

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2014

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 0-23599

MERCURY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

MASSACHUSETTS
(State or other jurisdiction of
incorporation or organization)

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

201 RIVERNECK ROAD
CHELMSFORD, MA
(Address of principal executive offices)

01824
(Zip Code)

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

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

Shares of Common Stock outstanding as of January 31, 2015: 34,149,555 shares

MERCURY SYSTEMS, INC.

INDEX

	<u>PAGE NUMBER</u>
PART I. FINANCIAL INFORMATION	
Item 1.	3
Financial Statements (unaudited)	
	3
Consolidated Balance Sheets as of December 31, 2014 and June 30, 2014	
	4
Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended December 31, 2014 and 2013	
	5
Consolidated Statements of Cash Flows for the six months ended December 31, 2014 and 2013	
	6
Notes to Consolidated Financial Statements	
Item 2.	18
Management's Discussion and Analysis of Financial Condition and Results of Operations	
Item 3.	28
Quantitative and Qualitative Disclosures about Market Risk	
Item 4.	28
Controls and Procedures	
PART II. OTHER INFORMATION	
Item 1.	29
Legal Proceedings	
Item 1A.	29
Risk Factors	
Item 6.	29
Exhibits	
	30
Signatures	

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCURY SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	December 31, 2014	June 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 56,987	\$ 47,287
Accounts receivable, net of allowance for doubtful accounts of \$77 and \$34 at December 31, 2014 and June 30, 2014, respectively	47,432	37,625
Unbilled receivables and costs in excess of billings	19,774	22,036
Inventory	30,011	31,655
Deferred income taxes	15,172	15,216
Prepaid income taxes	4,729	1,481
Prepaid expenses and other current assets	3,835	3,631
Current assets of discontinued operations	1,095	1,374
Total current assets	179,035	160,305
Restricted cash	264	265
Property and equipment, net	12,968	14,144
Goodwill	168,146	168,146
Intangible assets, net	21,481	25,006
Other non-current assets	1,238	987
Non-current assets of discontinued operations	2,235	4,859
Total assets	\$ 385,367	\$ 373,712
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 11,300	\$ 7,054
Accrued expenses	8,817	8,377
Accrued compensation	8,979	9,983
Deferred revenues and customer advances	8,778	5,898
Current liabilities of discontinued operations	1,583	1,618
Total current liabilities	39,457	32,930
Deferred gain on sale-leaseback	1,507	2,086
Deferred income taxes	5,021	5,911
Income taxes payable	3,277	3,154
Other non-current liabilities	1,165	1,666
Non-current liabilities of discontinued operations	724	818
Total liabilities	51,151	46,565
Commitments and contingencies (Note I)		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.01 par value; 85,000,000 shares authorized; 32,222,498 and 31,284,273 shares issued and outstanding at December 31, 2014 and June 30, 2014, respectively	322	312
Additional paid-in capital	248,228	241,725
Retained earnings	84,863	84,099
Accumulated other comprehensive income	803	1,011
Total shareholders' equity	334,216	327,147
Total liabilities and shareholders' equity	\$ 385,367	\$ 373,712

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Net revenues	\$ 57,089	\$ 50,932	\$ 111,150	\$ 101,658
Cost of revenues	30,054	26,607	60,116	55,771
Gross margin	27,035	24,325	51,034	45,887
Operating expenses:				
Selling, general and administrative	12,677	13,944	24,967	28,265
Research and development	7,895	10,142	15,846	19,454
Amortization of intangible assets	1,762	1,803	3,524	3,788
Restructuring and other charges	1,162	97	2,430	82
Total operating expenses	23,496	25,986	46,767	51,589
Income (loss) from operations	3,539	(1,661)	4,267	(5,702)
Interest income	4	3	7	4
Interest expense	(8)	(11)	(16)	(26)
Other income, net	398	440	392	872
Income (loss) from continuing operations before income taxes	3,933	(1,229)	4,650	(4,852)
Tax provision (benefit)	1,047	(442)	1,047	(1,761)
Income (loss) from continuing operations	2,886	(787)	3,603	(3,091)
Loss from discontinued operations, net of income taxes	(2,621)	(258)	(2,839)	(210)
Net income (loss)	\$ 265	\$ (1,045)	\$ 764	\$ (3,301)
Basic net earnings (loss) per share:				
Income (loss) from continuing operations	\$ 0.09	\$ (0.02)	\$ 0.11	\$ (0.10)
Loss from discontinued operations, net of income taxes	(0.08)	(0.01)	(0.09)	(0.01)
Net income (loss)	\$ 0.01	\$ (0.03)	\$ 0.02	\$ (0.11)
Diluted net earnings (loss) per share:				
Income (loss) from continuing operations	\$ 0.09	\$ (0.02)	\$ 0.11	\$ (0.10)
Loss from discontinued operations, net of income taxes	(0.08)	(0.01)	(0.09)	(0.01)
Net income (loss)	\$ 0.01	\$ (0.03)	\$ 0.02	\$ (0.11)
Weighted-average shares outstanding:				
Basic	32,052	30,988	31,880	30,820
Diluted	32,686	30,988	32,720	30,820
Comprehensive income (loss):				
Net income (loss)	\$ 265	\$ (1,045)	\$ 764	\$ (3,301)
Foreign currency translation adjustments	(111)	(74)	(208)	(15)
Total comprehensive income (loss)	\$ 154	\$ (1,119)	\$ 556	\$ (3,316)

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

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

	Six Months Ended December 31,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$ 764	\$ (3,301)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	7,150	8,028
Stock-based compensation expense	4,933	5,752
(Benefit) provision for deferred income taxes	(1,314)	796
Impairment of goodwill from discontinued operations	2,283	—
Excess tax benefit from stock-based compensation	(536)	(3)
Other non-cash items	(568)	(527)
Changes in operating assets and liabilities:		
Accounts receivable, unbilled receivables, and costs in excess of billings	(7,103)	7,332
Inventory	1,584	4,319
Prepaid income taxes	(3,587)	(6,312)
Prepaid expenses and other current assets	(182)	560
Other non-current assets	291	336
Accounts payable and accrued expenses	4,126	(6,495)
Deferred revenues and customer advances	2,458	(762)
Income taxes payable	123	—
Other non-current liabilities	(16)	(192)
Net cash provided by operating activities	10,406	9,531
Cash flows from investing activities:		
Purchases of property and equipment	(2,123)	(3,934)
Decrease (increase) in other investing activities	1	(300)
Net cash used in investing activities	(2,122)	(4,234)
Cash flows from financing activities:		
Proceeds from employee stock plans	1,313	580
Excess tax benefit from stock-based compensation	536	3
Payments of capital lease obligations	(320)	(343)
Net cash provided by financing activities	1,529	240
Effect of exchange rate changes on cash and cash equivalents	(113)	(128)
Net increase in cash and cash equivalents	9,700	5,409
Cash and cash equivalents at beginning of period	47,287	39,126
Cash and cash equivalents at end of period	\$ 56,987	\$ 44,535
Cash paid during the period for:		
Interest	\$ 16	\$ 26
Income taxes	\$ 5,512	\$ 5,068
Supplemental disclosures—non-cash activities:		
Issuance of restricted stock awards to employees	\$ 8,832	\$ 8,313
Capital lease financings	\$ —	\$ 494

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

MERCURY SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share data)

(Unaudited)

A. Description of Business

Mercury Systems, Inc. is a leading high-tech commercial provider of more affordable secure and sensor processing subsystems designed and made in the U.S.A. for critical defense and intelligence applications. The Company delivers innovative solutions, rapid time-to-value and service and support to its defense prime contractor customers. The Company's products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-35 and Reaper. The Company's organizational structure allows it to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector. The Company believes its total portfolio of services and solutions is unique in the industry for a commercial company.

