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, 2012

OR

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

COMMISSION FILE NUMBER: 0-23599

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

MASSACHUSETTS **(State or other jurisdiction of incorporation or organization)**	**04-2741391** **(I.R.S. Employer Identification No.)**
201 RIVERNECK ROAD **CHELMSFORD, MA** **(Address of principal executive offices)**	**01824** **(Zip Code)**

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

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

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

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

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

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, 2013: 32,288,527 shares

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCURY SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)
(Unaudited)

	December 31, 2012	June 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 33,900	$ 115,964
Accounts receivable, net of allowance for doubtful accounts of $32 and $5 at December 31, 2012 and June 30, 2012, respectively	35,275	38,532
Unbilled receivables and costs in excess of billings	12,567	10,918
Inventory	40,783	25,845
Deferred income taxes	13,194	7,653
Prepaid income taxes	2,617	2,585
Prepaid expenses and other current assets	5,444	6,206
Total current assets	143,780	207,703
Restricted cash	658	3,281
Property and equipment, net	18,261	15,929
Goodwill	178,429	132,621
Intangible assets, net	39,565	25,083
Other non-current assets	1,446	989
Total assets	$ 382,139	$ 385,606
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 8,875	$ 9,002
Accrued expenses	9,822	9,895
Accrued compensation	10,558	13,190
Deferred revenues and customer advances	6,007	4,855
Total current liabilities	35,262	36,942
Deferred gain on sale-leaseback	3,821	4,399
Deferred income taxes	12,768	7,197
Income taxes payable	2,597	2,597
Other non-current liabilities	1,608	1,367
Total liabilities	56,056	52,502
Commitments and contingencies (Note I)		
Shareholders' equity:		
Preferred stock, $.01 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $.01 par value; 85,000,000 shares authorized; 30,181,112 and 29,729,065 shares issued and outstanding at December 31, 2012 and June 30, 2012, respectively	302	297
Additional paid-in capital	227,827	222,769
Retained earnings	96,748	108,732
Accumulated other comprehensive income	1,206	1,306
Total shareholders' equity	326,083	333,104
Total liabilities and shareholders' equity	$ 382,139	$ 385,606

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

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MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

(In thousands, except per share data)
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Net revenues	$49,804	$67,959	$ 99,232	$117,081
Cost of revenues	32,232	27,046	61,270	46,252
Gross margin	17,572	40,913	37,962	70,829
Operating expenses:				
Selling, general and administrative	14,574	14,419	29,107	28,064
Research and development	7,588	11,724	17,627	23,589
Amortization of intangible assets	2,230	692	4,018	1,508
Restructuring and other charges	217	—	5,201	—
Acquisition costs and other related expenses	42	593	272	618
Total operating expenses	24,651	27,428	56,225	53,779
(Loss) income from operations	(7,079)	13,485	(18,263)	17,050
Interest income	2	3	4	9
Interest expense	(15)	(9)	(23)	(18)
Other income, net	116	394	455	799
(Loss) income from operations before income taxes	(6,976)	13,873	(17,827)	17,840
Tax (benefit) provision	(2,192)	4,828	(5,843)	6,142
Net (loss) income	$ (4,784)	$ 9,045	$ (11,984)	$ 11,698
Basic net (loss) earnings per share:	$ (0.16)	$ 0.31	$ (0.40)	$ 0.40
Diluted net (loss) earnings per share:	$ (0.16)	$ 0.30	$ (0.40)	$ 0.39
Weighted-average shares outstanding:				
Basic	30,107	29,457	29,995	29,367
Diluted	30,107	29,969	29,995	30,001
Comprehensive (loss) income:				
Net (loss) income	$ (4,784)	$ 9,045	$ (11,984)	$ 11,698
Foreign currency translation adjustments	(132)	(20)	(100)	38
Total comprehensive (loss) income	$ (4,916)	$ 9,025	$ (12,084)	$ 11,736

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, 2012	Six Months Ended December 31, 2011
Cash flows from operating activities:		
Net (loss) income	$ (11,984)	$ 11,698
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization expense	8,420	5,268
Stock-based compensation expense	4,359	3,852
Benefit for deferred income taxes	(5,890)	(716)
Excess tax benefit from stock-based compensation	(9)	(412)
Other non-cash items	(275)	(358)
Changes in operating assets and liabilities, net of effects of business acquired:		
Accounts receivable, unbilled receivable, and cost in excess of billings	5,110	1,162
Inventory	(2,847)	(4,184)
Prepaid income taxes	804	705
Prepaid expenses and other current assets	1,230	121
Other non-current assets	566	696
Accounts payable and accrued expenses	(9,689)	(5,693)
Deferred revenues and customer advances	822	1,970
Income taxes payable	486	1,778
Other non-current liabilities	507	(643)
Net cash (used in) provided by operating activities	(8,390)	15,244
Cash flows from investing activities:		
Acquisition of business, net of cash acquired	(67,721)	(70,370)
Purchases of property and equipment	(1,726)	(3,571)
Payments for acquired intangible assets	—	(20)
Increase in other investing activities	(377)	(281)
Net cash used in investing activities	(69,824)	(74,242)
Cash flows from financing activities:		
Proceeds from employee stock plans	670	785
Excess tax benefits from stock-based compensation	9	412
Payments of deferred financing and offering costs	(774)	(30)
Payments of acquired debt	(6,575)	—
Decrease in restricted cash	3,000	—
Payments of capital lease obligations	(268)	(102)
Net cash (used in) provided by financing activities	(3,938)	1,065
Effect of exchange rate changes on cash and cash equivalents	88	13
Net decrease in cash and cash equivalents	(82,064)	(57,920)
Cash and cash equivalents at beginning of period	115,964	162,875
Cash and cash equivalents at end of period	$ 33,900	$ 104,955
Cash paid (received) during the period for:		
Interest	$ 23	$ 18
Income taxes	$ (1,308)	$ 4,510
Supplemental disclosures—non-cash activities:		
Issuance of restricted stock awards to employees	$ 12,324	$ 6,201
Unvested stock options assumed from Micronetics	$ 513	$ —

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. (formerly Mercury Computer Systems, Inc.) (the "Company" or "Mercury") is a best of breed provider of commercially developed, open sensor and Big Data processing systems, software and services for critical commercial, defense and intelligence applications. The Company's solutions play a critical role in a wide range of applications, processing and transforming streaming real-time data to information for storage, analysis and interpretation. The Company's goal is to grow and build on its position as a critical component of the defense and intelligence industrial base and be the leading provider of open and affordable sensor processing subsystems for intelligence, surveillance and reconnaissance ("ISR"), electronic warfare ("EW"), and Big Data applications. In military reconnaissance and surveillance platforms, the Company's sub-systems receive, process, and store real-time radar, video, sonar and signals intelligence data. The Company provides radio frequency ("RF") and microwave products for enhanced signal acquisitions and communications in military and commercial applications. Additionally, Mercury Federal Systems, focuses on direct and indirect contracts supporting the defense, intelligence, and homeland security agencies. The Company has growing capabilities in the area of Big Data processing, analytics and analysis in support of both the U.S. Department of Defense ("DoD") and to the intelligence community as they enhance their ability to acquire, process and exploit large amounts of data for both real-time analytics and "forensic" analysis.

