP measures for reporting financial performance of our business. We believe this information provides investors with insight as to our ongoing business performance. Organic revenue represents total company revenue excluding net revenue from acquired companies for the first four full quarters since the entities' acquisition date (which excludes intercompany transactions). Acquired revenue represents revenue from acquired companies for the first four full quarters since the entities' acquisition date (which excludes intercompany transactions). After the completion of four full fiscal quarters, acquired revenue is treated as organic for current and comparable historical periods.

The following table reconciles the most directly comparable GAAP financial measure to the non-GAAP financial measure:

| (In thousands) | Fiscal 2020 | As a % of Total Net Revenue | Fiscal 2019 | As a % of Total Net Revenue | \$ Change | % Change |
|---------------------------------|-------------|-----------------------------|-------------|-----------------------------|------------|----------|
| Organic revenue | \$ 732,572 | 92 % | \$ 641,209 | 98 % | \$ 91,363 | 14 % |
| Acquired revenue ⁽¹⁾ | 64,038 | 8 % | 13,535 | 2 % | 50,503 | 373 % |
| Total revenues | \$ 796,610 | 100 % | \$ 654,744 | 100 % | \$ 141,866 | 22 % |

(1) Acquired revenue for all preceding periods presented has been recast for comparative purposes.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

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

REVENUE RECOGNITION

We recognize revenue at a point in time or over time as the performance obligations are met. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. Contracts with distinct performance obligations recognized at a point in time, with or without an allocation of the transaction price, totaled 73% and 77% of revenues for the fiscal years ended July 3, 2020 and June 30, 2019, respectively. Total revenue recognized under long-term contracts over time was 27% and 23% of revenues for the fiscal years ended July 3, 2020 and June 30, 2019, respectively.

Revenue recognized at a point in time generally relates to contracts that include a combination of components, modules and sub-assemblies, integrated subsystems and related system integration or other services. Revenue is recognized at a point in time for these products and services (versus over time recognition) due to the following: (i) customers are only able to consume the benefits provided by us upon completion of the product or service; (ii) customers do not control the product or service prior to completion; and (iii) we do not have an enforceable right to payment at all times for performance completed to date. Accordingly, there is little judgment in determining when control of the good or service transfers to the customer, and revenue is generally recognized upon shipment (for goods) or completion (for services).

For contracts with multiple performance obligations, the transaction price is allocated to each performance obligation using the standalone selling price of each distinct good or service in the contract. Standalone selling prices of our goods and services are generally not directly observable. Accordingly, the primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which we forecast the expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service. The objective of the expected cost plus a margin approach is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of the expected cost plus a margin approach involves the consideration of several factors based on the specific facts and circumstances of each contract. Specifically, we consider the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, our ongoing pricing strategy and policies, often based

on 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.

Revenue is recognized over time (versus point in time recognition) for long-term contracts with development, production and service activities where the performance obligations are satisfied over time. These long-term contracts involve the design, development, manufacture, or modification of complex modules and sub-assemblies or integrated subsystems and related services. Revenue is recognized over time, due to the fact that: (i) our performance creates or enhances an asset that the customer controls as the asset is created or enhanced; and (ii) our performance creates an asset with no alternative use to us and we have an enforceable right to payment for performance completed to date. We consider the nature of these contracts and the types of products and services provided when determining the proper accounting for a particular contract. These contracts include both fixed-price and cost reimbursable contracts. Our cost reimbursable contracts typically include cost-plus fixed fee and time and material (“T&M”) contracts. We consider whether contracts should be combined or segmented, and based on this assessment, we combine closely related contracts when all the applicable criteria 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 contract, which should be combined to reflect an overall profit rate. Similarly, we may separate an arrangement, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement and the related performance criteria were negotiated. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period. For all types of contracts, we recognize anticipated contract losses as soon as they become known and estimable. These losses are recognized in advance of contract performance and as of July 3, 2020, approximately \$0.8 million of these costs were in accrued expenses on our balance sheet.

For long-term contracts, we typically leverage the input method, using a cost-to-cost measure of progress. We believe that this method represents the most faithful depiction of our performance because it directly measures value transferred to the customer. Contract estimates and estimates of any variable consideration are based on various assumptions to project the outcome of future events that may span several years. These assumptions include: the amount of time to complete the contract, including the assessment of the nature and complexity of the work to be performed; the cost and availability of materials; the availability of subcontractor services and materials; and the availability and timing of funding from the customer. We bear the risk of changes in estimates to complete on a fixed-price contract which may cause profit levels to vary from period to period. For cost reimbursable contracts, we are reimbursed periodically for allowable costs and are paid a portion of the fee based on contract progress. In the limited instances where we enter into T&M contracts, revenue recognized 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 direct billable costs. For T&M contracts, we elected to use a practical expedient permitted by ASC 606 whereby revenue is recognized in the amount for which we have a right to invoice the customer based on the control transferred to the customer. For over time contracts, we recognize anticipated contract losses as soon as they become known and estimable.

Accounting for long-term contracts requires significant judgment relative to estimating total contract revenues and costs, in particular, assumptions relative to the amount of time to complete the contract, including the assessment of the nature and complexity of the work to be performed. Our estimates are based upon the professional knowledge and experience of our 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.

We generally do not provide our customers with rights of product return other than those related to assurance warranty provisions that permit repair or replacement of defective goods over a period of 12 to 36 months. We accrue for anticipated warranty costs upon product shipment. We do not consider activities related to such assurance warranties, if any, to be a separate performance obligation. We offer separately priced extended warranties which generally range from 12 to 36 months that are treated as separate performance obligations. The transaction price allocated to extended warranties is recognized over time in proportion to the costs expected to be incurred in satisfying the obligations under the contract.

On long-term contracts, the portion of the payments retained by the customer is not considered a significant financing component because most contracts have a duration of less than one year and payment is received as progress is made. Many of our long-term contracts have milestone payments, which align the payment schedule with the progress towards completion on the performance obligation. On some contracts, we may be entitled to receive an advance payment, which is not considered a significant financing component because it is used to facilitate inventory demands at the onset of a contract and to safeguard us from the failure of the other party to abide by some or all of their obligations under the contract.

We define service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold by us. Examples of our service revenues include: analyst

services and systems engineering support, consulting, maintenance and other support, testing and installation. We combine our product and service revenues into a single class as services revenues are less than 10 percent of total revenues.

INVENTORY VALUATION

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

GOODWILL, INTANGIBLE ASSETS AND LONG-LIVED ASSETS

We evaluate our goodwill for impairment annually in the fourth quarter and in any interim period in which events or circumstances arise that indicate our goodwill may be impaired. Indicators of impairment include, but are not limited to, a significant deterioration in overall economic conditions, a decline in our market capitalization, the loss of significant business, significant decreases in funding for our contracts, or other significant adverse changes in industry or market conditions.

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

As part of our annual goodwill impairment testing, we utilized a discount rate for each of our reporting units, as defined by ASC 350, *Intangibles-Goodwill and Other*, that we believe represents the risks that our businesses face, considering their sizes, the current economic environment, and other industry data we believe is appropriate. The discount rates for Sensor and Mission Processing (“SMP”), Advanced Microelectronic Solutions (“AMS”) and Mercury Defense Systems (“MDS”) were 7.0%, 6.5%, and 7.0%, respectively. The annual testing indicated that the fair values of our SMP, AMS, and MDS reporting units significantly exceeded their carrying values, and thus no further testing was required.

We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our finite-lived intangible assets or long-lived assets decline because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary.

INCOME TAXES

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

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

We use a two-step approach to recognize and measure uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not

to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. We reevaluate our uncertain tax positions on a quarterly basis and any changes to these positions as a result of tax audits, tax laws or other facts and circumstances could result in additional charges to operations.

BUSINESS COMBINATIONS

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

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

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note B to consolidated financial statements (under the caption “Recently Issued Accounting Pronouncements”).

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

See Note B to consolidated financial statements (under the caption “Recently Adopted Accounting Pronouncements”).

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk is related primarily to our investment portfolio and the Revolver.

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

We also are exposed to the impact of interest rate changes primarily through our borrowing activities. For our variable rate borrowings, we may use a fixed interest rate swap, effectively converting a portion of variable rate borrowings to fixed rate borrowings in order to mitigate the impact of interest rate changes on earnings. We utilize interest rate derivatives to mitigate interest rate exposure with respect to our financing arrangements. There were no outstanding borrowings against the Revolver or swaps outstanding at July 3, 2020.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. We place our cash and cash equivalents with financial institutions with high credit quality. As of July 3, 2020 and June 30, 2019, we had \$226.8 million and \$257.9 million, respectively, of cash and cash equivalents on deposit or invested with our financial and lending institutions.

We provide credit to customers in the normal course of business. We perform ongoing credit evaluations of our customers’ financial condition and limit the amount of credit extended when deemed necessary. As of July 3, 2020, five customers accounted for 52% of our receivables, unbilled receivables and costs in excess of billings. As of June 30, 2019, five customers accounted for 56% of our receivables, unbilled receivables and costs in excess of billings.

FOREIGN CURRENCY RISK

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

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Mercury Systems, Inc.:

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting

We have audited the accompanying consolidated balance sheets of Mercury Systems, Inc. and subsidiaries (the Company) as of July 3, 2020 and June 30, 2019, the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the fiscal years in the three-year period ended July 3, 2020, and the related notes and financial statement schedule II (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of July 3, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 3, 2020 and June 30, 2019, and the results of its operations and its cash flows for each of the fiscal years in the three-year period ended July 3, 2020, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of July 3, 2020 based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Company acquired American Panel Corporation (“APC”) during fiscal year 2020, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of July 3, 2020, APC's internal control over financial reporting associated with 7 percent of total consolidated assets (of which 5 percent represented goodwill and intangible assets included within the scope of the assessment) and 3 percent of total consolidated revenues included in the consolidated financial statements of the Company as of and for the fiscal year ended July 3, 2020. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of APC.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgment. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Estimate of total contract costs to be incurred for fixed price contract revenue recognized over time

As discussed in Note B to the consolidated financial statements, fixed price contract revenue recognized over time for the year ended July 3, 2020 represented 27% of total revenues. For those fixed price contracts recognized over time the Company recognizes revenue based on the ratio of (1) actual contract costs incurred to date to (2) the Company's estimate of total contract costs to be incurred.

We identified the evaluation of total contract costs to be incurred for fixed price contract revenue recognized over time as a critical audit matter given the complex nature of the Company's products sold under such contracts. In particular, evaluating the Company's judgments regarding the amount of time to complete the contracts, including the assessment of the nature and complexity of the work to be performed, involved a high degree of subjective auditor judgment.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls over the Company's process to develop estimates of total contract costs to be incurred for partially completed performance obligations. Such controls included controls over the estimated amount of time to complete the contracts, including the assessment of the nature and complexity of the work to be performed. We considered factors, including the value and stage of completion, to select customer contracts to evaluate the Company's assumptions underlying the estimate of total contract costs to be incurred. We inspected the selected contracts to evaluate the Company's identification of performance obligations and the determined method for measuring contract progress. We compared the Company's original or prior period estimate of total contract costs to be incurred to the actual costs incurred for completed contracts to assess the Company's ability to accurately estimate costs. We inquired of operational personnel of the Company to evaluate progress to date, the estimate of remaining costs to be incurred, and factors impacting the amount of time and cost to complete the selected contracts, including the assessment of the nature and complexity of the work to be performed. We inspected correspondence, if any, between the Company and the customer for the selected contracts as part of our evaluation of contract progress.

/s/ KPMG LLP

We have served as the Company's auditor since 2006.

Boston, Massachusetts

August 18, 2020

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
MERCURY SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| | July 3, 2020 | June 30, 2019 |
|---|---------------------|---------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 226,838 | \$ 257,932 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,451 and \$1,228 at July 3, 2020 and June 30, 2019, respectively | 120,438 | 118,832 |
| Unbilled receivables and costs in excess of billings | 90,289 | 57,387 |
| Inventory | 178,093 | 137,112 |
| Prepaid income taxes | 2,498 | 90 |
| Prepaid expenses and other current assets | 16,613 | 10,819 |
| Total current assets | <u>634,769</u> | <u>582,172</u> |
| Property and equipment, net | 87,737 | 60,001 |
| Goodwill | 614,076 | 562,146 |
| Intangible assets, net | 208,748 | 206,124 |
| Operating lease right-of-use assets | 60,613 | — |
| Other non-current assets | 4,777 | 6,534 |
| Total assets | <u>\$ 1,610,720</u> | <u>\$ 1,416,977</u> |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 41,877 | \$ 39,030 |
| Accrued expenses | 23,794 | 18,897 |
| Accrued compensation | 41,270 | 28,814 |
| Deferred revenues and customer advances | 18,974 | 11,291 |
| Total current liabilities | <u>125,915</u> | <u>98,032</u> |
| Deferred income taxes | 13,889 | 17,814 |
| Income taxes payable | 4,117 | 1,273 |
| Operating lease liabilities | 66,981 | — |
| Other non-current liabilities | 15,034 | 15,119 |
| Total liabilities | <u>225,936</u> | <u>132,238</u> |
| Commitments and contingencies (Note L) | | |
| 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; 54,702,322 and 54,247,532 shares issued and outstanding at July 3, 2020 and June 30, 2019, respectively | 547 | 542 |
| Additional paid-in capital | 1,074,667 | 1,058,745 |
| Retained earnings | 312,455 | 226,743 |
| Accumulated other comprehensive loss | (2,885) | (1,291) |
| Total shareholders' equity | <u>1,384,784</u> | <u>1,284,739</u> |
| Total liabilities and shareholders' equity | <u>\$ 1,610,720</u> | <u>\$ 1,416,977</u> |

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

MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In thousands, except per share data)

| | For the Fiscal Years Ended | | |
|---|----------------------------|------------------|------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Net revenues | \$ 796,610 | \$ 654,744 | \$ 493,184 |
| Cost of revenues | 439,766 | 368,588 | 267,326 |
| Gross margin | 356,844 | 286,156 | 225,858 |
| Operating expenses: | | | |
| Selling, general and administrative | 132,253 | 110,717 | 88,365 |
| Research and development | 98,485 | 68,925 | 58,807 |
| Amortization of intangible assets | 30,560 | 27,914 | 26,004 |
| Restructuring and other charges | 1,805 | 560 | 3,159 |
| Acquisition costs and other related expenses | 2,679 | 1,456 | 2,538 |
| Total operating expenses | 265,782 | 209,572 | 178,873 |
| Income from operations | 91,062 | 76,584 | 46,985 |
| Interest income | 2,151 | 932 | 32 |
| Interest expense | (1,006) | (9,109) | (2,850) |
| Other income (expense), net | 1,726 | (8,880) | (1,594) |
| Income before income taxes | 93,933 | 59,527 | 42,573 |
| Tax provision | 8,221 | 12,752 | 1,690 |
| Net income | <u>\$ 85,712</u> | <u>\$ 46,775</u> | <u>\$ 40,883</u> |
| Basic net earnings per share | <u>\$ 1.57</u> | <u>\$ 0.98</u> | <u>\$ 0.88</u> |
| Diluted net earnings per share | <u>\$ 1.56</u> | <u>\$ 0.96</u> | <u>\$ 0.86</u> |
| Weighted-average shares outstanding: | | | |
| Basic | <u>54,546</u> | <u>47,831</u> | <u>46,719</u> |
| Diluted | <u>55,115</u> | <u>48,500</u> | <u>47,471</u> |
| Comprehensive income: | | | |
| Net income | \$ 85,712 | \$ 46,775 | \$ 40,883 |
| Foreign currency translation adjustments | 174 | (232) | (137) |
| Pension benefit plan, net of tax | (1,768) | (2,350) | 354 |
| Total other comprehensive (loss) income, net of tax | (1,594) | (2,582) | 217 |
| Total comprehensive income | <u>\$ 84,118</u> | <u>\$ 44,193</u> | <u>\$ 41,100</u> |