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

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

B. Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to the Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures, normally included in annual consolidated financial statements have been condensed or omitted pursuant to those rules and regulations; however, in the opinion of management the financial information reflects all adjustments, consisting of adjustments of a normal recurring nature, necessary for fair presentation. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended June 30, 2014 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on August 14, 2014. The results for the three and six months ended December 31, 2014 are not necessarily indicative of the results to be expected for the full fiscal year.

The Company is comprised of the following operating segments: MCE and MDS. See Note L of the Notes to Consolidated Financial Statements for further discussion.

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

USE OF ESTIMATES

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

REVENUE RECOGNITION

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

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

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

The Company enters into multiple-deliverable arrangements that may include a combination of hardware components, related integration or other services. These arrangements generally do not include any performance-, cancellation-, termination- or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements was 26% and 28% of total revenues in the three and six months ended December 31, 2014, respectively. Total revenue recognized under multiple-deliverable revenue arrangements was 56% and 42% of total revenues in the three and six months ended December 31, 2013, respectively.

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

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

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

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

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

The Company also engages in long-term contracts for development, production and services activities which it accounts for consistent with FASB ASC 605-35, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and other relevant revenue recognition accounting literature. The Company considers the nature of these contracts and the types of products and services provided when determining the proper accounting for a particular contract. Generally for fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method or, for certain short-term contracts, by the completed contract method. Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate input or output methods to measure service provided, and contract costs are expensed as incurred. The Company establishes billing terms at the time project deliverables and milestones are agreed. Revenues recognized in excess of the amounts invoiced to clients are classified as unbilled receivables. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract

billing rate, as well as reimbursement of other billable direct costs. For all types of contracts, the Company recognizes anticipated contract losses as soon as they become known and estimable.

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

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

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

WEIGHTED-AVERAGE SHARES

Weighted-average shares were calculated as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Basic weighted-average shares outstanding	32,052	30,988	31,880	30,820
Effect of dilutive equity instruments	634	—	840	—
Diluted weighted-average shares outstanding	32,686	30,988	32,720	30,820

Equity instruments to purchase 654 and 740 shares of common stock were not included in the calculation of diluted net earnings per share for the three and six months ended December 31, 2014, because the equity instruments were anti-dilutive. Equity instruments to purchase 3,871 shares of common stock were not included in the calculation of diluted net earnings per share for the three and six months ended December 31, 2013, because the equity instruments were anti-dilutive.

C. Discontinued Operations

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

As of June 30, 2014, the Company's MIS operating segment met the "held for sale" criteria in accordance with FASB ASC 205. As the Company will not have continuing involvement in the operations of MIS after its divestiture in January 2015, the MIS operating results have been reported as a discontinued operation for all periods presented. On January 23, 2015, the Company completed the sale of the MIS operating segment.

MIS is considered its own operating segment and was previously aggregated with MDS into one reportable segment based on similar economic and qualitative factors in accordance with FASB ASC 280. As MIS is a discontinued operation, the results of MIS have been excluded from the MDS reportable segment. Accordingly, the revenues, costs of revenue, operating expenses, assets and liabilities of MIS have been reported separately in the Consolidated Statements of Operations and Comprehensive Income (Loss) and Consolidated Balance Sheets for all periods presented. The discontinued operation's balances in the Consolidated Balance Sheets do not reflect intercompany receivable balances of MIS, and the results of discontinued operations do not reflect interest expense or the allocation of the Company's corporate general and administrative expenses.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Net revenues of discontinued operations	\$ 1,321	\$ 2,158	\$ 3,160	\$ 5,372
Costs of discontinued operations:				
Cost of revenues	951	1,545	2,176	3,736
Selling, general and administrative	600	809	1,247	1,588
Research and development	105	89	276	121
Amortization of intangible assets	124	124	248	248
Acquisition costs and other related expenses	76	—	109	—
Impairment of goodwill	2,283	—	2,283	—
Loss from discontinued operations before income taxes	(2,818)	(409)	(3,179)	(321)
Tax benefit	(197)	(151)	(340)	(111)
Loss from discontinued operations, net of income taxes	\$ (2,621)	\$ (258)	\$ (2,839)	\$ (210)

The amounts reported as assets and liabilities of the discontinued operations were as follows:

	December 31, 2014	June 30, 2014
Accounts receivable, net	\$ 452	\$ 925
Unbilled receivables and costs in excess of billings	133	248
Deferred income taxes	88	77
Prepaid income taxes	340	—
Prepaid expenses and other current assets	82	124
Property and equipment, net	387	475
Goodwill	—	2,283
Intangible assets, net	1,815	2,062
Other non-current assets	33	39
Assets of discontinued operations	\$ 3,330	\$ 6,233
Accounts payable	\$ 5	\$ 127
Accrued expenses	1,041	802
Accrued compensation	537	689
Deferred income taxes	724	818
Liabilities of discontinued operations	\$ 2,307	\$ 2,436

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Depreciation	\$ 45	\$ 39	\$ 89	\$ 77
Amortization of intangible assets	\$ 124	\$ 124	\$ 248	\$ 248
Capital expenditures	\$ —	\$ 18	\$ —	\$ 18
Impairment of goodwill	\$ 2,283	\$ —	\$ 2,283	\$ —
Stock-based compensation expense	\$ 62	\$ 101	\$ 126	\$ 148

During the three months ended December 31, 2014, the Company began exclusive negotiations with a potential buyer of MIS. Based primarily on these negotiations, the Company determined that the MIS reporting unit's carrying value of goodwill exceeded its implied fair value, resulting in a goodwill impairment charge of \$2,283. The impairment charge is reflected within discontinued operations of the Company's accompanying consolidated financial statements.

On January 23, 2015, the Company completed the sale of the MIS operating segment for a selling price approximating the net book value of the business after the goodwill impairment charge recorded in the second fiscal quarter of 2015.

D. Fair Value of Financial Instruments

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

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

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

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

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at December 31, 2014:

	Fair Value Measurements			
	December 31, 2014	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 56,987	\$ 56,987	\$ —	\$ —
Restricted cash	264	264	—	—
Total	\$ 57,251	\$ 57,251	\$ —	\$ —

The carrying values of cash and cash equivalents, including all U.S. Treasury Bills and money market funds, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities.