The Company's products and solutions address mission-critical requirements within the defense industry for C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance) and electronic warfare systems and services, and target several markets including maritime defense, airborne reconnaissance, ballistic missile defense, ground mobile and force protection systems and tactical communications and network systems. The Company's products and solutions have been deployed in more than 300 different programs with over 25 different prime defense contractors. The Company delivers commercially developed technology and solutions that are based on open system architectures and widely adopted industry standards, and supports all of this with services and support capabilities.

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, 2012 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on August 22, 2012. The results for the three and six months ended December 31, 2012 are not necessarily indicative of the results to be expected for the full fiscal year.

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

BUSINESS COMBINATIONS

The Company utilizes the acquisition method of accounting under Financial Accounting Standard Boards ("FASB") Accounting Standard Codification ("ASC") 805, *Business Combinations*, ("FASB ASC 805"), for all transactions and events which it obtains control over one or more other businesses, to recognize the fair value of all assets and liabilities acquired, even if less than one hundred percent ownership is acquired, and in establishing the acquisition date fair value as measurement date for all assets and liabilities assumed. The Company also utilizes FASB ASC 805 for the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in business combinations.

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 from sales are 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.

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 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 33% and 31% of total revenues in the three and six months ended December 31, 2012, respectively. Total revenue recognized under multiple-deliverable revenue arrangements was 55% and 51% of total revenues in the three and six months ended December 31, 2011, respectively.

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

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

The Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact if the product or service were sold by the Company on a standalone basis.

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

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

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

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.

WEIGHTED-AVERAGE SHARES

Weighted-average shares were calculated as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Basic weighted-average shares outstanding	30,107	29,457	29,995	29,367
Effect of dilutive equity instruments	—	512	—	634
Diluted weighted-average shares outstanding	30,107	29,969	29,995	30,001

Equity instruments to purchase 4,301 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, 2012, because the equity instruments were anti-dilutive. Equity instruments to purchase 1,500 and 925 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, 2011, respectively, because the equity instruments were anti-dilutive.

C. Acquisitions

MICRONETICS ACQUISITION

On June 8, 2012, the Company and Wildcat Merger Sub Inc., a newly formed, wholly-owned subsidiary of the Company (the "Merger Sub"), entered into an Agreement and Plan of Merger (the "Merger Agreement") with Micronetics, Inc. ("Micronetics"). On August 8, 2012, the transaction was closed. The Merger Sub merged with and into Micronetics with Micronetics continuing as the surviving company and wholly-owned subsidiary of the Company.

Headquartered in Hudson, NH, Micronetics is a leading designer and manufacturer of microwave and radio frequency (RF) subsystems and components for defense and commercial customers.

Pursuant to the terms of the Merger Agreement, at the closing of the merger on August 8, 2012, each share of common stock of Micronetics issued and outstanding immediately prior to the closing was converted into the right to receive $14.80 in cash, without interest (the "Merger Consideration"). All outstanding options to acquire shares of Micronetics common stock that were vested as of the closing were cancelled and the holders of such options were entitled to receive an amount of cash equal to the product of the total number of shares previously subject to such vested options and the excess of the Merger Consideration over the exercise price per share. All outstanding Micronetics stock options that were unvested at the closing were replaced by Mercury. The replacement stock options granted were determined based on a conversion ratio provided in the Merger Agreement. Micronetics existing bank debt was paid in full by Mercury on the closing date. Mercury funded the acquisition with cash on hand.

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

	Amounts
Consideration transferred	
Cash paid to shareholders and to settle vested options	$69,830
Value allocated to unvested options	513
Less cash acquired	(2,109)
Net purchase price	$68,234
Estimated fair value of tangible assets acquired and liabilities assumed	
Cash	$ 2,109
Accounts receivable	3,592
Inventory	12,080
Fixed assets	5,301
Other current and non-current assets	2,893
Accounts payable and accrued expenses	(6,014)
Long-term debt	(6,575)
Deferred taxes	(8,052)
Estimated fair value of net tangible assets acquired	5,334
Estimated fair value of identifiable intangible assets	18,500
Estimated fair value of goodwill	46,509
Estimated fair value of assets acquired	$70,343
Less cash acquired	(2,109)
Net purchase price	$68,234

The amounts above represent the preliminary fair value estimates as of December 31, 2012 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period ending August 7, 2013 and finalizes its fair value estimates. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill or income, as applicable.

The goodwill of $46,509 arising from the Micronetics acquisition largely reflects the potential synergies and expansion of the Company's service offerings across product segments and markets complementary to the Company's existing products and markets. The Micronetics acquisition provides the Company with additional capability and expertise related to microwave and radio frequency technology. The acquisition is directly aligned with the Company's strategy of expanding its capabilities, services and offerings along the sensor processing chain.

For the three and six months ended December 31, 2012, Micronetics' revenue of $9,499 and $14,406, respectively, and net loss of $2,894 and $4,513, respectively, were included in the Company's consolidated statements of operations. The Company has not furnished pro forma financial information relating to the Micronetics acquisition because such information is not material to the Company's financial results.

D. Goodwill

The following table sets forth the changes in the carrying amount of goodwill for the six months ended December 31, 2012:

	ACS	MFS	Total
Balance at June 30, 2012	$113,471	$19,150	$132,621
Goodwill arising from the Micronetics acquisition	46,509	—	46,509
Goodwill adjustment for the KOR acquisition	(701)	—	(701)
Balance at December 31, 2012	$159,279	$19,150	$178,429

In the six months ended December 31, 2012, 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 goodwill adjustment for the KOR acquisition is the result of changes in fair value estimates derived from additional information obtained during the measurement period which ended December 30, 2012.

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, ACS and MFS.

E. Acquired Intangible Assets

Acquired intangible assets consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
DECEMBER 31, 2012				
Customer relationships	$43,770	$ (11,444)	$32,326	6.5 years
Licensing agreements and patents	4,095	(2,678)	1,417	5.4 years
Completed technologies	5,570	(1,546)	4,024	5.3 years
Trademarks	990	(190)	800	6.0 years
Backlog	2,300	(1,385)	915	1.3 years
Non-compete agreements	500	(417)	83	5.0 years
	$57,225	$ (17,660)	$39,565	
JUNE 30, 2012				
Customer relationships	$26,770	$ (9,217)	$17,553	6.9 years
Licensing agreements and patents	4,095	(2,365)	1,730	5.4 years
Completed technologies	5,570	(1,007)	4,563	5.3 years
Trademarks	990	(95)	895	6.0 years
Backlog	800	(588)	212	2.0 years
Non-compete agreements	500	(370)	130	5.0 years
	$38,725	$ (13,642)	$25,083	

Estimated future amortization expense for acquired intangible assets remaining at December 31, 2012 is as follows:

	Year Ending June 30,
2013	$ 4,699
2014	7,797
2015	7,503
2016	7,018
2017	5,537
Thereafter	7,011
Total future amortization expense	$ 39,565

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the Micronetics acquisition. These assets are included in the Company's gross and net carrying amounts as of December 31, 2012.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
Customer relationships	$17,000	$ (1,127)	$15,873	6.0 years
Backlog	1,500	(597)	903	1.0 years
Total	$18,500	$ (1,724)	$16,776	

F. 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, 2012:

		Fair Value Measurements		
	December 31, 2012	Level 1	Level 2	Level 3
Assets:				
U.S. Treasury bills and money market funds	$ 22,051	$22,051	$ —	$ —
Restricted cash	658	658	—	—
Total	$ 22,709	$22,709	$ —	$ —

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.

