

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
COMMISSION FILE NUMBER - 000-23599

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

MASSACHUSETTS
(State or other jurisdiction of
Incorporation or organization)

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

199 RIVERNECK ROAD, CHELMSFORD MASSACHUSETTS
(Address of principal executive offices)

01824
(Zip code)

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

NASDAQ NATIONAL MARKET
(Name exchange on which registered)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE
SECURITIES EXCHANGE ACT OF 1934:
None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE
SECURITIES EXCHANGE ACT OF 1934:
Common Stock, Par Value \$.01 Per Share

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

Aggregate market value of Registrant's voting stock held by non-affiliates of the Registrant as of August 31, 2000: \$606,551,311.

Shares of Common Stock outstanding as of August 31, 2000: 21,399,637 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for its special meeting in lieu of the 2000 Annual Meeting of Stockholders to be held on November 16, 2000 (the "Proxy Statement") are incorporated by reference into Part III of this report. Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K.

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PART I

ITEM 1. BUSINESS

OVERVIEW

Mercury Computer Systems, Inc. (the "Company" or "Mercury") designs, manufactures and markets high performance, real-time digital signal processing computer systems that transform sensor generated data into information which can be displayed as images for human interpretation or subjected to additional computer analysis. These multicomputer systems are heterogeneous and scalable, allowing them to accommodate several different microprocessor types and to scale from a few to hundreds of microprocessors within a single system. Mercury's system architecture is specifically designed for digital signal processing ("DSP") applications, which are typically, computation intensive and require I/O capacity and interprocessor bandwidth not available on a general purpose PC or workstation.

The two primary markets for Mercury's products are defense electronics and medical diagnostic imaging. Both of these markets have computing needs which benefit from the unique system architecture developed by the Company. Mercury's computer systems are generally used on real-world signal data to enable a military commander to "see" the battle space through natural barriers such as clouds, darkness, water or foliage, so that the position and strength of the enemy can be determined, or to enable a physician to "see" within the body instead of performing invasive surgery.

During the past several years, the majority of the Company's revenues have been generated from sales of its products to the defense electronics market, generally for use in reconnaissance and intelligence gathering systems. The Company's activities in this area have focused on the proof of concept, development and deployment of advanced military applications in radar, sonar and airborne surveillance. The Company has established relationships with many of the major prime contractors to the worldwide defense industry, including Lockheed Martin Corporation, Hughes Aircraft Company, Raytheon Systems Company, Northrop Grumman Corporation, MIT/Lincoln Laboratory, GEC Marconi Limited, Ericsson Microwave Systems AB, MATRA Systems & Information, Mitsubishi Heavy Industries, Ltd., British Aerospace and a prime contractor owned by the Israeli Ministry of Defense.

Medical diagnostic imaging is the other primary market currently served by the Company. Mercury's computer systems are embedded in Magnetic Resonance Imaging ("MRI"), Computed Tomography ("CT") and Positron Emission Tomography ("PET") machines. Mercury has supplied computer systems for use in several of GE Medical Systems' diagnostic imaging systems since 1987, and has established relationships with Siemens Medical Systems, Inc., and Picker International. The major medical imaging manufacturers are currently developing the next generation of MRI, CT and digital x-ray machines, which are expected to provide better performance at lower cost. Mercury has secured design wins on programs with certain of the major medical imaging manufacturers for their next generation MRI, CT and digital x-ray machines.

Mercury's computer systems are designed to process continuous streams of data from sensors attached to radar, sonar, medical imaging equipment and other devices. The resulting image is transmitted to the battlefield commander, pilot, technician or physician in order to assist in the decision making or diagnostic process. Due to the nature of the applications in which many of Mercury's computer systems are embedded, they are frequently confined in limited spaces and therefore are designed to generate a minimum amount of heat. The Company employs the RACEway Interconnect, an industry standard system area network developed by Mercury, which allows for high interprocessor bandwidth and I/O capacity. The Company uses its proprietary ASICs to integrate microprocessors, memory and related components into the RACEway Interconnect to provide optimum system performance. The Company uses industry standard processors, such as Motorola's PowerPC, in the same system. The Company believes that the RACEway Interconnect and its proprietary ASICs, working together with a group of mixed microprocessors in the same system, allow the most efficient use of space and power with an optimal price/performance ratio.

Since July 1996, Mercury has targeted the emerging shared storage market for introduction of a new product, "Sanergy". This business unit was created to exploit some of Mercury's innovative software developments. It has evolved into software for use in applications and market segments that, while exciting and potentially offering a large return, are outside of Mercury's core businesses and strengths. Therefore, On January 18, 2000, the Company completed the sale the SSBU to IBM. Payments are structured with an initial payment of \$4.5 million (excluding \$1.0 million to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of \$1.5 million plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The Company has recorded a \$4.8 million gain on the sale of this division, which includes cash received of \$6.1 million less legal and advisory costs of \$0.6 million, costs reimbursable to IBM of \$0.5 million, and the net book value of equipment and inventories sold of \$0.2 million.

INDUSTRY BACKGROUND

Defense Electronics

Digital signal processing computer systems are embedded into air, sea and land-based platforms for processing radar, sonar and signal intelligence applications. The Company believes that an important factor underlying the development of this market is a continuing desire by military commanders for increased battle space information, which can be obtained through radar, sonar, signal intelligence and image intelligence systems. Military commanders also need more powerful computers with similar attributes in order to conduct dynamic battle simulations and mission planning tasks utilizing today's complex weapons systems.

Another important trend in the defense electronics marketplace is the movement away from so-called "stove pipe" systems designed by prime contractors with special purpose hardware specifically for a single application, largely without regard to cost. The market is moving toward the use of systems which incorporate selected commercial-off-the-shelf ("COTS") hardware and software components in order to save money and development time. Recent Department of Defense ("DOD") leaders and federal regulations have mandated widespread use of COTS components in defense electronics applications. All of Mercury's computer systems are eligible for use in defense electronics applications as COTS components.

Medical Imaging

The principal modalities of medical diagnostic imaging systems include MRI, CT, digital x-ray, PET, SPECT (single photon emission computed tomography) and ultrasound devices. Although demand for medical imaging equipment has been sluggish in recent years due primarily to cost containment pressures and consolidation in the health care industry, the Company believes that demand for medical diagnostic imaging equipment will increase modestly over the next three years. The Company believes that this increase will be primarily due to the introduction of next-generation devices, together with the anticipated future development by the major medical imaging manufacturers of new international markets for their diagnostic equipment. The Company believes medical imaging equipment manufacturers will continue to replace in-house designed digital signal processing systems with commercially available systems designed by the Company and others.

This industry demand is driven in part by the need to provide physicians with rapid, sharp and clear images of areas of a patient's body suspected to be diseased or injured, while using the least intrusive means. These images provide a significant diagnostic tool for the physician, who can more readily understand the patient's malady and prescribe appropriate corrective action. In order to provide such images, medical imaging machines must be capable of processing a continuous stream of data on a real-time basis. A parallel concern in the health care industry is the need to reduce costs. Hospitals, in particular, continue to be under significant pressure to contain costs and, at the same time, maintain quality of care. Such pressures are forcing hospitals to be as technologically efficient as possible. Toward this end, hospitals seek to reduce the required period of time a patient must spend in their medical imaging machines, which has the added benefit of increasing the total number of patients who can be diagnosed with this expensive equipment during a given period of time. One way to reduce patient time in medical imaging machines and improve image quality is to utilize more powerful signal processing computers, such as those supplied by Mercury.

MARKETS AND CUSTOMERS

Defense Electronics

Mercury provides high performance embedded computer systems as standard products to the defense electronics market by using commercial and selected rugged components and by working closely with defense contractors to complete a design which matches the specified requirements of military applications. The Company engages in frequent, detailed communication with the end users of Mercury's systems, military executives and program managers in government and defense contractors regarding the technical capabilities of Mercury's advanced signal processing computers and the successful incorporation of its computers in numerous military programs.

Mercury employs industry specialist managers to monitor the defense programs of each major branch of the United States armed services and additional managers based in Europe and Japan to keep abreast of developments in their respective regions. This approach provides relevant information to Mercury regarding major military procurements worldwide. Mercury maintains sales and technical support groups to service defense industry participants in six branch offices in the United States, and through Mercury's subsidiary offices or distributors in 11 other countries. At Mercury's headquarters in Chelmsford, Massachusetts, a group of systems engineers specializing in radar, sonar and surveillance problems provides support on an as-needed basis to the remote offices to assist in securing inclusion in targeted military programs.

Medical Imaging

Mercury strives to provide a superior combination of high performance and competitively priced embedded computer systems to the medical imaging market. The Company focuses on establishing strong relationships with its customers, the medical equipment manufacturers. By maintaining frequent, in-depth communications with its customers and working closely with their engineering groups, the Company is able to understand their needs and provide appropriate solutions. In addition, the Company intends to continue its efforts to install its computer systems in place of alternative designs created by the in-house design teams employed by the medical imaging equipment manufacturers.

The Company currently is working closely with major medical equipment companies to design the next generation of MRI, CT and digital x-ray systems, which the Company believes will lead to faster time-to-market and competitive advantages for the medical equipment companies that use Mercury's computer systems for inclusion in their imaging machines. Mercury's industrial PC class hardware system provides the medical imaging industry with increased performance densities at lower costs and an architecture that accommodates performance upgrades as new technology becomes available. Integrating the high-bandwidth RACEway Interconnect system area network within the PCI environment results in highly scalable systems. This allows medical equipment suppliers to design systems that can satisfy a broad range of price/performance requirements and meet the needs of global markets, all with the same Mercury architecture.

Mercury's medical OEM customers consist of the leading manufacturers of diagnostic imaging equipment. They include GE Medical, headquartered in Wisconsin, GE Medical Systems Europe in France, GE Yokugawa Medical Systems in Japan, Siemens Medical in Germany, and Picker International. These companies have adopted Mercury's PCI or VME computer systems as part of their developments in either MRI, CT, or digital x-ray systems and, in the case of some companies, multiple types of systems. The Company has supplied GE Medical with computer systems for use in three successive generations of MRI machines from 1987 through the present, as well as for use in other GE Medical equipment, such as PET. In addition, GE Medical and Siemens Medical, the two leading global suppliers of medical imaging equipment, have awarded contracts to Mercury to design the signal processing system for the next generation of their CT medical diagnostic equipment.

The Company is building systems based on Analog Devices' SHARC DSP processor and Motorola's Power PC processor to fulfill design wins in CT. The Company also is building a system based on the Power PC chip to fulfill a design win in digital x-ray. The Company believes that the principal reason for its medical imaging design wins is Mercury's experienced team of systems and applications engineers who work closely with the medical equipment designers and with the Company's product development engineers. This joint design effort frequently precedes the first production orders by approximately two to three years. However, once selected, the production contracts typically continue for the life of the medical imaging system. In addition, the equipment manufacturers typically offer computer system upgrades to their customers, potentially resulting in additional sales of Mercury products.

AgileVision

On September 1, 1999, the Company formed a joint venture with the Sarnoff Corporation incorporated as AgileVision LLC. The venture will use Mercury technology to design, develop, and deliver products and solutions expected to dramatically reduce the cost of digital TV infrastructure for the broadcast and cable markets. The many business uncertainties that attend the new venture make revenue projections at this time inappropriate. Mercury's share of losses is reported as a separate line item in its profit and loss statement.

Wireless Communications

During the fourth quarter of fiscal 1999, the Company announced that it will pursue the wireless communications opportunity internally, offering its technology and expertise to manufacturers for incorporation within next generation base stations that require substantially more flexible and powerful signal processing capabilities. Returns on Mercury's investments in fiscal 2000 and 2001 would not begin before fiscal 2003. The market opportunity however, is very large, amounting to several hundred millions of dollars annually, and it represents an OEM business model, which Mercury understands well. In this past year, Mercury has carried out extensive activities creating a business development plan that merges its future technology with the processing requirements of the evolving wireless infrastructure.

KEY TECHNOLOGY COMPETENCIES

Many of Mercury's customers share a common requirement: the need to process high-volume, real-time digital data streams. Whether from an antenna in a defense application or a medical scanner, the computer must have the ability to process incoming data as quickly as it is received. Data rates can range from a few to several hundreds of megabytes per second (or several billion bits per second). The ability to process this continuous flow of high-bandwidth data is a fundamental difference between the majority of computing systems in the world (such as personal computers, workstations and servers) and the computers built by Mercury.

Mercury has developed a set of core technical strengths specifically targeted to, and defined by, the application areas of signal, image and media processing. These technical strengths are pivotal to Mercury's success in the real-time market segments of the defense electronics and medical imaging industries and have resulted in the following developments and capabilities:

Heterogeneous Switched-Fabric Interconnects. Mercury connects different microprocessor types (RISC, DSP and specialized computing devices) and I/O devices in a bus-less, high-bandwidth manner based on multi-stage switches in its system area network. Among the engineering developments which distinguish Mercury's systems are the RACEway Interconnect built using the multi-port RACEway crossbar chip which supports high bandwidth point-to-point data transfers and fibre channel chassis-to-chassis extensions for RACEway in large system configurations.

Heterogeneous Processor Integration. Mercury has developed several ASICs which integrate standard microprocessors and special purpose mathematics and graphics processors into a single heterogenous environment. Mercury develops systems consisting of different microprocessor types with a single-system software model. Mercury's processor independent software offers a consistent set of software tools and interfaces, which can drive a heterogeneous mix of microprocessor types, such as Motorola's PowerPC processor and Analog Devices' SHARC DSP processor.

Performance Density. The Company has been using high performance packaging technology such as multi-chip modules and ball grid arrays in its systems since the early 1990's. The Company's thermal analysis expertise allows it to design products that optimize the dissipation of heat from the system in order to meet the environmental constraints imposed by many of its customers' applications. The Company's modular hardware and software building blocks allow it to design systems that best meet the application's specific data profiles. All together, these attributes combine to deliver the maximum performance in processing, reliability and bandwidth in the smallest possible space.