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

MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the Fiscal Years Ended July 3, 2020, June 30, 2019 and June 30, 2018

(In thousands)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---------------|---------------|----------------------------------|----------------------|--|----------------------------------|
| | Shares | Amount | | | | |
| Balance at June 30, 2017 | 46,303 | \$ 463 | \$ 584,795 | \$ 139,085 | \$ 1,074 | \$ 725,417 |
| Issuance of common stock under employee stock incentive plans | 868 | 8 | 655 | — | — | 663 |
| Issuance of common stock under employee stock purchase plan | 82 | 1 | 2,781 | — | — | 2,782 |
| Retirement of common stock | (329) | (3) | (15,505) | — | — | (15,508) |
| Stock-based compensation | — | — | 17,437 | — | — | 17,437 |
| Net income | — | — | — | 40,883 | — | 40,883 |
| Other Comprehensive Income | — | — | — | — | 217 | 217 |
| Balance at June 30, 2018 | 46,924 | 469 | 590,163 | 179,968 | 1,291 | 771,891 |
| Issuance of common stock under employee stock incentive plans | 478 | 5 | (5) | — | — | — |
| Issuance of common stock under employee stock purchase plan | 102 | 1 | 3,660 | — | — | 3,661 |
| Retirement of common stock | (156) | (2) | (7,966) | — | — | (7,968) |
| Follow-on public stock offering | 6,900 | 69 | 453,504 | — | — | 453,573 |
| Stock-based compensation | — | — | 19,389 | — | — | 19,389 |
| Net income | — | — | — | 46,775 | — | 46,775 |
| Other Comprehensive Loss | — | — | — | — | (2,582) | (2,582) |
| Balance at June 30, 2019 | 54,248 | 542 | 1,058,745 | 226,743 | (1,291) | 1,284,739 |
| Issuance of common stock under employee stock incentive plans | 562 | 6 | (1) | — | — | 5 |
| Issuance of common stock under employee stock purchase plan | 89 | 1 | 5,311 | — | — | 5,312 |
| Retirement of common stock | (197) | (2) | (16,247) | — | — | (16,249) |
| Stock-based compensation | — | — | 26,859 | — | — | 26,859 |
| Net income | — | — | — | 85,712 | — | 85,712 |
| Other Comprehensive Loss | — | — | — | — | (1,594) | (1,594) |
| Balance at July 3, 2020 | <u>54,702</u> | <u>\$ 547</u> | <u>\$ 1,074,667</u> | <u>\$ 312,455</u> | <u>\$ (2,885)</u> | <u>\$ 1,384,784</u> |

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

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

| | For the Fiscal Years Ended | | |
|--|-----------------------------------|----------------------|----------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Cash flows from operating activities: | | | |
| Net income | \$ 85,712 | \$ 46,775 | \$ 40,883 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization expense | 49,330 | 46,392 | 42,277 |
| Stock-based compensation expense | 26,538 | 19,422 | 17,314 |
| Benefit for deferred income taxes | (3,019) | (1,557) | (5,464) |
| Gain on investments | (5,817) | — | — |
| Termination of interest rate swap | — | 5,420 | — |
| Other non-cash items | 3,509 | 3,779 | 2,103 |
| Changes in operating assets and liabilities, net of effects of businesses acquired: | | | |
| Accounts receivable, unbilled receivables, and costs in excess of billings | (31,079) | (28,096) | (22,751) |
| Inventory | (31,609) | (17,101) | (16,230) |
| Prepaid income taxes | (2,792) | 3,843 | (2,327) |
| Prepaid expenses and other current assets | (2,116) | (1,075) | (361) |
| Other non-current assets | (1,260) | 101 | 296 |
| Accounts payable, accrued expenses and accrued compensation | 13,610 | 17,949 | (5,267) |
| Deferred revenues and customer advances | 7,082 | (1,531) | 6,035 |
| Income taxes payable | (131) | 3,152 | (11,187) |
| Other non-current liabilities | 7,226 | 44 | (2,000) |
| Net cash provided by operating activities | 115,184 | 97,517 | 43,321 |
| Cash flows from investing activities: | | | |
| Acquisition of businesses, net of cash acquired | (96,502) | (127,083) | (185,396) |
| Purchases of property and equipment | (43,294) | (26,691) | (15,106) |
| Proceeds from sale of investment | 4,310 | — | — |
| Other investing activities | — | — | (375) |
| Net cash used in investing activities | (135,486) | (153,774) | (200,877) |
| Cash flows from financing activities: | | | |
| Proceeds from employee stock plans | 5,317 | 3,661 | 3,445 |
| Payments for retirement of common stock | (16,249) | (7,968) | (15,508) |
| Payments under credit facilities | (200,000) | (324,500) | (15,000) |
| Borrowings under credit facilities | 200,000 | 129,500 | 210,000 |
| Proceeds from equity offering, net | — | 454,343 | — |
| Termination of interest rate swap | — | (5,420) | — |
| Payments of deferred financing and offering costs | — | (1,851) | — |
| Net cash (used in) provided by financing activities | (10,932) | 247,765 | 182,937 |
| Effect of exchange rate changes on cash and cash equivalents | 140 | (97) | (497) |
| Net (decrease) increase in cash and cash equivalents | (31,094) | 191,411 | 24,884 |
| Cash and cash equivalents at beginning of year | 257,932 | 66,521 | 41,637 |
| Cash and cash equivalents at end of year | \$ 226,838 | \$ 257,932 | \$ 66,521 |
| Cash paid during the period for: | | | |
| Interest | \$ 1,046 | \$ 10,368 | \$ 1,607 |
| Income taxes | \$ 12,939 | \$ 7,351 | \$ 17,004 |
| Supplemental disclosures—non-cash activities: | | | |
| Non-cash investing activity | \$ 2,623 | \$ — | \$ — |
| Non-cash financing activity | \$ — | \$ 770 | \$ — |

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

MERCURY SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

A. Description of Business

Mercury Systems, Inc. (the “Company” or “Mercury”) is a leading technology company serving the aerospace and defense electronics industry, positioned at the intersection of high-tech and defense. Headquartered in Andover, Massachusetts, the Company delivers solutions that power a broad range of aerospace and defense programs, optimized for mission success in some of the most challenging and demanding environments. The Company envisions, creates and delivers innovative technology solutions purpose-built to meet our customers’ most-pressing high-tech needs, including those specific to the defense community.

As a leading manufacturer of essential components, modules and subsystems, the Company sells to defense prime contractors, the U.S. government and original equipment manufacturers (“OEM”) commercial aerospace companies. The Company has built a trusted, contemporary portfolio of proven product solutions purpose-built for aerospace and defense that it believes meets and exceeds the performance needs of its defense and commercial customers. Customers add their own applications and algorithms to our specialized, secure and innovative pre-integrated solutions. This allows them to complete their full system by integrating with their platform, the sensor technology and, in some cases, the processing from Mercury, with their platform. The Company’s products and solutions are deployed in more than 300 programs with over 25 different defense prime contractors and commercial aviation customers.

The Company’s transformational business model accelerates the process of making new technology profoundly more accessible to its customers by bridging the gap between commercial technology and aerospace and defense applications. The Company’s long-standing deep relationships with leading high-tech companies, coupled with the Company’s high level of research and development (“R&D”) investments and industry-leading trusted and secure design and manufacturing capabilities, are the foundational tenets of this highly successful model.

The Company’s capabilities, technology and R&D investment strategy combine to differentiate Mercury in its industry. The Company’s technologies and capabilities include secure embedded processing modules and subsystems, mission computers, secure and rugged rack-mount servers, safety-critical avionics, radio frequency (“RF”) components, multi-function assemblies, subsystems and custom microelectronics. The Company maintains our technological edge by investing in critical capabilities and intellectual property (“IP” or “building blocks”) in processing and RF, leveraging open standards and open architectures to adapt quickly those building blocks into solutions for highly data-intensive applications, including emerging needs in areas such as artificial intelligence (“AI”).

The Company’s mission critical solutions are deployed by its customers for a variety of applications including command, control, communications, computers, intelligence, surveillance and reconnaissance (“C4ISR”), electronic intelligence, avionics, electro-optical/infrared (“EO/IR”), electronic warfare, weapons and missile defense, hypersonics and radar.

On September 23, 2019, the Company acquired American Panel Corporation (“APC”) on a cash-free, debt-free basis for a total purchase price of \$100,000, prior to net working capital and net debt adjustments. Based in Alpharetta, Georgia, APC is a leading innovator in large area display technology for the aerospace and defense market. APC’s capabilities are deployed on a wide range of next-generation platforms.

On May 20, 2019, the Company announced the commencement of an underwritten public offering of its common stock, par value \$0.01 per share. On May 31, 2019 the Company closed the offering, including the full over-allotment allocation, selling an aggregate of 6,900 shares of common stock at a price to the public of \$69.00 for total net proceeds of \$454,343.

On April 18, 2019, the Company acquired The Athena Group, Inc. (“Athena”) and Syntonic Microwave LLC (“Syntonic”) on a cash-free, debt-free basis for a combined total purchase price of \$46,000, prior to net working capital and net debt adjustments. Athena was a privately-held company based in Gainesville, Florida and a leading provider of cryptographic and countermeasure IP vital to securing defense computing systems. Syntonic was a privately held company based in Campbell, California and a leading provider of advanced synthesizers, wideband phase coherent tuners and microwave converters optimized for signals intelligence and electronic intelligence applications demanding frequency coverage up to 40 GHz with 2 GHz instantaneous bandwidth.

On January 29, 2019, the Company acquired GECO Avionics, LLC (“GECO”) on a cash-free, debt-free basis for a total purchase price of \$36,500. Based in Mesa, Arizona, GECO has over twenty years of experience designing and manufacturing affordable safety-critical avionics and mission computing solutions.

On July 31, 2018, the Company acquired Germane Systems, LC (“Germane”) on a cash-free, debt-free basis for a total purchase price of \$45,000, prior to net working capital and net debt adjustments. Based in Chantilly, Virginia, Germane is an industry leader in the design, development and manufacturing of rugged servers, computers and storage systems for command, control and intelligence (“C2I”) applications.

For further details on the acquisitions, see Note C to the consolidated financial statements.

B. Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

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

BASIS OF PRESENTATION

Effective July 1, 2019, the Company's fiscal year has changed to the 52-week or 53-week period ending on the Friday closest to the last day in June. All references to fiscal 2020 are to the 53-week period from July 1, 2019 to July 3, 2020. All references to fiscal 2019 and 2018 are to the 52-week periods from July 1, 2018 to June 30, 2019 and July 1, 2017 to June 30, 2018, respectively. There have been no reclassifications of prior comparable periods due to this change.

USE OF ESTIMATES

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

BUSINESS COMBINATIONS

The Company utilizes the acquisition method of accounting under ASC 805, *Business Combinations*, (“ASC 805”), for all transactions and events in 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 of the measurement date for all assets and liabilities assumed. The Company also utilizes ASC 805 for the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in business combinations. Other estimates include:

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

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

LEASES

Effective July 1, 2019, the Company adopted ASC 842, *Leases*, (“ASC 842”), which requires lessees to recognize a right-of-use (“ROU”) asset and lease liability for most lease arrangements. The Company has adopted ASC 842 using the optional transition method and, as a result, there have been no reclassifications of prior comparable periods due to this adoption.

The Company has arrangements involving the lease of facilities, machinery and equipment. Under ASC 842, at inception of the arrangement, the Company determines whether the contract is or contains a lease and whether the lease should be classified as an operating or a financing lease. This determination, among other considerations, involves an assessment of whether the Company can control the underlying asset and have the right to obtain substantially all of the economic benefits or outputs from the asset.

The Company recognizes ROU assets and lease liabilities as of the lease commencement date based on the net present value of the future minimum lease payments over the lease term. ASC 842 requires lessees to use the rate implicit in the lease unless it is not readily determinable and then it may use its incremental borrowing rate (“IBR”) to discount the future minimum

lease payments. Most of the Company's lease arrangements do not provide an implicit rate; therefore, the Company uses its IBR to discount the future minimum lease payments. The Company determines its IBR with its credit rating and current economic information available as of the commencement date, as well as the identified lease term. During the assessment of the lease term, the Company considers its renewal options and extensions within the arrangements and the Company includes these options when it is reasonably certain to extend the term of the lease.

The Company has lease arrangements with both lease and non-lease components. Consideration is allocated to lease and non-lease components based on estimated standalone prices. The Company has elected to exclude non-lease components from the calculation of its ROU assets and lease liabilities. In the Company's adoption of ASC 842, leases with an initial term of 12 months or less will not result in recognition of a ROU asset and a lease liability and will be expensed as incurred over the lease term. Leases of this nature were immaterial to the Company's consolidated financial statements.

The Company has lease arrangements that contain incentives for tenant improvements as well as fixed rent escalation clauses. For contracts with tenant improvement incentives that are determined to be a leasehold improvement that will be owned by the lessee and the Company is reasonably certain to exercise, it records a reduction to the lease liability and amortizes the incentive over the identified term of the lease as a reduction to rent expense. The Company records rental expense on a straight-line basis over the identified lease term on contracts with rent escalation clauses.

Finance leases are not material to the Company's consolidated financial statements and the Company is not a lessor in any material lease arrangements. There are no material restrictions, covenants, sale and leaseback transactions, variable lease payments or residual value guarantees in the Company's lease arrangements. Operating leases are included in Operating lease right-of-use assets, Accrued expenses, and Operating lease liabilities in the Company's Consolidated Balance Sheets. The standard had no impact on the Company's Consolidated Statements of Operations and Comprehensive Income or Consolidated Statements of Cash Flows. See Note J to the consolidated financial statements for more information regarding the adoption of this standard.