E. Inventory

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

	December 31, 2014	June 30, 2014
Raw materials	\$ 13,691	\$ 13,755
Work in process	12,263	12,677
Finished goods	4,057	5,223
Total	\$ 30,011	\$ 31,655

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

F. Goodwill

The following table sets forth the carrying amount of goodwill by reporting units as of December 31, 2014 and June 30, 2014:

	December 31, 2014	June 30, 2014
MCE goodwill	\$ 134,378	\$ 134,378
MDS goodwill	33,768	33,768
Total goodwill	<u>\$ 168,146</u>	<u>\$ 168,146</u>

In the six months ended December 31, 2014, there were no triggering events, as defined by FASB ASC 350, which required an interim goodwill impairment test. The Company performs its annual goodwill impairment test in the fourth quarter of each fiscal year.

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

G. Restructuring Plan

During fiscal 2014 the Company announced a restructuring plan ("2014 Plan") that was implemented as part of the final phase of integration activities relating to the Company's recent acquisitions. The integration activities included the consolidation of manufacturing facilities, centralization of administrative functions using common information systems and processes, and realignment of research and development resources. During the three months ended December 31, 2014, the Company has successfully completed the integration plan and incurred restructuring and other charges of \$1,162. These charges were primarily associated with the third phase of the Chelmsford, Massachusetts headquarters consolidation and severance related costs. In the event that the Company is unable to sublease the unoccupied portion of its headquarters complex in Chelmsford, MA, it will incur nominal, periodic restructuring charges through fiscal 2017. These restructuring and other charges affect the MCE reportable segment.

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

	Severance & Related	Facilities & Other	Total
Restructuring liability at June 30, 2014	\$ 1,371	\$ 772	\$ 2,143
MCE restructuring and other charges	997	1,498	2,495
MDS restructuring and other charges	33	—	33
Cash paid	(1,365)	(557)	(1,922)
Reversals(*)	(98)	—	(98)
Restructuring liability at December 31, 2014	<u>\$ 938</u>	<u>\$ 1,713</u>	<u>\$ 2,651</u>

(*) Reversals result from unused outplacement services.

All of the restructuring and other charges are classified as operating expenses in the consolidated statements of operations and comprehensive income (loss) and any remaining obligations are expected to be paid by the end of fiscal 2017. The restructuring liability is classified as accrued expenses in the consolidated balance sheets.

H. Income Taxes

The Company recorded a tax provision of \$1,047 and a tax benefit of \$442 on income from continuing operations before income taxes of \$3,933 and loss from continuing operations before income taxes of \$1,229 for the three months ended December 31, 2014 and 2013, respectively. The Company recorded a tax provision of \$1,047 and a tax benefit of \$1,761 on income from continuing operations before income taxes of \$4,650 and loss from continuing operations before income taxes of \$4,852 for the six months ended December 31, 2014 and 2013, respectively. Income tax for the three and six months ended December 31, 2014 differed from the federal statutory rate primarily due to the impact of federal research and development credits, Section 199 manufacturing deduction, stock compensation and state taxes. Income tax benefit for the three and six months ended December 31, 2013 differed from the federal statutory rate primarily due to the impact of federal research and development tax credits, Section 199 manufacturing deduction, stock compensation and state taxes.

On December 19, 2014, the Tax Increase Prevention Act of 2014 was enacted, which retroactively reinstated and extended the federal research and development credits from January 1, 2014 through December 31, 2014. Based on the extension, the Company estimates that there was an additional \$894 credit earned in calendar year 2014, of which \$487 relating to fiscal year 2014 was recognized as a discrete benefit in the three months ended December 31, 2014.

The Company's unrecognized tax positions increased by \$123 during the three and six months ended December 31, 2014. The increase relates to reserves on the additional research and development credits for fiscal year 2014.

The Company estimates that unrecognized tax benefits of up to \$1,022 could be realized within the next 12 months as a result of resolutions of tax positions and the expiration of applicable statutes of limitations. The Company is currently under audit by the Internal Revenue Service for fiscal year 2013. There have been no significant changes to the status of this examination during the six months ended December 31, 2014.

I. Commitments and Contingencies

LEGAL CLAIMS

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

INDEMNIFICATION OBLIGATIONS

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

PURCHASE COMMITMENTS

As of December 31, 2014, the Company has entered into non-cancelable purchase commitments for certain inventory components and services used in its normal operations. The purchase commitments covered by these agreements are for less than one year and aggregate to \$34,336.

J. Debt

Senior Unsecured Credit Facility

As of December 31, 2014, there was \$101,357 of borrowing capacity available under the Company's credit agreement with a syndicate of commercial banks, with Key Bank National Association acting as the administrative agent. The Company can borrow up to \$200,000 based on the Company's consolidated EBITDA for the trailing four quarters. There were no borrowings outstanding on the credit agreement; however, there were outstanding letters of credit of \$3,934. The Company was in compliance with all covenants and conditions under the credit agreement.

K. Stock-Based Compensation

STOCK OPTION PLANS

The number of shares authorized for issuance under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan"), is 11,424 shares at December 31, 2014. On October 21, 2014, the Company's number of shares authorized for issuance under the 2005 Plan increased 3,406 shares, including 206 shares as a result of cancellations, forfeitures or terminations under the 1997 Plan. The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant and the options generally have a term of seven years. There were 3,548 shares available for future grant under the 2005 Plan at December 31, 2014.

On August 15, 2014, as part of the Company's ongoing annual equity grant program for employees, the Company granted, for the first time, performance-based restricted stock awards to certain executives pursuant to the 2005 Plan. These performance awards vest annually over a three year requisite service period subject to the achievement of specific financial performance targets

related to adjusted EBITDA as a percentage of revenue. Based on the performance targets, these awards require graded vesting that results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company will monitor the probability of achieving the performance targets on a quarterly basis and may adjust periodic compensation expense accordingly.

EMPLOYEE STOCK PURCHASE PLAN

The number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,400 shares. Under the ESPP, rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six-month offering period. The ESPP permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the ESPP. There were 41 and 55 shares issued under the ESPP during the six months ended December 31, 2014 and 2013, respectively. Shares available for future purchase under the ESPP totaled 123 at December 31, 2014.