Scalable Software. Mercury's software has been designed to scale to nearly one thousand processors in real-time environments while maintaining a high-bandwidth capability. Regardless of the number of processors, the Company's software provides the same programming environment for a software developer working with Mercury's computer systems, allowing faster time-to-market and lower life cycle maintenance costs for its customers.

Optimized Algorithm Development. Mercury specializes in algorithm development for single and multi-processor implementations. The Company believes that using the mathematical algorithms in Mercury's scientific algorithm library significantly increases the performance of customers' applications, reduces development time and minimizes life cycle support costs.

System Engineering Expertise. Mercury has established a core competency in providing total system solutions to its customers. The Company has the knowledge and technical staff to act as an extension of the customer's engineering organization in order to fashion solutions to some of the world's most demanding real-time, signal processing applications. Mercury has partnered with its customers to understand and resolve the challenging problems encountered in applications as diverse as radar, sonar and signal intelligence for the military, and diagnostic imaging for MRI, CT, PET and digital x-ray in the medical imaging market. The Company also provides an integration and development service to meet the demands of its customers with advanced applications that cannot be satisfied with standard products. This service combines the variety of standard products with custom hardware and software to meet the specific configuration demands of an application.

Leverage and Create Standards. Mercury uses existing standards where applicable and has been successful in developing new standards. For example, Mercury adheres to VME and PCI standard bus interfaces and form factors. The RACEway Interconnect system area network that Mercury developed was adopted as an ANSI/VITA standard in 1995, and since then has been adopted by several companies offering products and services for embedded real-time applications.

PRODUCTS

HARDWARE PRODUCTS

Mercury offers three classes of systems for the Company's target markets. Each class of product is scalable to meet the full range of requirements in signal processing applications.

High Performance Class. For the highest-performance applications, Mercury offers a family of high performance systems for the most compute intensive, I/O capacity and interprocessor bandwidth demanding applications in the defense electronics market. These applications include space time adaptive processing, ground-penetrating and foliage-penetrating radar and synthetic aperture radar. These high-performance systems, known as MultiPort(TM), can scale to a thousand processors and today include compute modules based on the PowerPC processors.

VME Class. The VME bus has been the traditional standard for many embedded applications. Mercury's VME systems each support RACEway Interconnect. Systems contain modules based on the PowerPC and i860 processors and can scale to several hundred processors. The VME-based systems and components are primarily used in the defense market where backward and forward compatibility is required for the long system life cycles of military equipment. This class of RACE Series systems meets the computing speed, bandwidth and scalability requirements of many of today's medium performance radar, sonar and signal intelligence applications. Advanced and future radar systems are more likely to use the high performance class systems.

Industrial PC Class. Based on the PCI bus standard, these systems use the RACEway Interconnect to provide the extended bandwidth required for real-time applications. Currently, Mercury provides compute modules based on the SHARC and PowerPC processors. These systems scale to hundreds of processors and are primarily directed to the medical imaging market, which is moving from VME to PCI based designs.

SOFTWARE PRODUCTS

Mercury has developed a comprehensive line of signal processing software products for the defense, medical imaging, and other commercial markets. Certain of Mercury's software products are included in a heterogeneous development software package that enables customers to develop application software that will run on Mercury hardware. The development software package includes the MC/OS operating system, scientific algorithm libraries, debugging tools and compilers. License fees range from \$10,000 to \$50,000 based on the number of seats chosen by the user for its application, ranging from a single user license to a project license.

Set forth below are certain signal processing software products offered by the Company.

MC/OS Version 5.X. The MC/OS runtime operating environment allows maximum use of the RACE heterogeneous multi-computer architecture in a single-system model incorporating a consistent set of system and application programming interfaces, and a common development environment. MC/OS is supported on the high performance, VME and industrial PC classes of Mercury hardware systems. MC/OS is included in Mercury's development software package.

Scientific Algorithm Library (SAL). Mercury's scientific algorithm library consists of more than 400 assembly language routines developed by Mercury's programmers and optimized for execution on Mercury's RACE architecture, permitting extensive code reusability. The library encompasses a comprehensive selection of functions including vector processing and data conversion commonly performed by digital signal processing applications. SAL is included in Mercury's development software package.

Parallel Application System (PAS). PAS is a set of high performance libraries which form a complete programming environment for developing parallel applications in a distributed memory multicomputer system. The libraries speed the development of advanced applications using many processors in parallel. PAS is included in Mercury's development software package.

SuperVision(TM). SuperVision(TM) is a state-of-the-art debugging tool for observation and control of embedded, real-time multicomputing systems. SuperVision(TM) speeds application development by selectively monitoring individual and large groups of processors, while simultaneously performing detailed process-level debugging. SuperVision(TM) is sold separately.

ENGINEERING, RESEARCH AND DEVELOPMENT

The Company's engineering, research and development efforts are focused on developing new products as well as enhancing existing products. Mercury's research and development goal is to fully exploit and maintain the Company's technological lead in the high performance, real-time, signal processing industry.

Mercury is involved with researchers from other companies and government organizations to develop new signaling technologies using fiber optics. This has the potential for providing more bandwidth per line than conventional techniques and is directed at the 21(st) century challenges of the next generation of advanced signal processing systems. Similar cooperative developments are underway to develop open software solutions for code portability. This research is focused on developing generic applications, which can be targeted to Mercury's products through the use of industry standard tools with Mercury-specific libraries. Some of these research areas benefit from cost sharing through DARPA grants in those areas where the DOD will obtain benefit from the development.

As of June 30, 2000, the Company had 183 people primarily engaged in engineering, research and development, including hardware and software architects, design engineers and engineers with expertise in developing medical, defense and other commercial software systems. During fiscal years 2000, 1999 and 1998, the Company's total research and development costs were approximately \$28.9 million, \$20.7 million, and \$14.5 million, respectively.

CUSTOMER SUPPORT AND INTEGRATION

Mercury's Customer Services Group is engaged in a full range of support functions, including training, technical program management, integration and design services, host porting services and the traditional maintenance and support services. The Company has invested in the range of tools, analyzers, simulators, instruments and workstations to provide a rapid response to both development and customer support requirements. Within the Customer Services Group, the solutions systems department has developed many custom interfaces, reviewed customers' designs, developed special hardware and software components and provided program management on behalf of defense and medical customers. The capabilities of this group enable the Company to respond to the demanding individuality of many programs and have resulted in Mercury being selected for both development, high volume production and deployed programs.

MANUFACTURING AND TESTING

Mercury's strengths include the design, development and testing of products which meet the exacting technology and quality expectations of the Company's defense electronics and medical imaging customers. Board assembly is outsourced to a number of electronic contract manufacturers. The supplier typically inserts most of the components into a printed circuit board, solders the connections, conducts preliminary testing and returns the boards to Mercury. The Company conducts final assembly, burn-in and system level testing.

Mercury utilizes Optimal Supply Chain Management to provide highly flexible manufacturing solutions which can be tailored to the specific needs of the Company's customers, while maintaining the highest level of quality and control of product assembly. This standard is maintained through demanding Quality Assurance and Reliability Programs, such as Statistical Process Control, which are integrated throughout the manufacturing process.

The Company's outsourcing strategy provides maximum flexibility to respond to customer requirements and schedule adjustments, with minimal asset investment by Mercury. This outsourcing strategy also provides multiple sources of supply, both to support the breadth and complexity of Mercury's product lines, as well as to ensure continuity of supply. By outsourcing assembly to electronic contract manufacturers, Mercury is able to focus its manufacturing efforts on designing more reliable products, designing more efficient methods of building its products, systems integration, testing and supply chain management.

Mercury's manufacturing approach is based on a highly integrated process that takes a product from concept through production. All products are required to meet specified standards of performance, quality, reliability and safety. The Company manufactures both commercial and ruggedized versions of its computer systems. Extensive testing is a fundamental part of the Company's process. Computer Integrated Manufacturing, Concurrent Engineering, Material Requirements Planning and Just-In-Time techniques are also integrated into manufacturing operations as part of an on-time delivery philosophy. Mercury has been ISO 9001 certified since 1995.

COMPETITION

The markets for the Company's products are highly competitive and are characterized by rapidly changing technology, frequent product performance improvements and evolving industry standards. Competition typically occurs at the design stage, where the customer evaluates alternative design approaches, including those from internal development organizations. A design win usually ensures a customer will purchase the product until their next generation system is developed. Occasionally, the Company's computer systems compete with computer systems from workstation vendors, all of whom have substantially greater research and development resources, long term guaranteed supply capacity, marketing and financial resources, manufacturing capability and customer support organizations than those of the Company. The Company believes that its future ability to compete effectively will depend, in part, upon its ability to continue to improve product and process technologies and develop new technologies in order to maintain the performance advantages of products and processes relative to competitors, to adapt products and processes to technological changes, to identify and adopt emerging industry standards and to adapt to customer needs.

The principal bases for selection in sales of digital signal processing systems to the defense electronics industry are performance (measured primarily in terms of processing speed, I/O capacity and interprocessor bandwidth, processing density per cubic foot, power consumption and heat dissipation), systems engineering support, overall quality of products and associated services, use of industry standards, ease of use and price. Competitors in the defense electronics industry include a relatively small number of companies that design, manufacture and market DSP board level products and in-house design teams employed by prime defense contractors. In-house design efforts historically have provided a significant amount of competition to the Company. However, competition from in-house design teams has diminished in significance in recent years due to the increasing use of COTS products and the trend toward greater use of outsourcing. Despite this recent change, there can be no assurance that in-house developments will not re-emerge as a major competitive force in the future. Prime contractors are much larger than Mercury and have substantially more resources to invest in research and development. Increased use of in-house design teams by defense contractors in the future may have a material adverse effect on the Company's business, financial condition and results of operations.

In the medical imaging industry the principal bases for selection are performance (measured primarily in terms of processing speed, I/O capacity and interprocessor bandwidth and power consumption), price, systems engineering support, overall quality of products and associated services, use of industry standards and ease of use. Competitors in the medical imaging market include in-house design teams, a small number of companies that design, manufacture and market DSP board level products and workstation manufacturers. Workstations have become a competitive factor primarily in the market for low-end MRI and CT machines and, to date, have not been a significant factor in the high-performance market, Mercury's primary focus. There can be no assurance that workstation manufacturers will not attempt to penetrate the high-performance market for medical imaging machines. Workstation manufacturers typically have greater resources than Mercury and their entry into markets historically targeted by Mercury may have a material adverse effect on the Company's business, financial condition and results of operations.

Some of the Company's competitors have greater financial and other resources than the Company, and the Company may be operating at a cost disadvantage compared to manufacturers who have greater direct buying power from component suppliers or who have lower cost structures. There can be no assurance that the Company will be able to compete successfully in the future with any of these sources of competition. In addition, there can be no assurance that competitive pressures will not result in price erosion, reduced margins, loss of market share or other factors, that could have a material adverse effect on the Company's business, financial condition and results of operations.

INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS

The Company relies on a combination of patent, copyright, trademark and trade secret laws to establish and protect its rights in its products and proprietary technology. In addition, the Company currently requires its employees and consultants to enter into nondisclosure and assignment of invention agreements to limit use of, access to and distribution of, proprietary information. There can be no assurance that the Company's means of protecting its proprietary rights in the U.S. or abroad will be adequate. The laws of some foreign countries may not protect the Company's proprietary rights as fully or in the same manner as do the laws of the U.S. Also, despite the steps taken by the Company to protect its proprietary rights, it may be possible for unauthorized third parties to copy or reverse engineer aspects of the Company's products, develop similar technology independently or otherwise obtain and use information that the Company regards as proprietary. There can be no assurance that others will not develop technologies similar or superior to the Company's technology or design around the proprietary rights owned by the Company. Although the Company is not aware that its products infringe on the proprietary rights of third parties, there can be no assurance that others will not assert claims of infringement in the future or that, if made, such claims will not be successful. Litigation to determine the validity of any claims, whether or not such litigation is determined in favor of the Company, could result in significant expense to the Company and divert the efforts of the Company's technical and management personnel from daily operations. In the event of any adverse ruling in any litigation regarding intellectual property, the Company may be required to pay substantial damages, discontinue the sale of infringing

products, expend significant resources to develop non-infringing technology or obtain licenses to use infringing or substituted technology. The failure to develop, or license on acceptable terms, a substitute technology could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company holds three issued United States patents covering aspects of the RACE architecture and the SuperVision (debugging tool). In addition, the Company has one pending United States patent application covering additional aspects of the RACE architecture and the Company's Parallel Application System. The Company may file additional patent applications seeking protection for other proprietary aspects of its technology in the future. Patent positions frequently are uncertain and involve complex and evolving legal and factual questions. The coverage sought in a patent application either can be denied or significantly reduced before or after the patent is issued. Consequently, there can be no assurance that any patents from pending patent applications or from any future patent application will be issued, that the scope of any patent protection will exclude competitors or provide competitive advantages to the Company, that any of the Company's patents will be held valid if subsequently challenged or that others will not claim rights in or ownership of the patents and other proprietary rights held by the Company. Since patent applications are secret until patents are issued in the United States or corresponding applications are published in international countries, and since publication of discoveries in the scientific or patent literature often lags behind actual discoveries, the Company cannot be certain that it was the first to make the inventions covered by each of its pending patent applications or that it was the first to file patent applications for such inventions. In addition, there can be no assurance that competitors, many of which have substantial resources and have made substantial investments in competing technologies, will not seek to apply for and obtain patents that will prevent, limit or interfere with the Company's ability to make, use or sell its products either in the United States or in international markets.