REVENUE RECOGNITION

The Company recognizes revenue in accordance with the five step model set forth by ASC 606, *Revenue from Contracts with Customers*, ("ASC 606"), which involves identification of the contract(s), identification of performance obligations in the contract, determination of the transaction price, allocation of the transaction price to the previously identified performance obligations, and revenue recognition as the performance obligations are satisfied.

During step one of the five step model, the Company considers whether contracts should be combined or segmented, and based on this assessment, the Company combines closely related contracts when all the applicable criteria 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 contract, which should be combined to reflect an overall profit rate. Similarly, the Company may separate an arrangement, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement and the related performance criteria were negotiated. The conclusion to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when the performance obligation is satisfied. 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's contracts with customers generally do not include a right of return relative to delivered products. In certain cases, contracts are modified to account for changes in the contract specifications or requirements. In most instances, contract modifications are accounted for as part of the existing contract. Certain contracts with customers have options for the customer to acquire additional goods or services. In most cases the pricing of these options are reflective of the standalone selling price of the good or service. These options do not provide the customer with a material right and are accounted for only when the customer exercises the option to purchase the additional goods or services. If the option on the customer contract was not indicative of the standalone selling price of the good or service, the material right would be accounted for as a separate performance obligation.

The Company is a leader in making trusted, secure mission-critical technologies profoundly more accessible to aerospace and defense. Revenues are derived from the sales of products that are grouped into one of the following three categories: (i) components; (ii) modules and sub-assemblies; and (iii) integrated subsystems. The Company also generates revenues from the

performance of services, including systems engineering support, consulting, maintenance and other support, testing and installation. Each promised good or service within a contract is accounted for separately under the guidance of ASC 606 if they are distinct. Promised goods or services not meeting the criteria for being a distinct performance obligation are bundled into a single performance obligation with other goods or services that together meet the criteria for being distinct. The appropriate allocation of the transaction price and recognition of revenue is then determined for the bundled performance obligation.

Once the Company identifies the performance obligations, the Company then determines the transaction price, which includes estimating the amount of variable consideration to be included in the transaction price, if any. Variable consideration typically arises due to volume discounts, or other provisions that can either decrease or increase the transaction price. To the extent the transaction price includes variable consideration, the Company estimates the amount of variable consideration that should be included in the transaction price utilizing either the expected value method or the most likely amount method depending on the method the Company expects to better predict the amount of consideration to which it will be entitled. The determination of the estimates for variable consideration require judgment, and are based on past history with similar contracts and anticipated performance. Further, variable consideration is only included in the determination of the transaction price if it is probable that a significant reversal in the amount of revenue recognized will not occur. There are no constraints on the variable consideration recorded.

For contracts with multiple performance obligations, the transaction price is allocated to each performance obligation using the standalone selling price of each distinct good or service in the contract. Standalone selling prices of the Company's goods and services are generally not directly observable. Accordingly, the primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which the Company forecasts the expected costs of satisfying a performance obligation and then adds an appropriate margin for that distinct good or service. The objective of the expected cost plus a margin approach 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 the expected cost plus a margin approach involves the consideration of several factors based on the specific facts and circumstances of each contract. 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, often based on 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 standalone selling prices used in its allocation of transaction price on contracts at least annually. Standalone selling prices will be analyzed on a more frequent basis if a significant change in the Company's business necessitates a more frequent analysis or if the Company experiences significant variances in its selling prices.

Revenue recognized at a point in time generally relates to contracts that include a combination of components, modules and sub-assemblies, integrated subsystems and related system integration or other services. Contracts with distinct performance obligations recognized at a point in time, with or without an allocation of the transaction price, totaled 73%, 77% and 79% of revenues in the fiscal years ended July 3, 2020, June 30, 2019 and 2018, respectively. Revenue is recognized at a point in time for these products and services (versus over time recognition) due to the following: (i) customers are only able to consume the benefits provided by the Company upon completion of the product or service; (ii) customers do not control the product or service prior to completion; and (iii) the Company does not have an enforceable right to payment at all times for performance completed to date. Accordingly, there is little judgment in determining when control of the good or service transfers to the customer, and revenue is generally recognized upon shipment (for goods) or completion (for services).

The Company engages in long-term contracts for development, production and service activities and recognizes revenue for performance obligations over time. These long-term contracts involve the design, development, manufacture, or modification of complex modules and sub-assemblies or integrated subsystems and related services. Revenue is recognized over time, due to the fact that: (i) the Company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; and (ii) the Company's performance creates an asset with no alternative use to the Company and the Company has an enforceable right to payment for performance completed to date. 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. These contracts include both fixed-price and cost reimbursable contracts. The Company's cost reimbursable contracts typically include cost-plus fixed fee and time and material ("T&M") contracts.

For long-term contracts, the Company typically leverages the input method, using a cost-to-cost measure of progress. The Company believes that this method represents the most faithful depiction of the Company's performance because it directly measures value transferred to the customer. Contract estimates and estimates of any variable consideration are based on various assumptions to project the outcome of future events that may span several years. These assumptions include: the amount of time to complete the contract, including the assessment of the nature and complexity of the work to be performed; the cost and availability of materials; the availability of subcontractor services and materials; and the availability and timing of funding from the customer. The Company bears the risk of changes in estimates to complete on a fixed-price contract which may cause profit levels to vary from period to period. For cost reimbursable contracts, the Company is reimbursed periodically for allowable

costs and is paid a portion of the fee based on contract progress. In the limited instances where the Company enters into T&M contracts, revenue recognized 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 direct billable costs. For T&M contracts, the Company recognizes revenue in the amount for which the Company has a right to invoice the customer based on the control transferred to the customer. For over time contracts, the Company recognizes anticipated contract losses as soon as they become known and estimable.

Accounting for long-term contracts requires significant judgment relative to estimating total contract revenues and costs, in particular, assumptions relative to the amount of time to complete the contract, including the assessment of the nature and complexity of the work to be performed. 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.

Total revenue recognized under long-term contracts over time was 27%, 23% and 21% of revenues in the fiscal years ended July 3, 2020, June 30, 2019 and 2018, respectively.

The Company generally does not provide its customers with rights of product return other than those related to assurance warranty provisions that permit repair or replacement of defective goods over a period of 12 to 36 months. The Company accrues for anticipated warranty costs upon product shipment. The Company does not consider activities related to such assurance warranties, if any, to be a separate performance obligation. The Company does offer separately priced extended warranties which generally range from 12 to 36 months that are treated as separate performance obligations. The transaction price allocated to extended warranties is recognized over time in proportion to the costs expected to be incurred in satisfying the obligations under the contract.

On long-term contracts, the portion of the payments retained by the customer is not considered a significant financing component because most contracts have a duration of less than one year and payment is received as progress is made. Many of the Company's long-term contracts have milestone payments, which align the payment schedule with the progress towards completion on the performance obligation. On some contracts, the Company may be entitled to receive an advance payment, which is not considered a significant financing component because it is used to facilitate inventory demands at the onset of a contract and to safeguard the Company from the failure of the other party to abide by some or all of their obligations under the contract.

All revenues are reported net of government assessed taxes (e.g., sales taxes or value-added taxes).

COSTS TO OBTAIN AND FULFILL A CONTRACT

The Company expenses sales commissions as incurred for contracts where the amortization period would have been one year or less. The Company has not deferred sales commissions for contracts where the amortization period is greater than one year because such amounts that would qualify for deferral are not significant.

The Company has elected to treat shipping and handling activities performed after the customer has obtained control of the related goods as a fulfillment cost. Such costs are accrued for in conjunction with the recording of revenue for the goods and are classified as cost of revenues.

CONTRACT BALANCES

Contract balances result from the timing of revenue recognized, billings and cash collections, and the generation of contract assets and liabilities. Contract assets represent revenue recognized in excess of amounts invoiced to the customer and the right to payment is not subject to the passage of time. Contract assets are presented as unbilled receivables and costs in excess of billings on the Company's Consolidated Balance Sheets. Contract liabilities consist of deferred product revenue, billings in excess of revenues, deferred service revenue, and customer advances. Deferred product revenue represents amounts that have been invoiced to customers, but are not yet recognizable as revenue because the Company has not satisfied its performance obligations under the contract. Billings in excess of revenues represents milestone billing contracts where the billings of the contract exceed recognized revenues. Deferred service revenue primarily represents amounts invoiced to customers for annual maintenance contracts or extended warranty contracts, which are recognized over time in proportion to the costs expected to be incurred in satisfying the obligations under the contract. Customer advances represent deposits received from customers on an order. Contract liabilities are included in deferred revenue and the long-term portion of deferred revenue is included within other non-current liabilities on the Company's Consolidated Balance Sheets. Contract balances are reported in a net position on a contract-by-contract basis.

The contract asset balances were \$90,289 and \$57,387 as of July 3, 2020 and June 30, 2019, respectively. The contract asset balance increased due to growth in revenue recognized under long-term contracts over time during the fiscal year ended

July 3, 2020. The contract liability balances were \$19,892 and \$12,362 as July 3, 2020 and June 30, 2019, respectively. The contract liability increased due to a higher volume of contracts with milestone and progress payments.

Revenue recognized during fiscal 2020 that was included in the contract liability balance at June 30, 2019 was \$10,216.

REMAINING PERFORMANCE OBLIGATIONS

The Company includes in its computation of remaining performance obligations customer orders for which it has accepted signed sales orders. The definition of remaining performance obligations excludes those contracts that provide the customer with the right to cancel or terminate the order with no substantial penalty, even if the Company's historical experience indicates the likelihood of cancellation or termination is remote. As of July 3, 2020, the aggregate amount of the transaction price allocated to remaining performance obligations was \$280,346. The Company expects to recognize approximately 73% of its remaining performance obligations as revenue in the next 12 months and the balance thereafter.

CASH AND CASH EQUIVALENTS

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

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company places its cash and cash equivalents with financial institutions of high credit quality. As of July 3, 2020 and June 30, 2019, the Company had \$226,838 and \$257,932, respectively, of cash and cash equivalents on deposit or invested with its financial and lending institutions.

The Company provides credit to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. As of July 3, 2020, five customers accounted for 52% of the Company's accounts receivable, unbilled receivables and costs in excess of billings. As of June 30, 2019, five customers accounted for 56% of the Company's accounts receivable, unbilled receivables and costs in excess of billings.

The Company maintains an allowance for doubtful accounts to provide for the estimated amount of receivables that will not be fully collected. The allowance is based on the assessment of the following factors; customer creditworthiness, historical payment experience, age of outstanding receivables and any applicable collateral.

INVENTORY

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

SEGMENT INFORMATION

The Company uses the management approach for segment disclosure, which designates the internal organization that is used by management for making operating decisions and assessing performance as the source of its reportable segments. The

Company manages its business on the basis of one reportable segment, as a leader in making trusted, secure mission-critical technologies profoundly more accessible to aerospace and defense.

GOODWILL AND INTANGIBLE ASSETS

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

Intangible assets result from the Company’s various business acquisitions (see Note H) and certain licensed technologies, and consist of identifiable intangible assets, including completed technology, licensing agreements, patents, customer relationships, trademarks, backlog, and non-compete agreements. Intangible assets are reported at cost, net of accumulated amortization and are either amortized on a straight-line basis over their estimated useful lives of up to 12.5 years or over the period the economic benefits of the intangible asset are consumed.

LONG-LIVED ASSETS

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

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

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

Expenditures for major software purchases and software developed for internal use are capitalized and depreciated using the straight-line method over the estimated useful lives of the related assets, which are generally three years. For software developed for internal use, all external direct costs for material and services and certain payroll and related fringe benefit costs are capitalized in accordance with ASC 350. During fiscal 2020, 2019 and 2018, the Company capitalized \$905, \$749 and \$733 of software development costs, respectively.

INCOME TAXES

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

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

PRODUCT WARRANTY ACCRUAL

The Company’s product sales generally include a 12 to 36 month standard hardware warranty. At time of product shipment, the Company accrues for the estimated cost to repair or replace potentially defective products. Estimated warranty

costs are based upon prior actual warranty costs for substantially similar transactions and any specifically identified warranty requirements. Product warranty accrual is included as part of accrued expenses in the accompanying Consolidated Balance Sheets. The following table presents the changes in the Company's product warranty accrual.

| | Fiscal 2020 | Fiscal 2019 | Fiscal 2018 |
|--|-----------------|-----------------|-----------------|
| Beginning balance | \$ 1,870 | \$ 1,336 | \$ 1,691 |
| Warranty assumed from APC | 739 | — | — |
| Warranty assumed from Germane | — | 169 | — |
| Warranty assumed from Themis | — | — | 117 |
| Accruals for warranties issued during the period | 2,839 | 2,274 | 1,318 |
| Settlements made during the period | (1,613) | (1,909) | (1,790) |
| Ending balance | <u>\$ 3,835</u> | <u>\$ 1,870</u> | <u>\$ 1,336</u> |

RESEARCH AND DEVELOPMENT COSTS

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

STOCK-BASED COMPENSATION

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

RETIREMENT OF COMMON STOCK

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

NET EARNINGS PER SHARE

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

Basic and diluted weighted average shares outstanding were as follows:

| | Fiscal Years | | |
|---|---------------|---------------|---------------|
| | 2020 | 2019 | 2018 |
| Basic weighted-average shares outstanding | 54,546 | 47,831 | 46,719 |
| Effect of dilutive equity instruments | 569 | 669 | 752 |
| Diluted weighted-average shares outstanding | <u>55,115</u> | <u>48,500</u> | <u>47,471</u> |

Equity instruments to purchase 8, 32 and 329 shares of common stock were not included in the calculation of diluted net earnings per share for the fiscal years ended July 3, 2020, June 30, 2019 and 2018, respectively, because the equity instruments were anti-dilutive.

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) ("AOCI") includes foreign currency translation adjustments and pension benefit plan adjustments. The components of AOCI included \$174, \$(232) and \$(137) of foreign currency translation adjustments for the fiscal years ended July 3, 2020, June 30, 2019 and 2018, respectively. In addition, pension benefit plan adjustments totaled \$(1,768), \$(2,350) and \$354 for the fiscal years ended July 3, 2020, June 30, 2019 and 2018 respectively.

FOREIGN CURRENCY

Local currencies are the functional currency for the Company's subsidiaries in Switzerland, the United Kingdom, France, Japan, Spain and Canada. The accounts of foreign subsidiaries are translated using exchange rates in effect at period-end for assets and liabilities and at average exchange rates during the period for results of operations. The related translation adjustments are reported in accumulated other comprehensive income in shareholders' equity. Gains (losses) resulting from non-U.S. currency transactions are included in Other income (expense), net in the Consolidated Statements of Operations and Comprehensive Income and were immaterial for all periods presented.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, an amendment of the FASB Accounting Standards Codification. Subsequent to the issuance of ASU 2016-13, there were various updates that amended and clarified the impact of ASU 2016-13. This ASU broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The amendments in this ASU will require an entity to record an allowance for credit losses for certain financial instruments and financial assets, including trade receivables, based on expected losses rather than incurred losses. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The use of forecasted information incorporates more timely information in the estimate of expected credit losses. For public business entities, the standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company does not expect this guidance to have a material impact to its consolidated financial statements or related disclosures.