STOCK OPTION AND AWARD ACTIVITY

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

	Options Outstanding		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Outstanding at June 30, 2014	1,435	\$ 11.76	2.23
Granted	—	—	
Exercised	(221)	7.63	
Cancelled	(70)	21.48	
Outstanding at December 31, 2014	1,144	\$ 11.98	1.99

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

	Non-vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2014	2,091	\$ 10.15
Granted	759	11.63
Vested	(733)	10.37
Forfeited	(160)	10.79
Outstanding at December 31, 2014	1,957	\$ 10.59

STOCK-BASED COMPENSATION EXPENSE

The Company recognized the full expense of its share-based payment plans in the consolidated statements of operations for the three and six months ended December 31, 2014 and 2013 in accordance with FASB ASC 718 and did not capitalize any such costs on the consolidated balance sheets, as such costs that qualified for capitalization were not material. Under the fair value recognition provisions of FASB ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period, net of estimated forfeitures. The following table presents share-based compensation expenses included in the Company's consolidated statements of operations:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Cost of revenues	\$ 115	\$ 192	\$ 266	\$ 399
Selling, general and administrative	1,778	2,004	3,744	4,318
Research and development	363	420	797	887
Share-based compensation expense before tax	2,256	2,616	4,807	5,604
Income tax benefit	(839)	(894)	(1,759)	(1,966)
Net compensation expense	\$ 1,417	\$ 1,722	\$ 3,048	\$ 3,638

L. Operating Segment, Geographic Information and Significant Customers

Operating segments are defined as components of an enterprise evaluated regularly by the Company's chief operating decision maker ("CODM") in deciding how to allocate resources and assess performance. The Company utilizes the management approach for determining reportable segments in accordance with the authoritative guidance. The following operating segments were determined based upon the nature of the products offered to customers, the market characteristics of each operating segment and the Company's management structure:

- Mercury Commercial Electronics ("MCE"): this operating segment delivers affordable, innovative, commercially developed, specialized processing subsystems for critical commercial, defense and intelligence applications. MCE delivers secure solutions that are based upon open architectures and widely adopted industry standards. MCE delivers rapid time-to-value and service and support to prime defense contractors and commercial customers. MCE provides solutions to prime contractor customers on a variety of programs. MCE also provides technology building blocks to Mercury Defense Systems on key classified and unclassified programs. MCE has a legacy of embedded multi-computing and embedded sensor processing expertise. More recently, MCE has added substantial capabilities around radio frequency ("RF") and microwave technologies as well as emerging new manufacturing capabilities to bring design, production and test capabilities of its RF and microwave solutions to market on a more scalable basis.
- Mercury Defense Systems ("MDS"): this operating segment provides significant capabilities relating to pre-integrated, open, affordable electronic warfare ("EW"), electronic attack ("EA") and electronic counter measure ("ECM") subsystems, and signals intelligence ("SIGINT") and electro-optical/infrared ("EO/IR") processing technologies. MDS deploys these solutions on behalf of defense prime contractors and the Department of Defense ("DoD"), leveraging commercially available technologies and solutions (or "building blocks") from the MCE business and other commercial suppliers. MDS leverages this technology to develop integrated sensor processing subsystems, often including classified application-specific software and intellectual property ("IP") for the C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ECM markets. MDS brings significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

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

Prior year results have been restated for the reclassification of the MIS operating segment as discontinued operations. MIS was previously aggregated with MDS into one reportable segment based on similar economic and qualitative factors in accordance with FASB ASC 280 (see Note C).

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

Adjusted EBITDA is defined as income from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition costs and other related expenses, fair value adjustments from purchase accounting and stock-based compensation costs. Additionally, asset information by reportable segment is not reported because the Company and its CODM utilize consolidated asset information when making business decisions. The following is a summary of the performance of the Company's operations by reportable segment:

	MCE	MDS	Eliminations	Total
THREE MONTHS ENDED DECEMBER 31, 2014				
Net revenues to unaffiliated customers	\$ 51,806	\$ 4,767	\$ 516	\$ 57,089
Intersegment revenues	923	72	(995)	—
Net revenues	<u>\$ 52,729</u>	<u>\$ 4,839</u>	<u>\$ (479)</u>	<u>\$ 57,089</u>
Adjusted EBITDA	<u>\$ 10,510</u>	<u>\$ 284</u>	<u>\$ (87)</u>	<u>\$ 10,707</u>
THREE MONTHS ENDED DECEMBER 31, 2013				
Net revenues to unaffiliated customers	\$ 42,305	\$ 8,445	\$ 182	\$ 50,932
Intersegment revenues	2,733	—	(2,733)	—
Net revenues	<u>\$ 45,038</u>	<u>\$ 8,445</u>	<u>\$ (2,551)</u>	<u>\$ 50,932</u>
Adjusted EBITDA	<u>\$ 4,082</u>	<u>\$ 1,066</u>	<u>\$ 89</u>	<u>\$ 5,237</u>
SIX MONTHS ENDED DECEMBER 31, 2014				
Net revenues to unaffiliated customers	\$ 100,362	\$ 10,147	\$ 641	\$ 111,150
Intersegment revenues	1,425	211	(1,636)	—
Net revenues	<u>\$ 101,787</u>	<u>\$ 10,358</u>	<u>\$ (995)</u>	<u>\$ 111,150</u>
Adjusted EBITDA	<u>\$ 17,799</u>	<u>\$ 770</u>	<u>\$ 141</u>	<u>\$ 18,710</u>
SIX MONTHS ENDED DECEMBER 31, 2013				
Net revenues to unaffiliated customers	\$ 85,793	\$ 16,361	\$ (496)	\$ 101,658
Intersegment revenues	3,847	—	(3,847)	—
Net revenues	<u>\$ 89,640</u>	<u>\$ 16,361</u>	<u>\$ (4,343)</u>	<u>\$ 101,658</u>
Adjusted EBITDA	<u>\$ 6,425</u>	<u>\$ 2,128</u>	<u>\$ 7</u>	<u>\$ 8,560</u>

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Income (loss) from continuing operations	\$ 2,886	\$ (787)	\$ 3,603	\$ (3,091)
Interest expense, net	4	8	9	22
Tax provision (benefit)	1,047	(442)	1,047	(1,761)
Depreciation	1,590	1,942	3,290	3,916
Amortization of intangible assets	1,762	1,803	3,524	3,788
Restructuring and other charges	1,162	97	2,430	82
Stock-based compensation expense	2,256	2,616	4,807	5,604
Adjusted EBITDA	<u>\$ 10,707</u>	<u>\$ 5,237</u>	<u>\$ 18,710</u>	<u>\$ 8,560</u>

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

	US	Europe	Asia Pacific	Eliminations	Total
THREE MONTHS ENDED					
DECEMBER 31, 2014					
Net revenues to unaffiliated customers	\$ 55,625	\$ 355	\$ 1,109	\$ —	\$ 57,089
Inter-geographic revenues	964	179	—	(1,143)	—
Net revenues	<u>\$ 56,589</u>	<u>\$ 534</u>	<u>\$ 1,109</u>	<u>\$ (1,143)</u>	<u>\$ 57,089</u>
THREE MONTHS ENDED					
DECEMBER 31, 2013					
Net revenues to unaffiliated customers	\$ 50,351	\$ 451	\$ 130	\$ —	\$ 50,932
Inter-geographic revenues	679	47	—	(726)	—
Net revenues	<u>\$ 51,030</u>	<u>\$ 498</u>	<u>\$ 130</u>	<u>\$ (726)</u>	<u>\$ 50,932</u>
SIX MONTHS ENDED					
DECEMBER 31, 2014					
Net revenues to unaffiliated customers	\$ 108,710	\$ 701	\$ 1,739	\$ —	\$ 111,150
Inter-geographic revenues	1,547	179	—	(1,726)	—
Net revenues	<u>\$ 110,257</u>	<u>\$ 880</u>	<u>\$ 1,739</u>	<u>\$ (1,726)</u>	<u>\$ 111,150</u>
SIX MONTHS ENDED					
DECEMBER 31, 2013					
Net revenues to unaffiliated customers	\$ 99,806	\$ 959	\$ 893	\$ —	\$ 101,658
Inter-geographic revenues	1,498	204	140	(1,842)	—
Net revenues	<u>\$ 101,304</u>	<u>\$ 1,163</u>	<u>\$ 1,033</u>	<u>\$ (1,842)</u>	<u>\$ 101,658</u>