BACKLOG

As of June 30, 2000, the Company had a backlog of orders aggregating approximately \$60.2 million. The Company includes in its backlog, customer orders for products and services for which it has accepted signed purchase orders with assigned delivery dates within twelve months. Orders included in backlog may be canceled or rescheduled by customers without penalty. 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. The Company cannot assure the timely replacement of canceled, delayed or reduced orders. Significant or numerous cancellations, reductions or delays in orders by a customer or group of customers could materially adversely affect the Company's business, financial condition and results of operations. Backlog should not be relied upon as indicative of the Company's revenues for any future period.

EMPLOYEES

At June 30, 2000, the Company employed a total of 490 persons, including 183 in research and development, 166 in sales, marketing and customer support, 56 in manufacturing and 85 in general and administration. Fourteen of the Company's employees are located in Europe, six in Japan and the remainder in the U.S. None of the Company's employees are represented by a labor organization and the Company believes that its relations with employees are good. Competition for qualified personnel in the engineering fields is intense and the Company is aware that much of its future success will depend on its continued ability to attract and retain qualified personnel. The Company seeks to attract new employees by offering competitive compensation packages, including salary, bonus, stock options and employee benefits. There can be no assurance, however, that the Company will be successful in retaining its key employees or that it will be able to attract skilled personnel for the development of its business.

RISK FACTORS

In this report, as well as oral statements made by the Company, that are prefaced with the words "may," "will," "expect," "anticipate," "continue," "estimate," "project," "intend," "designed" and similar expressions, are intended to identify forward-looking statements regarding events, conditions and financial trends that may affect the Company's future plans of operations, business strategy, results of operations and financial position. These statements are based on the Company's current expectations and estimates as to prospective events and circumstances about which the Company can give no firm assurance. Further, any forward-looking statement speaks only as of the date on which such statement is made, and 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. As it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of actual future financial condition or results. These forward-looking statements, like any forward-looking statements, involve risks and uncertainties that could cause actual results to differ materially from those projected or unanticipated. Such risks and uncertainties include the factors set forth below.

DEPENDENCE ON DEFENSE ELECTRONICS BUSINESS; UNCERTAINTY ASSOCIATED WITH GOVERNMENT CONTRACTS. Sales of the Company's computer systems to the defense electronics market accounted for approximately 71%, 77%, and 79% of the Company's revenues in fiscal 2000, 1999, and 1998, respectively. Reductions in government spending on programs that incorporate the Company's products could have a material adverse effect on the Company's business, financial condition and results of operations. Moreover, the Company's government contracts and subcontracts are subject to special risks, such as: delays in funding; ability of the government agency to unilaterally terminate the prime contract; reduction or modification in the event of changes in government policies or as the result of budgetary constraints or political changes; increased or unexpected costs under fixed price contracts; and other factors that are not under the control of the Company. In addition, consolidation among defense industry contractors has resulted in fewer contractors with increased bargaining power relative to the Company. No assurance can be given that such increased bargaining power will not adversely affect the Company's business, financial condition or results of operations in the future.

The Company's contracts with the U.S. and foreign governments and their prime and subcontractors are subject to termination either upon default by the Company or at the convenience of the government. Termination for convenience provisions generally entitle the Company to recover costs incurred, settlement expenses and profit on work completed prior to termination. In addition to the right of the government to terminate, government contracts are generally conditioned upon the continuing availability of legislative appropriations. Funds are usually appropriated for a given program each fiscal year even though contract performance may take more than one fiscal year. Consequently, at the outset of a major program, the contract is usually partially funded, and additional monies normally are incrementally committed to the contract by the procuring agency from appropriations made for future fiscal years. No assurance can be given that the Company will realize the revenue expected from performing under such contracts. Because the Company contracts to supply goods and services to U.S. and foreign governments it is also subject to other risks, including contract suspensions, protests by disappointed bidders of contract awards which can result in the reopening of the bidding process, changes in governmental policies or regulations or other political factors.

DEPENDENCE ON KEY CUSTOMERS. The Company is dependent on a small number of customers for a large portion of its revenues. In fiscal 2000, Raytheon Systems Company, Lockheed Martin, Northrop Grumman Corporation and GE Medical accounted for 19%, 14%, 12% and 12%, respectively, of the Company's revenues. In fiscal 1999, Raytheon Systems Company, Lockheed Martin, and GE Medical accounted for 22%, 16%, and 12%, respectively, of the Company's revenues. In fiscal 1998, Raytheon Systems Company, Northrop Grumman Corporation, and GE Medical accounted for 20%, 10%, and 10%, respectively, of the Company's revenues. The Company's largest customer in the medical imaging market, GE Medical, accounted for 59%, 85%, and 76% of the Company's aggregate sales to the medical imaging market in fiscal 2000, 1999, and 1998, respectively. Customers in the defense electronics market generally purchase the Company's products in connection with government programs that have a limited duration, leading to fluctuating sales to any particular customer in the defense electronics market from year to year. By contrast, many customers in the medical imaging market historically have purchased the Company's products over a number of years for use in successive generations of medical imaging devices, although there can be no assurance that such past behavior will continue in the future. A significant diminution in the sales to or loss of any of the Company's major customers would have a material adverse effect on the Company's business, financial condition and results of operations. In addition, the Company's revenues are largely dependent upon the ability of its customers to develop and sell products that incorporate the Company's products. No assurance can be given that the Company's customers will not experience financial or other difficulties that could adversely affect their operations and, in turn, the results of operations of the Company.

FLUCTUATIONS IN OPERATING RESULTS. The Company has experienced fluctuations in its results of operations in large part due to the sale by the Company of its computer systems in relatively large dollar amounts to a relatively small number of customers. Operating results also have fluctuated due to competitive pricing programs and volume discounts, the loss of customers, market acceptance of the Company's products, product obsolescence and general economic conditions. In addition, the Company, from time to time, has entered into contracts to engineer a specific solution based on modifications to the Company's standard products (a "development contract"). The Company's gross margins from development contract revenues are typically lower than the Company's gross margins from standard product revenues. The Company intends to continue to enter into development contracts and anticipates that the gross margins associated with development contract revenues will continue to be lower than its gross margins on standard product revenues. The Company expects research and development expenses to continue to increase as the Company continues to develop products to serve its markets, all of which are subject to rapidly changing technology, frequent product performance improvements and evolving industry standards. The ability to deliver superior technological performance on a timely and cost effective basis is a critical factor in securing design wins for future generations of defense electronics and medical imaging systems. Significant research and development spending by the Company does not ensure that the Company's computer systems will be designed into a customer's system. Because future production orders are usually contingent upon securing a design win, the Company's operating results may fluctuate due to either obtaining or failing to obtain design wins for significant customer systems.

The Company's quarterly results may be subject to fluctuations resulting from the foregoing factors, as well as a number of other factors, including the timing of significant orders, delays in completion of internal product development projects, delays in shipping the Company's computer systems and software programs, delays in acceptance testing by customers, a change in the mix of products sold to the defense electronics and medical imaging markets, production delays due to quality problems with outsourced components, shortages of components, the timing of product line transitions and declines in quarterly revenues from old generations of products following announcement of replacement products containing more advanced technology. Another factor contributing to fluctuations in quarterly results is the fixed nature of the Company's expenditures on personnel, facilities and marketing programs. The Company's expense levels for personnel, facilities and marketing programs are based, in significant part, on the Company's expectations of future revenues on a quarterly basis. If actual quarterly revenues are below management's expectations, results of operations likely will be adversely affected. As a result of the foregoing factors, the Company's 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 price of the Company's Common Stock.

DEPENDENCE ON SUPPLIERS. Several components used in the Company's products are currently obtained from sole source suppliers. Mercury is dependent on LSI Logic Corporation for four custom designed ASICs, on Analog Devices for its SHARC processors, on International Business Machines Corporation for ball grid array packaging, on Motorola for some of its PowerPC processors and on Intel for its i860 processors. IBM may terminate its contract with the Company without cause upon thirty days notice and may cease offering products to the Company upon sixty days notice. Analog Devices may discontinue or modify any product upon 180 days notice and LSI Logic may discontinue any product upon 180 days notice. If LSI Logic, Analog Devices, IBM, Motorola or Intel were to limit or reduce the sale of such components to the Company, or if these or other suppliers to the Company were to experience financial difficulties or other problems which prevented them from supplying the Company with the necessary components, such events could have a material adverse effect on the Company's business, financial condition and results of operations. These sole source suppliers are subject to quality and performance issues, materials shortages, excess demand, reduction in capacity and other factors that may disrupt the flow of goods to the Company or its customers and thereby adversely affect the Company's business and customer relationships. The Company has no guaranteed supply arrangements with its suppliers and there can be no assurance that its suppliers will continue to meet the Company's requirements. If the Company's supply arrangements are interrupted, there can be no assurance that the Company would be able to find another supplier on a timely or satisfactory basis. Any shortage or interruption in the supply of any of the components used in the Company's products, or the inability of the Company to procure these components from alternate sources on acceptable terms could have a material adverse effect on the Company's business, financial condition and results of operations. There can be no assurance that severe shortages of components will not occur in the future. Such shortages could increase the cost or delay the shipment of the Company's products, which could have a material adverse effect on the Company's business, financial condition and results of operations. Significant increases in the prices of these components would also materially adversely affect the Company's financial performance since the Company may not be able to adjust product pricing to reflect the increase in component costs. The Company could incur set-up costs and delays in manufacturing should it become necessary to replace any key vendors due to work stoppages, shipping delays, financial difficulties or other factors and, under certain circumstances, these costs and delays could have a material adverse effect on the Company's business, financial condition and results of operations.

DEPENDENCE UPON KEY PERSONNEL AND SKILLED EMPLOYEES. The Company is largely dependent upon the skills and efforts of its senior management, particularly James R. Bertelli, its President and Chief Executive Officer, as well as its managerial, sales and technical employees. None of the senior management or other key employees of the Company is subject to any employment contract or noncompetition agreement. The Company maintains key-man life insurance on Mr. Bertelli and certain other senior managers. The loss of services of any of its executives or other key personnel could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's future success will depend to a significant extent on its ability to attract, train, motivate and retain highly skilled technical professionals, particularly project managers, engineers and other senior technical personnel. The Company believes that there is a shortage of, and significant competition for, technical development professionals with the skills and experience necessary to perform the services offered by the Company. The Company's ability to maintain and renew existing engagements and obtain new business depends, in large part, on its ability to hire and retain technical personnel with the skills that keep pace with continuing changes in industry standards, technologies and client preferences. The inability to hire additional qualified personnel could impair the Company's ability to satisfy its growing client base, requiring an increase in the level of responsibility for both existing and new personnel. There can be no assurance that the Company will be successful in retaining current or future employees.

DEPENDENCE ON MEDICAL IMAGING MARKET; POTENTIAL ADVERSE EFFECT OF HEALTH CARE REFORM. Sales of the Company's computer systems to the medical imaging market accounted for approximately 19%, 14%, and 13% of the Company's revenues in fiscal 2000, 1999, and 1998, respectively. These customers are original equipment manufacturers ("OEMs") of medical imaging devices and, as a result, any change in the demand for such devices which renders any of the Company's products unnecessary or obsolete, or any change in the technology in such devices, could have a material adverse effect on the Company's

business, financial condition and results of operations. Such OEM customers, the end-users of their products and the health care industry generally are subject to extensive federal, state and local regulation in the U.S. as well as in other countries. Changes in applicable health care laws and regulations or new interpretations of existing laws and regulations could have a material adverse effect on such customers or end-users. There can be no assurance that future health care or budgetary legislation or other changes in the administration or interpretation of governmental health care programs both in the U.S. and abroad will not have a material adverse effect on the Company's business, financial condition or results of operations.

RISK OF ENTRY INTO NEW MARKETS. The Company's expansion strategy includes developing new products and entering new markets. The Company's ability to compete in new markets will depend upon a number of factors including, without limitation, the Company's ability to create demand for its products in such markets, its ability to manage its growth effectively, the quality of its products, its ability to respond to changes in its customers' businesses by updating existing products and introducing, in a timely fashion, products which meet the needs of its customers and the ability of the Company to respond rapidly to technological change. The failure of the Company to do any of the foregoing could result in a material adverse effect on its business, financial condition and results of operations. In addition, the Company may face competition in these new markets from various companies which may have substantially greater research and development resources, marketing and financial resources, manufacturing capability and customer support organizations than those of the Company.

RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS. The Company markets and sells its products in certain international markets, and the Company has established offices in the United Kingdom, Japan and France. Foreign revenue is based on the country in which the legal subsidiary is domiciled. Foreign revenue accounted for approximately 10%, 8%, and 8% of total consolidated revenues in fiscal 2000, 1999, and 1998, respectively. Long-lived assets represent less than 10% of the Company's total long-lived assets for the fiscal years ended June 30, 2000, 1999, and 1998, respectively. If revenues generated by foreign activities are not adequate to offset the expense of establishing and maintaining these foreign subsidiaries and activities, the Company's business, financial condition and results of operations could be materially adversely affected. In addition, there are certain risks inherent in transacting business internationally, such as changes in applicable laws and regulatory requirements, export and import restrictions, export controls relating to technology, tariffs and other trade barriers, less favorable intellectual property laws, difficulties in staffing and managing foreign operations, longer payment cycles, problems in collecting accounts receivable, political instability, fluctuations in currency exchange rates, expatriation controls and potential adverse tax consequences, any of which could adversely impact the success of the Company's international activities. In the recent past, the financial markets in Asia have experienced significant turmoil. There can be no assurance that such turmoil in the Asian financial markets will not negatively affect the sales by the Company to that region. A portion of the Company's revenues from sales to foreign entities, including foreign governments, is in the form of foreign currencies. There can be no assurance that one or more of such factors will not have a material adverse effect on the Company's future international activities and, consequently, on the Company's business, financial condition or results of operations.