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

In March 2018, the FASB issued ASU No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects for Accumulated Other Comprehensive Income*, an amendment of the FASB Accounting Standards Codification. This ASU permits a company to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act of 2017 on items within AOCI to retained earnings. The amounts applicable for reclassification should include the effect of the change in the U.S. Federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of the enactment of the Tax Cuts and Jobs Act of 2017 related to the items remaining in AOCI. The effect of the change in the U.S. Federal corporate income tax rate on gross valuation allowances that were originally charged to income from continuing operations shall not be included. The Company has determined that there is no activity that falls within the scope of this ASU.

In August 2018, the FASB issued ASU No. 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Topic 715) Changes to the Disclosure Requirements for Defined Benefit Plans*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU remove disclosures that no longer are considered cost-beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. For public business entities, the standard is effective for fiscal years ending after December 15, 2020. The ASU requires retrospective adoption and permits early adoption for all entities. The Company does not expect this guidance to have a material impact to its consolidated financial statements or related disclosures.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40)*, an amendment of the FASB Accounting Standards Codification. The ASU provides guidance to determine whether to capitalize implementation costs of a cloud computing arrangement that is a service contract or expense as incurred. Costs of arrangements that do not include a software license should be accounted for as a service contract and expensed as incurred. This ASU is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The ASU permits two methods of adoption: prospectively to all implementation costs incurred after the date of adoption, or retrospectively to each prior reporting period presented. The Company does not expect this guidance to have a material impact to its consolidated financial statements or related disclosures.

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU simplify the accounting for income taxes by removing certain exceptions for intraperiod tax allocations and deferred tax liabilities for equity

method investments and adds guidance whether a step-up in tax basis of goodwill relates to a business combination or a separate transaction. This ASU is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the effect that ASU 2019-12 will have on its consolidated financial statements and related disclosures.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2019, the Company adopted ASC 842, *Leases*, which requires lessees to recognize a ROU asset and lease liability for most lease arrangements. This ASU supersedes existing lease guidance, including ASC 840, *Leases (Topic 840)*. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. This ASU, among other things, allows companies to elect an optional transition method to apply the new lease standard through a cumulative-effect adjustment in the period of adoption. The Company adopted ASC 842 using the optional transition method and, as a result, did not recast prior period consolidated financial statements. All prior period amounts and disclosures remain presented under ASC 840. The Company elected the package of practical expedients which allows the Company to not reassess: 1) whether any expired or existing contracts are or contain leases; 2) the lease classification for any expired or existing leases; and 3) initial direct costs for any existing leases. The Company also elected the hindsight practical expedient, permitting the use of hindsight when determining the lease term and assessing impairment of ROU assets. Adoption of the new standard resulted in additional lease assets and lease liabilities on the Consolidated Balance Sheets with no cumulative impact to retained earnings and did not have a material impact on our Consolidated Statements of Operations and Comprehensive Income or Consolidated Statements of Cash Flows.

C. Acquisitions

AMERICAN PANEL CORPORATION ACQUISITION

On September 23, 2019, the Company acquired American Panel Corporation. Based in Alpharetta, Georgia, APC is a leading innovator in large area display technology for the aerospace and defense market. APC's capabilities are deployed on a wide range of next-generation platforms. The Company acquired APC for an all cash purchase price of \$100,000, prior to net working capital and net debt adjustments. The Company funded the acquisition with cash on hand.

The following table presents the net purchase price and the fair values of the assets and liabilities of APC on a preliminary basis:

| | |
|--|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 100,826 |
| Working capital and net debt adjustment | (5,952) |
| Liabilities assumed | 2,454 |
| Less cash acquired | (826) |
| Net purchase price | <u>\$ 96,502</u> |
| Estimated fair value of tangible assets acquired and liabilities assumed | |
| Cash | \$ 826 |
| Accounts receivable | 3,726 |
| Inventory | 11,271 |
| Fixed assets | 690 |
| Other current and non-current assets | 3,494 |
| Accounts payable | (1,554) |
| Accrued expenses | (1,252) |
| Other current and non-current liabilities | (5,749) |
| Estimated fair value of net tangible assets acquired | 11,452 |
| Estimated fair value of identifiable intangible assets | 33,200 |
| Estimated goodwill | 52,676 |
| Estimated fair value of net assets acquired | 97,328 |
| Less cash acquired | (826) |
| Net purchase price | <u>\$ 96,502</u> |

The amounts above represent the preliminary fair value estimates as of July 3, 2020 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 estimate includes customer relationships of \$20,600 with a useful life of 11 years, completed technology of \$10,400 with a useful life of 11 years and backlog of \$2,200 with a useful life of two years. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$52,676 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the Sensor and Mission Processing ("SMP") reporting unit. Since APC was a qualified subchapter S subsidiary, the acquisition is treated as an asset purchase for tax purposes. 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 July 3, 2020, the Company had \$51,553 of goodwill deductible for tax purposes. The Company has not furnished pro forma information relating to APC because such information is not material to the Company's financial results.

The revenues and income before income taxes from APC included in the Company's consolidated results for fiscal year ended July 3, 2020 were \$27,383 and \$3,309, respectively. The APC results include expenses resulting from purchase accounting, which include amortization of intangible assets and inventory step-up.

THE ATHENA GROUP ACQUISITION

On April 18, 2019, the Company acquired The Athena Group, Inc., a privately-held company based in Gainesville, Florida and a leading provider of cryptographic and countermeasure IP vital to securing defense computing systems. The Company acquired Athena for an all cash purchase price of \$34,000, prior to net working capital and net debt adjustments, which was funded through the revolving credit facility ("the Revolver").

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

| | Amounts |
|---|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 34,049 |
| Working capital and net debt adjustment | (446) |
| Less cash acquired | (49) |
| Net purchase price | \$ 33,554 |
| Fair value of tangible assets acquired and liabilities assumed | |
| Cash | \$ 49 |
| Accounts receivable | 726 |
| Fixed assets | 74 |
| Other current and non-current assets | 398 |
| Accounts payable | (48) |
| Accrued expenses | (520) |
| Other current and non-current liabilities | (600) |
| Deferred tax liability | (5,183) |
| Fair value of net tangible liabilities acquired | (5,104) |
| Fair value of identifiable intangible assets | 23,700 |
| Goodwill | 15,007 |
| Fair value of net assets acquired | 33,603 |
| Less cash acquired | (49) |
| Net purchase price | \$ 33,554 |

On April 18, 2020, the measurement period for Athena expired. The identifiable intangible assets include completed technology of \$23,700 with a useful life of 11 years.

The goodwill of \$15,007 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the Mercury Defense Systems ("MDS") reporting unit.

SYNTONIC MICROWAVE LLC ACQUISITION

On April 18, 2019, the Company acquired Syntonic Microwave LLC, a privately held company based in Campbell, California and a leading provider of advanced synthesizers, wideband phase coherent tuners and microwave converters optimized for signals intelligence and electronic intelligence applications demanding frequency coverage up to 40 GHz with 2 GHz instantaneous bandwidth. The Company acquired Syntonic for an all cash purchase price of \$12,000, prior to net working capital and net debt adjustments, which was funded through the Revolver.

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

| | Amounts |
|--|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 13,118 |
| Less cash acquired | (1,118) |
| Net purchase price | <u>\$ 12,000</u> |
| Fair value of tangible assets acquired and liabilities assumed | |
| Cash | \$ 1,118 |
| Accounts receivable | 281 |
| Inventory | 482 |
| Fixed assets | 31 |
| Other current and non-current assets | 6 |
| Accounts payable | (71) |
| Accrued expenses | (61) |
| Fair value of net tangible assets acquired | 1,786 |
| Fair value of identifiable intangible assets | 7,100 |
| Goodwill | 4,232 |
| Fair value of net assets acquired | 13,118 |
| Less cash acquired | (1,118) |
| Net purchase price | <u>\$ 12,000</u> |

On April 18, 2020, the measurement period for Syntonic expired. The identifiable intangible assets include customer relationships of \$4,200 with a useful life of 10 years, completed technology of \$2,500 with a useful life of nine years and backlog of \$400 with a useful life of one year.

The goodwill of \$4,232 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the Advanced Microelectronic Solutions ("AMS") reporting unit. Since Syntonic was a limited liability company, the acquisition is treated as an asset purchase for tax purposes. 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 July 3, 2020, the Company had \$2,986 of goodwill deductible for tax purposes.

GECO AVIONICS AQUISITION

On January 29, 2019, the Company announced that it had acquired GECO Avionics, LLC, a privately held company in Mesa, Arizona, with over twenty years of experience designing and manufacturing affordable safety-critical avionics and mission computing solutions. The Company acquired GECO for an all cash purchase price of \$36,500, which was funded through the Revolver.

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

| | Amounts |
|--|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 36,500 |
| Net purchase price | <u>\$ 36,500</u> |
| Estimated fair value of tangible assets acquired and liabilities assumed | |
| Accounts receivable | \$ 1,320 |
| Inventory | 1,454 |
| Fixed assets | 459 |
| Accounts payable | (217) |
| Accrued expenses | (239) |
| Fair value of net tangible assets acquired | <u>2,777</u> |
| Fair value of identifiable intangible assets | 12,700 |
| Goodwill | <u>21,023</u> |
| Fair value of net assets acquired | <u>36,500</u> |
| Net purchase price | <u>\$ 36,500</u> |

On January 29, 2020, the measurement period for GECO expired. The identifiable intangible assets include customer relationships of \$6,900 with a useful life of 11 years, completed technology of \$4,800 with a useful life of 10 years and backlog of \$1,000 with a useful life of two years.

The goodwill of \$21,023 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the SMP reporting unit. Since GECO was a limited liability company, the acquisition is treated as an asset purchase for tax purposes. 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 July 3, 2020, the Company had \$19,766 of goodwill deductible for tax purposes.

GERMANE SYSTEMS ACQUISITION

On July 31, 2018, the Company announced that it had entered into a membership interest purchase agreement (the "Purchase Agreement") and acquired Germane Systems, LC pursuant to the terms of the Purchase Agreement.

Based in Chantilly, Virginia, Germane is an industry leader in the design, development and manufacturing of rugged servers, computers and storage systems for C2I applications. The Company acquired Germane for an all cash purchase price of \$45,000, prior to net working capital and net debt adjustments. The Company funded the acquisition with borrowings obtained under the Revolver. On December 12, 2018 the Company and former owners of Germane agreed to post-closing adjustments totaling \$1,244, which decreased the Company's net purchase price.

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

| | Amounts |
|---|------------------|
| Consideration transferred | |
| Cash paid at closing | \$ 47,166 |
| Working capital and net debt adjustment | (1,244) |
| Less cash acquired | (193) |
| Net purchase price | \$ 45,729 |
| Fair value of tangible assets acquired and liabilities assumed | |
| Cash | \$ 193 |
| Accounts receivable | 4,277 |
| Inventory | 8,575 |
| Fixed assets | 867 |
| Other current and non-current assets | 596 |
| Accounts payable | (3,146) |
| Accrued expenses | (1,394) |
| Other current and non-current liabilities | (514) |
| Fair value of net tangible assets acquired | 9,454 |
| Fair value of identifiable intangible assets | 12,910 |
| Goodwill | 23,558 |
| Fair value of net assets acquired | 45,922 |
| Less cash acquired | (193) |
| Net purchase price | \$ 45,729 |

On July 31, 2019, the measurement period for Germane expired. The identifiable intangible assets include customer relationships of \$8,500 with a useful life of 11 years, completed technology of \$4,200 with a useful life of eight years and backlog of \$210 with a useful life of one year.

The goodwill of \$23,558 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the MDS reporting unit. Since Germane was a limited liability company, the acquisition is treated as an asset purchase for tax purposes. 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 July 3, 2020, the Company had \$20,555 of goodwill deductible for tax purposes.

D. Fair Value of Financial Instruments

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at July 3, 2020:

| | Fair Value Measurements | | | |
|-------------------------|-------------------------|-----------------|------------------|-------------|
| | July 3, 2020 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Certificates of deposit | \$ 10,006 | \$ — | \$ 10,006 | \$ — |
| U.S. equity securities | 2,007 | 2,007 | — | — |
| Total | \$ 12,013 | \$ 2,007 | \$ 10,006 | \$ — |

During the fiscal year ended July 3, 2020, the Company received gross proceeds and recorded a gain on a cost-method investment of \$4,310 and \$3,810, respectively. The Company's cost-method investment did not have a readily determinable fair value and was recorded at cost within Other non-current assets in the Consolidated Balance Sheet prior to its sale.

The Company also recorded a gain on the change in fair value of a cost-method investment of \$2,007. The change in fair value of these U.S equity securities was the result of an observable price change during the fourth quarter of fiscal 2020. Its fair value is based on a quoted price of identical instruments in an active market and is included within Prepaid expenses and other current assets on the Consolidated Balance Sheet as of July 3, 2020.

The gain on investments were included within Other income (expense), net in the Consolidated Statements of Operations and Comprehensive Income for the fiscal year ended July 3, 2020.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at June 30, 2019:

| | Fair Value Measurements | | | |
|-------------------------|-------------------------|-------------|------------------|-------------|
| | June 30, 2019 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Certificates of deposit | \$ 31,522 | \$ — | \$ 31,522 | \$ — |
| Total | \$ 31,522 | \$ — | \$ 31,522 | \$ — |

The carrying values of cash and cash equivalents, including money market funds, restricted cash, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The Company terminated its interest rate swap during the fourth quarter of fiscal 2019 in conjunction with the net proceeds generated by the follow-on equity offering. As such, the Company had no interest rate swaps as of July 3, 2020 and June 30, 2019.

E. Inventory

Inventory was comprised of the following:

| | As of | |
|-----------------|-------------------|-------------------|
| | July 3, 2020 | June 30, 2019 |
| Raw materials | \$ 111,225 | \$ 84,561 |
| Work in process | 49,647 | 38,525 |
| Finished goods | 17,221 | 14,026 |
| Total | \$ 178,093 | \$ 137,112 |

The \$40,981 increase in inventory was due to an increase in overall demand, especially for larger, more complex sub-assemblies and integrated sub-systems, advanced purchases intended to mitigate potential disruptions to the supply chain resulting from the COVID pandemic and the acquisition of APC.