G. 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. 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, 2012	June 30, 2012
Raw materials	$ 16,431	$11,246
Work in process	14,128	8,979
Finished goods	10,224	5,620
Total	$ 40,783	$25,845

The $14,938 increase of inventory was primarily due to inventory from the Micronetics acquisition, valued at $12,080 at the date of acquisition. There are no amounts in inventory relating to contracts having production cycles longer than one year.

H. Debt

Senior Unsecured Credit Facility

On October 12, 2012, the Company entered into a credit agreement (the “Credit Agreement”) with a syndicate of commercial banks, with KeyBank National Association acting as the administrative agent. The Credit Agreement provides for a $200,000 senior unsecured revolving line of credit (the “Revolver”). The Company can borrow up to $200,000 based on consolidated EBITDA for the four quarters ended December 31, 2012 and subject to compliance with the financial covenants discussed below. The Revolver is available for working capital, acquisitions, and general corporate purposes of the Company and its subsidiaries. The Revolver is available for borrowing during a five year period, with interest payable periodically during such period as provided in the Credit Agreement and principal due at the maturity of the Revolver.

The Credit Agreement has an accordion feature permitting the Company to request from the lenders an increase in the aggregate amount of the credit facility in the form of an incremental revolver or term loan in an amount not to exceed $50,000. Any such increase would require only the consent of the lenders increasing their respective commitments under the credit facility.

The interest rates applicable to borrowings under the Credit Agreement involve various rate options that are available to the Company. The rates are calculated using a combination of conventional base rate measures plus a margin over those rates. The base rates consist of LIBOR rates or prime rates. The actual rates will depend on the level of these underlying rates plus a margin based on the Company’s leverage at the time of borrowing.

Borrowings under the Credit Agreement are senior unsecured loans. Each of the Company’s domestic subsidiaries is a guarantor under the Credit Agreement.

The Credit Agreement provides for conventional affirmative and negative covenants, including a maximum leverage ratio of 3.50x and a minimum interest coverage ratio of 3.0x. Each of the two ratios referred to above is calculated based on consolidated EBITDA, as defined in the Credit Agreement, for each consecutive four fiscal quarter period, after giving pro forma effect for any acquisitions or dispositions. Acquisitions are permitted under the Credit Agreement without any dollar limitation so long as, among other requirements, no default or event of default exists or would result therefore; as of December 31, 2012, the Company is in compliance with a maximum leverage ratio of 3.25x and a minimum interest coverage ratio of 3.0x, in each case, after giving pro forma effect to the applicable acquisition. In addition, the Credit Agreement contains certain customary representations and warranties, and events of default.

As of December 31, 2012, there was $77,000 of borrowing capacity available. There were no borrowings outstanding on the Credit Agreement; however, there were outstanding letters of credit of $3,000. The Company was in compliance with all covenants and conditions under the Credit Agreement.

Senior Secured Credit Facility

In connection with entering into the Credit Agreement, on October 12, 2012, the Company terminated its Loan and Security Agreement with Silicon Valley Bank dated February 12, 2010, as amended on March 30, 2011 (the “Loan Agreement”). The Loan Agreement provided for a $35,000 revolving line of credit. The Company terminated the Loan Agreement early without penalty. Silicon Valley Bank released its security interests in the Company’s assets in connection with the termination of the Loan Agreement.

I. Commitments and Contingencies

LEGAL CLAIMS

The U.S. Department of Justice (“DOJ”) conducted an investigation into the conduct of certain former employees of Paragon Dynamics, Inc. (“PDI”) (which was acquired by the Company in connection with the acquisition of KOR Electronics on December 30, 2011) in the 2008-2009 time frame, asserting, among other things, that such conduct may have constituted a violation of the Procurement Integrity Act. On August 31, 2012, the DOJ and PDI entered into a settlement agreement related to the investigation pursuant to which the DOJ released PDI and its affiliates from any civil monetary claims relating to the alleged conduct. PDI did not admit liability for the alleged conduct in the settlement. We were indemnified with respect to this matter by the former shareholders of KOR Electronics pursuant to the Company’s merger agreement with KOR dated December 30, 2011.

In addition to the foregoing, 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, 2012, 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 $12,608.

J. 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 7,764 shares at December 31, 2012. On October 17, 2012, the Company's shareholders approved an increase in the number of shares authorized for issuance under the 2005 plan to 7,592 shares, an increase of 1,500 shares. The 2005 Plan will be increased by any future cancellations, forfeitures or terminations (other than by exercise) under the Company's 1997 Stock Option Plan (the "1997 Plan"). The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant and the options generally have a term of seven years. There were 2,223 shares available for future grant under the 2005 Plan at December 31, 2012.

The number of shares authorized for issuance under the 1997 Plan was 8,650 shares, of which 100 shares could be issued pursuant to restricted stock grants. The 1997 Plan provided for the grant of non-qualified and incentive stock options and restricted stock to employees and non-employees. All stock options were 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. The options typically vest over periods up to four years and have a maximum term of 10 years. Following shareholder approval of the 2005 Plan on November 14, 2005, the Company's Board of Directors determined that no further grants of stock options or other awards would be made under the 1997 Plan, and the 1997 Plan subsequently expired in June 2007. The foregoing does not affect any outstanding awards under the 1997 Plan, which remains in full force and effect in accordance with their terms.

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 52 and 58 shares issued under the ESPP during the six months ended December 31, 2012 and 2011. Shares available for future purchase under the ESPP totaled 307 at December 31, 2012.

Stock Option and Award Activity

The following table summarizes activity of the Company's stock option plans since June 30, 2011:

	Options Outstanding		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Outstanding at June 30, 2011	**2,293**	**$ 14.35**	**3.88**
Granted	—	—	
Exercised	(72)	6.48	
Cancelled	(36)	23.70	
Outstanding at June 30, 2012	**2,185**	**$ 14.46**	**2.89**
Granted	271	4.75	
Exercised	(40)	6.65	
Cancelled	(232)	15.98	
Outstanding at December 31, 2012	**2,184**	**$ 13.23**	**3.04**

On August 8, 2012, the Company completed its acquisition of Micronetics. Pursuant to the terms of the Merger Agreement, all outstanding options to acquire shares of Micronetics common stock that were vested at the closing were cancelled and the holders of such options received an amount of cash equal to the product of the total number of shares previously subject to such vested options and the excess of the merger consideration over the exercise price per share. All outstanding Micronetics stock options that were unvested at the closing were replaced by the Company. The replacement stock options granted were determined based on a conversion ratio provided in the Merger Agreement. The 271 of stock options granted in the table above reflect the replacement of the unvested Micronetics stock options as of August 8, 2012.

STOCK OPTION ASSUMPTIONS

The following table sets forth the weighted-average key fair value results and assumptions for stock options granted during the three and six months ended December 31, 2012 and 2011:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Weighted-average fair value of options granted	— (*)	— (*)	3.80	— (*)
Option life(1)	— (*)	— (*)	4.5 years	— (*)
Risk-free interest rate(2)	— (*)	— (*)	0.7%	— (*)
Stock volatility(3)	— (*)	— (*)	58%	— (*)
Dividend rate	— (*)	— (*)	0%	— (*)

(1) The option life was determined based upon historical option activity.
(2) The risk-free interest rate for each grant is equal to the U.S. Treasury yield curve in effect at the time of grant for instruments with a similar expected life.
(3) The stock volatility for each grant is measured using the weighted average of historical daily price changes of the Company's common stock over the most recent period equal to the expected option life of the grant, the historical short-term trend of the option and other factors, such as expected changes in volatility arising from planned changes in the Company's business operations.
(*) No stock options were granted by the Company during these periods.