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

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

	U.S.	Europe	Asia Pacific	Eliminations	Total
December 31, 2014	\$ 12,928	\$ 36	\$ 4	\$ —	\$ 12,968
June 30, 2014	\$ 14,090	\$ 48	\$ 6	\$ —	\$ 14,144

Identifiable long-lived assets exclude goodwill and intangible assets.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Raytheon Company	36%	12%	35%	13%
Lockheed Martin Corporation	18%	31%	24%	21%
Northrop Grumman Corporation	*	14%	*	15%
	<u>54%</u>	<u>57%</u>	<u>59%</u>	<u>49%</u>

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Patriot	18%	*	18%	*
SEWIP	*	*	13%	*
F-35	11%	*	11%	*
Aegis	10%	28%	10%	16%
	39%	28%	52%	16%

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

M. Subsequent Events

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

On January 23, 2015, the Company completed the sale of the MIS operating segment for a selling price approximating the net book value of that business unit on the date of sale.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

From time to time, information provided, statements made by our employees or information included in our filings with the Securities and Exchange Commission may contain statements that are not historical facts but that are "forward-looking statements," which involve risks and uncertainties. You can identify these statements by the use of the words "may," "will," "could," "should," "would," "plans," "expects," "anticipates," "continue," "estimate," "project," "intend," "likely," "forecast," "probable," "potential," and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, federal export control or procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions, divestitures and restructurings, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, changes to export regulations, increases in tax rates, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as set forth under Part I-Item 1A (Risk Factors) in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

OVERVIEW

Mercury Systems, Inc. is a leading high-tech commercial provider of more affordable secure and sensor processing subsystems designed and made in the U.S.A. for critical defense and intelligence applications. We deliver innovative solutions, rapid time-to-value and service and support to our defense prime contractor customers. Our products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-35 and Reaper. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector. We believe our total portfolio of services and solutions is unique in the industry for a commercial company. Mercury Systems operates across a broad spectrum of defense programs and, effective for fiscal 2015, we deliver our solutions and services via two business units: (i) Mercury Commercial Electronics; and (ii) Mercury Defense Systems. In the fourth quarter of fiscal 2014, we initiated a plan to divest our Mercury Intelligence Systems business unit. Consequently, its operating results are included in discontinued operations for all periods presented (see Note C to the consolidated financial statements).

As of December 31, 2014, we had 625 employees. Our revenue, income from continuing operations and adjusted EBITDA for the three month period ended December 31, 2014 were \$57.1 million, \$2.9 million, and \$10.7 million, respectively. Our revenue, income from continuing operations and adjusted EBITDA for the six month period ended December 31, 2014 were \$111.2 million, \$3.6 million, and \$18.7 million respectively. See the Non-GAAP Financial Measures section for a reconciliation of our income from continuing operations to adjusted EBITDA.

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

Mercury Commercial Electronics, or MCE, provides affordable, innovative, commercially designed and developed, specialized processing subsystems for critical commercial, defense and intelligence applications. We deliver innovative solutions, rapid time-to-value and service and support to our prime defense contractor customers. Our technologies and capabilities include embedded processing modules and subsystems, RF and microwave multi-function assemblies as well as subsystems, and RF and microwave components.

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

For the six months ended December 31, 2014, MCE accounted for approximately 91% of our total net revenues.

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

For the six months ended December 31, 2014, MDS accounted for approximately 9% of our total net revenues.

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

RESULTS OF OPERATIONS:

Three months ended December 31, 2014 compared to the three months ended December 31, 2013

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

<u>(In thousands)</u>	<u>December 31, 2014</u>	<u>As a % of Total Net Revenue</u>	<u>December 31, 2013</u>	<u>As a % of Total Net Revenue</u>
Net revenues	\$ 57,089	100.0 %	\$ 50,932	100.0 %
Cost of revenues	30,054	52.6	26,607	52.2
Gross margin	27,035	47.4	24,325	47.8
Operating expenses:				
Selling, general and administrative	12,677	22.2	13,944	27.4
Research and development	7,895	13.9	10,142	20.0
Amortization of intangible assets	1,762	3.1	1,803	3.5
Restructuring and other charges	1,162	2.0	97	0.2
Total operating expenses	23,496	41.2	25,986	51.1
Income (loss) from operations	3,539	6.2	(1,661)	(3.3)
Other income, net	394	0.7	432	0.9
Income (loss) from continuing operations before income taxes	3,933	6.9	(1,229)	(2.4)
Tax provision (benefit)	1,047	1.8	(442)	(0.9)
Income (loss) from continuing operations	2,886	5.1	(787)	(1.5)
Loss from discontinued operations, net of taxes	(2,621)	(4.6)	(258)	(0.6)
Net income (loss)	\$ 265	0.5 %	\$ (1,045)	(2.1)%

REVENUES

<u>(In thousands)</u>	<u>December 31, 2014</u>	<u>December 31, 2013</u>	<u>\$ Change</u>	<u>% Change</u>
MCE	\$ 51,806	\$ 42,305	\$ 9,501	22 %
MDS	4,767	8,445	(3,678)	(44)%
Eliminations	516	182	334	184 %
Total revenues	\$ 57,089	\$ 50,932	\$ 6,157	12 %

Total revenues increased \$6.2 million, or 12%, to \$57.1 million during the three months ended December 31, 2014 as compared to the comparable period in fiscal 2014. This increase was driven by higher defense sales of \$4.9 million and higher commercial sales of \$1.3 million. The increase in total revenues is primarily attributed to higher revenues from the Patriot, SEWIP, and F-35 programs. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, increased \$5.3 million to \$14.6 million during the three months ended December 31, 2014, compared to \$9.3 million in the same period in the prior fiscal year. The increase was primarily driven by higher revenues from the Patriot, Aegis, and Global Hawk programs. International revenues represented 26% and 18% of total revenues during the three months ended December 31, 2014 and 2013, respectively.

Net MCE revenues increased \$9.5 million, or 22%, during the three months ended December 31, 2014 as compared to the same period in the prior fiscal year. This increase was primarily driven by higher defense sales of \$8.2 million related to increases from the Patriot, SEWIP, and F-35 programs, and a \$1.3 million increase in commercial sales.

Net MDS revenues decreased \$3.7 million, or 44%, during the three months ended December 31, 2014 as compared to the same period in the previous fiscal year. This decrease was primarily driven by lower revenues related to the Gorgon Stare program in the most recent quarter.