F. Property and Equipment

Property and equipment consisted of the following:

| | Estimated Useful Lives (Years) | As of | |
|---------------------------------|--|------------------|------------------|
| | | July 3, 2020 | June 30, 2019 |
| Computer equipment and software | 3-4 | \$ 85,705 | \$ 78,195 |
| Furniture and fixtures | 5 | 5,993 | 5,330 |
| Leasehold improvements | lesser of estimated useful life or lease term | 36,874 | 25,646 |
| Machinery and equipment | 5-10 | 90,970 | 63,792 |
| | | 219,542 | 172,963 |
| Less: accumulated depreciation | | (131,805) | (112,962) |
| | | \$ 87,737 | \$ 60,001 |

The \$27,736 increase in property and equipment was primarily due to current year additions and property and equipment associated with improvements to the Company's facilities, including the expansion of its trusted custom microelectronics business and the acquisition of APC. These increases were partially offset by depreciation expense. During fiscal 2020 and 2019, the Company retired \$64 and \$3,980, respectively, of computer equipment and software, furniture, and fixtures, leasehold improvements, and machinery and equipment that were no longer in use by the Company.

Depreciation expense related to property and equipment for the fiscal years ended July 3, 2020, June 30, 2019 and 2018 was \$18,770, \$18,478 and \$16,273, respectively.

G. Goodwill

The following table sets forth the changes in the carrying amount of goodwill by reporting unit for the year ended July 3, 2020:

| | Total |
|---|-------------------|
| Balance at June 30, 2019 | \$ 562,146 |
| Goodwill adjustment for the Germane acquisition | 447 |
| Goodwill adjustment for the GECO acquisition | (200) |
| Goodwill adjustment for the Athena acquisition | (993) |
| Goodwill arising from the APC acquisition | 52,676 |
| Balance at July 3, 2020 | <u>\$ 614,076</u> |

As defined by ASC 350, goodwill is tested for impairment on an interim basis at the occurrence of certain triggering events or at a minimum on an annual basis. In fiscal 2020, there were no triggering events, which required an interim goodwill impairment test. The Company performed its annual goodwill impairment test in the fourth quarter of fiscal 2020 with no impairment noted.

H. Intangible Assets

Intangible assets consisted of the following:

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|----------------------------------|--------------------------------------|-------------------------------------|------------------------------------|---|
| July 3, 2020 | | | | |
| Customer relationships | \$ 181,960 | \$ (48,450) | \$ 133,510 | 11.4 years |
| Licensing agreements and patents | 1,505 | (1,404) | 101 | 3.5 years |
| Completed technologies | 107,992 | (34,522) | 73,470 | 9.2 years |
| Backlog | 3,200 | (1,533) | 1,667 | 2.0 years |
| | <u>\$ 294,657</u> | <u>\$ (85,909)</u> | <u>\$ 208,748</u> | |
| June 30, 2019 | | | | |
| Customer relationships | \$ 167,460 | \$ (38,308) | \$ 129,152 | 11.4 years |
| Licensing agreements and patents | 1,505 | (1,022) | 483 | 3.5 years |
| Completed technologies | 97,592 | (22,246) | 75,346 | 9.0 years |
| Backlog | 1,610 | (467) | 1,143 | 1.6 years |
| | <u>\$ 268,167</u> | <u>\$ (62,043)</u> | <u>\$ 206,124</u> | |

Estimated future amortization expense for intangible assets remaining at July 3, 2020 is as follows:

| Fiscal Year | Totals |
|-----------------------------------|-------------------|
| 2021 | \$ 30,326 |
| 2022 | 29,114 |
| 2023 | 26,857 |
| 2024 | 23,614 |
| 2025 | 22,034 |
| Thereafter | 76,803 |
| Total future amortization expense | <u>\$ 208,748</u> |

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the APC acquisition. These assets are included in the Company's gross and net carrying amounts as of July 3, 2020.

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Useful Life |
|------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------------------|
| Customer relationships | \$ 20,600 | \$ (1,405) | \$ 19,195 | 11.0 years |
| Completed technologies | 10,400 | (709) | 9,691 | 11.0 years |
| Backlog | 2,200 | (825) | 1,375 | 2.0 years |
| | <u>\$ 33,200</u> | <u>\$ (2,939)</u> | <u>\$ 30,261</u> | |

I. Restructuring

Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities. During fiscal 2020, the Company incurred \$1,805 of net restructuring and other charges primarily related to severance costs associated with the elimination of 20 positions, predominantly in SG&A and R&D functions.

During fiscal 2019, the Company incurred \$560 of net restructuring and other charges primarily related to severance costs associated with the acquired Germane business.

During fiscal 2018, the Company incurred \$3,159 related to the elimination of 38 positions predominantly in R&D and operations functions as well as executive severance.

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 remaining restructuring liability is classified as accrued expenses in the Consolidated Balance Sheets.

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

| | Severance & Related | Facilities & Other | Total |
|--|---------------------|--------------------|---------------|
| Restructuring liability at June 30, 2018 | \$ 1,801 | \$ — | \$ 1,801 |
| Restructuring charges | 549 | 80 | 629 |
| Cash paid | (2,333) | (24) | (2,357) |
| Reversals (*) | (13) | (56) | (69) |
| Restructuring liability at June 30, 2019 | 4 | — | 4 |
| Restructuring charges | 1,730 | 75 | 1,805 |
| Cash paid | (1,137) | (75) | (1,212) |
| Restructuring liability at July 3, 2020 | <u>\$ 597</u> | <u>\$ —</u> | <u>\$ 597</u> |

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

J. Leases

The Company enters into lease arrangements to facilitate its operations, including manufacturing, storage, as well as engineering, sales, marketing, and administration resources. As described in Note B to the consolidated financial statements, effective July 1, 2019, the Company adopted ASC 842 using the optional transition method and, as a result, did not recast prior period unaudited consolidated comparative financial statements. As such, all prior period amounts and disclosures are presented under ASC 840, *Leases (Topic 840)*. Finance leases are not material to the Company's consolidated financial statements and therefore are excluded from the following disclosures.

SUPPLEMENTAL BALANCE SHEET INFORMATION

Supplemental operating lease balance sheet information is summarized as follows:

| | As of July 3, 2020 |
|-------------------------------------|-------------------------------|
| Operating lease right-of-use assets | <u>\$ 60,613</u> |
| Accrued expenses ⁽¹⁾ | \$ 6,950 |
| Operating lease liabilities | 66,981 |
| Total operating lease liabilities | <u>\$ 73,931</u> |

(1) The short term portion of the Operating lease liabilities is included within Accrued expenses on the Consolidated Balance Sheet.

OTHER SUPPLEMENTAL INFORMATION

Other supplemental operating lease information is summarized as follows:

| | For the Fiscal Year Ended July 3, 2020 |
|--|---|
| Cash paid for amounts included in the measurement of operating lease liabilities | \$ 6,929 |
| Right-of-use assets obtained in exchange for new lease liabilities | \$ 19,942 |
| Weighted average remaining lease term | 9.3 years |
| Weighted average discount rate | 4.91 % |

MATURITIES OF LEASE COMMITMENTS

Maturities of operating lease commitments as of July 3, 2020 were as follows:

| Fiscal Year | Totals |
|--|------------------|
| 2021 | \$ 9,572 |
| 2022 | 10,741 |
| 2023 | 10,272 |
| 2024 | 9,333 |
| 2025 | 9,356 |
| Thereafter | 44,763 |
| Total lease payments | <u>94,037</u> |
| Less: imputed interest | (20,106) |
| Present value of operating lease liabilities | <u>\$ 73,931</u> |

As previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2019, future minimum lease payments for non-cancelable operating leases were as follows:

| Fiscal Year | Totals |
|------------------------------|------------------|
| 2020 | \$ 10,205 |
| 2021 | 8,949 |
| 2022 | 8,280 |
| 2023 | 7,414 |
| 2024 | 6,496 |
| Thereafter | 28,286 |
| Total minimum lease payments | <u>\$ 69,630</u> |

During fiscal 2020 and 2019, the Company recognized operating lease expense of \$10,029 and \$8,710, respectively. There were no material restrictions, covenants, sale and leaseback transactions, variable lease payments or residual value guarantees imposed by the Company's leases at July 3, 2020.

K. Income Taxes

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

| | Fiscal Years | | |
|------------------------------------|------------------|------------------|------------------|
| | 2020 | 2019 | 2018 |
| Income before income taxes: | | | |
| United States | \$ 93,388 | \$ 57,281 | \$ 43,368 |
| Foreign | 545 | 2,246 | (795) |
| | <u>\$ 93,933</u> | <u>\$ 59,527</u> | <u>\$ 42,573</u> |
| Tax provision (benefit): | | | |
| Federal: | | | |
| Current | \$ 8,442 | \$ 11,454 | \$ 4,470 |
| Deferred | (1,077) | (3,008) | (4,527) |
| | 7,365 | 8,446 | (57) |
| State: | | | |
| Current | 3,407 | 5,194 | 2,370 |
| Deferred | (2,327) | (1,421) | (537) |
| | 1,080 | 3,773 | 1,833 |
| Foreign: | | | |
| Current | 475 | 546 | 186 |
| Deferred | (699) | (13) | (272) |
| | (224) | 533 | (86) |
| | <u>\$ 8,221</u> | <u>\$ 12,752</u> | <u>\$ 1,690</u> |

The following is the reconciliation between the statutory Federal income tax rate and the Company's effective income tax rate:

| | Fiscal Years | | |
|---|--------------|---------------|--------------|
| | 2020 | 2019 | 2018 |
| Tax provision at federal statutory rates | 21.0 % | 21.0 % | 28.0 % |
| State income tax, net of federal tax benefit | 6.1 | 5.9 | 5.6 |
| Research and development tax credits | (11.9) | (4.5) | (5.1) |
| Provision to return | (3.1) | — | — |
| Excess tax benefits related to stock compensation | (7.7) | (4.5) | (18.5) |
| Domestic manufacturing deduction | — | — | (2.0) |
| Deemed repatriation of foreign earnings | — | — | 1.9 |
| Foreign income tax rate differential | 0.1 | 0.1 | 0.3 |
| Non-deductible compensation | 2.6 | 2.0 | 1.7 |
| Acquisition costs | — | 0.1 | 1.4 |
| Reserves for unrecognized income tax benefits | 3.0 | 0.3 | 0.3 |
| Tax rate changes | (0.5) | — | (2.3) |
| Impacts related to acquired tax attributes | — | — | (8.7) |
| Other | (0.8) | 1.0 | 1.4 |
| | <u>8.8 %</u> | <u>21.4 %</u> | <u>4.0 %</u> |

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted by the U.S. government. The Tax Act impacted the U.S. corporate tax rate that the Company will use going forward, which has been reduced to 21% from 35%. As the Company has a June 30 fiscal year-end, the lower U.S. corporate tax rate was phased in, resulting in a U.S. corporate tax rate of approximately 28% for the Company's fiscal year ended June 30, 2018, and 21% for fiscal year ended June 30, 2019 and subsequent fiscal years.

The Tax Act also includes provisions that increase the Company's tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on deductions for executive compensation. In

addition, the effective tax rate may be materially different than the statutory Federal tax rate due to state taxes, Federal research and development tax credits, excess tax benefits related to stock compensation, reserves for unrecognized income tax benefits, and other book to tax permanent differences.

The effective tax rate for fiscal 2020 and 2019 differed from the Federal statutory rate primarily due to benefits related to research and development tax credits and excess tax benefits related to stock compensation, partially offset by additional tax expense related to state taxes and non-deductible compensation. During fiscal 2020 and 2019, the Company recognized a tax benefit of \$7,259 and \$2,672 related to excess tax benefits on stock compensation, respectively. The Company also recognized a tax benefit of \$6,325 and a tax reserve of \$2,240, related to research and development tax credits claimed on prior year federal and state tax returns and other favorable provision to return adjustments of \$2,917.

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

| | As of | |
|---|--------------------|--------------------|
| | July 3, 2020 | June 30, 2019 |
| Deferred tax assets: | | |
| Inventory valuation and receivable allowances | \$ 12,066 | \$ 10,313 |
| Accrued compensation | 5,941 | 4,644 |
| Stock compensation | 5,062 | 4,595 |
| Federal and state tax credit carryforwards | 11,782 | 15,510 |
| Other accruals | 1,086 | 1,128 |
| Deferred compensation | 930 | 1,561 |
| Acquired net operating loss carryforward | 425 | 721 |
| Operating lease liabilities | 20,035 | — |
| Capital loss carryforwards | — | 2,354 |
| Other | 1,876 | 2,258 |
| | <u>59,203</u> | <u>43,084</u> |
| Valuation allowance | (11,264) | (16,666) |
| Total deferred tax assets | <u>47,939</u> | <u>26,418</u> |
| Deferred tax liabilities: | | |
| Prepaid expenses | (1,111) | (848) |
| Property and equipment | (10,668) | (4,927) |
| Intangible assets | (33,007) | (38,399) |
| Operating lease right-of-use assets | (16,426) | — |
| Other | (616) | (58) |
| Total deferred tax liabilities | <u>(61,828)</u> | <u>(44,232)</u> |
| Net deferred tax liabilities | <u>\$ (13,889)</u> | <u>\$ (17,814)</u> |
| As reported: | | |
| Deferred tax liabilities | <u>\$ (13,889)</u> | <u>\$ (17,814)</u> |
| | <u>\$ (13,889)</u> | <u>\$ (17,814)</u> |

At July 3, 2020, the Company evaluated the need for a valuation allowance on deferred tax assets. In assessing whether the deferred tax assets are realizable, management considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the Company's past and recent operating performance and results, future taxable income including the reversal of existing deferred tax liabilities, and tax planning strategies. The Company continues to conclude that its deferred tax assets are more likely than not to be realized with the exception of certain state research and development tax credits, which management continues to believe that it is not more likely than not to be realized. The change in valuation allowance is primarily related to the expiration of capital loss carryforwards that had a full valuation allowance. Any future changes in the valuation allowance will impact income tax expense.

The Company has state research and development tax credit carryforwards of \$14,884, which will expire starting in fiscal year 2021 through fiscal year 2034.

The Company is subject to taxation in the U.S. (Federal and state) and various foreign jurisdictions that it operates in. The Company has established reserves to provide for additional income taxes that management believes will more likely than not be due in future years as these previously filed tax returns are audited. These reserves have been established based upon management's assessment as to the potential exposures. All tax reserves are analyzed quarterly and adjustments are made as events occur and warrant modification.

During the period ended July 3, 2020, the Company filed amended Federal and state tax returns primarily relating to the research and development tax credits. As part of the study, the Company adjusted the reserve previously recorded on the research and development tax credits claimed.