TECHNOLOGICAL CHANGES; RISK OF DESIGN-IN PROCESS. The Company's future success will depend in part on its ability to enhance its 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. The defense electronics market, in particular, demands constant technological improvements as a means of gaining military advantage. Military planners historically have funded significantly more design projects than actual deployments of new equipment, and those systems which 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, the Company must be able to demonstrate its ability to deliver superior technological performance on a timely and cost-effective basis. There can be no assurance that the Company will be able to secure an adequate number of defense electronics design wins in the future, that the equipment in which the Company's products are intended to function eventually will be deployed in the field, or that the Company's products will be included in such equipment if it eventually is deployed.

Customers in the medical imaging market also seek technological improvements through product enhancements and new generations of products. The Company believes that medical imaging machines in which the Company's computers are installed have a long product life cycle. Medical equipment OEMs historically have selected certain suppliers whose products have been included in the OEMs' machines for a significant portion of the products' life cycle. There can be no assurance that the Company will be selected to participate in the future design of any medical imaging equipment, or that, if selected, the Company will generate any revenues for such design work. Failure to participate in future designs of medical imaging equipment could have a material adverse effect on the Company's business, financial condition and results of operations.

The design-in process is typically lengthy and expensive, and there can be no assurance that the Company will be able to continue to meet the product specifications of its customers in a timely and adequate manner. In addition, any failure by the Company to anticipate or respond adequately to changes in technology and customer preferences, or any significant delay in product developments or introductions, could have a material adverse effect on the Company's business, financial condition and results of operations. Because of the complexity of its products, the Company has experienced delays from time to time in completing products on a timely

basis. If the Company is unable to design, develop or introduce competitive new products on a timely basis, its future operating results would be adversely affected. There can be no assurance that the Company will be successful in developing new products or enhancing its existing products on a timely or cost-effective basis, or that such new products or product enhancements will achieve market acceptance.

COMPETITION. The markets for the Company's products are highly competitive and are characterized by rapidly changing technology, frequent product performance improvements and evolving industry standards. See "Item 1. Business - - Competition."

LIMITED PROTECTION OF PROPRIETARY RIGHTS; POTENTIAL INFRINGEMENT OF THIRD PARTY RIGHTS. There can be no assurance that the Company's means of protecting its proprietary rights in the U.S. or abroad will be adequate, or that others will not develop technologies similar or superior to the Company's technology or design around the proprietary rights owned by the Company. In addition, there can be no assurance that others will not assert claims of infringement in the future or that, if made, such claims will not be successful. See "Item 1. Business - Intellectual Property and Proprietary Rights."

POTENTIAL ACQUISITIONS. In the normal course of its business, the Company evaluates potential acquisitions of businesses, products and technologies that could complement or expand the Company's business. In the event the Company were to identify an appropriate acquisition candidate, there is no assurance that the Company would be able to successfully negotiate the terms of any such acquisition, finance such acquisition and integrate such acquired business, products or technologies into the Company's existing business and operations. Furthermore, the integration of an acquired business could cause a diversion of management time and resources. In addition, there can be no assurance that any acquisition of new technology will lead to the successful development of new products, or that any such new products, if developed, will achieve market acceptance or prove to be profitable. There can be no assurance that a given acquisition, when consummated, would not materially adversely affect the Company's business, financial condition or results of operations. If the Company proceeds with one or more significant acquisitions in which the consideration consists of cash, a substantial portion of the Company's available cash could be used to consummate the acquisitions. If the Company consummates one or more significant acquisitions in which the consideration consists of stock, or is financed with the net proceeds of the issuance of stock, stockholders of the Company could suffer a significant dilution of their interests in the Company.

YEAR 2000 COMPLIANCE. As of the date of this report, the Company has not experienced nor does it expect to experience any business disruption resulting from any Year 2000 failures from either its Products, IT Systems, or non-IT Systems.

ITEM 2. PROPERTIES

The Company's headquarters consist of two buildings approximating 187,000 square feet of space in Chelmsford, Massachusetts. These two buildings were purchased by the Company during fiscal 1999. In fiscal 2000, the Company purchased approximately 179,000 square feet of land adjacent to the two existing lots. The Company also maintains offices near Los Angeles and San Jose, California, and in Dallas, Texas, Chanhassen, Minnesota, Madison, Wisconsin, Port St Lucie, Florida, Bellevue, Washington and Vienna, Virginia and has international offices in the United Kingdom, France, the Netherlands and Japan.

ITEM 3. LEGAL PROCEEDINGS

To the Company's knowledge, there are no pending legal proceedings, which are, material to the Company or its business to which it is a party or to which any of its properties is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of stockholders during the fourth quarter of the fiscal year ended June 30, 2000.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDERS' MATTERS

The Company's Common Stock is traded in the over-the-counter market and is quoted on the Nasdaq National Market under the symbol MRCY. The following table sets forth, for the periods indicated, the high and low transactions per share during such periods. Such over-the-counter market quotations reflect inter-dealer prices without retail markup, markdown or commission.

1999	First quarter	17 3/8	9 3/4
	Second quarter	28 5/8	12 1/2
	Third quarter	28 1/4	17 1/8
	Fourth quarter	33 3/8	15 1/16
2000	First quarter	17 1/4	11 3/8
	Second quarter	35	16
	Third quarter	68 1/8	27 7/8
	Fourth quarter	48 7/8	24 1/4

As of August 31, 2000 the Company had approximately 15,000 shareholders including record and nominee holders.

The Company has never declared or paid cash dividends on shares of its Common Stock and does not expect to declare or pay cash dividends on its Common Stock in the foreseeable future. The Company currently intends to retain any earnings for future growth.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

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

YEAR ENDED JUNE 30,	2000	1999	1998	1997	1996
STATEMENT OF OPERATIONS DATA:					
Revenues	\$ 140,944	\$ 106,571	\$ 85,544	\$ 64,574	\$ 58,300
Cost of revenues	39,146	34,237	30,084	22,034	24,688
Gross profit	101,798	72,334	55,460	42,540	33,612
Operating expenses:					
Selling, general and administrative	39,475	33,002	27,879	22,631	16,927
Research and development	28,862	20,709	14,476	12,837	9,776
Total operating expenses	68,337	53,711	42,355	35,468	26,703
Income from operations	33,461	18,623	13,105	7,072	6,909
Interest income, net	1,699	1,285	1,084	560	548
Equity loss in joint venture	(3,721)	--	--	--	--
Gain on sale of division, net	4,820	--	--	--	--
Other income (expense), net	86	185	(30)	(88)	(77)
Income before income taxes	36,345	20,093	14,159	7,544	7,380
Provision for income taxes	11,449	6,631	5,428	2,933	2,952
Net income	\$ 24,896	\$ 13,462	\$ 8,731	\$ 4,611	\$ 4,428
Net income per common share (1)					
Basic	\$ 1.19	\$ 0.66	\$ 0.60	\$ 0.45	\$ 0.44
Diluted	\$ 1.10	\$ 0.62	\$ 0.47	\$ 0.29	\$ 0.28
Weighted average number of common and common equivalent shares outstanding (1,3)					
Basic	21,000	20,336	14,470	10,282	10,100
Diluted	22,703	21,600	18,540	15,794	15,966
JUNE 30,	2000	1999	1998	1997	1996
BALANCE SHEET DATA:					
Working capital	\$ 68,198	\$ 42,312	\$ 32,794	\$ 27,547	\$ 23,554
Total assets	144,217	97,511	73,569	44,848	33,264
Long term obligations	14,052	590	--	--	--
Convertible preferred stock (2)	--	--	--	1,200	1,200
Total stockholders' equity	108,360	77,440	61,040	33,322	28,529

- (1) Note: Previously published financial data have restated to give effect to the two-for-one stock split effected in the form of a 100% stock dividend distributed on December 21, 1999.
- (2) Upon completion of the Company's initial public offering on January 29, 1998, the Company's series A convertible preferred stock was converted into 2,556,792 shares of common stock.
- (3) See Note B of Notes to Consolidated Financial Statements for an explanation of the determination of the weighted average common and common equivalent shares used to compute basic and diluted net income per common share.

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

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS. In this report, as well as oral statements made by the Company, phrases that are prefaced with the words "may," "will," "expect," "anticipate," "continue," "estimate," "project," "intend," "designed" and similar expressions, are intended to identify forward-looking statements regarding events, conditions and financial trends that may affect the Company's future plans of operations, business strategy, results of operations and financial position. These statements are based on the Company's current expectations and estimates as to prospective events and circumstances about which the Company can give no firm assurance. Further, any forward-looking statement speaks only as of the date on which such statement is made, and 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. As it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of actual future financial condition or results. These forward-looking statements, like any 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 certain factors identified in the following discussion as well as the risk factors reported in the Company's Form 10-K filed with the Securities and Exchange Commission.

OVERVIEW. Mercury designs, manufactures and markets high performance, real-time digital signal processing computer systems that transform sensor-generated data into information which can be displayed as images for human interpretation or subjected to additional computer analysis. These multicomputer systems are heterogeneous and scalable, allowing them to accommodate several microprocessor types and to scale from several to hundreds of microprocessors within a single system.

During the past several years, the majority of the Company's revenues have been generated from sales of its products to the defense electronics market, generally for use in intelligence gathering electronic warfare systems. The Company's activities in this area have focused on the proof of concept, development and deployment of advanced military applications in radar, sonar and airborne surveillance. Medical diagnostic imaging is the other primary market currently served by the Company. Mercury's computer systems are embedded principally in Magnetic Resonance Imaging ("MRI"), and Computed Tomography ("CT") machines. The remaining revenues are derived from computer systems used in such commercial applications as baggage scanning, seismic analysis and automatic testing equipment, and, until the sale of the Company's shared storage business unit ("SSBU") in January, 2000, shared storage products, SANergy(R) software and related products and services.

Mercury uses a direct sales force to sell its computer systems to the defense electronics markets in the U.S., Japan, the United Kingdom and France. Defense electronics sales to other countries are achieved through distributors. The Company also uses a direct sales force to sell its computer systems to the U.S. and international medical imaging markets. The Company sells its products to OEMs, value added re-sellers and end-users. Over the past three fiscal years, the Company has expanded its sales force to support growing revenues and has made significant expenditures to recruit additional technical and professional staff, to invest in information technology and to improve the Company's financial, administrative and management infrastructure.

Revenues are generated from the sale of hardware and software products, development contracts, services such as maintenance, training, engineering consulting and system integration of Mercury software with third-party hardware. Revenues from maintenance, training, engineering consulting services and system integration historically have not constituted a material portion of total revenues. Revenue from product sales is recorded upon receipt of customer purchase order or where applicable, a signed contract executed by both parties provided that delivery has occurred, customer acceptance is not uncertain and collectability is deemed probable. The Company accrues anticipated warranty costs upon shipment. Service revenue is recognized ratably over applicable contract periods or as the services are performed. Revenue from contracts involving significant product modification or customizations that are eligible for the percentage-of-completion accounting method are recognized on an efforts expended basis. Changes to total estimated costs and anticipated losses, if any, are recognized in the period in which they are determined.

Cost of revenues includes the cost of materials, component assembly, internal labor and related overhead. Cost of revenues also can include engineering and other technical labor and related overhead incurred in development and engineering consulting contracts.

Gross profit as a percentage of revenues ("gross margin") varies from period to period depending upon numerous variables, including the mix of revenues from hardware, software, development and engineering consulting contracts; the mix of revenues among the markets served by the Company; the cost of raw materials; the cost of outsourced services and labor; operational efficiencies; actual production volume compared to planned volume; and the mix of applications for which the Company's computer systems are sold. Historically, the Company's gross margins on service revenues have been lower than on product revenues. In addition, the Company's gross margins from development contract revenues are typically lower than the Company's gross margins from standard product revenues. The Company intends to continue to enter into development contracts and anticipates that the gross margins associated with development contract revenues will continue to be lower than its gross margins on standard product revenues.

Mercury has made significant investments in research and development in an effort to maintain its technology leadership in digital signal processing. Mercury invested \$14.5 million, \$20.7 million and \$28.9 million in fiscal years 1998, 1999 and 2000, respectively, in development activities associated with the Company's key technology competencies as well as in activities that are targeted at developing new technologies and products. The Company expects research and development expenses to continue to increase as the Company continues to develop products to serve its markets, all of which are subject to rapidly changing technology, frequent product performance improvements and evolving industry standards. The ability to deliver superior technological performance on a timely and cost-effective basis is a critical factor in securing design wins for future generations of defense electronics and medical imaging systems. Significant research and development spending by the Company does not ensure that the Company's computer systems will be designed into a customer's system. Because future production orders are usually contingent upon securing a design win, the Company's operating results may fluctuate due to either obtaining or failing to obtain design wins for significant customer systems.

RESULTS OF OPERATIONS. The following table sets forth, for the periods indicated, certain financial data as a percentage of total revenues.

YEAR ENDED JUNE 30,	2000	1999	1998
	-----	-----	-----
Revenues	100.0%	100.0%	100.0%
Cost of revenues	27.8	32.1	35.2
	-----	-----	-----
Gross profit	72.2	67.9	64.8
Operating expenses:			
Selling, general and administrative	28.0	31.0	32.6
Research and development	20.5	19.4	16.9
	-----	-----	-----
Total operating expenses	48.5	50.4	49.5
	-----	-----	-----
Income from operations	23.7	17.5	15.3
Other income, net	2.1	1.4	1.3
	-----	-----	-----
Income before income taxes	25.8	18.9	16.6
Provision for income taxes	8.1	6.3	6.4
	-----	-----	-----
Net income	17.7%	12.6%	10.2%
	=====	=====	=====

FISCAL 1999 VS. FISCAL 2000

REVENUES. Total revenues increased 32% from \$106.6 million during the year ended June 30, 1999 to \$140.9 million during the year ended June 30, 2000.

Defense electronics revenues increased 21% from \$82.6 million or 77% of total revenues during the year ended June 30, 1999 to \$100.3 million or 71% of total revenues during the year ended June 30, 2000. This increase in revenue was primarily due to the increased unit demand for defense electronics products, largely comprised of advanced military applications in radar, sonar, and airborne surveillance.