The following table summarizes the status of the Company's non-vested restricted stock awards since June 30, 2011:

	Non-vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2011	**1,187**	**$ 11.23**
Granted	585	14.30
Vested	(409)	10.62
Forfeited	(88)	13.14
Outstanding at June 30, 2012	**1,275**	**$ 12.71**
Granted	1,297	9.50
Vested	(360)	11.57
Forfeited	(95)	11.28
Outstanding at December 31, 2012	**2,117**	**$ 11.00**

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, 2012 and 2011 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. 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,	
	2012	2011	2012	2011
Cost of revenues	$ 99	$ 70	$ 230	$ 158
Selling, general and administrative	1,706	1,573	3,609	3,248
Research and development	205	169	520	446
Share-based compensation expense before tax	2,010	1,812	4,359	3,852
Income taxes	(752)	(664)	(1,605)	(1,383)
Net compensation expense	$ 1,258	$ 1,148	$ 2,754	$ 2,469

K. Operating Segment, Geographic Information and Significant Customers

Operating segments are defined as components of an enterprise evaluated regularly by the Company's senior management in deciding how to allocate resources and assess performance. The Company is presently organized in two operating segments. These reportable 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:

- Advanced Computing Solutions: this operating segment is focused on specialized, high-performance embedded, real-time digital signal and image processing solutions that encompass signal acquisition, including microwave front-end, digitalization, digital signal processing, exploitation processing, high capacity digital storage and communications, targeted to key market segments, including defense, communications and other commercial applications. With the addition of KOR, the ACS segment also designs and develops Digital Radio Frequency Memory (DRFM) units for a variety of modern EW applications, as well as radar environment simulation and test systems for defense applications.
- Mercury Federal Systems: this operating segment is focused on services and support work with the Department of Defense and federal intelligence and homeland security agencies, including designing, engineering, and deploying new ISR capabilities to address present and emerging threats to U.S. forces. With the addition of PDI, the MFS segment also provides sophisticated analysis and exploitation, multi-sensor data fusion and enrichment, and data processing services for the U.S. intelligence community.

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 chief operating decision maker ("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 earnings from continuing operations before interest income and expense, income taxes, depreciation, amortization of acquired intangible assets, restructuring, impairment of long-lived assets, acquisition costs and other related expenses, fair value adjustments from purchase accounting and stock-based compensation costs. Prior year's amounts have been presented to reflect the current profitability measures for comparative purposes. 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:

	ACS	MFS	Eliminations	Total
THREE MONTHS ENDED DECEMBER 31, 2012				
Net revenues to unaffiliated customers	$ 43,453	$ 7,862	$ (1,511)	$ 49,804
Intersegment revenues	3,239	4	(3,243)	—
Net revenues	$ 46,692	$ 7,866	$ (4,754)	$ 49,804
Adjusted EBITDA	$ 2,376	$ (727)	$ (650)	$ 999
THREE MONTHS ENDED DECEMBER 31, 2011				
Net revenues to unaffiliated customers	$ 64,062	$ 5,191	$ (1,294)	$ 67,959
Intersegment revenues	1,996	—	(1,996)	—
Net revenues	$ 66,058	$ 5,191	$ (3,290)	$ 67,959
Adjusted EBITDA	$ 18,097	$ 1,065	$ (325)	$ 18,837
SIX MONTHS ENDED DECEMBER 31, 2012				
Net revenues to unaffiliated customers	$ 81,261	$17,778	$ 193	$ 99,232
Intersegment revenues	8,147	12	(8,159)	—
Net revenues	$ 89,408	$17,790	$ (7,966)	$ 99,232
Adjusted EBITDA	$ 1,942	$ 726	$ (27)	$ 2,641
SIX MONTHS ENDED DECEMBER 31, 2011				
Net revenues to unaffiliated customers	$109,458	$ 9,363	$ (1,740)	$117,081
Intersegment revenues	3,929	—	(3,929)	—
Net revenues	$113,387	$ 9,363	$ (5,669)	$117,081
Adjusted EBITDA	$ 26,251	$ 1,573	$ (259)	$ 27,565

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

(In thousands)	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
Net (loss) income	$(4,784)	$ 9,045	$(11,984)	$11,698
Interest expense, net	13	6	19	9
Tax (benefit) provision	(2,192)	4,828	(5,843)	6,142
Depreciation	2,191	1,905	4,402	3,760
Amortization of intangible assets	2,230	692	4,018	1,508
Restructuring and other charges	217	—	5,201	—
Acquisition costs and other related expenses	42	593	272	618
Fair value adjustments from purchase accounting	1,272	(44)	2,197	(22)
Stock-based compensation expense	2,010	1,812	4,359	3,852
Adjusted EBITDA	$ 999	$18,837	$ 2,641	$27,565

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

	US	Europe	Asia Pacific	Eliminations	Total
THREE MONTHS ENDED DECEMBER 31, 2012					
Net revenues to unaffiliated customers	$ 45,953	$1,084	$ 2,767	$ —	$ 49,804
Inter-geographic revenues	2,749	138	19	(2,906)	—
Net revenues	$ 48,702	$1,222	$ 2,786	$ (2,906)	$ 49,804
THREE MONTHS ENDED DECEMBER 31, 2011					
Net revenues to unaffiliated customers	$ 66,458	$ 349	$ 1,152	$ —	$ 67,959
Inter-geographic revenues	762	178	11	(951)	—
Net revenues	$ 67,220	$ 527	$ 1,163	$ (951)	$ 67,959
SIX MONTHS ENDED DECEMBER 31, 2012					
Net revenues to unaffiliated customers	$ 93,588	$1,428	$ 4,216	$ —	$ 99,232
Inter-geographic revenues	3,927	187	45	(4,159)	—
Net revenues	$ 97,515	$1,615	$ 4,261	$ (4,159)	$ 99,232
SIX MONTHS ENDED DECEMBER 31, 2011					
Net revenues to unaffiliated customers	$113,335	$1,141	$ 2,605	$ —	$117,081
Inter-geographic revenues	2,944	435	31	(3,410)	—
Net revenues	$116,279	$1,576	$ 2,636	$ (3,410)	$117,081

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, 2012	$18,229	$ 32	$ —	$ —	$18,261
June 30, 2012	$15,895	$ 32	$ 2	$ —	$15,929

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,	
	2012	2011	2012	2011
Northrop Grumman Corporation	13%	27%	12%	23%
Raytheon Company	12	30	*	27
Lockheed Martin Corporation	*	17	*	14
	25%	74%	12%	64%

* 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 revenue for the periods shown below are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Joint Strike Fighter	*%	21%	*%	19%
Classified Airborne Radar Program	*	19%	*	11%
Aegis	*	13%	*	11%
	0%	53%	0%	41%

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

L. Income Taxes

The Company recorded a tax benefit of $2,192 and tax expense of $4,828 on a loss from operations before taxes of $6,976 and income from operations of $13,873 for the three months ended December 31, 2012 and 2011, respectively. The Company recorded a tax benefit of $5,843 and tax expense of $6,142 on a loss from operations before taxes of $17,827 and income from operations of $17,840 for the six months ended December 31, 2012 and 2011, respectively. Income tax benefit for the three and six months ended December 31, 2012 differed from the federal statutory rate primarily due to the impact of a Section 199 manufacturing deduction, state taxes and stock compensation. Income tax expense for the three and six months ended December 31, 2011 differed from the federal statutory rate primarily due to the impact of a Section 199 manufacturing deduction and research and development tax credits.