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

| | Fiscal Years | |
|---|-----------------|-----------------|
| | 2020 | 2019 |
| Unrecognized tax benefits, beginning of period | \$ 1,273 | \$ 998 |
| Increases for tax positions taken related to a prior period | 2,146 | — |
| Increases for tax positions taken during the current period | 854 | 275 |
| Decreases for tax positions taken related to a prior period | — | — |
| Decreases for tax positions taken during current period | — | — |
| Decreases for settlements of previously recognized positions | — | — |
| Decreases as a result of a lapse of the applicable statute of limitations | (156) | — |
| Unrecognized tax benefits, end of period | <u>\$ 4,117</u> | <u>\$ 1,273</u> |

The \$4,117 of unrecognized tax benefits as of July 3, 2020, if released, would reduce income tax expense. The Company increased its unrecognized income tax benefits primarily due to additional research and development tax credits claimed on prior year Federal and state returns.

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. The total amount of gross interest and penalties accrued was \$175 and \$84 as of July 3, 2020 and June 30, 2019, respectively, and the amount of interest and penalties recognized in fiscal 2020, 2019 and 2018 was \$91, \$101 and \$42, respectively.

The Company's major tax jurisdiction is the U.S. (Federal and state) and the open tax years are fiscal 2016 through 2020.

L. 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 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.

PURCHASE COMMITMENTS

As of July 3, 2020, 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 \$103,548.

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 Statements of Cash Flows.

M. Debt

Revolving Credit Facilities

On September 28, 2018, the Company amended its Credit Agreement (the "Credit Agreement") with a syndicate of commercial banks to increase and extend the borrowing capacity of the Revolver to a \$750,000, 5-year revolving credit line, with the maturity extended to September 28, 2023 (the "Amended Credit Agreement"). The Company evaluated the Amended Credit Agreement under ASC 470, *Debt*, and determined that the amendment represented a modification of the Credit Agreement. Due to the increase in the borrowing capacity of the Revolver, new costs associated with the amendment and the previous balance of unamortized deferred financing costs totaling \$4,369, are being amortized to Other income (expense), net on a straight line basis over the new term of the Revolver. As of July 3, 2020, there were no outstanding borrowings against the Revolver. The Company incurred interest expense from the Revolver of \$1,006 and \$9,109 for the fiscal years ended July 3, 2020 and June 30, 2019, respectively. There were also outstanding letters of credit of \$904 as of July 3, 2020.

Maturity

The Revolver has a five year maturity, which was extended to September 28, 2023.

Interest Rates and Fees

Borrowings under the Revolver bear interest, at the Company's option, at floating rates tied to LIBOR or the prime rate plus an applicable percentage. The applicable percentage is set at LIBOR plus a markup pursuant to a pricing grid based on the Company's total net leverage ratio. As of July 3, 2020, the applicable percentage was set at LIBOR plus 1.125% based on the Company's total net leverage ratio.

In addition to interest on the aggregate outstanding principal amounts of any borrowings, the Company will also pay a quarterly commitment fee on the unutilized commitments under the Revolver. The applicable percentage is pursuant to a pricing grid based on the Company's total net leverage ratio. As of July 3, 2020, the stated interest rate for unutilized commitments was 0.20% per annum. The Company will also pay customary letter of credit and agency fees.

Covenants and Events of Default

The Revolver provides for customary negative covenants. The Revolver also requires the Company to comply with certain financial covenants, including a quarterly minimum consolidated cash interest charge ratio test and a quarterly maximum consolidated total net leverage ratio test.

The Revolver also provides for customary representations and warranties, affirmative covenants and events of default. If an event of default occurs, the lenders under the Revolver will be entitled to take various actions, including the termination of unutilized commitments, the acceleration of amounts outstanding under the Revolver and all actions permitted to be taken by a secured creditor. As of July 3, 2020, the Company was in compliance with all covenants and conditions under the Revolver.

Guarantees and Security

The Company's obligations under the Revolver are guaranteed by certain of its material domestic wholly-owned restricted subsidiaries (the "Guarantors"). The obligations of both the Company and the Guarantors are secured by a perfected security interest in substantially all of the assets of the Company and the Guarantors, in each case, now owned or later acquired, including a pledge of all of the capital stock of substantially all of its domestic wholly-owned restricted subsidiaries and 65% of the capital stock of certain of its foreign restricted subsidiaries, subject in each case to the exclusion of certain assets and additional exceptions.

N. Employee Benefit Plans

Pension Plan

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

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

On January 1, 2019, the independent pension fund changed the conversion rate for accumulated retirement savings. The Company's results contain the effects of this change in conversion rates by the independent pension fund as prior service costs. These prior service costs are amortized from AOCI to net periodic benefit costs over approximately 10 years.

At July 3, 2020, the accumulated benefit obligation of the Plan equals the fair value of the Plan's assets. The Plan's funded status at July 3, 2020 and 2019 was a net liability of \$11,877 and \$9,186, respectively, which is recorded in other non-current liabilities on the Consolidated Balance Sheets. The Company recorded a net loss of \$1,768 and \$2,350 in AOCI during the fiscal years ended July 3, 2020 and June 30, 2019, respectively. Total employer contributions to the Plan were \$911 during the year ended July 3, 2020, and the Company's total expected employer contributions to the Plan during fiscal 2021 are \$957.

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

| Fiscal Year | Total |
|---------------------------|------------------|
| 2021 | \$ 900 |
| 2022 | 1,059 |
| 2023 | 1,401 |
| 2024 | 1,253 |
| 2025 | 1,040 |
| Thereafter (next 5 years) | 6,423 |
| Total | \$ 12,076 |

The following table outlines the components of net periodic benefit cost of the Plan for the fiscal years ended July 3, 2020 and June 30, 2019:

| | Fiscal Years Ended | |
|------------------------------------|--------------------|---------------|
| | July 3, 2020 | June 30, 2019 |
| Service cost | \$ 1,375 | \$ 903 |
| Interest cost | 125 | 156 |
| Expected return on assets | (233) | (183) |
| Amortization of prior service cost | (63) | (61) |
| Amortization net of loss | 33 | — |
| Net periodic benefit cost | <u>\$ 1,237</u> | <u>\$ 815</u> |

The following table reflects the related actuarial assumptions used to determine net periodic benefit cost of the Plan for the fiscal years ended July 3, 2020 and June 30, 2019:

| | Fiscal Years Ended | |
|--|--------------------|---------------|
| | July 3, 2020 | June 30, 2019 |
| Discount rate | 0.30 % | 0.50 % |
| Expected rate of return on Plan assets | 1.50 % | 1.50 % |
| Expected inflation | 1.20 % | 1.20 % |
| Rate of compensation increases | 1.50 % | 1.50 % |

The calculation of the projected benefit obligation ("PBO") utilized BVG 2015 Generational data for assumptions related to the mortality rates, disability rates, turnover rates, and early retirement ages.

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

| | Fiscal Years Ended | |
|---|--------------------|------------------|
| | July 3, 2020 | June 30, 2019 |
| Projected benefit obligation, beginning | \$ 24,274 | \$ 18,127 |
| Service cost | 1,375 | 903 |
| Interest cost | 125 | 156 |
| Employee contributions | 1,916 | 3,577 |
| Actuarial loss | 2,387 | 2,859 |
| Benefits paid | (906) | (1,607) |
| Foreign exchange loss | 784 | 259 |
| Projected benefit obligation at end of year | <u>\$ 29,955</u> | <u>\$ 24,274</u> |

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

| | Fiscal Years Ended | |
|--|--------------------|------------------|
| | July 3, 2020 | June 30, 2019 |
| Fair value of Plan assets, beginning | \$ 15,088 | \$ 12,029 |
| Actual return on Plan assets | 582 | 167 |
| Company contributions | 911 | 741 |
| Employee contributions | 1,916 | 3,577 |
| Benefits paid | (906) | (1,607) |
| Foreign exchange gain | 487 | 181 |
| Fair value of Plan assets at end of year | <u>\$ 18,078</u> | <u>\$ 15,088</u> |

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

| | As of | |
|---|--------------------|-------------------|
| | July 3, 2020 | June 30, 2019 |
| Projected benefit obligation at end of year | \$ 29,955 | \$ 24,274 |
| Fair value of plan assets at end of year | 18,078 | 15,088 |
| Funded status | <u>\$ (11,877)</u> | <u>\$ (9,186)</u> |

The fair value of Plan assets were \$18,078 at July 3, 2020. The Plan is denominated in a foreign currency, the Swiss Franc, which can have an impact on the fair value of Plan assets. The Plan was not subject to material fluctuations during the years ended July 3, 2020 or June 30, 2019. The Plan's assets are administered by an independent pension fund foundation (the "foundation"). As of July 3, 2020, the foundation has invested the assets of the Plan in various investments vehicles, including cash, real estate, equity securities, and bonds. The investments are measured at fair value using a mix of Level 1, Level 2 and Level 3 inputs.

401(k) Plan

The Company maintains a qualified 401(k) plan (the "401(k) Plan") for its U.S. employees. During fiscal years 2020, 2019 and 2018, the Company matched employee contributions up to 3% of eligible compensation. The Company may also make optional contributions to the plan for any plan year at its discretion. Expense recognized by the Company for matching contributions related to the 401(k) plan was \$5,954, \$4,525 and \$3,684 during the fiscal years ended July 3, 2020, June 30, 2019, and 2018, respectively.

O. Shareholders' Equity

PREFERRED STOCK

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

SHELF REGISTRATION STATEMENT

On August 28, 2017, the Company filed a shelf registration statement on Form S-3ASR with the SEC. The shelf registration statement, which was effective upon filing with the SEC, registered each of the following securities: debt securities, preferred stock, common stock, warrants and units. The Company has an unlimited amount available under the shelf registration statement. Additionally, as part of the shelf registration statement, the Company has entered into an equity distribution agreement, which allows the Company to sell an aggregate of up to \$200,000 of its common stock from time to time through its agents.

FOLLOW-ON EQUITY OFFERING

On May 20, 2019 the Company announced the commencement of an underwritten public offering of 5,000 shares of its common stock, par value \$0.01, with an over-allotment allocation of an additional 750 shares. On May 23, 2019, the Company announced it upsized the initial 5,000 share public offering to 6,000 shares, with an over-allotment allocation of 900 shares. On May 31, 2019 the Company closed the offering, including the full over-allotment allocation, selling an aggregate of 6,900 shares of common stock at a price to the public of \$69.00 for total net proceeds of \$454,343.

P. Stock-Based Compensation

STOCK INCENTIVE PLANS

The Board of Directors approved the Company's 2018 Stock Incentive Plan (the "2018 Plan") on July 23, 2018. The 2018 Plan became effective upon the approval of shareholders at the Company's annual meeting held on October 24, 2018. The aggregate number of shares authorized for issuance under the 2018 Plan is 2,862 shares, with an additional 710 shares rolled into the 2018 Plan that were available for future grant under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan") at the time of shareholder approval of the 2018 Plan. The 2018 Plan replaced the 2005 Plan. On November 6, 2019, an additional 184 shares from the 2005 Plan were rolled into the 2018 Plan as a result of forfeiture, cancellation, or termination (other than by exercise) of previously-made grants under the 2005 Plan. The shares authorized for issuance under the 2018 Plan will continue to be increased by any future cancellations, forfeitures or terminations (other than by exercise) of awards under the 2005 Plan. The foregoing does not affect any outstanding awards under the 2005 Plan, which remain in full force and effect in accordance with their terms. The 2018 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 2,632 shares available for future grant under the 2018 Plan at July 3, 2020.

As part of the Company's ongoing annual equity grant program for employees, the Company grants performance-based restricted stock awards to certain executives and employees pursuant to the 2018 Plan. Performance awards vest based on the requisite service period subject to the achievement of specific financial performance targets. Based on the performance targets, some of these awards require graded vesting which results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company monitors the probability of achieving the performance targets on a quarterly basis and may adjust periodic stock compensation expense accordingly based on its determination of the likelihood for reaching targets. The performance targets generally include the achievement of internal performance targets in relation to a peer group of companies.

EMPLOYEE STOCK PURCHASE PLAN

The number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,800 shares. Under the ESPP, rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six-month offering period. The ESPP permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the ESPP. The number of shares issued under the ESPP during fiscal years 2020, 2019, and 2018 was 89, 102 and 82, respectively. Shares available for future purchase under the ESPP totaled 29 at July 3, 2020.

STOCK OPTION AND AWARD ACTIVITY

The following table summarizes activity of the Company's stock option plans since June 30, 2018:

| | Options Outstanding | | | |
|--|---------------------|---------------------------------|---|--|
| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value as of 7/3/2020 |
| Outstanding at June 30, 2018 | 4 | \$ 5.52 | 3.13 | |
| Granted | — | — | | |
| Exercised | — | — | | |
| Cancelled | — | — | | |
| Outstanding at June 30, 2019 | 4 | \$ 5.52 | 2.13 | |
| Granted | — | \$ — | | |
| Exercised | (1) | \$ 5.52 | | |
| Cancelled | — | \$ — | | |
| Outstanding at July 3, 2020 | 3 | \$ 5.52 | 1.12 | \$ 208 |
| Vested and expected to vest at July 3, 2020 | 3 | \$ 5.52 | 1.12 | \$ 208 |
| Exercisable at July 3, 2020 | 3 | \$ 5.52 | 1.12 | \$ 208 |

The intrinsic value of the options exercised during fiscal years 2020, and 2018 was \$67 and \$1,780, respectively. There were no options exercised during fiscal 2019. Non-vested stock options are subject to the risk of forfeiture until the fulfillment of specified conditions. As of July 3, 2020, June 30, 2019 and 2018, there was no unrecognized compensation cost related to non-vested options granted under the Company's stock plans. There were no stock options granted during fiscal years 2020, 2019 or 2018.

The following table summarizes the status of the Company's non-vested restricted stock awards since June 30, 2018:

| | Non-Vested Restricted Stock Awards | |
|-------------------------------------|------------------------------------|--|
| | Number of Shares | Weighted Average Grant Date Fair Value |
| Outstanding at June 30, 2018 | 1,135 | \$ 27.26 |
| Granted | 468 | 52.50 |
| Vested | (478) | 51.50 |
| Forfeited | (79) | 36.97 |
| Outstanding at June 30, 2019 | 1,046 | \$ 39.62 |
| Granted | 522 | 80.87 |
| Vested | (562) | 31.40 |
| Forfeited | (49) | 54.96 |
| Outstanding at July 3, 2020 | 957 | \$ 61.59 |

The total fair value of restricted stock awards vested during fiscal years 2020, 2019, and 2018 was \$46,089, \$24,596 and \$38,344, respectively.

Non-vested restricted stock awards are subject to the risk of forfeiture until the fulfillment of specified conditions. As of July 3, 2020, there was \$44,690 of total unrecognized compensation cost related to non-vested restricted stock awards granted under the Company's stock plans that is expected to be recognized over a weighted-average period of 2.4 years from July 3, 2020. As of June 30, 2019, there was \$32,886 of total unrecognized compensation cost related to non-vested restricted stock awards granted under the Company's stock plans that is expected to be recognized over a weighted-average period of 2.5 years from June 30, 2019.