Medical imaging revenues increased 77% from \$15.3 million or 14% of total revenues during the year ended June 30, 1999 to \$27.1 million or 19% of total revenues during the year ended June 30, 2000. The increase in medical imaging revenues reflects the increase in production volume of products in the CT application.

Other revenues increased 55% from \$8.7 million or 8% of total revenues during the year ended June 30, 1999 to \$13.5 million or 10% of total revenues during the year ended June 30, 2000. The increase in other revenues was due primarily to the addition of a new commercial customer, offset in part by the sale of the SSBU in January, 2000.

COST OF REVENUES. Cost of revenues increased 14% from \$34.2 million during the year ended June 30, 1999 to \$39.1 million during the year ended June 30, 2000. Cost of revenues as a percentage of total revenues decreased from 32% during the year ended June 30, 1999 to 31% during the year ended June 30, 2000. The decrease in costs as a percentage of total revenues was primarily due to a decline in component costs and tighter control over manufacturing spending.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative expenses increased 20% from \$33.0 million during the year ended June 30, 1999 to \$39.5 million during the year ended June 30, 2000. Selling, general and administrative expenses as a percentage of total revenues were 28% during the year ended June 30, 1999 and 28% during the year ended June 30, 2000. The increase in expense dollars reflects the hiring of additional sales and administrative personnel, increased commissions related to increased revenues, investment in an enterprise resource planning system, as well as the ongoing development of the Company's financial, administrative and management infrastructure to support the Company's growth.

RESEARCH AND DEVELOPMENT. Research and development expenses increased 39% from \$20.7 million during the year ended June 30, 1999 to \$28.9 million during the year ended June 30, 2000. Research and development expenses as a percentage of total revenues were 19% during the year ended June 30, 1999 and 20% during the year ended June 30, 2000. The increase in research and development expenses was due primarily to the hiring of additional software and hardware engineers to develop and enhance the features and functionality of the Company's products and an increased level of introduction of new products in response to a high demand for next generation products. Engineering expenses currently are running higher than management's target levels as the Company is working on several major development programs to deliver important new technology to its customers. Management believes that higher engineering spending will continue through fiscal 2001.

The Company's future success and ability to make the appropriate engineering investments, will depend to a significant extent on its ability to attract, train, motivate and retain highly skilled technical professionals, particularly project managers, engineers and other senior technical personnel. The Company believes that there is a shortage of, and significant competition for, technical development professionals with the skills and experience necessary to perform the services offered by the Company. The Company's ability to maintain and renew existing engagements and obtain new business depends, in large part, on its ability to hire and retain technical personnel with the skills that keep pace with continuing changes in industry standards, technologies and client preferences. The inability to hire additional qualified personnel could impair the Company's ability to satisfy its growing client base, requiring an increase in the level of responsibility for both existing and new personnel. There can be no assurance that the Company will be successful in retaining current or future employees and therefore able to continue to make the investments in engineering at the projected higher expenditure levels. Furthermore, the Company's inability to retain or hire technical personnel may require contracting or outsourcing engineering activities. This factor could result in higher than planned engineering expenses and therefore, a possible fluctuation in the Company's operating results.

INCOME FROM OPERATIONS. Income from operations increased 80% from \$18.6 million during the year ended June 30, 1999 to \$33.5 million during the year ended June 30, 2000. This increase is primarily associated with higher sales volume and lower cost of goods sold.

Included in income from operations during the year ended June 30, 2000 were \$1.8 million in hardware and software revenues and \$2.4 million in direct expenses related to activities of the SSBU. Included in income from operations during the year ended June 30, 1999 were \$2.2 million in hardware and software revenues and \$4.0 million in direct expenses related to the SSBU. The direct expenses include expenses from marketing and engineering activities, primarily related to compensation, trade shows, prototype development and direct costs related to the sale of the product.

GAIN ON SALE OF BUSINESS UNIT. On January 18, 2000, the Company completed the sale of the SSBU to IBM. Payments are structured with an initial payment of \$4,500,000 (excluding \$1,000,000 to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of \$1,500,000 plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The Company has recorded a \$4,820,000 gain on the sale of this division which includes cash received of \$6,100,000 less legal and advisory costs of \$581,000, costs reimbursable to IBM of \$499,000, and the net book value of equipment and inventories sold of \$200,000.

EQUITY LOSS IN JOINT VENTURE. In September, 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television ("DTV"). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's contribution to AgileVision was \$3.5 million in cash. During the year ended June 30, 2000, the Company recognized \$3.7 million in expenses related to the operation of AgileVision. No expenses were recognized during the year ended June 30, 1999.

INTEREST INCOME, NET. The Company earned \$1.3 million in interest income, net, during the year ended June 30, 1999 and \$1.7 million during the year ended June 30, 2000. This increase primarily reflects higher average cash balances.

PROVISION FOR INCOME TAXES. The Company's provision for income taxes was \$6.6 million during the year ended June 30, 1999 and \$11.4 million during the year ended June 30, 2000. The Company's effective tax rate was 33.0% during the year ended June 30, 1999 and 31.5% during the year ended June 30, 2000. During fiscal 2000, the tax rate was reduced primarily due to a reduction in state taxes.

FISCAL 1998 VS. FISCAL 1999

REVENUES. Total revenues increased 25% from \$85.5 million during the year ended June 30, 1998 to \$106.6 million during the year ended June 30, 1999.

Defense electronics revenues increased 23% from \$67.2 million or 79% of total revenues during the year ended June 30, 1998 to \$82.6 million or 77% of total revenues during the year ended June 30, 1999. The increase in revenues was due primarily to increased unit demand for defense electronics products.

Medical imaging revenues increased 36% from \$11.2 million or 13% of total revenues during the year ended June 30, 1998 to \$15.3 million or 14% of total revenues during the year ended June 30, 1999. The increase in revenues was due primarily to the expansion of the business into new applications.

Other revenues increased 22% from \$7.1 million or 8% of total revenues during the year ended June 30, 1998 to \$8.7 million or 8% of total revenues during the year ended June 30, 1999. The increase was due to the shared storage business unit revenue increasing by 152% while the other commercial businesses remained relatively flat over the year.

COST OF REVENUES. Cost of revenues increased 14% from \$30.1 million during the year ended June 30, 1998 to \$34.2 million during the year ended June 30, 1999. Cost of revenues as a percentage of total revenues decreased from 35% during the year ended June 30, 1998 to 32% during the year ended June 30, 1999. The decrease in costs as a percentage of total revenues was primarily due to a decline in component costs and tighter control over manufacturing spending.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative expenses increased 18% from \$27.9 million during the year ended June 30, 1998 to \$33.0 million during the year ended June 30, 1999. Selling, general and administrative expenses as a percentage of total revenues were 33% during the year ended June 30, 1998 and 31% during the year ended June 30, 1999. The increase in expense dollars reflects the hiring of additional sales and administrative personnel, increased commissions and marketing communication related to increased revenues, as well as the ongoing development of the Company's financial, administrative and management infrastructure to support the Company's growth.

RESEARCH AND DEVELOPMENT. Research and development expenses, excluding capitalized software expenditures, increased 43% from \$14.5 million during the year ended June 30, 1998 to \$20.7 million during the year ended June 30, 1999. Research and development expenses as a percentage of total revenues were 17% during the year ended June 30, 1998 and 19% during the year ended June 30, 1999. The increase in research and development expenses was due primarily to the hiring of additional software and hardware engineers to develop and enhance the features and functionality of the Company's products in response to increased demand for next generation products. Engineering expenses currently are running higher than management's target levels as the Company is working on some major development programs to deliver important new technology to its customers.

INCOME FROM OPERATIONS. Income from operations increased 42% from \$13.1 million during the year ended June 30, 1998 to \$18.6 million during the year ended June 30, 1999. Included in income from operations during the year ended June 30, 1999 were \$2.2 million in hardware and software revenues and \$4.0 million in direct expenses related to the shared storage business. The expenses include direct expenses from marketing and engineering activities, primarily relate to compensation, trade shows, prototype development and direct costs related to the sale of the product. Included in income from operations during the year ended June 30, 1998 were \$885,000 in hardware and software revenues and \$4.3 million in direct expenses related to the shared storage business. Revenues from the shared storage business increased substantially year over year due primarily to the expanding distribution base and the availability of fiber channel interconnect technology.

INTEREST INCOME, NET. The Company earned \$1.1 million in interest income, net, during the year ended June 30, 1998 and \$1.3 million during the year ended June 30, 1999. This increase reflects higher average cash balances primarily as a result of proceeds received from the Company's initial public offering in mid fiscal 1998. Offsetting the effect of higher average cash balances were lower yields achieved on the Company's cash. These lower yields were the result of a shift in investment strategy from taxable money market instruments to non-taxable securities.

PROVISION FOR INCOME TAXES. The Company's provision for income taxes was \$5.4 million during the year ended June 30, 1998 and \$6.6 million during the year ended June 30, 1999. The Company's effective tax rate was 38% during the year ended June 30, 1998 and 33% during the year ended June 30, 1999. During fiscal 1999, the tax rate was reduced primarily due to a one-time state investment tax credit ("ITC") benefit resulting from the purchase of two facilities during the year, increase in research and development credits, and a shift in investment strategy from taxable to non-taxable securities.

LIQUIDITY AND CAPITAL RESOURCES. As of June 30, 2000 the Company had cash and marketable securities of approximately \$68.3 million. During the year ended June 30, 2000 the Company generated approximately \$29.9 million in cash from operations compared to \$9.1 million generated during the year ended June 30, 1999. The increase in cash generated from operations is attributable primarily to the Company's improved profitability. The Company's days sales, based on revenues of each calendar quarter, decreased from 88 days at the end of 1999 to 70 days at the end of 2000. This decrease in days sales was due to the resolution of a supplier issue at the end of fiscal year 1999, which had delayed shipments until the last few weeks of the fourth quarter. Consequently, the accounts receivable balance at June 30, 1999 was inflated.

In September, 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television ("DTV"). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's total contribution to AgileVision was \$3.5 million in cash. During the year ended June 30, 2000, the Company recognized \$3.7 million in expenses related to the operation of AgileVision. The Company has funded the losses of AgileVision to date and as of June 30, 2000 intends to continue to fund this venture. No expenses were recognized during the year ended June 30, 1999.

On January 18, 2000, the Company completed the sale of the SSBU to IBM. Payments are structured with an initial payment of \$4.5 million (excluding \$1.0 million to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of \$1.5 million plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property.

The Company used approximately \$45.9 million in investing activities during the year ended June 30, 2000 compared to \$12.7 million during the year ended June 30, 1999. During the year ended June 30, 2000, the Company's investing activities consisted of \$40.8 million for the purchase of marketable securities (net of sales), \$3.5 million for investment in AgileVision, \$1.1 million for the purchase of land adjacent to its existing headquarters and \$5.5 million for computers, furniture and equipment. These payments were partially offset by the receipt of \$5.0 million, net of selling costs from sale of a division. During the year June 30, 1999, the Company's investing activities consisted of \$15.1 million for the purchase of an existing office building and construction of an adjacent building, \$4.3 million for computers, furniture, equipment and leasehold improvements, and \$810,000 for capitalized software. These cash outflows were partially offset by the net sale of marketable securities of \$7.2 million and a repayment of notes receivable from related parties amounting to \$325,000.

The Company generated approximately \$17.4 million in cash from financing activities during the year ended June 30, 2000 compared to \$1.4 million during the year ended June 30, 1999. During the year ended June 30, 2000 the Company's financing activities consisted primarily of \$14.5 million in proceeds received upon the issuance of two 7.30% senior secured financing notes. These notes are due November 2014. In addition, \$3.7 million in cash was generated from the employee stock purchase plan and the exercise of stock options. These cash inflows were partially offset by the payment of debt and capital lease obligations amounting to approximately \$828,000. During the year ended June 30, 1999, \$1.7 million in cash was generated from the employee stock purchase plan and the exercise of stock options and \$303,000 was used for the payment of capital lease obligations.

Management believes that the Company's available cash, marketable securities, cash generated from operations, and from the arrangement related to the sale of the SSBU, will be sufficient to provide for the Company's working capital and capital expenditure requirements for at least the next twenty four months. If the Company acquires one or more businesses or products, the Company's capital requirements could increase substantially. In the event of such an acquisition or in the event that unanticipated circumstances arise which significantly increase the Company's capital requirements, there can be no assurance that necessary additional capital will be available on terms acceptable to the Company, if at all.

YEAR 2000 COMPLIANCE. As of the date of this report, the Company has not experienced nor does it expect to experience any business disruption resulting from any Year 2000 failures from either its Products, IT Systems, or non-IT Systems.

RECENT ACCOUNTING PRONOUNCEMENTS. See Note B to the Company's Consolidated Financial Statements for a description of the impact on the Company of recent accounting pronouncements.