No material changes in the Company's unrecognized tax positions occurred during the three and six months ended December 31, 2012. The Company estimates that the unrecognized tax benefits could decrease by up to $630 within the next 12 months as a result of resolutions of tax positions and the expiration of applicable statutes of limitations.

On January 2, 2013, the "American Taxpayer Relief Act of 2012" was enacted into law by Congress. The American Taxpayer Relief Act of 2012 extended the research and development tax credit provisions of the tax code retroactively to January 1, 2012. Based on the extension, the Company estimates that there was an additional $875 credit earned in calendar 2012.

M. Restructuring Plan

In the first quarter of fiscal 2013, the Company announced a restructuring plan ("2013 Plan") affecting the ACS business segment. The 2013 Plan was implemented to cope with reduced defense revenues and the near term uncertainties in the defense industry driven by the potential for sequestration. The 2013 Plan primarily consisted of involuntary separation costs related to the reduction in force which eliminated 142 positions largely in engineering, manufacturing and administrative functions, as well as reductions associated with the first phase of integration of Micronetics. Restructuring expenses of $217 and $5,201 were recognized for the three and six months ended December 31, 2012, respectively. Future restructuring expenses of approximately $203 associated with the 2013 Plan are expected in the second half of fiscal 2013 as the Company continues transitioning manufacturing activities related to the Micronetics acquisition. These restructuring expenses affect the ACS business segment.

In the fourth quarter of fiscal 2012, the Company announced a restructuring plan ("2012 Plan") affecting both the ACS and MFS business segments. The 2012 Plan primarily consisted of involuntary separation costs related to the reduction in force which eliminated 41 positions largely in engineering and manufacturing functions; and facility costs related to outsourcing of certain manufacturing activities at the Company's

Huntsville, Alabama site. Future restructuring expenses of approximately $404 associated with the 2012 Plan are expected in the second half of fiscal 2013 as the Company continues transitioning the manufacturing activities formerly conducted at the Huntsville, Alabama facility. This restructuring expense will affect the ACS business segment.

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

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

	Severance & Related	Facilities & Other	Total
ACS restructuring charges	$ 2,406	$ 306	$ 2,712
MFS restructuring charges	109	—	109
Total 2012 provision	2,515	306	2,821
Cash paid	(2)	(121)	(123)
Restructuring liability at June 30, 2012	$ 2,513	$ 185	$ 2,698
ACS restructuring charges	5,333	146	5,479
MFS restructuring charges	—	—	—
Total 2013 provision	5,333	146	5,479
Cash paid	(5,103)	(148)	(5,251)
Reversals(*)	(278)	—	(278)
Restructuring liability at December 31, 2012	$ 2,465	$ 183	$ 2,648

(*) Reversals consist primarily of a true up for the finalization of severance agreements and unused outplacement services.

N. 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.

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. The words "may," "will," "would," "should," "could," "plan," "expect," "believe," "anticipate," "continue," "estimate," "project," "intend," "likely," "forecast," "probable," and similar expressions are intended to identify forward-looking statements regarding events, conditions and financial trends that may affect our future plans of operations, business strategy, results of operations and financial position. These forward-looking statements, which include those related to our strategic plans, business outlook, and future business and financial performance, 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 and the timing of such funding, including the potential for a continuing resolution for the defense budget and the potential for defense budget sequestration, general economic and business conditions, including unforeseen economic weakness in our markets, effects of continued geo-political unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing various engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in the U.S. Government's interpretation of federal procurement rules and regulations, market acceptance of our products, shortages in components, production delays due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions 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, 2012. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

OVERVIEW

We design, manufacture and market commercially-developed, high-performance embedded, real-time digital signal and image processing sub-systems and software for specialized defense and commercial markets. Our solutions play a critical role in a wide range of applications, processing and transforming sensor data to information for storage, analysis and interpretation. Our goal is to grow and build on our position as a critical component of the defense and intelligence industrial base and be the leading provider of open and affordable sensor processing subsystems for intelligence, surveillance and reconnaissance ("ISR"), electronic warfare ("EW"), and missile defense applications. In military reconnaissance and surveillance platforms, our sub-systems receive, process, and store real-time radar, video, sonar and signals intelligence data. We provide radio frequency ("RF") and microwave products for enhanced signal acquisition and communications in military and commercial applications. Additionally, Mercury Federal Systems, focuses on direct and indirect contracts supporting the defense, intelligence, and homeland security agencies. We have growing capabilities in the area of "Big Data" processing, analytics and analysis in support of both the U.S. Department of Defense ("DoD") and to the intelligence community as they enhance their ability to acquire, process and exploit large amounts of data for both real-time analytics and "forensic" analysis.

Our products and solutions address mission-critical requirements within the defense industry for C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance) and electronic warfare, systems and services, and target several markets including maritime defense, airborne reconnaissance, ballistic missile defense, ground mobile and force protection systems and tactical communications and network systems. We deliver commercially developed technology and solutions that are based on open system architectures and widely adopted industry standards, and support all of this with services and support capabilities.

As of December 31, 2012, we had 769 employees. Our revenue, net loss and adjusted EBITDA for the three month period ended December 31, 2012 were $49.8 million, ($4.8) million, and $1.0 million, respectively. Our revenue, net loss and adjusted EBITDA for the six month period ended December 31, 2012 were $99.2 million, ($12.0) million and $2.6 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation of our adjusted EBITDA to net loss.

Our operations are presently organized in the following two business segments:

Advanced Computing Solutions, or ACS. This business segment is focused on specialized, high-performance embedded, real-time digital signal and image processing solutions that encompass signal acquisition, including microwave front-end, digitization, digital signal processing, exploitation processing, high capacity digital storage and communications, targeted to key market segments, including defense, communications and other commercial applications. ACS's open system architecture solutions span the full range of embedded technologies from board level products to fully integrated sub-systems. Our products utilize leading-edge processor and other technologies architected to address highly data-intensive applications that include signal, sensor and image processing within environmentally challenging and size, weight and power constrained military and commercial applications. In addition, ACS has a portfolio of RF and microwave sub-assemblies to address needs in EW, signal intelligence ("SIGINT"), electronic intelligence ("ELINT"), and high bandwidth communications subsystems.

These products are highly optimized for size, weight and power, as well as for the performance and ruggedization requirements of our customers. Customized design and sub-systems integration services extend our capabilities to tailor solutions to meet the specialized requirements of our customers. We continue to innovate our technologies around challenging requirements and have technologies available today and planned for the future to address them as they evolve and become increasingly demanding.

With the addition of KOR Electronics ("KOR") in December 2011, we added a focus on the exploitation of RF signals. Leveraging our analog-to-digital and digital-to-analog technologies and expertise, KOR delivers innovative high end solutions and services to the defense communities:

- DRFM (Digital Radio Frequency Memory) products which offer state of the art performance at low cost, for EW applications; and
- radar and EW environment test and simulator products that are DRFM based and use modular and scalable building blocks including commercial-off-the-shelf hardware.

With the acquisition of Micronetics, Inc. ("Micronetics") in August 2012, we added a leading designer and manufacturer of microwave and RF subsystems and components for defense and commercial customers. The acquisition was directly aligned with our strategy of expanding our capabilities, services and offerings along the sensor processing chain.

For the six months ended December 31, 2012, ACS accounted for 82% of our total net revenues.