STOCK-BASED COMPENSATION EXPENSE

The Company recognizes expense for its share-based payment plans in the Consolidated Statements of Operations and Comprehensive Income in accordance with ASC 718. The Company had \$562 and \$241 of capitalized stock-based compensation expense on the Consolidated Balance Sheets as of July 3, 2020 and June 30, 2019, respectively. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period. The following table presents share-based compensation expenses from continuing operations included in the Company's Consolidated Statements of Operations and Comprehensive Income:

| | Fiscal Years Ended | | |
|---|--------------------|------------------|------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Cost of revenues | \$ 989 | \$ 820 | \$ 502 |
| Selling, general and administrative | 21,688 | 16,188 | 14,828 |
| Research and development | 3,861 | 2,414 | 1,984 |
| Stock-based compensation expense before tax | 26,538 | 19,422 | 17,314 |
| Income taxes | (6,900) | (5,263) | (5,713) |
| Stock-based compensation expense, net of income taxes | <u>\$ 19,638</u> | <u>\$ 14,159</u> | <u>\$ 11,601</u> |

Q. Operating Segment, Geographic Information and Significant Customers

Operating segments are defined as components of an enterprise evaluated regularly by the Company's chief operating decision maker ("CODM") in deciding how to allocate resources and assess performance. The Company is comprised of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with ASC 280, *Segment Reporting*.

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

| | U.S. | Europe | Asia Pacific | Eliminations | Total |
|--|-------------------|------------------|-----------------|--------------------|-------------------|
| YEAR ENDED JULY 3, 2020 | | | | | |
| Net revenues to unaffiliated customers | \$ 744,270 | \$ 50,092 | \$ 2,248 | \$ — | \$ 796,610 |
| Inter-geographic revenues | 4,938 | 3,067 | — | (8,005) | — |
| Net revenues | <u>\$ 749,208</u> | <u>\$ 53,159</u> | <u>\$ 2,248</u> | <u>\$ (8,005)</u> | <u>\$ 796,610</u> |
| Identifiable long-lived assets (1) | \$ 82,588 | \$ 5,144 | \$ 5 | \$ — | \$ 87,737 |
| YEAR ENDED JUNE 30, 2019 | | | | | |
| Net revenues to unaffiliated customers | \$ 599,422 | \$ 49,332 | \$ 5,990 | \$ — | \$ 654,744 |
| Inter-geographic revenues | 10,570 | 1,343 | — | (11,913) | — |
| Net revenues | <u>\$ 609,992</u> | <u>\$ 50,675</u> | <u>\$ 5,990</u> | <u>\$ (11,913)</u> | <u>\$ 654,744</u> |
| Identifiable long-lived assets (1) | \$ 54,952 | \$ 5,037 | \$ 12 | \$ — | \$ 60,001 |
| YEAR ENDED JUNE 30, 2018 | | | | | |
| Net revenues to unaffiliated customers | \$ 450,218 | \$ 35,000 | \$ 7,966 | \$ — | \$ 493,184 |
| Inter-geographic revenues | 10,650 | 925 | — | (11,575) | — |
| Net revenues | <u>\$ 460,868</u> | <u>\$ 35,925</u> | <u>\$ 7,966</u> | <u>\$ (11,575)</u> | <u>\$ 493,184</u> |
| Identifiable long-lived assets (1) | \$ 47,997 | \$ 2,974 | \$ 9 | \$ — | \$ 50,980 |

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

In recent years, the Company completed a series of acquisitions that changed its technological capabilities, applications and end markets. As these acquisitions and changes occurred, the Company increased the proportion of its revenue derived from the sale of components in different technological areas, and also increased the amount of revenue associated with combining technologies into more complex and diverse products including modules, sub-assemblies and integrated subsystems. The following tables present revenue consistent with the Company's strategy of expanding its technological capabilities and program content. As additional information related to the Company's products by end user, application and/or product grouping is attained, the categorization of these products can vary over time. When this occurs, the Company reclassifies revenue by end user, application and/or product grouping for prior periods. Such reclassifications typically do not materially change the sizing of, or the underlying trends of results within, each revenue category.

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

| | Fiscal Years Ended | | |
|--|---------------------------|----------------------|----------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Domestic (1) | \$ 704,722 | \$ 580,935 | \$ 410,050 |
| International/Foreign Military Sales (2) | 91,888 | 73,809 | 83,134 |
| Total Net Revenue | \$ 796,610 | \$ 654,744 | \$ 493,184 |

(1) Domestic revenues consist of sales where the end user is within the U.S., as well as sales to prime defense contractor customers where the ultimate end user location is not defined.

(2) International/Foreign Military Sales consist of sales to U.S. prime defense contractor customers where the end user is outside the U.S., foreign military sales through the U.S. government, and direct sales to non-U.S. based customers intended for end use outside of the U.S.

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

| | Fiscal Years Ended | | |
|-------------------------------|---------------------------|----------------------|----------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Radar (1) | \$ 233,967 | \$ 164,046 | \$ 159,737 |
| Electronic Warfare (2) | 161,782 | 128,841 | 114,801 |
| Other Sensor and Effector (3) | 105,175 | 90,245 | 48,088 |
| Total Sensor and Effector | 500,924 | 383,132 | 322,626 |
| C4I (4) | 207,000 | 183,172 | 87,414 |
| Other (5) | 88,686 | 88,440 | 83,144 |
| Total Net Revenues | \$ 796,610 | \$ 654,744 | \$ 493,184 |

(1) Radar includes end-use applications where radio frequency signals are utilized to detect, track, and identify objects.

(2) Electronic Warfare includes end-use applications comprising the offensive and defensive use of the electromagnetic spectrum.

(3) Other Sensor and Effector products include all Sensor and Effector end markets other than Radar and Electronic Warfare.

(4) C4I includes rugged secure rackmount servers that are designed to drive the most powerful military processing applications.

(5) Other products include all component and other sales where the end use is not specified.

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

| | Fiscal Years Ended | | |
|--------------------------------|--------------------|-------------------|-------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Components (1) | \$ 225,292 | \$ 184,870 | \$ 142,982 |
| Modules and Sub-assemblies (2) | 203,432 | 180,873 | 194,377 |
| Integrated Subsystems (3) | 367,886 | 289,001 | 155,825 |
| Total Net Revenues | \$ 796,610 | \$ 654,744 | \$ 493,184 |

(1) Components include technology elements typically performing a single, discrete technological function, which when physically combined with other components may be used to create a module or sub-assembly. Examples include but are not limited to power amplifiers and limiters, switches, oscillators, filters, equalizers, digital and analog converters, chips, MMICs (monolithic microwave integrated circuits), and memory and storage devices.

(2) Modules and Sub-assemblies include combinations of multiple functional technology elements and/or components that work together to perform multiple functions but are typically resident on or within a single board or housing. Modules and sub-assemblies may in turn be combined to form an integrated subsystem. Examples of modules and sub-assemblies include but are not limited to embedded processing modules, embedded processing boards, switch fabric boards, high speed input/output boards, digital receiver boards, graphics and video processing and Ethernet and IO (input-output) boards, multi-chip modules, integrated radio frequency and microwave multi-function assemblies, tuners, and transceivers.

(3) Integrated Subsystems include multiple modules and/or sub-assemblies combined with a backplane or similar functional element and software to enable a solution. These are typically but not always integrated within a chassis and with cooling, power and other elements to address various requirements and are also often combined with additional technologies for interaction with other parts of a complete system or platform. Integrated subsystems also include spare and replacement modules and sub-assemblies sold as part of the same program for use in or with integrated subsystems sold by the Company.

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

| | Fiscal Years Ended | | |
|---------------------------|--------------------|-------------------|-------------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Airborne (1) | \$ 402,670 | \$ 306,412 | \$ 242,611 |
| Land (2) | 102,956 | 83,034 | 41,841 |
| Naval (3) | 157,225 | 136,966 | 110,620 |
| Other (4) | 133,759 | 128,332 | 98,112 |
| Total Net Revenues | \$ 796,610 | \$ 654,744 | \$ 493,184 |

(1) Airborne platform includes products that relate to personnel, equipment, or pieces of equipment designed for airborne applications

(2) Land platform includes products that relate to fixed or mobile equipment, or pieces of equipment for personnel, weapon systems, vehicles and support elements operating on land

(3) Naval platform includes products that relate to personnel, equipment, or pieces of equipment designed for naval operations

(4) All platforms other than Airborne, Land or Naval.

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

| | Fiscal Years Ended | | |
|-----------------------------|--------------------|---------------|---------------|
| | July 3, 2020 | June 30, 2019 | June 30, 2018 |
| Raytheon Technologies | 16 % | 20 % | 19 % |
| Lockheed Martin Corporation | 16 % | 17 % | 19 % |
| | 32 % | 37 % | 38 % |

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. There were no programs comprising 10% or more of the Company's revenues for the years ended July 3, 2020, June 30, 2019 and 2018.

R. Subsequent Events

The Company has evaluated subsequent events from the date of the Consolidated Balance Sheet through the date the consolidated financial statements were issued.

SUPPLEMENTARY INFORMATION (UNAUDITED)

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

| 2020 (In thousands, except per share data) | 1ST QUARTER | 2ND QUARTER | 3RD QUARTER | 4TH QUARTER |
|---|--------------------|--------------------|--------------------|--------------------|
| Net revenues | \$ 177,304 | \$ 193,913 | \$ 208,016 | \$ 217,377 |
| Gross margin | \$ 78,400 | \$ 88,506 | \$ 93,325 | \$ 96,613 |
| Income from operations | \$ 17,476 | \$ 20,825 | \$ 26,342 | \$ 26,419 |
| Income before income taxes | \$ 17,229 | \$ 20,786 | \$ 28,928 | \$ 26,990 |
| Income tax (benefit) provision | \$ (2,018) | \$ 5,110 | \$ 5,363 | \$ (234) |
| Net income | \$ 19,247 | \$ 15,676 | \$ 23,565 | \$ 27,224 |
| Net income per share: | | | | |
| Basic net income per share | \$ 0.35 | \$ 0.29 | \$ 0.43 | \$ 0.50 |
| Diluted net income per share | \$ 0.35 | \$ 0.29 | \$ 0.43 | \$ 0.49 |

| 2019 (In thousands, except per share data) | 1ST QUARTER | 2ND QUARTER | 3RD QUARTER | 4TH QUARTER |
|---|--------------------|--------------------|--------------------|--------------------|
| Net revenues | \$ 144,056 | \$ 159,089 | \$ 174,636 | \$ 176,963 |
| Gross margin | \$ 61,583 | \$ 70,887 | \$ 73,847 | \$ 79,839 |
| Income from operations | \$ 13,810 | \$ 19,861 | \$ 22,062 | \$ 20,851 |
| Income before income taxes | \$ 10,608 | \$ 16,866 | \$ 19,466 | \$ 12,587 |
| Income tax provision (benefit) | \$ 3,129 | \$ 4,483 | \$ 5,357 | \$ (217) |
| Net income | \$ 7,479 | \$ 12,383 | \$ 14,109 | \$ 12,804 |
| Net income per share: | | | | |
| Basic net income per share | \$ 0.16 | \$ 0.26 | \$ 0.30 | \$ 0.26 |
| Diluted net income per share | \$ 0.16 | \$ 0.26 | \$ 0.29 | \$ 0.25 |

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

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

We conducted an evaluation as of July 3, 2020 under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), and concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, the "Exchange Act") were effective as of July 3, 2020 and designed to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that it is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS

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

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of the Chief Executive Officer and Chief Financial Officer, management conducted an assessment of the effectiveness of our internal control over financial reporting as of July 3, 2020 based on the framework in Internal Control - Integrated Framework (2013) published by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of this assessment, management concluded that our internal control over financial reporting was effective as of July 3, 2020. The effectiveness of our internal control over financial reporting as of July 3, 2020 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report.

The audited consolidated financial statements of the Company include the results of the acquired APC business on and after September 23, 2019, as described in Note C to the Consolidated Financial Statements. Upon consideration of the scope of fiscal 2020, the APC acquisition, and the time constraints under which our management's assessment would have to be made, management determined that it would not conduct an assessment of APC's internal controls over financial reporting environment as allowable under Section 404 of the Sarbanes-Oxley Act of 2002. Accordingly, these operations have been excluded from the management's assessment of internal controls for fiscal year 2020. However, management is in the process of integrating this entity into the overall internal control over financial reporting environment for fiscal year 2021. The Company's consolidated financial statements reflect revenues and total assets from the acquired APC business of approximately 3 percent and 7 percent (of which 5 percent represented goodwill and intangible assets included within the scope of the Company's assessment), respectively, as of and for the year ended July 3, 2020.

(d) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of fiscal 2020 identified in connection with our Chief Executive Officer's and Chief Financial Officer's evaluation that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Management is in the process of integrating the APC business into our overall internal control over financial reporting environment.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated herein by reference to our Proxy Statement for our 2020 Annual Meeting of Shareholders (the "Shareholders Meeting"), except that information required by this item concerning our executive officers appears in Part I, Item 4.1. of this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

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

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

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

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

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

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

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

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) FINANCIAL STATEMENTS, SCHEDULES AND EXHIBITS

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

1. Financial statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of July 3, 2020 and June 30, 2019

Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended July 3, 2020, June 30, 2019, and June 30, 2018

Consolidated Statements of Shareholders' Equity for the fiscal years ended July 3, 2020, June 30, 2019, and June 30, 2018

Consolidated Statements of Cash Flows for the years ended July 3, 2020, June 30, 2019, and June 30, 2018

Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

II. Valuation and Qualifying Accounts

MERCURY SYSTEMS, INC.

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
FOR FISCAL YEARS ENDED JULY 3, 2020, JUNE 30, 2019, and JUNE 30, 2018
(In thousands)

Allowance for Doubtful Accounts

| | BALANCE AT BEGINNING OF PERIOD | ADDITIONS | REVERSALS | WRITE- OFFS | BALANCE AT END OF PERIOD |
|------|---|-----------|-----------|----------------|--------------------------------|
| 2020 | \$ 1,228 | \$ 705 | \$ 8 | \$ 474 | \$ 1,451 |
| 2019 | \$ 359 | \$ 1,223 | \$ 264 | \$ 90 | \$ 1,228 |
| 2018 | \$ 83 | \$ 359 | \$ 31 | \$ 52 | \$ 359 |

Deferred Tax Asset Valuation Allowance

| | BALANCE AT BEGINNING OF PERIOD | CHARGED TO COSTS & EXPENSES | CHARGED TO OTHER ACCOUNTS | DEDUCTIONS | BALANCE AT END OF PERIOD |
|------|---|-----------------------------------|---------------------------------|------------|--------------------------------|
| 2020 | \$ 16,666 | \$ (842) | \$ — | \$ 4,560 | \$ 11,264 |
| 2019 | \$ 16,992 | \$ (326) | \$ — | \$ — | \$ 16,666 |
| 2018 | \$ 16,570 | \$ 422 | \$ — | \$ — | \$ 16,992 |

3. Exhibits:

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index on page 91, which is incorporated herein by reference.