ITEM 7(A) QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

INTEREST RATE RISK MANAGEMENT. Due to the short-term duration, the fair value of the Company's cash and investment portfolio at June 30, 2000 approximated carrying value. Interest rate risk is estimated as the potential decrease in fair value resulting from a hypothetical 10% increase in interest rates for issues contained in the investment portfolio. The resulting hypothetical fair value was not materially different from the year-end carrying value.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE DATA) JUNE 30,

	2000	1999
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,850	\$ 3,676
Marketable securities	36,784	12,762
Trade accounts receivable, net of allowance for doubtful accounts of \$308 and \$376 at June 30, 2000 and 1999, respectively	27,408	28,915
Inventory	15,975	12,431
Deferred income taxes, net	1,909	2,617
Income tax receivable	722	--
Prepaid expenses and other current assets	1,355	1,392
	-----	-----
Total current assets	90,003	61,793
Marketable securities	25,705	8,978
Property and equipment, net	27,574	25,325
Deferred income taxes, net	787	668
Other assets	148	747
	-----	-----
Total assets	\$ 144,217	\$ 97,511
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 9,231	\$ 5,580
Accrued expenses	2,486	3,694
Accrued compensation	6,143	4,292
Capital lease - short term	580	434
Notes payable-short term	577	--
Billings in excess of revenues and customer advances	2,788	3,169
Income taxes payable	--	2,312
	-----	-----
Total current liabilities	21,805	19,481
Commitments and Contingencies (Note F)	--	--
Capital lease - long term	447	590
Notes payable-long term	13,605	--
STOCKHOLDERS' EQUITY		
Common stock, \$.01 par value; 40,000,000 shares authorized; 21,395,137 and 10,310,877 shares issued and outstanding at June 30, 2000 and 1999, respectively	214	103
Additional paid-in capital	34,446	28,515
Retained earnings	73,841	48,945
Accumulated other comprehensive income	(141)	(123)
	-----	-----
Total stockholders' equity	108,360	77,440
	-----	-----
Total liabilities and stockholders' equity	\$ 144,217	\$ 97,511
	=====	=====

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)
YEAR ENDED JUNE 30,

	2000 -----	1999 -----	1998 -----
Net revenues	\$ 140,944	\$ 106,571	\$ 85,544
Cost of revenues	39,146	34,237	30,084
	-----	-----	-----
Gross profit	101,798	72,334	55,460
Operating expenses:			
Selling, general and administrative	39,475	33,002	27,879
Research and development	28,862	20,709	14,476
	-----	-----	-----
Total operating expenses	68,337	53,711	42,355
	-----	-----	-----
Income from operations	33,461	18,623	13,105
Interest income	2,430	1,336	1,084
Interest expense	(731)	(51)	--
Equity loss in joint venture	(3,721)	--	--
Gain on sale of division, net	4,820	--	--
Other income (expense), net	86	185	(30)
	-----	-----	-----
Income before income tax provision	36,345	20,093	14,159
Income tax provision	11,449	6,631	5,428
	-----	-----	-----
Net income	\$ 24,896	\$ 13,462	\$ 8,731
	=====	=====	=====
Net income per common share:			
Basic	\$ 1.19	\$ 0.66	\$ 0.60
	=====	=====	=====
Diluted	\$ 1.10	\$ 0.62	\$ 0.47
	=====	=====	=====
Weighted average number of common and common equivalent shares outstanding:			
Basic	21,000	20,336	14,470
	-----	-----	-----
Diluted	22,703	21,600	18,540
	=====	=====	=====

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE
30, 2000, 1999, AND 1998
(IN THOUSANDS)

	Series A Convertible Preferred Stock		Common Stock		Add'l Paid-In Capital	Retained Earnings	Accumulated Other Compre- hensive Income	Compre- hensive Income	Subscriptions and Related Parties Notes Receivable	Total Stock- holder's Equity
	Shares	Amount	Shares	Amount						
Balance, June 30, 1997	\$852	\$1,200	5,202	\$ 52	\$ 5,703	\$26,752	\$ (60)		\$(325)	\$33,322
Exercise of common stock options			204	2	506					508
Issuance of common stock pursuant to initial public offering, net of issuance costs of \$952			2,000	20	18,558					18,578
Conversion of series A convertible Preferred stock into common stock	(852)	(1,200)	2,557	26	1,174					--
Exercise of common stock warrants			10		20					20
Comprehensive income:										
Net income						8,731		8,731		8,731
Foreign currency translation							(119)	(119)		(119)
Comprehensive income								\$ 8,612		
Balance June 30, 1998	--	--	9,973	100	25,961	35,483	(179)		(325)	61,040
Exercise of common stock options			309	3	1,213					1,216
Issuance of common stock in Conjunction with employee Stock purchase plan			29		469					469
Tax benefit from disqualified Dispositions					826					826
Stock compensation					46					46
Payment of notes by related parties									325	325
Comprehensive income:										
Net income						13,462		13,462		13,462
Unrealized loss on securities							(30)	(30)		(30)
Foreign currency translation							86	86		86
Comprehensive income								\$13,518		
Balance June 30, 1999	--	--	10,311	\$103	\$28,515	\$48,945	\$(123)		--	\$77,440
Exercise of common stock options			169	1	1,148					1,149
Two-for-one stock split			10,480	105	(105)					--
Exercise of common stock options			396	4	1,851					1,855
Issuance of common stock in Conjunction with employee stock purchase plan			39	1	736					737
Tax benefit from disqualified Dispositions					1,877					1,877
Stock compensation					424					424
Comprehensive income:										
Net income						24,896		24,896		24,896
Unrealized loss on securities							(41)	(41)		(41)
Foreign currency translation							23	23		23
Comprehensive income								\$24,878		
Balance June 30, 2000	--	--	21,395	\$214	\$34,446	\$73,841	\$(141)		--	\$108,360

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS) YEAR ENDED JUNE 30,

	2000	1999	1998
	-----	-----	-----
Cash flows from operating activities:			
Net income	\$ 24,896	\$ 13,462	\$ 8,731
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization of property and equipment	4,786	3,916	2,829
Gain on sale of division, net	(4,820)	--	--
Amortization of capitalized software development costs	313	602	490
Equity loss in joint venture	3,721	--	--
Provision for inventory write-downs	1,012	2,786	1,583
Stock option compensation expense	424	46	--
Provision for doubtful accounts	--	249	99
Deferred income taxes	590	(1,187)	(1,133)
Tax benefit from disqualified dispositions	1,877	826	--
Changes in assets and liabilities:			
Trade accounts receivable	1,504	(11,871)	(4,596)
Contracts in progress	--	--	1,096
Inventory	(4,673)	(6,048)	(2,398)
Prepaid expenses and other current assets	(690)	(108)	(560)
Other assets	71	(98)	(69)
Accounts payable	3,654	2,216	570
Accrued expenses and compensation	674	1,874	1,908
Billings in excess of revenues and customer advances	(366)	2,151	(1,847)
Income taxes payable	(2,311)	284	411
	-----	-----	-----
Net cash provided by operating activities	30,662	9,100	7,114
	-----	-----	-----
Cash flows from investing activities:			
Purchase of marketable securities	(127,019)	(114,574)	(73,571)
Sale of marketable securities	86,230	121,768	44,605
Purchases of property and equipment	(6,637)	(19,440)	(6,336)
Investment in joint venture	(3,500)	--	--
Proceeds from sale of division, net of selling costs	5,032	--	--
Capitalized software development costs	--	(810)	(111)
Note receivable from related parties	--	325	--
	-----	-----	-----
Net cash used in investing activities	(45,894)	(12,731)	(35,413)
	-----	-----	-----
Cash flows from financing activities:			
Proceeds from employee stock purchase program	737	469	--
Proceeds from exercise of stock options	3,004	1,216	508
Proceeds from issuance of common stock	--	--	18,578
Proceeds from exercise of stock warrants	--	--	20
Proceeds from issuance of notes	14,500	--	--
Payments of debt	(318)	--	--
Principal payments under capital lease obligations	(510)	(303)	--
	-----	-----	-----
Net cash provided by financing activities	17,413	1,382	19,106
	-----	-----	-----
Net decrease in cash and cash equivalents	2,181	(2,249)	(9,193)
Effect of exchange rate changes on cash and cash equivalents	(7)	(129)	54
Cash and cash equivalents at beginning of year	3,676	6,054	15,193
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 5,850	\$ 3,676	\$ 6,054
	=====	=====	=====
Cash paid during the year for:			
Interest	\$ 685	\$ 51	\$ --
Income taxes	12,692	7,155	6,166
Non-cash transactions:			
Equipment acquired under capital leases	\$ 513	\$ 1,327	\$ --
Series A convertible preferred stock converted to common stock	--	--	1,200

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(TABLES IN THOUSANDS EXCEPT FOR SHARE AND PER SHARE DATA)

A. DESCRIPTION OF BUSINESS:

Mercury Computer Systems, Inc. (the "Company") designs, manufactures and markets high-performance real-time digital signal processing computer systems, which transform sensor-generated data into information that can be displayed as images for human interpretation or subjected to additional computer analysis. These multicomputer systems are heterogeneous and scalable, allowing them to accommodate several different microprocessor types and to scale from a few to hundreds of microprocessors within a single system. The two primary markets for the Company's products are defense electronics and medical diagnostic imaging. Both of these markets have computing needs, which benefit from the unique system architecture developed by the Company.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

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

REVENUE RECOGNITION. Revenue from product sales is recorded upon receipt of a customer purchase order or where applicable, a signed contract executed by both parties, provided that delivery has occurred and customer acceptance is not uncertain and collectability is deemed probable. The Company accrues for anticipated warranty costs upon shipment. Service revenue is recognized ratably over applicable contract periods or as the services are performed. Revenue from contracts involving significant product modification or customization that are eligible for the percentage-of-completion accounting method are recognized on an efforts-expended basis. Changes to total estimated costs and anticipated losses, if any, are recognized in the period in which determined. There was no revenue recognized for year ended June 30, 2000 and 1999 under the percentage-of-completion method while \$3,835,000 of revenue was recognized under the percentage-of-completion method for the fiscal year ended June 30, 1998. There were no retainages at June 30, 2000, 1999, or 1998.

BILLINGS IN EXCESS OF REVENUES AND CUSTOMER ADVANCES. Billings in excess of revenues and customer advances include amounts billed on uncompleted contracts and amounts billed on annual maintenance contracts.

CASH AND CASH EQUIVALENTS. Cash equivalents, consisting of money market funds and U.S. government and U.S. government agency issues with original maturities of 90 days or less, are carried at fair value.

MARKETABLE SECURITIES. The Company classifies investments in marketable securities as either trading, available-for-sale or held-to-maturity at the time of purchase and periodically re-evaluates such classification. There were no securities classified as trading or held-to-maturity as of June 30, 2000 and 1999. Securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at cost with corresponding premiums or discounts amortized over the life of the investment to interest income. Securities classified as available-for-sale are reported at fair market value. Unrealized gains or losses on available-for-sale securities are included, net of tax, in accumulated other comprehensive income in shareholder's equity until disposition. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in other income. The cost of securities sold is based on the specific identification method.

The fair market value of cash equivalents and short-term and long-term investments in marketable securities represents the quoted market prices at the balance sheet dates. The short-term marketable securities have original maturities greater than 90 days and remaining maturities less than one year. Long-term marketable securities have remaining maturities greater than one year. Long-term marketable securities have maturities of one to three years. At June 30, 2000 and 1999, marketable securities were classified as follows:

	2000 Available- For-Sale	1999 Available- For-Sale
Short-term marketable securities:		
Municipal/tax free bonds & money market instruments	\$36,784	\$12,762
Long-term marketable securities:		
Municipal/tax free bonds	\$25,705	\$8,978

CONCENTRATION OF CREDIT RISK . Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, marketable securities and trade accounts receivable. The Company places its cash and cash equivalents with financial institutions which management believes are of high credit quality. At June 30, 2000 and 1999, the Company had approximately \$3,088,000 and \$2,904,000, respectively, on deposit or invested with its primary financial and lending institution

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

YEAR ENDED JUNE 30,	2000	1999
Customer A	25%	3%
Customer B	6%	27%
Customer C	5%	17%
Customer D	8%	11%

INVENTORY. Inventory is stated at the lower of cost, determined on the first-in, first-out (FIFO) basis, or market.

PROPERTY AND EQUIPMENT. Property and equipment are recorded at cost. 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 following estimated useful lives of the assets using the straight-line method:

Computer equipment	3 years
Machinery and equipment	5 years
Furniture and fixtures	5 years
Buildings	15 - 30 years
Building improvements	10 years
Leasehold improvements	Shorter of the lease term or economic life

Expenditures for additions, renewals and betterment of property and equipment are capitalized. Expenditures for repairs and maintenance are charged to expense as incurred. 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.

CAPITALIZED SOFTWARE DEVELOPMENT COSTS. The Company capitalizes software development costs incurred after a product's technological feasibility has been established and before it is available for general release to customers. Amortization of capitalized software costs is computed on an individual product basis and is the greater of a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or b) the straight-line method over the estimated economic life of the product. The Company uses an estimated economic life of two years or less for all capitalized software costs. No costs were eligible for capitalization during the year ended June 30, 2000.

RESEARCH AND DEVELOPMENT COSTS. Research and development costs are expensed as incurred.

INCOME TAXES. 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 liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using currently 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.

NET INCOME PER COMMON SHARE. The Company previously adopted SFAS No. 128, "Earnings per Share" (Statement 128). Statement 128 specifies the calculation and presentation of basic and diluted net income per share. Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is calculated by dividing net income by the sum of the weighted average number of common shares plus additional common shares that would have been outstanding if potential dilutive common shares had been issued for granted stock options.

FOREIGN CURRENCY. 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 local currency for all foreign subsidiaries is the functional currency. The related translation adjustments are reported in accumulated other comprehensive income in stockholders' equity. Gains (losses) resulting from foreign currency transactions are included in other income (expense) and are immaterial for all periods presented.

RECLASSIFICATION. Certain reclassifications have been made to the prior years' financial statements to conform to the current year's presentation.

NEW ACCOUNTING PRONOUNCEMENTS. In June 1999, the Financial Accounting Standards Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which was issued in June 1998. SFAS No. 137 defers the effective date of SFAS No. 133 to the first quarter of fiscal years beginning after June 15, 2000. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in either current earnings or accumulated other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and the type of hedge transaction. As of July 1, 2000, The Company did not hold any derivative instruments.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements". SAB 101 summarizes the staff's view in applying generally accepted accounting principles to selected revenue recognition issues. The application of the guidance in SAB 101 will be required in the Company's fourth quarter of fiscal year 2001. The effects of applying this guidance will be reported as a cumulative effect adjustment resulting from a change in accounting principle. The Company has not completed its evaluation of SAB 101 and therefore is unable to determine its impact.