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

GROSS MARGIN

Gross margin was 47.4% for the three months ended December 31, 2014, a slight decrease of 40 basis points from the 47.8% gross margin achieved during the same period in fiscal 2014. The slightly lower gross margin between years was due to changes in product mix, including more revenues from certain lower-margin commercial products in the three months ended December 31, 2014 as compared to the same period in the prior fiscal year.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses decreased \$1.2 million, or 9%, to \$12.7 million during the three months ended December 31, 2014, compared to \$13.9 million during the comparable period in fiscal 2014. The decrease was primarily due to lower employee compensation expenses as a result of further progress achieved on our plan of integrating and consolidating facilities, systems, and processes. This plan was successfully completed in the second quarter of fiscal 2015. Selling, general and administrative expenses decreased as a percentage of revenues to 22.2% during the three months ended December 31, 2014 from 27.4% during the same period in fiscal 2014 due to higher revenues in the second quarter of fiscal 2015 coupled with overall expense reductions, as compared to the comparable period in fiscal 2014.

RESEARCH AND DEVELOPMENT

Research and development expenses decreased \$2.2 million, or 22%, to \$7.9 million during the three months ended December 31, 2014, compared to \$10.1 million during the comparable period in fiscal 2014. The decrease was primarily due to higher customer funded development during fiscal 2015.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets was \$1.8 million for both the three months ended December 31, 2014 and 2013.

RESTRUCTURING AND OTHER CHARGES

In fiscal 2014, the Company announced a restructuring plan ("2014 Plan") that was implemented as part of the final phase of integration activities relating to the Company's recent acquisitions. The integration plan included the consolidation of manufacturing facilities, centralization of administrative functions using common information systems and processes, and realignment of research and development resources. During the second quarter of fiscal 2015, the 2014 Plan was completed and the Company incurred restructuring and other charges of \$1.2 million, primarily associated with the final phase of the Chelmsford, Massachusetts headquarters consolidation and severance costs. In the event that the Company is unable to sublease the unoccupied portion of its headquarters complex in Chelmsford, Massachusetts, it will incur nominal, periodic restructuring charges through fiscal 2017.

OTHER INCOME, NET

Other income, net was \$0.4 million during both the three months ended December 31, 2014 and 2013. Other income, net for the three months ended December 31, 2014 and 2013, include \$0.3 million related to the amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts. Interest income and interest expense for both periods were de minimis.

INCOME TAXES

We recorded an income tax provision of \$1.0 million during the three months ended December 31, 2014 as compared to a \$0.4 million income tax benefit for the comparable period in the prior fiscal year. Our income taxes for the three months ended December 31, 2014 differed from the federal statutory tax rate primarily due to the impact of federal research and development credits, Section 199 manufacturing deduction, stock compensation and state taxes. Our income tax benefit during the comparable period in fiscal 2014 also differed from the federal statutory rate primarily due to the impact of the federal research and development tax credits, Section 199 manufacturing deduction, and stock compensation.

DISCONTINUED OPERATIONS

We incurred a loss from discontinued operations of \$2.6 million in the three month ended in December 31, 2014 compared to a loss from discontinued operations of \$0.3 million for the same period in fiscal 2014. The loss from discontinued operations during the three months ended December 31, 2014 included a \$2.3 million impairment of goodwill in our MIS business. On January 23, 2015, we completed the sale of MIS for a price approximating the net book value of that business unit on the date of sale.

SEGMENT OPERATING RESULTS

We use adjusted EBITDA as the profitability measure for our segment reporting. Adjusted EBITDA for MCE increased \$6.4 million during the three months ended December 31, 2014 to \$10.5 million as compared to \$4.1 million for the comparable period in fiscal 2014. The increase in adjusted EBITDA is driven by higher revenues of \$9.5 million primarily from defense programs, coupled with lower operating expenses.

Adjusted EBITDA for MDS decreased \$0.8 million during the three months ended December 31, 2014 to \$0.3 million as compared to \$1.1 million for the comparable period in fiscal 2014. The decrease in adjusted EBITDA was primarily due to lower revenues from the Gorgon Stare program.

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

Six months ended December 31, 2014 compared to the six months ended December 31, 2013

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

<u>(In thousands)</u>	<u>December 31, 2014</u>	<u>As a % of Total Net Revenue</u>	<u>December 31, 2013</u>	<u>As a % of Total Net Revenue</u>
Net revenues	\$ 111,150	100.0 %	\$ 101,658	100.0 %
Cost of revenues	60,116	54.1	55,771	54.9
Gross margin	51,034	45.9	45,887	45.1
Operating expenses:				
Selling, general and administrative	24,967	22.5	28,265	27.8
Research and development	15,846	14.2	19,454	19.1
Amortization of intangible assets	3,524	3.2	3,788	3.7
Restructuring and other charges	2,430	2.2	82	0.1
Total operating expenses	46,767	42.1	51,589	50.7
Income (loss) from operations	4,267	3.8	(5,702)	(5.6)
Other income, net	383	0.4	850	0.8
Income (loss) from continuing operations before income taxes (benefit)	4,650	4.2	(4,852)	(4.8)
Tax provision (benefit)	1,047	0.9	(1,761)	(1.8)
Income (loss) from continuing operations	\$ 3,603	3.3	\$ (3,091)	(3.0)
Loss from discontinued operations, net of income taxes	(2,839)	(2.6)	(210)	(0.2)
Net income (loss)	<u>\$ 764</u>	<u>0.7 %</u>	<u>\$ (3,301)</u>	<u>(3.2)%</u>

REVENUES

(In thousands)	December 31, 2014	December 31, 2013	\$ Change	% Change
MCE	\$ 100,362	\$ 85,793	\$ 14,569	17 %
MDS	10,147	16,361	(6,214)	(38)%
Eliminations	641	(496)	1,137	229 %
Total revenues	\$ 111,150	\$ 101,658	\$ 9,492	9 %

Total revenues increased \$9.5 million, or 9%, to \$111.2 million during the six months ended December 31, 2014 as compared to the comparable period in fiscal 2014. This increase was driven by higher defense sales of \$13.0 million, partially offset by a \$3.5 million decrease in commercial sales. The increase in total revenues is primarily attributed to increases in the Patriot, SEWIP, and F-35 programs that were partially offset by lower revenues from the Aegis and Gorgon Stare programs.

Net MCE revenues increased \$14.6 million, or 17%, during the six months ended December 31, 2014 as compared to the same period in the prior fiscal year. This increase was primarily driven by higher defense sales of \$18.1 million related to increases in the Aegis, Patriot, F-35, and Global Hawk programs, partially offset by a \$3.5 million decrease in commercial sales.

Net MDS revenues decreased \$6.2 million, or 38%, during the six months ended December 31, 2014 as compared to the same period in the prior fiscal year. This decrease was primarily driven by lower revenues related to the Gorgon Stare program and radar environment test and simulation sales.