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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 Andover, Massachusetts, on August 18, 2020.

MERCURY SYSTEMS, INC.

By /s/ MICHAEL D. RUPPERT

Michael D. Ruppert
EXECUTIVE VICE PRESIDENT, CHIEF FINANCIAL OFFICER, AND
TREASURER
[PRINCIPAL FINANCIAL OFFICER]

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title(s)</u> | <u>Date</u> |
|---|--|-----------------|
| <u>/s/ MARK ASLETT</u> Mark Aslett | President, Chief Executive Officer and Director (principal executive officer) | August 18, 2020 |
| <u>/S/ MICHAEL D. RUPPERT</u> Michael D. Ruppert | Executive Vice President, Chief Financial Officer, and Treasurer (principal financial officer) | August 18, 2020 |
| <u>/S/ MICHELLE M. MCCARTHY</u> Michelle M. McCarthy | Vice President, Chief Accounting Officer (principal accounting officer) | August 18, 2020 |
| <u>/S/ VINCENT VITTO</u> Vincent Vitto | Chairman of the Board of Directors | August 18, 2020 |
| <u>/S/ JAMES K. BASS</u> James K. Bass | Director | August 18, 2020 |
| <u>/S/ ORLANDO P. CARVALHO</u> Orlando P. Carvalho | Director | August 18, 2020 |
| <u>/S/ MICHAEL A. DANIELS</u> Michael A. Daniels | Director | August 18, 2020 |
| <u>/S/ LISA S. DISBROW</u> Lisa S. Disbrow | Director | August 18, 2020 |
| <u>/S/ MARY LOUISE KRAKAUER</u> Mary Louise Krakauer | Director | August 18, 2020 |
| <u>/S/ BARRY R. NEARHOS</u> Barry R. Nearhos | Director | August 18, 2020 |
| <u>/S/ WILLIAM K. O'BRIEN</u> William K. O'Brien | Director | August 18, 2020 |

EXHIBIT INDEX

| ITEM NO. | DESCRIPTION OF EXHIBIT |
|----------|--|
| 3.1.1 | Articles of Organization (incorporated herein by reference to Exhibit 3.1.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009) |
| 3.1.2 | Articles of Amendment (incorporated herein by reference to Exhibit 3.1.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010) |
| 3.1.3 | Articles of Amendment (incorporated herein by reference to Exhibit 1 of the Company's registration statement on Form 8-A filed on December 15, 2005) |
| 3.1.4 | Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on November 13, 2012) |
| 3.1.5 | Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on June 30, 2015) |
| 3.2 | Bylaws, amended and restated, effective as of July 28, 2020 (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on July 31, 2020) |
| 4.1 | Form of Stock Certificate (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1/A filed on January 7, 1998) |
| 4.2† | Description of Registrant's Securities |
| 10.1* | 1997 Employee Stock Purchase Plan, as amended and restated (incorporated herein by reference to Appendix B to the Company's definitive proxy statement filed on October 29, 2015) |
| 10.2* | Form of Indemnification Agreement between the Company and each of its current directors (incorporated herein by reference to Exhibit 10.4 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009) |
| 10.3* | 2005 Stock Incentive Plan, as amended and restated (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on September 20, 2016) |
| 10.4.1* | Form of Stock Option Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011) |
| 10.4.2* | Form of Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011) |
| 10.4.3* | Form of Deferred Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.3 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011) |
| 10.4.4* | Form of Stock Option Agreement for performance stock options under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on September 28, 2007) |
| 10.4.5* | Form of Amended and Restated Performance-Based Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2014) |
| 10.5* | 2018 Stock Incentive Plan, as amended and restated (incorporated herein by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed on January 24, 2019) |
| 10.6.1* | Form of Stock Option Agreement under the 2018 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019) |
| 10.6.2* | Form of Restricted Stock Award Agreement under the 2018 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019) |
| 10.6.3* | Form of Deferred Stock Award Agreement under the 2018 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.3 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019) |
| 10.6.4* | Form of Performance-Based Stock Option Agreement under the 2018 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.4 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019) |

| ITEM NO. | DESCRIPTION OF EXHIBIT |
|-----------------|--|
| 10.6.5* | Form of Performance-Based Restricted Stock Award Agreement under the 2018 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.5 of the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019) |
| 10.7.1* | Form of Change in Control Severance Agreement between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.9.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011) |
| 10.7.2* | Form of Change in Control Severance Agreement between the Company and Non-CEO Executives (incorporated herein by reference to Exhibit 10.9.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011) |
| 10.8† | Compensation Policy for Non-Employee Directors |
| 10.9.1* | Employment Agreement, dated as of November 19, 2007, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on November 20, 2007) |
| 10.9.2* | First Amendment to Employment Agreement, dated as of December 20, 2008, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.2 of the Company's quarterly report on Form 10-Q for the quarter ended December 31, 2008) |
| 10.9.3* | Second Amendment to Employment Agreement, dated as of September 30, 2009, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2009) |
| 10.9.4* | Third Amendment to Employment Agreement, dated as of August 13, 2019, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.9.4 of the Company's annual report on Form 10-K for the fiscal year ended July 30, 2019) |
| 10.10* | Agreement, dated July 12, 2016, by and between the Company and Christopher C. Cambria (incorporated herein by reference to Exhibit 10.9 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2018) |
| 10.11.1 | Credit Agreement, dated May 2, 2016, among the Company, the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on May 2, 2016) |
| 10.11.2 | Amendment No. 1 to Credit Agreement, dated June 27, 2017, among the Company, the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on June 27, 2017) |
| 10.11.3 | Amendment No. 3 to Credit Agreement, dated September 28, 2018, among the Company, the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on October 1, 2018) |
| 10.12 | Agreement and Plan of Merger by and among the Company, Thunderbird Merger Sub, Inc., Ceres Systems and the Shareholder Representatives Named Herein Dated as of December 21, 2017 (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on February 1, 2018) |
| 10.13* | Letter Agreement, dated August 7, 2014, as amended to date, between Michael D. Ruppert and the Company (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on February 6, 2018) |
| 10.14* | Form of Severance Benefits Agreement between the Company and Non-CEO Executives (incorporated herein by reference to Exhibit 10.14 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2019) |
| 21.1† | Subsidiaries of the Company |
| 23.1† | Consent of KPMG LLP |
| 31.1† | Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2† | Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1† | Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

| ITEM NO. | DESCRIPTION OF EXHIBIT |
|-----------------|---|
| 101† | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheet, (ii) Consolidated Statement of Operations, (iii) Consolidated Statement of Shareholders' Equity, (iv) Consolidated Statement of Cash Flows, and (v) Notes to Consolidated Financial Statements |
| 101.INS | eXtensible Business Reporting Language (XBRL) Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 104 | Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

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

† Filed with this Form 10-K.

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

CERTIFICATION

I, Mark Aslett, certify that:

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

Date: August 18, 2020

/s/ MARK ASLETT

Mark Aslett

PRESIDENT AND CHIEF EXECUTIVE OFFICER
[PRINCIPAL EXECUTIVE OFFICER]

CERTIFICATION

I, Michael D. Ruppert, certify that:

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

Date: August 18, 2020

/s/ MICHAEL D. RUPPERT

Michael D. Ruppert

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

Mercury Systems, Inc.

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

In connection with the Annual Report of Mercury Systems, Inc. (the “Company”) on Form 10-K for the fiscal year ended July 3, 2020 as filed with the Securities and Exchange Commission (the “Report”), we, Mark Aslett, President and Chief Executive Officer of the Company, and Michael D. Ruppert, Executive Vice President, Chief Financial Officer, and Treasurer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that to our knowledge the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 18, 2020

/s/ MARK ASLETT

Mark Aslett
PRESIDENT AND CHIEF EXECUTIVE OFFICER

/s/ MICHAEL D. RUPPERT

Michael D. Ruppert
EXECUTIVE VICE PRESIDENT,
CHIEF FINANCIAL OFFICER, AND TREASURER

SHAREHOLDER RETURN PERFORMANCE GRAPH

Set forth below is a line graph comparing the cumulative total shareholder return of our common stock against the cumulative total return of the Spade Defense Index and a peer group of 21 companies for the period of June 30, 2015 through July 3, 2020. The graph and table assume that \$100 was invested on June 30, 2015 in each of our common stock, the Spade Defense Index, and a peer group and that all dividends were reinvested. The peer group consists of the following companies:

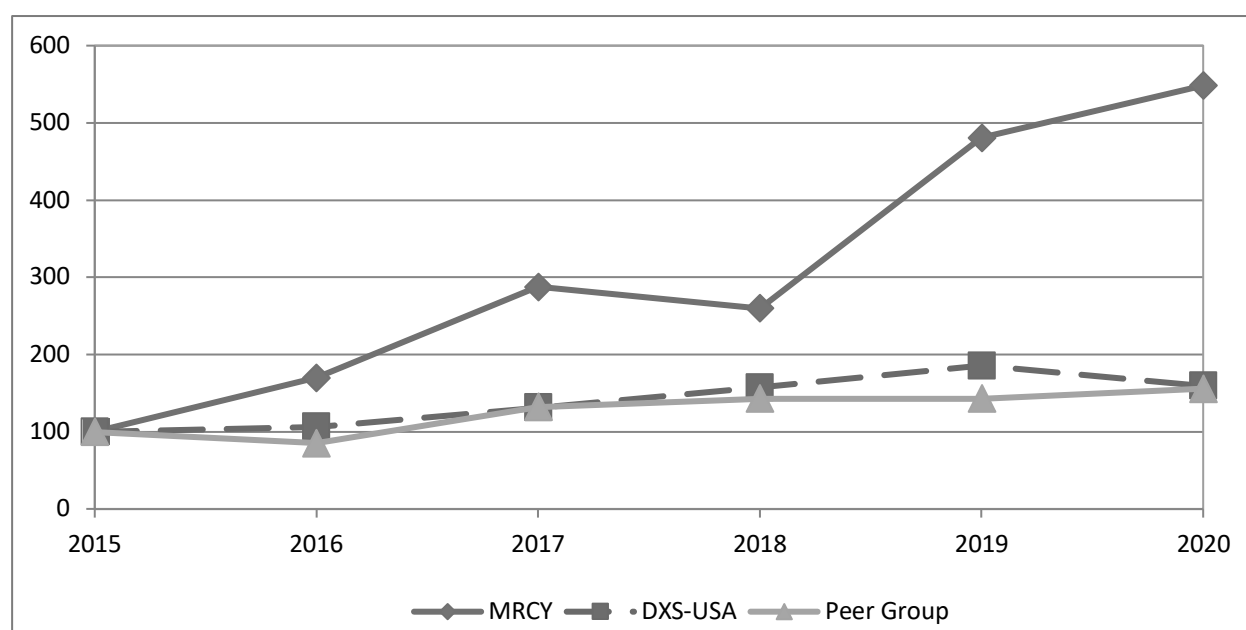
| | | |
|----------------------------------|---|-----------------------------|
| ADTRAN, Inc. | Ducommun Incorporated | MKS Instruments, Inc. |
| Astronics Corporation | II-VI Inc. | Netgear Inc. |
| Brooks Automation, Inc. | Infinera Corporation | NetScout Systems, Inc. |
| Cognex Corporation | iRobot Corporation | Novanta Inc. |
| Comtech Telecommunications Corp. | Kratos Defense & Security Solutions, Inc. | OSI Systems, Inc. |
| CTS Corp. | M/A-COM Technology Solutions Holdings, Inc. | Ribbon Communications, Inc. |
| Diodes Inc. | Methode Electronics, Inc. | Rogers Corp. |

We retained the same peer group as the prior fiscal year, with the exception that Cray Inc. was removed due to it being acquired in an M&A transaction.

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

| <u>Measurement Point</u> | <u>Mercury Systems, Inc.</u> | <u>Spade Defense Index (DXSK)</u> | <u>Peer Group</u> |
|--------------------------|------------------------------|-----------------------------------|-------------------|
| 6/30/15 | 100.00 | 100.00 | 100.00 |
| 6/30/16 | 169.81 | 106.47 | 85.49 |
| 6/30/17 | 287.50 | 131.32 | 132.02 |
| 6/30/18 | 259.97 | 157.29 | 142.95 |
| 6/30/19 | 480.53 | 185.85 | 143.00 |
| 7/3/20 | 548.29 | 159.40 | 155.95 |

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



ASSUMES \$100 INVESTED ON JUNE 30, 2015
ASSUMES DIVIDEND REINVESTED
FISCAL YEAR ENDED JULY 3, 2020

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DIRECTORS & MANAGEMENT

EXECUTIVE OFFICERS

Mark Aslett

President and
Chief Executive Officer

Christopher C. Cambria

Executive Vice President,
General Counsel,
and Secretary

Michael D. Ruppert

Executive Vice President,
Chief Financial Officer,
and Treasurer

Didier M.C. Thibaud

Executive Vice President,
Chief Operating Officer

BOARD OF DIRECTORS

Vincent Vitto

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

Mark Aslett

President and
Chief Executive Officer
Mercury Systems Inc.

James K. Bass

Former President and CEO
Piper Aircraft Inc.

Orlando P. Carvalho

Former Executive Vice President
Aeronautics, Lockheed Martin

Michael A. Daniels

Former Chairman and CEO
Mobile 365 Inc. and
Network Solutions Inc.

Lisa S. Disbrow

Under Secretary
of the U.S. Air Force (Retired)

Mary Louise Krakauer

Former Executive
Dell and EMC

Barry R. Nearhos

Former Managing Partner
PricewaterhouseCoopers

William K. O'Brien

Former Chairman and CEO
Enterasys Networks

CORPORATE INFORMATION

CORPORATE OFFICE

MERCURY SYSTEMS INC.
50 Minuteman Road
Andover, MA 01810
Tel 978.256.1300 866.411.MRCY
ir.mrcy.com NASDAQ: MRCY

AUDITOR

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

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services
P.O. Box 505000
Louisville, KY 04233-5000
Tel 877.373.6374
computershare.com/investor

COMMON STOCK

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

STOCKHOLDER INFORMATION

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

INVESTOR RELATIONS

Mercury Systems Inc.
50 Minuteman Road
Andover, MA 01810
Tel 866.411.MRCY

PROVEN. PURPOSE-BUILT. PROFOUNDLY ACCESSIBLE.

Mercury Systems is the leader in making trusted, secure mission-critical technologies profoundly more accessible to aerospace and defense. We deliver pre-integrated subsystems and modules with faster design cycles, purpose-built to withstand extreme environments and meet our customers' most pressing needs for performance, safety, security and affordability. From system scale to chip scale, we deliver solutions critical to a safe and secure world. Innovation That Matters® by and for People Who Matter.

mrcy.com