C. NET INCOME PER COMMON SHARE:

The following table sets forth the computation of basic and diluted net income per common share:

FOR THE YEARS ENDED JUNE, 30	2000	1999	1998
Net income	\$24,896	\$ 13,462	\$ 8,731
	=====	=====	=====
Shares used in computation of net income per share - basic	21,000	20,336	14,470
effect of dilutive securities:			
Convertible preferred stock	--	--	2,984
Stock options	1,703	1,264	1,084
Warrants	--	--	2
	-----	-----	-----
Dilutive potential common shares	1,703	1,264	4,070
	-----	-----	-----
Shares used in computation of diluted net income per share	22,703	21,600	18,540
	=====	=====	=====
Net income per share - basic	\$ 1.19	\$ 0.66	\$ 0.60
	=====	=====	=====
Net income per share - dilutive	\$ 1.10	\$ 0.62	\$ 0.47
	=====	=====	=====

Options to purchase 141,000 shares of common stock in 2000, 222,000 shares in 1999, and 58,000 in 1998 were outstanding during the years then ended but were not included in the year-to-date calculation of diluted net income per share because the options' exercise price was greater than the average market price of the common shares during those periods.

D. INVENTORY:

Inventory consists of the following:

JUNE 30,	2000	1999
Raw materials	\$ 4,252	\$ 3,508
Work in process	7,415	6,841
Finished goods	4,308	2,082
	-----	-----
Total	\$ 15,975	\$ 12,431
	=====	=====

E. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

JUNE 30,	2000	1999
Computer equipment and software	\$ 22,406	\$ 17,280
Buildings	15,819	15,819
Land	2,985	1,852
Machinery and equipment	605	404
Furniture and fixtures	3,709	3,365
Building and leasehold improvements	1,585	1,334
	-----	-----
	47,109	40,054
Less: accumulated depreciation and amortization	(19,535)	(14,729)
	-----	-----
	\$ 27,574	\$ 25,325
	=====	=====

During the fiscal year ended June 30, 1999, the Company purchased its existing headquarters building and an adjacent newly constructed facility, including land for \$15,058,000. In addition, during the fiscal year ended June 30, 1999, \$1,289,000 of property and equipment was retired of which \$1,260,000 was fully depreciated.

During the fiscal year ended June 30, 2000 the Company invested \$1.1 million for the purchase of land adjacent to its existing headquarters.

F. COMMITMENTS AND CONTINGENCIES:

LONG TERM DEBT FINANCING ARRANGEMENT. Long-term debt at June 30, 2000 and 1999 consisted of the following:

	2000	1999
Notes payable	\$14,182	--
Less current maturities	577	--
	-----	-----
	\$13,605	--
	=====	=====

On November 3, 1999, the Company completed a lending agreement with a commercial financing company, issuing two 7.30% senior secured financing notes (the "Notes"), due November 2014. The original principle value of the Notes amounted to \$14,500,000. The Notes are collateralized by the Company's corporate headquarters, which consists of two buildings. The Notes' agreements contain certain covenants, which, among other provisions, require the Company to maintain a minimum tangible net worth. As of June 30, 2000, the Company was in compliance with the covenants of the Notes' agreements.

Maturities of long term debt are as follows:

Year ending June 30,

2001	\$ 577
2002	621
2003	667
2004	718
2005	772
Thereafter	10,827

	\$14,182
	=====

During the fiscal year ended June 30, 1999, the Company had a credit agreement with a commercial bank to borrow up to \$5,000,000 at an interest rate equal to the prime rate or, at the election of the Company, two and one-quarter percentage points above the London InterBank Offered Rate, payable monthly. The credit agreement contained certain covenants, including restrictions on incurrence of additional indebtedness and liens on its assets, capital expenditures, disposition of assets, investments and acquisitions, limitations on distributions, and required the Company to meet certain financial tests pertaining to current and debt ratios and income before tax provision. During the fiscal year ended June 30, 1999, the Company terminated this financing arrangement. Accordingly, there were no borrowings outstanding at June 30, 2000 or 1999.

LEGAL. In July 1999, a former employee brought a wrongful termination action against the Company and certain officers of the Company. The plaintiff seeks severance pay, the right to purchase 60,000 shares of the Company's common stock at a price of \$2.00 per share, the right to exercise 96,000 stock options at an exercise price of \$2.00 per share, and other financial consideration. Discovery has commenced and the action has been referred to binding arbitration. The position of the Company's management after consultation with external counsel, is that it is not possible to estimate the amount of a probable loss, if any, to the Company that might result from this action. Accordingly, no loss accrual has been recorded. If the plaintiff were to prevail on its claims, depending on the price of the Company's common stock, a judgement for a material amount could be awarded against the Company. The Company has objected to the claims and is aggressively defending the matter.

LEASE COMMITMENTS. The Company leases certain of its facilities and machinery and equipment under capital and operating leases expiring in various years through 2000. The leases contain various renewal options. Rental charges are subject to escalation for increases in certain operating costs of the lessor.

Minimum lease payments under operating and capital leases are as follows:

YEAR ENDING JUNE 30,	Real Estate	Operating lease Equipment	Capital Lease Equipment
2001	191	264	679
2002	175	---	325
2003	40	---	100
	----	----	-----
Total minimum lease payments	\$406	\$264	\$1,104
	=====	=====	=====
Less: amounts representing interest			77

Present value of minimum lease payments			1,027
Less: current portion			580

Long-term portion			\$ 447
			=====

Rental expense during the fiscal years ended June 30, 2000, 1999 and 1998 was approximately \$524,000, \$1,116,000 and \$1,029,000, respectively.

G. STOCKHOLDERS' EQUITY:

The Company is authorized to issue 1,000,000 shares of preferred stock with a par value of \$.01 per share.

COMMON STOCK. On November 18, 1999, the Company's Board of Directors authorized a two-for-one stock split effected in the form of a 100% stock dividend distributed on December 21, 1999 to shareholders of record as of December 6, 1999. As a result of the stock split, the accompanying consolidated financial statements reflect an increase in the number of outstanding shares of common stock and the transfer of the par value of these additional shares from paid-in capital. All share and per share amounts have been restated to reflect the retroactive effect of the stock split, except the capitalization of the Company.

SERIES A CONVERTIBLE PREFERRED STOCK. The series A convertible preferred stock had a liquidation preference of \$1.41 per share and voting rights similar to the common stock. Each of the preferred stockholders had one vote for each share of common stock into which the series A convertible preferred stock was convertible. On January 29, 1998, the series A convertible preferred stock was converted into common stock on a three-for-one basis.

H. STOCK BASED COMPENSATION

At June 30, 2000, the Company had both stock option plans and a stock purchase plan. In fiscal year 1997, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation" SFAS No. 123 requires that companies either recognize compensation expense for grants of stock, stock options and other equity instruments based on fair value or provide pro forma disclosure of net income and earnings per share in the notes to the financial statements. The Company adopted the disclosure provisions of SFAS No. 123 in fiscal 1997 and has applied APB Opinion No. 25 and related interpretations in accounting for all of its stock option and employee stock purchase plans. Compensation cost is measured as the excess, if any, of the fair market value of the Company's stock at the date of grant over the amount an individual must pay to acquire the stock. Compensation expense recognized for stock based compensation amounted to \$424,000, \$46,000, and \$0 for the fiscal years ended June 30, 2000, 1999, and 1998, respectively.

STOCK OPTION PLANS. The Company has five stock option plans. The 1982, 1991, and 1993 Stock Option Plans (the "Plans") provide for the granting of options to purchase an aggregate of not more than 1,950,000 shares of the Company's common stock to employees and directors. Under these plans, options are granted at not less than the fair value of the stock on the date of grant as determined by the Board. The terms of the options are established by the Board on an individual basis. The options generally vest between three and five years and have a maximum term of ten years.

The 1997 Stock Option Plan (the "1997 Plan"), which the Board approved in June 1997, provides for the granting of options to purchase an aggregate of not more than 1,325,000 shares of the Company's common stock. The Plan provides for the grant of non-qualified and incentive stock options to employees. Incentive stock options are granted at a price set by the Board of Directors not to be less than 100% of the fair value at the date of the grant. Non-qualified stock options are granted at not less than 50% of the fair value of the stock on the date of grant as determined by the Board. The options vest over five years and have a maximum term of ten years. In 1999, an amendment to the plan was adopted by the Board of Directors of the Corporation, which provided for an increase in the number of shares reserved for issuance under the Plan from 1,325,000 shares of common stock to 2,325,000 and a reduction in the vesting period for future options from five to four years. With the implementation of the 1997 Plan, no further stock options were granted under the 1982 and 1991 Stock Option Plans.

The 1998 Stock Option Plan (the "1998 Plan"), which the Board approved in September 1998, provides for the granting of options to purchase an aggregate of not more than 50,000 shares of the Company's common stock. The Plan provides for the grant of non-qualified stock options to non-employee directors. Non-qualified stock options are granted at fair value of the stock at the date of the grant as determined by the Board of Directors. The options vest over three years and have a maximum term of ten years. With the implementation of the 1998 Plan, no further stock options were granted under the 1993 Stock Option Plan.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value of Options Granted
Outstanding at June 30, 1997	1,689,184	1.71	
Granted	942,262	4.71	\$ 2.64
Exercised	(408,936)	1.24	
Canceled	(33,386)	3.56	

Outstanding at June 30, 1998	2,189,124	3.06	

Granted	1,271,410	9.65	\$ 6.04
Exercised	(618,324)	1.97	
Canceled	(76,454)	5.18	

Outstanding at June 30, 1999	2,765,756	6.27	

Granted	928,684	26.42	\$19.03
Exercised	(734,592)	4.09	
Canceled	(258,000)	8.67	

Outstanding at June 30, 2000	2,701,848	13.56	
	=====		

Information related to the stock options outstanding as of June 30, 2000, is as follows:

Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable Number of Options	Exercisable Weighted Average Exercise Price
\$ 1.25 - \$ 4.00	701,578	6.73	\$2.99	253,778	\$2.72
\$ 5.00 - \$ 8.625	462,686	8.21	7.73	60,961	7.64
\$ 8.844 - \$ 9.563	139,400	8.04	9.03	32,030	8.96
\$ 11.688 - \$ 11.688	473,900	8.63	11.69	57,900	11.69
\$ 12.00 - \$ 23.438	604,684	9.28	20.13	4,360	12.66
\$ 24.25 - \$ 48.00	319,600	9.65	37.50	--	--
	-----			-----	
\$ 1.25 - \$ 48.00	2,701,848	8.30	13.56	409,029	5.32
	=====			=====	

There were 605,612 and 754,480 options exercisable at June 30, 1999 and 1998, respectively, with weighted average exercise prices of \$2.77 and \$1.79. The fair value of each option granted during fiscal years ended June 30, 2000, 1999 and 1998, is estimated on the date of grant using the Black-Scholes option-pricing model utilizing the following weighted-average assumptions: (1) expected risk-free interest rate of 6.34% in 2000, 4.90% in 1999 and 6.25% in 1998; (2) expected option life of 6 years; (3) expected stock volatility of 77% for June 30, 2000, 63% for June 30, 1999 and 50% for June 30, 1998; and (4) expected dividend yield of 0.0%.

EMPLOYEE STOCK PURCHASE PLAN. During 1997, the Company adopted the 1997 Employee Stock Purchase Plan ("ESPP") and authorized 250,000 shares for future issuance under which 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 plan permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the plan. During the two offerings in fiscal 2000, the Company issued 22,923 and 15,868 shares of common stock to employees who participated in the plan at prices of \$13.39 and \$27.47, respectively. Shares available for future purchase under the ESPP totaled 404,761 at June 30, 2000.

The weighted-average fair value of purchase rights granted in fiscal 2000 and 1999 was \$8.40 and \$3.23, respectively. The fair value of the employees' purchase rights was estimated using the Black-Scholes model with the following assumptions; dividend yield of 0.0%, an expected life of 6 months, expected volatility of 77% for June 30, 2000 and 63% for June 30, 1999, and risk-free interest rate of 5.25% for June 30, 2000 and 4.9% for June 30, 1999.

Had compensation cost for the Company's stock option grants and stock issued in conjunction with the ESPP been determined based on the fair value at the grant dates, as calculated in accordance with SFAS No. 123, the Company's net income and net income per common share for the fiscal years ended June 30, 2000, 1999 and 1998, would approximate the following pro forma amounts as compared to the amounts reported:

	Net Income	Net Income per Common Share - Basic	Net Income per Common Share - Diluted
As reported:			
2000	\$24,896	\$ 1.19	\$ 1.10
1999	\$13,462	\$ 0.66	\$ 0.62
1998	\$ 8,731	\$ 0.60	\$ 0.47
Pro forma:			
2000	\$20,791	\$ 0.99	\$ 0.92
1999	\$11,950	\$ 0.59	\$ 0.55
1998	\$ 8,244	\$ 0.57	\$ 0.44

The effects of applying SFAS No. 123 in this disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to 1995 and additional awards in future years are anticipated.

I. INCOME TAXES:

Income tax expense consisted of the following:

YEAR ENDED JUNE 30,	2000	1999	1998
Federal:			
Current	\$10,081	\$6,377	\$ 5,680
Deferred	544	(479)	(1,172)
	-----	-----	-----
	10,625	5,898	4,508
State:			
Current	755	1,295	925
Deferred	46	(708)	(111)
	-----	-----	-----
	801	587	814
Foreign - current	23	146	106
	-----	-----	-----
	\$11,449	\$6,631	\$ 5,428
	=====	=====	=====

The following is a reconciliation between the statutory provision for federal income taxes and the effective income tax expense:

YEAR ENDED JUNE 30,	2000	1999	1998
Income taxes at federal statutory rates	35.0%	35.0%	35.0%
State income tax, net of federal tax benefit and credits	1.3	1.9	3.7
Research and development credits utilized	(3.4)	(3.8)	(2.2)
Tax-exempt interest income	(1.6)	(1.8)	--
Other	0.2	1.7	1.8
	-----	-----	-----
	31.5	33.0	38.3
	=====	=====	=====

The components of the net deferred tax asset are as follows:

JUNE 30,	2000	1999
Receivables, allowances and inventory reserves	\$1,083	\$1,654
Accrued vacation	402	368
Property and equipment	167	301
Capitalized software development costs	--	(125)
State tax credit carryforwards	620	491
Other temporary differences	424	596
	-----	-----
Total deferred tax asset, net	\$2,696	\$3,285
	=====	=====

No valuation allowance was deemed necessary for the deferred tax asset. Management believes it is more likely than not that all of the deferred tax asset will be realized.