Mercury Federal Systems, or MFS. This business segment is focused on services and support work with the DoD and federal intelligence and homeland security agencies, including designing, engineering, and deploying new ISR capabilities to address present and emerging threats to U.S. forces. With the addition of Paragon Dynamics, Inc. ("PDI") in December 2011, our MFS segment also provides sophisticated analysis and exploitation, multi-sensor data fusion and enrichment, and data processing services for the U.S. intelligence community. MFS is part of our long-term strategy to expand our software and services presence and pursue growth within the intelligence community. MFS offers a wide range of engineering architecture and design services that enable clients to deploy leading edge computing capabilities for ISR applications on an accelerated time cycle. This business segment enables us to combine classified intellectual property with the commercially developed application-ready sub-systems being developed by ACS, providing customers with platform-ready, affordable ISR sub-systems. For the six months ended December 31, 2012, MFS accounted for 18% of our total net revenues.

Since we are an OEM supplier to our commercial markets and conduct business with our defense customers via commercial terms, 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, 2012 compared to the three months ended December 31, 2011

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

(In thousands)	December 31, 2012	As a % of Total Net Revenue	December 31, 2011	As a % of Total Net Revenue
Net revenues	$ 49,804	100.0%	$ 67,959	100.0%
Cost of revenues	32,232	64.7	27,046	39.8
Gross margin	17,572	35.3	40,913	60.2
Operating expenses:				
Selling, general and administrative	14,574	29.3	14,419	21.2
Research and development	7,588	15.2	11,724	17.3
Amortization of intangible assets	2,230	4.5	692	1.0
Restructuring and other charges	217	0.4	—	—
Acquisition costs and other related expenses	42	0.1	593	0.9
Total operating expenses	24,651	49.5	27,428	40.4
(Loss) income from operations	(7,079)	(14.2)	13,485	19.8
Other income, net	103	0.2	388	0.6
(Loss) income from operations before income taxes	(6,976)	(14.0)	13,873	20.4
Tax (benefit) provision	(2,192)	(4.4)	4,828	7.1
Net (loss) income	$ (4,784)	(9.6)%	$ 9,045	13.3%

REVENUES

(In thousands)	December 31, 2012	December 31, 2011	$ Change	% Change
ACS	$ 43,453	$ 64,062	$(20,609)	(32)%
MFS	7,862	5,191	2,671	51%
Eliminations	(1,511)	(1,294)	(217)	17%
Total revenues	$ 49,804	$ 67,959	$(18,155)	(27)%

Total revenues decreased $18.2 million, or 27%, to $49.8 million during the three months ended December 31, 2012 as compared to the comparable period in fiscal 2012. International revenues represented approximately 8% and 2% of total revenues during the three months ended December 31, 2012 and 2011, respectively.

Net ACS revenues decreased $20.6 million, or 32%, during the three months ended December 31, 2012 as compared to the same period in fiscal 2012. This decrease was primarily driven by lower defense sales of $20.8 million which were slightly offset by a $0.2 million increase in commercial sales. Organic ACS defense revenues for the three months ended December 31, 2012 declined $36.5 million as a result of lower revenues in four particular programs year over year and a general slowdown in funding due to current constraints on U.S. defense spending and uncertainties surrounding the future defense budget. This decline was offset by $6.2 million and $9.5 million of revenues from the acquisitions of KOR Electronics and Micronetics, respectively.

Net MFS revenues increased $2.7 million during the three months ended December 31, 2012 as compared to the same period in fiscal 2012. This increase was primarily driven by $3.4 million in revenues contributed from the acquisition of PDI, partially offset by lower revenues from a wide area persistent surveillance contract.

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 35.3% for the three months ended December 31, 2012, a change of 24.9% from the 60.2% gross margin achieved during the same period in fiscal 2012. The decrease in gross margin was primarily due to a shift in program revenue mix coupled with a revenue decline in our higher margin organic ACS digital computing business. In addition, the acquisitions of KOR, PDI, and Micronetics generate lower gross margins than our organic ACS digital computing business. In the long term, we expect our future gross margins to be in line with our targeted business model of 45%.

Selling, General and Administrative

Selling, general and administrative expenses increased $0.2 million, or 1%, to $14.6 million during the three months ended December 31, 2012, compared to $14.4 million during the comparable period in fiscal 2012. The increase was primarily due to a $0.4 million increase in employee compensation expense, primarily as a result of the KOR, PDI and Micronetics acquisitions which was partially offset by the cost reduction initiatives as a result of our fiscal 2013 restructuring plan. Selling, general and administrative expenses increased as a percentage of revenues to 29.3% during the three months ended December 31, 2012 from 21.2% during the same period in fiscal 2012 due to lower revenues in the second quarter of fiscal 2013 as compared to the comparable period in fiscal 2012.

Research and Development

Research and development expenses decreased $4.1 million, or 35%, to $7.6 million during the three months ended December 31, 2012, compared to $11.7 million during the comparable period in fiscal 2012. The decrease was primarily due to cost reduction initiatives as a result of our fiscal 2013 restructuring plan, including a $3.7 million decrease in employee compensation expense, including stock-based compensation, and a $1.5 million decrease in costs of prototype and development materials directly related to headcount reduction. These decreases were partially offset by $1.0 million in lower resource allocations to customer funded projects and $0.4 million due to the acquisition of KOR, PDI, and Micronetics.

Amortization of Intangible Assets

Amortization of acquired intangible assets increased $1.5 million, to $2.2 million for the three months ended December 31, 2012 as compared to $0.7 million during the comparable period in fiscal 2012, primarily due to amortization of intangible assets from the KOR, PDI and Micronetics acquisitions.

Restructuring Expense

We implemented restructuring plans in the first quarter of fiscal 2013 and in the fourth quarter of fiscal 2012. These plans consisted of involuntary separation costs related to a reduction in force and facility costs related to the outsourcing of certain manufacturing activities. The plans were implemented to cope with reduced defense revenues and the near term uncertainties in the defense industry driven by the potential for sequestration. The $0.2 million of restructuring expense recorded during the three months ended December 31, 2012 was primarily attributed to charges for facility space idled during the period. We expect to generate approximately $25.0 million in annualized savings from the fiscal 2012 and 2013 cost reduction activities.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred less than $0.1 million of acquisition costs and other related expenses during the three months ended December 31, 2012, in connection with the acquisition of Micronetics. Acquisition costs and other related expenses of $0.6 million incurred during the comparable period in fiscal 2012 were in connection with the KOR and PDI acquisitions.

OTHER INCOME, NET

Other income, net decreased $0.3 million, or 73%, to $0.1 million during the three months ended December 31, 2012, as compared to the same period in fiscal 2012. Other income, net consists of $0.3 million in amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts offset by net foreign currency exchange losses. Interest income and interest expense were de minimis.

INCOME TAXES

We recorded an income tax benefit of $2.2 million during the three months ended December 31, 2012 as compared to a $4.8 million income tax provision, for the same period in fiscal 2012. Our income tax benefit for the three months ended December 31, 2012 differed from the federal statutory tax rate of 35% primarily due to the impact of the Section 199 manufacturing deduction, state taxes and stock compensation. Our effective tax rate during the comparable period in fiscal 2012 also differed from the federal statutory rate primarily due to the impact of the Section 199 manufacturing deduction and research and development tax credits. Due to the enactment of the “American Taxpayer Relief Act of 2012”, we expect to realize a tax benefit of $1.2 million in the second half of fiscal 2013 as a result of the retroactive extension of the research and development tax credits.