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

GROSS MARGIN

Gross margin was 45.9% for the six months ended December 31, 2014, as compared to 45.1% gross margin during the same period in fiscal 2014. The higher gross margin between years was due to a more favorable product mix, primarily driven by stronger revenues in our higher margin digital signal processing products within MCE.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses decreased \$3.3 million, or 12%, to \$25.0 million during the six months ended December 31, 2014, compared to \$28.3 million during the comparable period in fiscal 2014. The decrease was primarily due to lower employee compensation expenses as a result of further progress achieved on our plan of integrating and consolidating facilities, systems and processes. This plan was successfully completed in the second quarter of fiscal 2015. Selling, general and administrative expenses decreased as a percentage of revenues to 22.5% during the six months ended December 31, 2014 from 27.8% during the same period in fiscal 2014 due to higher revenues in the first six months of fiscal 2015 coupled with overall expense reductions, as compared to the comparable period in fiscal 2014.

RESEARCH AND DEVELOPMENT

Research and development expenses decreased \$3.6 million, or 19%, to \$15.8 million during the six months ended December 31, 2014, compared to \$19.4 million during the comparable period in fiscal 2014. The decrease was primarily due to higher customer funded development and lower headcount during fiscal 2015.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets decreased \$0.3 million, or 7%, to \$3.5 million during the six months ended December 31, 2014, compared to \$3.8 million during the comparable period in fiscal 2014, primarily due to a portion of the Micronetics related intangible assets being fully amortized during the first quarter of fiscal 2014.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges were \$2.4 million for the six months ended December 31, 2014, as compared to less than \$0.1 million during the comparable period in fiscal 2014. In fiscal 2014, the Company announced a restructuring plan ("2014 Plan") that was implemented as part of the final phase of integration activities relating to the Company's recent acquisitions. The integration plan included the consolidation of manufacturing facilities, centralization of administrative functions using common information systems and processes, and realignment of research and development resources. During the first six months of fiscal 2015, the 2014 Plan was completed and the Company incurred restructuring and other charges of 2.4 million, primarily associated with the final phases of the Chelmsford, Massachusetts headquarters consolidation and severance costs. In the event that the Company is unable to sublease the unoccupied portion of its headquarters complex in Chelmsford, Massachusetts, it will incur nominal, periodic restructuring charges through fiscal 2017.

OTHER INCOME, NET

Other income, net decreased to \$0.4 million during the six months ended December 31, 2014, as compared to \$0.9 million for the same period in fiscal 2014. The decrease was driven by a \$0.3 million write off of an escrow receivable in the first half of fiscal 2015. Other income, net for the six months ended December 31, 2014 and 2013, also includes \$0.6 million in amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts. Interest income and interest expense for both periods were de minimis.

INCOME TAXES

We recorded an income tax provision of \$1.0 million during the six months ended December 31, 2014 as compared to a \$1.8 million income tax benefit for the comparable period in the prior fiscal year. Our income taxes for the six months ended December 31, 2014 differed from the federal statutory tax rate of 35% primarily due to the impact of federal research and development tax credits, Section 199 manufacturing deduction, stock compensation and state taxes. Our income tax benefit during the comparable period in fiscal 2014 also differed from the federal statutory rate primarily due to the impact of the federal research and development tax credits, Section 199 manufacturing deduction, stock compensation and state taxes.

DISCONTINUED OPERATIONS

We incurred a loss from discontinued operations of \$2.8 million in the six months ended in December 31, 2014 compared to loss from discontinued operations of \$0.2 million for the same period in fiscal 2014. The loss from discontinued operations during the six months ended December 31, 2014 included a \$2.3 million impairment of goodwill in our MIS business. On January 23, 2015, we completed the sale of MIS for a price approximating the net book value of that business unit on the date of sale.

SEGMENT OPERATING RESULTS

We use adjusted EBITDA as the profitability measure for our segment reporting. Adjusted EBITDA for MCE increased \$11.4 million during the six months ended December 31, 2014 to \$17.8 million as compared to \$6.4 million for the comparable period in fiscal 2014. The increase in adjusted EBITDA is primarily driven by higher revenues of \$14.6 million primarily from the Patriot, SEWIP and F-35 programs, coupled with higher gross margins.

Adjusted EBITDA for MDS decreased \$1.4 million during the six months ended December 31, 2014 to \$0.8 million as compared to \$2.2 million for the comparable period in fiscal 2014. The decrease in adjusted EBITDA was primarily due to lower revenues from the Gorgon Stare program and radar environment test and simulation sales.

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

LIQUIDITY AND CAPITAL RESOURCES

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

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

Senior Unsecured Credit Facility

As of December 31, 2014, there was \$101.4 million of borrowing capacity available under our credit agreement with a syndicate of commercial banks, with Key Bank National Association acting as the administrative agent. The Company can borrow up to \$200.0 million based on the Company's consolidated EBITDA for the trailing four quarters. There were no borrowings

outstanding on the credit agreement; however, there were outstanding letters of credit of \$3.9 million. We were in compliance with all covenants and conditions under the credit agreement.

Shelf Registration Statement

On August 15, 2014, we filed a shelf registration statement on Form S-3 with the SEC. The shelf registration statement, which has been declared effective by the SEC, registered up to \$500 million of debt securities, preferred stock, common stock, warrants and units. We intend to use the proceeds from a financing using the shelf registration statement for general corporate purposes, which may include the following:

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

CASH FLOWS

(In thousands)	As of and for the six month period ended December 31,	
	2014	2013
Net cash provided by operating activities	\$ 10,406	\$ 9,531
Net cash used in investing activities	\$ (2,122)	\$ (4,234)
Net cash provided by financing activities	\$ 1,529	\$ 240
Net increase in cash and cash equivalents	\$ 9,700	\$ 5,409
Cash and cash equivalents at end of period	\$ 56,987	\$ 44,535

Our cash and cash equivalents increased by \$9.7 million from June 30, 2014 to December 31, 2014, primarily as a result of \$10.4 million in cash generated from operating activities, partially offset by \$2.1 million in purchases of property and equipment.

Operating Activities

During the six months ended December 31, 2014, we generated \$10.4 million in cash from operating activities compared to \$9.5 million in cash generated from operating activities during the same period in fiscal 2014. During the six months ended December 31, 2014, we generated \$4.1 million in higher comparable net income, had a \$10.6 million decrease in cash used for payables and accrued expenses, and \$3.2 million more cash generated from deferred revenue and customer advances as compared to the same period in the prior year. These increases in cash generated from operations were partially offset by the timing of accounts receivable collections of \$14.4 million, and \$2.7 million in higher inventory purchases and \$2.1 million lower provision related to deferred taxes. Our ability to generate cash from operations in future periods will depend in large part on profitability, the rate and timing of collections of accounts receivable, our inventory turns and our ability to manage other areas of working capital.

Investing Activities

During the six months ended December 31, 2014, we used \$2.1 million in investing activities compared to a use of \$4.2 million in investing activities during the same period in fiscal 2014. Both amounts represent purchases of property and equipment and changes in restricted cash.