At June 30, 2000, the Company had state research and development tax credit carryforwards of approximately \$954,000 which begin to expire in 2014.

J. EMPLOYEE BENEFIT PLANS:

The Company maintains a qualified 401(k) Plan and up until December 31, 1999, maintained a qualified profit sharing 401(a) plan. The plan covers employees who have attained the age of 21. Employee contributions to the 401(k) Plan may range from 1% to 15% of compensation with a discretionary matching Company contribution. Effective January 1, 2000, the Company began matching up to 3% of compensation. Previously, the company matched up to 2% of compensation. The Company may also make optional contributions to the plan for any plan year at its discretion. The Company terminated its 401(a) plan as December 31, 1999.

Expense recognized by the Company under the 401(a) and 401(k) plans was approximately \$788,000, \$1,000,000 and \$710,000 during the years ended June 30, 2000, 1999 and 1998, respectively.

The Company maintains a bonus plan, which provides cash awards to employees based upon operating results and employee performance. Bonus expense to employees was approximately \$4,499,000, \$2,753,000, and \$1,988,000 during the years ended June 30, 2000, 1999 and 1998, respectively.

K. OPERATING SEGMENT AND GEOGRAPHIC INFORMATION:

The Company adopted SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" (Statement No. 131), in fiscal 1999. This Statement supersedes SFAS No. 14 "Financial Reporting for Segments of a Business Enterprise," but retains the requirement to report information about major customers. This statement establishes standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also establishes standards for related disclosures about products and services and geographic areas.

Operating segments are defined as components of an enterprise evaluated regularly by the Company's senior management in deciding how to allocate resources and in assessing performance. The Company has eight principal operating segments; North American defense and commercial, international defense and commercial, medical imaging, shared storage, wireless communications, digital video, research and development, and other commercial businesses. These operating segments were determined based upon the nature of the products offered to customers, the market characteristics of each operating segment, and the Company's management structure. The Company has six reportable segments; North American defense and commercial segment, international defense and commercial segment, medical imaging segment, shared storage segment, other defense and commercial segment, and research and development segment. The other commercial segment is comprised of wireless communications, digital video and other commercial businesses unrelated to the defense, medical imaging or shared storage businesses. These operating segments are not separately reported, as they do not meet any of Statement No. 131's quantitative thresholds. Effective January 18, 2000 the Company sold it's shared storage division, see note L.

The accounting policies of the business segments are the same as those described in "Note B: Summary of Significant Accounting Policies".

	North American Defense and Commercial Segment (2)	International Defense and Commercial Segment(2)	Medical Imaging Segment	Shared Storage Segment	Other Commercial Segment	Research and Development Segment	Corporate	Consolidated
2000								
Sales to unaffiliated customers	\$96,901	\$14,326	\$27,093	\$ 1,841	\$ 783	\$ --	\$ --	\$140,944
Income (loss) before taxes (1)	66,889	8,016	10,510	(582)	(3,289)	(27,740)	(17,459)	36,345
Depreciation/amortization expense	427	170	41	59	103	1,218	3,081	5,099
1999								
Sales to unaffiliated customers	\$79,906	\$ 8,894	\$15,295	\$ 2,232	\$ 244	\$ --	\$ --	\$106,571
Income (loss) before taxes(1)	53,174	(1,090)	6,353	(1,775)	3,837	(19,639)	(20,767)	20,093
Depreciation/amortization expense	191	11	70	102	--	1,263	2,881	4,518
1998								
Sales to unaffiliated customers	\$66,074	\$ 7,096	\$11,232	\$ 885	\$ 257	\$ --	\$ --	\$ 85,544
Income (loss) before taxes(1)	40,399	(635)	4,499	(3,423)	2,177	(12,917)	(15,941)	14,159
Depreciation/amortization expense	155	15	68	52	--	924	2,105	3,319

(1) Interest income, interest expense and foreign exchange gain/(loss) are reported in Corporate and not allocated to the principal operating segments. Only expenses directly related to an operating segment are charged to the appropriate operating segment. All other expenses for marketing and administrative support activities that cannot be specifically identified with a principal operating segment are allocated to Corporate.

(2) The North American defense and commercial segment and the International defense and commercial segment differ in definition from the defense market segment described in the Company's management discussion and analysis ("MD&A"). The defense market segment in the MD&A refers to the worldwide defense market. The North American defense and commercial segment and the International defense and commercial are operating segments as defined by Statement No. 131 and are subsets of the worldwide defense market discussed in the MD&A.

Foreign revenue is based on the country in which the legal subsidiary is domiciled. Foreign revenue and long-lived assets represent less than 10% of the Company's total long-lived assets for the fiscal years ended June 30, 2000, 1999, and 1998 respectively.

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

	YEAR ENDED JUNE 30,	2000	1999	1998
Customer D		12%	12%	10%
Customer E		14%	16%	--
Customer B		19%	22%	20%
Customer A		12%	--	10%

L. SALE OF DIVISION:

On January 18, 2000, the Company completed the sale of the SSBU to IBM. Payments are structured with an initial payment of \$4,500,000 (excluding \$1,000,000 to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of \$1,500,000 plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The contingency payments of \$1,500,000 are recognized when collected. The Company has recorded a \$4,820,000 gain on the sale of this division which includes cash received of \$6,100,000 less legal and advisory costs of \$581,000, costs reimbursable to IBM of \$499,000, and the net book value of equipment and inventories sold of \$200,000.

M. EQUITY LOSS IN JOINT VENTURE:

In September, 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television ("DTV"). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's contribution to AgileVision was \$3,500,000 in cash. During the year ended June 30, 2000, the Company recognized \$3,721,000 in expenses related to the operation of AgileVision. The Company has funded the losses of AgileVision to date and as of June 30, 2000, intends to continue to fund this venture. No expenses were recognized during the year ended June 30, 1999.

Summarized Income Statement results for AgileVision during the year ended June 30, 2000 are as follows:

Expenses	\$(3,721)

Loss from continuing operations	(3,721)

Net loss	\$(3,721)
	=====

Summarized Statement of Financial Position of AgileVision as of June 30, 2000:

Current assets	\$ 1,009
Non-current assets	12

Total assets	\$ 1,021
	=====
Current liabilities	\$ 2,744
Shareholders' equity	(1,723)

Total liabilities and equity	\$ 1,021
	=====

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) on page 37 present fairly, in all material respects, the financial position of Mercury Computer Systems, Inc. and its subsidiaries at June 30, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2000 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 14(a)(2) on page 38 present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PRICEWATERHOUSECOOPERS LLP

Boston, Massachusetts
August 17, 2000

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item is incorporated herein by reference to the Company's Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the Company's Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated herein by reference to the Company's Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company had loaned James R. Bertelli, President of the Company, an aggregate of \$200,000, of which \$150,000 accrued interest at an annual rate of 9.75% and \$50,000 accrued interest at an annual rate of 10.5%. In addition, the Company had loaned Albert Belle Isle, a Director of the Company, an aggregate of \$125,000, of which \$100,000 accrued interest at an annual interest rate of 8% and \$25,000 accrued interest at 9.25%. The notes evidencing such obligations of Mr. Bertelli and Dr. Belle Isle were paid in full in October, 1998.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(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:

Consolidated Balance Sheets as of June 30, 2000 and 1999

Consolidated Statements of Operations for the years ended June 30, 2000, 1999, and 1998

Consolidated Statements of Stockholders' Equity for the years ended June 30, 2000, 1999, and 1998

Consolidated Statements of Cash Flows for the years ended June 30, 2000, 1999, and 1998 Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

II. Valuation and Qualifying Accounts

MERCURY COMPUTER SYSTEMS, INC.
 SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
 FOR THE YEARS ENDED JUNE 30, 2000, 1999, AND 1998
 (IN THOUSANDS)

	BALANCE AT BEGINNING OF PERIOD -----	CHARGES TO EXPENSES -----	DEDUCTIONS -----	BALANCE AT END OF PERIOD -----
Allowance for Doubtful Accounts				
2000	\$376	--	\$68	\$308
1999	218	249	91	376
1998	119	99	--	218

	BALANCE AT BEGINNING OF PERIOD -----	CHARGES TO EXPENSES -----	DEDUCTIONS -----	BALANCE AT END OF PERIOD -----
Inventory Reserve				
2000	\$3,039	\$1,012	\$1,256	\$2,795
1999	1,857	2,786	1,604	3,039
1998	1,723	1,583	1,449	1,857

Charges to expenses for inventory are due to program cancellations, engineering change orders and obsolescence. Deductions are recorded when the inventory is written off. The Company wrote off \$1,256,000, \$1,604,000, \$1,449,000 during the years ended June 30, 2000, 1999, and 1998 respectively, in inventory relating primarily to engineering change orders and obsolescence.

3. Exhibits:

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index on page 40, which is incorporated herein by reference.

(b) Reports on Form 8-K

None.

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 Chelmsford, Massachusetts, on September 18, 2000.

MERCURY COMPUTER SYSTEMS, INC.

BY: /s/ G. MEAD WYMAN

G. MEAD WYMAN
SENIOR VICE PRESIDENT, CHIEF
FINANCIAL OFFICER AND TREASURER

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.

SIGNATURE	TITLE(S)	DATE
/s/ JAMES R. BERTELLI ----- James R. Bertelli	President, Chief Executive Officer and Director (principal executive officer)	September 18, 2000
/s/ G. MEAD WYMAN ----- G. Mead Wyman	Senior Vice President, Chief Financial Officer and Treasurer (principal financial and accounting officer)	September 18, 2000
/s/ GORDON B. BATY ----- Gordon B. Baty	Director	September 18, 2000
/s/ R. SCHORR BERMAN ----- R. Schorr Berman	Director	September 18, 2000
/s/ ALBERT P. BELLE ISLE ----- Albert P. Belle Isle	Director	September 18, 2000
/s/ SHERMAN N. MULLIN ----- Sherman N. Mullin	Director	September 18, 2000
/s/ MELVIN SALLEN ----- Melvin Sallen	Director	September 18, 2000

EXHIBIT INDEX

ITEM NO.	DESCRIPTION OF EXHIBIT
3.1	Organization. (incorporated herein by reference to Exhibit 3.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
3.2	Bylaws. (incorporated herein by reference to Exhibit 3.2 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
3.3	Articles of Amendment to Articles of Organization. (incorporated herein by reference to Exhibit 3.3 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
4.1	Form of Stock Certificate. (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.1	1982 Stock Option Plan, as amended. (incorporated herein by reference to Exhibit 10.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.2	1991 Stock Option Plan, as amended. (incorporated herein by reference to Exhibit 10.2 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.3	1993 Stock Option Plan for Non-Employee Directors. (incorporated herein by reference to Exhibit 10.3 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.4	1997 Stock Option Plan. (incorporated herein by reference to Exhibit 10.4 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.5	1997 Stock Purchase Plan. (incorporated herein by reference to Exhibit 10.5 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.6	Purchase and Sale Agreement, dated November 8, 1996 between Corcoran Chelmsford & Associates and Northland Development Corporation. (incorporated herein by reference to Exhibit 10.7 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.7#	Term Purchase Agreement, dated July 25, 1995 between the Company and Analog Devices, Inc. (incorporated herein by reference to Exhibit 10.8 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.8#	Risk Reproduction Agreement, dated March 20, 1996, between the Company and LSI Logic Corporation. (incorporated herein by reference to Exhibit 10.9 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.9#	Purchase Offer Agreement for OEM Manufacturer, dated February 16, 1995, between the Company & IBM Microelectronics Division. (incorporated herein by reference to Exhibit 10.10 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.10	Quitclaim Deed, dated October 1, 1997, executed by Corcoran Chelmsford & Associates Limited Partnership. (incorporated herein by reference to Exhibit 10.15 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.11	1998 Stock Option Plan
21.1*	Subsidiaries of the Registrant
23.1*	Consent of PricewaterhouseCoopers L.L.P.
27.1*	Financial Data Schedule.

* Filed with this Form 10-K.

Confidential treatment granted.

SUBSIDIARIES OF THE REGISTRANT

NAME	JURISDICTION OF ORGANIZATION
Mercury Computer Securities Corporation	Massachusetts
Riverneck Road	Delaware
199 Riverneck LLC	Delaware
Mercury Computer International Sales Corporation	Delaware
Mercury Computer Systems BV	The Netherlands
Nihon Mercury Computer Systems KK	Japan
Mercury Computer Systems SARL	France
Mercury Systems Ltd	United Kingdom
Mercury Computer Systems Export, Incorporated	Barbados

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-53291) of Mercury Computer Systems, Inc of our report dated August 17, 2000 relating to the financial statements and financial statement schedule, which appears in this Form 10-K.

PRICEWATERHOUSECOOPERS LLP

Boston, Massachusetts
September 27, 2000

12-MOS		
	JUN-30-2000	
	JUL-01-1999	
	JUN-30-2000	
	1	5,850
	36,784	
	27,408	
	308	
	15,975	
	90,003	47,109
	(19,535)	
	144,217	
21,805		0
	0	0
	0	214
	108,146	
144,217		140,944
	140,944	39,146
	39,146	
	65,453	
	0	
	0	
	36,345	
	11,449	
24,896		0
	0	0
	24,896	0
	1.19	
	1.10	