SEGMENT OPERATING RESULTS

Adjusted EBITDA, the profitability measure for our segment reporting, for ACS decreased $15.7 million during the three months ended December 31, 2012 to $2.4 million as compared to $18.1 million for the same period in fiscal 2012. The decrease in adjusted EBITDA is primarily driven by lower revenues of $20.6 million coupled with lower margins driven by both a shift in the organic ACS digital computing program mix and the KOR and Micronetics acquisitions.

Adjusted EBITDA for the MFS segment decreased $1.8 million during the three months ended December 31, 2012 to $(0.7) million as compared to $1.1 million for the same period in fiscal 2012. The decrease in adjusted EBITDA was primarily due to lower margins on a wide area persistent surveillance contract.

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

Six months ended December 31, 2012 compared to the six months ended December 31, 2011

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

(In thousands)	December 31, 2012	As a % of Total Net Revenue	December 31, 2011	As a % of Total Net Revenue
Net revenues	$ 99,232	100.0%	$ 117,081	100.0%
Cost of revenues	61,270	61.7	46,252	39.5
Gross margin	37,962	38.3	70,829	60.5
Operating expenses:				
Selling, general and administrative	29,107	29.3	28,064	24.0
Research and development	17,627	17.8	23,589	20.1
Amortization of intangible assets	4,018	4.1	1,508	1.3
Restructuring and other charges	5,201	5.2	—	—
Acquisition costs and other related expenses	272	0.3	618	0.5
Total operating expenses	56,225	56.7	53,779	45.9
(Loss) income from operations	(18,263)	(18.4)	17,050	14.6
Other income, net	436	0.4	790	0.6
(Loss) income from operations before income taxes	(17,827)	(18.0)	17,840	15.2
Tax (benefit) provision	(5,843)	(5.9)	6,142	5.2
Net (loss) income	$ (11,984)	(12.1)%	$ 11,698	10.0%

REVENUES

(In thousands)	December 31, 2012	December 31, 2011	$ Change	% Change
ACS	$ 81,261	$ 109,458	$(28,197)	(26)%
MFS	17,778	9,363	8,415	90%
Eliminations	193	(1,740)	1,933	111%
Total revenues	$ 99,232	$ 117,081	$(17,849)	(15)%

Total revenues decreased $17.8 million, or 15%, to $99.2 million during the six months ended December 31, 2012 as compared to the comparable period in fiscal 2012. International revenues represented approximately 6% and 3% of total revenues during the six months ended December 31, 2012 and 2011, respectively.

Net ACS revenues decreased $28.2 million, or 26%, during the six months ended December 31, 2012 as compared to the same period in fiscal 2012. This decrease was primarily driven by lower defense sales of $29.2 million which were slightly offset by a $1.0 million increase in commercial sales. Organic ACS defense revenues for the six months ended December 31, 2012 declined $55.7 million as a result of lower revenues in five particular programs year over year and a general slowdown in funding due to current constraints on U.S. defense spending and uncertainties surrounding the future defense budget. This decline was partially offset by $12.1 million and $14.4 million of revenues from the acquisitions of KOR Electronics and Micronetics, respectively.

Net MFS revenues increased $8.4 million during the six months ended December 31, 2012 as compared to the same period in fiscal 2012. This increase was primarily driven by $7.2 million in revenues contributed from the acquisition of PDI and higher revenues from a wide area persistent surveillance contract.

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 38.3% for the six months ended December 31, 2012, a change of 22.2% from the 60.5% gross margin achieved during the same period in fiscal 2012. The decrease in gross margin was primarily due to a shift in program revenue mix coupled with a revenue decline in our higher margin organic ACS digital computing business. In addition, the acquisitions of KOR, PDI, and Micronetics realize lower gross margins than our organic ACS digital computing business.

Selling, General and Administrative

Selling, general and administrative expenses increased $1.0 million, or 3.7%, to $29.1 million during the six months ended December 31, 2012, compared to $28.1 million during the comparable period in fiscal 2012. The increase was primarily due to a $0.8 million increase in employee compensation expense, including stock based compensation, primarily as a result of the KOR, PDI and Micronetics acquisitions which was partially offset by the cost reduction initiatives as a result of our fiscal 2013 restructuring plan. Selling, general and administrative expenses increased as a percentage of revenues to 29.3 % during the six months ended December 31, 2012 from 24.0% during the same period in fiscal 2012 due to lower revenues in the first six months of fiscal 2013 as compared to the same period in fiscal 2012.

Research and Development

Research and development expenses decreased $6.0 million, or 25.3%, to $17.6 million during the six months ended December 31, 2012, compared to $23.6 million during the comparable period in fiscal 2012. The decrease was primarily due to cost reduction initiatives as a result of our fiscal 2013 restructuring plan, including a $4.8 million decrease in employee compensation expense, and a $2.1 million decrease in costs of prototype and development materials directly related to headcount reductions. These decreases were partially offset by $0.9 million due to the inclusion of KOR, PDI, and Micronetics.

Amortization of Intangible Assets

Amortization of acquired intangible assets increased $2.5 million, to $4.0 million for the six months ended December 31, 2012 as compared to $1.5 million during the comparable period in fiscal 2012, primarily due to amortization of intangible assets from the KOR, PDI and Micronetics acquisitions.

Restructuring Expense

There was $5.2 million of restructuring expense recorded during the six months ended December 31, 2012. The restructuring plan implemented in the first quarter of fiscal 2013 consisted of involuntary separation costs related to the reduction in force which eliminated 35 positions at Micronetics and 107 positions primarily from our corporate headquarters located in Chelmsford, Massachusetts. These 142 positions were largely from our engineering, administrative and manufacturing functions. The 2013 Plan was implemented to cope with reduced defense revenues and the near term uncertainties in the defense industry driven by the potential for sequestration. In addition we incurred charges during the six months ended December 31, 2012 for facility space idled during the period. We expect to generate approximately $25.0 million in annualized savings from these cost reduction activities.

Acquisition Costs and Other Related Expenses

Acquisition costs and other related expenses decreased $0.3 million, to $0.3 million for the six months ended December 31, 2012 as compared to $0.6 million during the comparable period in fiscal 2012. The acquisition costs and other related expenses incurred during the six months ended December 31, 2012, were in connection with the acquisition of Micronetics. The acquisition costs and other related expenses incurred during the six months ended December 31, 2011, were in connection with the KOR and PDI acquisitions.

Other Income, Net

Other income, net decreased $0.4 million, or 45%, to $0.4 million during the six months ended December 31, 2012, as compared to the same period in fiscal 2012. Other income, net consists of $0.6 million in amortization of the gain on the sale leaseback of our corporate headquarters located in Chelmsford, Massachusetts offset by foreign currency exchange losses. Interest income and interest expense were de minimis.

Income Taxes

We recorded an income tax benefit of $5.8 million during the six months ended December 31, 2012 as compared to a $6.1 million income tax provision, for the same period in fiscal 2012. Our income tax benefit for the six months ended December 31, 2012 differed from the federal statutory tax rate of 35% primarily due to the impact of the Section 199 manufacturing deduction, state taxes and stock compensation. Our effective tax rate for the six months ended December 31, 2011 also differed from the federal statutory rate primarily due to the impact of the Section 199 manufacturing deduction and research and development tax credits. Due to the enactment of the “American Taxpayer Relief Act of 2012”, we expect to realize a tax benefit of $1.2 million in the second half of fiscal 2013 as a result of the retroactive extension of the research and development tax credits.