Financing Activities

During the six months ended December 31, 2014, we generated \$1.5 million from financing activities compared to \$0.2 million generated from financing activities during the same period in fiscal 2014. The \$1.3 million change in cash from financing activities was primarily due to a \$0.7 million increase in proceeds from employee stock plans and a \$0.5 million increase in excess tax benefits from stock-based compensation during the six months ended December 31, 2014.

COMMITMENTS, CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The following is a schedule of our commitments and contractual obligations outstanding at December 31, 2014:

(In thousands)	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
Purchase obligations	\$ 34,336	\$ 34,336	\$ —	\$ —	\$ —
Operating leases	23,472	5,036	7,648	3,642	7,146
Capital lease obligations and other	126	126	—	—	—
	<u>\$ 57,934</u>	<u>\$ 39,498</u>	<u>\$ 7,648</u>	<u>\$ 3,642</u>	<u>\$ 7,146</u>

We have a liability at December 31, 2014 of \$3.3 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. We do not know the ultimate resolution on these uncertain tax positions and as such, do not know the ultimate timing of payments related to this liability. Accordingly, these amounts are not included in the above table.

Purchase obligations represent open non-cancelable purchase commitments for certain inventory components and services used in normal operations. The purchase commitments covered by these agreements are for less than one year and aggregated approximately \$34.3 million at December 31, 2014.

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

Deferred Tax Assets

As of December 31, 2014, we had approximately \$10.9 million in net deferred tax assets. Each quarter, we determine the probability of realizing these assets, using significant judgments and estimates with respect to historical operating results, expectations of future earnings, tax planning strategies and other matters. If we determine in the future that there is not sufficient positive evidence to support the valuation of these assets, we may be required to adjust the valuation allowance accordingly. The Company continues to conclude that it is more likely than not that most domestic deferred tax assets would be realizable based on the current financial performance, projected future taxable income and the reversal of existing deferred tax liabilities.

The Company continues to record a full valuation allowance on certain state research and development and investment tax credits, and stock basis differences as of December 31, 2014 as management continues to believe that it is not more likely than not that these deferred tax assets would be realized. Any future reversals of the valuation allowance will impact income tax expense.

OFF-BALANCE SHEET ARRANGEMENTS

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

NON-GAAP FINANCIAL MEASURES

In our periodic communications, we discuss two important measures that are not calculated according to U.S. generally accepted accounting principles (“GAAP”), adjusted EBITDA and free cash flow.

Adjusted EBITDA, the profitability measure for our segment reporting, is defined as income (loss) from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition costs and other related expenses, fair value adjustments from purchase accounting and stock-based compensation costs. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining a component of bonus compensation for executive officers and other key employees based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe the adjusted EBITDA financial measure assists in providing a more complete understanding of our underlying operational measures to manage our business, to evaluate our performance compared to prior periods and the marketplace, and to establish operational goals. We believe that these non-GAAP financial adjustments are useful to investors

because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

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

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

(In thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Income (loss) from continuing operations	\$ 2,886	\$ (787)	\$ 3,603	\$ (3,091)
Interest expense, net	4	8	9	22
Tax provision (benefit)	1,047	(442)	1,047	(1,761)
Depreciation	1,590	1,942	3,290	3,916
Amortization of intangible assets	1,762	1,803	3,524	3,788
Restructuring and other charges	1,162	97	2,430	82
Stock-based compensation cost	2,256	2,616	4,807	5,604
Adjusted EBITDA	\$ 10,707	\$ 5,237	\$ 18,710	\$ 8,560

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

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

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

(In thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Cash provided by operating activities	\$ 8,229	\$ 7,358	\$ 10,406	\$ 9,531
Capital expenditures for property and equipment	(1,218)	(2,826)	(2,123)	(3,934)
Free cash flow	\$ 7,011	\$ 4,532	\$ 8,283	\$ 5,597

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

In November 2014, the FASB issued ASU No. 2014-14, *Pushdown Accounting (a consensus of the FASB Emerging Issues Task Force)*, an amendment of the FASB Accounting Standards Codification. This ASU allows an acquired entity to elect to apply pushdown accounting in its separate financial statements on a change-in-control event. The acquired entity elects whether to apply pushdown accounting individually for each change-in-control event, and may apply pushdown accounting during the reporting period in which the change-in-control event occurs. Effective November 18, 2014, an acquired entity may apply ASU 2014-17 to future change-in-control events. As this guidance is applicable to acquired entities, we do not expect this guidance to have a material impact to our consolidated financial statements.

For additional recently issued accounting pronouncements that have been issued, but are not yet effective, please refer to our Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 14, 2014.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2014, we adopted FASB ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, an amendment of the FASB Accounting Standards Codification. The ASU requires an unrecognized tax benefit to be presented as a decrease in a deferred tax asset when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist and certain criteria are met. Such adoption did not have a material impact to our consolidated financial statements.

Effective October 1, 2014, we adopted FASB ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)*, an amendment of the FASB Accounting Standards Codification. The ASU clarifies the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. Additionally, the amendments in this ASU require expanded disclosure for discontinued operations to provide users with more information about the assets, liabilities, revenues, and expenses. Such adoption did not have a material impact to our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in our exposure to market risk from June 30, 2014 to December 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), regarding the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2014. We continue to review our disclosure controls and procedures and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our Company's business. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

(b) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13c-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014. There have been no material changes from the factors disclosed in our 2014 Annual Report on Form 10-K filed on August 14, 2014, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

ITEM 6. EXHIBITS

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

- | | |
|-------|--|
| 31.1 | Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1+ | Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101 | The following materials from the Company's Quarterly Report on the Form 10-Q for the quarter ended December 31, 2014 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Cash Flows; and (iv) notes to the Consolidated Financial Statements |

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

MERCURY SYSTEMS, INC.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Chelmsford, Massachusetts, on February 5, 2015.

MERCURY SYSTEMS, INC.

By:

/s/ GERALD M. HAINES II

Gerald M. Haines II

Executive Vice President,

Chief Financial Officer, and Treasurer

CERTIFICATION

I, Mark Aslett, certify that:

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

Date: February 5, 2015

/s/ MARK ASLETT

Mark Aslett
PRESIDENT AND CHIEF EXECUTIVE OFFICER
[PRINCIPAL EXECUTIVE OFFICER]

CERTIFICATION

I, Gerald M. Haines II, certify that:

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

Date: February 5, 2015

/s/ GERALD M. HAINES II

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

Mercury Systems, Inc.

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

In connection with the Quarterly Report of Mercury Systems, Inc. (the "Company") on Form 10-Q for the period ended December 31, 2014 as filed with the Securities and Exchange Commission (the "Report"), we, Mark Aslett, President and Chief Executive Officer of the Company, and Gerald M. Haines II, Executive Vice President, Chief Financial Officer, and Treasurer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that to our knowledge the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 5, 2015

/s/ MARK ASLETT

Mark Aslett
PRESIDENT AND CHIEF EXECUTIVE OFFICER

/s/ GERALD M. HAINES II

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

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.