Segment Operating Results

Adjusted EBITDA, the profitability measure for our segment reporting, for ACS decreased $24.4 million during the six months ended December 31, 2012 to $1.9 million as compared to $26.3 million for the same period in fiscal 2012. The decrease in adjusted EBITDA is primarily driven by lower revenues of $28.2 million coupled with lower margins driven by both a shift in the organic ACS digital computing program mix and the KOR and Micronetics acquisitions.

Adjusted EBITDA for the MFS segment decreased $0.9 million during the six months ended December 31, 2012 to $0.7 million as compared to $1.6 million for the same period in fiscal 2012. The decrease in adjusted EBITDA was primarily due to lower margins related to the wide area persistent surveillance contract.

See Note K 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 came from existing cash and cash equivalents. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments with our contract manufacturers. We do not currently have any material commitments for capital expenditures.

Based on our current plans and business conditions, we believe that existing cash, cash equivalents, available 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

On October 12, 2012, we entered into a credit agreement (the “Credit Agreement”) with a syndicate of commercial banks, with KeyBank National Association acting as the administrative agent. The Credit Agreement provides for a $200.0 million senior unsecured revolving line of credit (the “Revolver”). We can borrow up to $200.0 million based on consolidated EBITDA for the four quarters ended December 31, 2012 and subject to compliance with the financial covenants discussed below. The Revolver is available for working capital, acquisitions, and general corporate purposes of the Company and its subsidiaries. The Revolver is available for borrowing during a five year period, with interest payable periodically during such period as provided in the Credit Agreement and principal due at the maturity of the Revolver.

The Credit Agreement has an accordion feature permitting us to request from the lenders an increase in the aggregate amount of the credit facility in the form of an incremental revolver or term loan in an amount not to exceed $50.0 million. Any such increase would require only the consent of the lenders increasing their respective commitments under the credit facility.

The interest rates applicable to borrowings under the Credit Agreement involve various rate options that are available to us. The rates are calculated using a combination of conventional base rate measures plus a margin over those rates. The base rates consist of LIBOR rates or prime rates. The actual rates will depend on the level of these underlying rates plus a margin based on our leverage at the time of borrowing.

Borrowings under the Credit Agreement are senior unsecured loans. Each of our domestic subsidiaries is a guarantor under the Credit Agreement.

The Credit Agreement provides for conventional affirmative and negative covenants, including a maximum leverage ratio of 3.50x and a minimum interest coverage ratio of 3.0x. Each of the two ratios referred to above is calculated based on consolidated EBITDA, as defined in the Credit Agreement, on a consolidated basis for each consecutive four fiscal quarter period, after giving pro forma effect for any acquisitions or dispositions. Acquisitions are permitted under the Credit Agreement without any dollar limitation so long as, among other requirements, no default or event of default exists or would result therefore; at December 31, 2012, we are in compliance with a maximum leverage ratio of 3.25x and a minimum interest coverage ratio of 3.0x, in each case, after giving pro forma effect to the applicable acquisition. In addition, the Credit Agreement contains certain customary representations and warranties, and events of default.

As of December 31, 2012, there was $77.0 million of borrowing capacity available. There were no borrowings outstanding on the Credit Agreement; however, there were outstanding letters of credit of $3.0 million. We were in compliance with all covenants and conditions under the Credit Agreement.

Senior Secured Credit Facility

On October 12, 2012, the Company terminated its Loan and Security Agreement with Silicon Valley Bank dated February 12, 2010, as amended on March 30, 2011 (the “Loan Agreement”). The Loan Agreement provided for a $35.0 million revolving line of credit. The Company terminated the Loan Agreement early without penalty. Silicon Valley Bank released its security interests in the Company’s assets in connection with the termination of the Loan Agreement.

Shelf Registration Statement

On August 2, 2011, 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 period ended December 31, 2012	2011
Net cash (used in) provided by operating activities	$ (8,390)	$ 15,244
Net cash used in investing activities	$(69,824)	$ (74,242)
Net cash (used in) provided by financing activities	$ (3,938)	$ 1,065
Net decrease in cash and cash equivalents	$(82,064)	$ (57,920)
Cash and cash equivalents at end of period	$ 33,900	$104,955

Our cash and cash equivalents decreased by $82.1 million from June 30, 2012 to December 31, 2012, primarily as a result of the $67.7 million payment, net of cash acquired, to acquire Micronetics, $6.6 million payment to repay debt held by Micronetics immediately prior to its acquisition by us, and funding a $8.4 million cash out flow from operating activities.

Operating Activities

During the six months ended December 31, 2012, we used $8.4 million in cash for operating activities compared to $15.2 million in cash generated from operating activities during the same period in fiscal 2012. The $23.6 million decline in cash generated by operating activities was primarily a result of lower comparable net income of $23.7 million and a $4.0 million increase in cash used for payables and accrued expenses. These increases in the use of cash were partially offset by $3.9 million in higher cash generation from the collection of receivables. 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, 2012, we used cash of $69.8 million in investing activities compared to $74.2 million used by investing activities during the same period in fiscal 2012. The $4.4 million decrease in cash used in investing activities was primarily driven by $2.7 million of less cash spent on acquisitions and $1.8 million of lower purchases of property and equipment.

Financing Activities

During the six months ended December 31, 2012, we used $3.9 million in financing activities compared to $1.1 million generated from financing activities during the same period in fiscal 2012. The $5.0 million change in cash from financing activities was primarily due to a $6.6 million payment to settle debt acquired as part of the Micronetics acquisition, the release of $3.0 million of cash formerly restricted in support of a letter of credit which is presently supported by our Credit Agreement, and $0.8 million in financing fees associated with the Credit Agreement.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following is a schedule of our commitments and contractual obligations outstanding at December 31, 2012:

(In thousands)	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
Purchase obligations	$12,608	$ 12,608	$ —	$ —	$ —
Operating leases	13,964	4,477	5,936	3,551	—
Capital lease obligations and other	888	384	504	—	—
	$27,460	$ 17,469	$6,440	$3,551	$—

We have a liability at December 31, 2012 of $2.6 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. We expect to make a payment of $0.6 million in the next twelve months as a result of resolutions of tax positions and the expiration of applicable statutes of limitations. This is 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 $12.6 million at December 31, 2012.

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.

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 earnings from continuing operations before interest income and expense, income taxes, depreciation, amortization of acquired intangible assets, restructuring, 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 net income, the most directly comparable GAAP financial measure, to our adjusted EBITDA:

(In thousands)	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
Net (loss) income	$(4,784)	$ 9,045	$(11,984)	$11,698
Interest expense, net	13	6	19	9
Tax (benefit) provision	(2,192)	4,828	(5,843)	6,142
Depreciation	2,191	1,905	4,402	3,760
Amortization of intangible assets	2,230	692	4,018	1,508
Restructuring and other charges	217	—	5,201	—
Acquisition costs and other related expenses	42	593	272	618
Fair value adjustments from purchase accounting	1,272	(44)	2,197	(22)
Stock-based compensation cost	2,010	1,812	4,359	3,852
Adjusted EBITDA	$ 999	$18,837	$ 2,641	$27,565

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures for property and equipment, which includes capitalized software development costs. We believe free cash flow provides investors with an important perspective on cash available for investments and acquisitions after making capital investments required to support ongoing business operations and long-term value creation. We believe that trends in our free cash flow 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, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
Cash provided by (used in) operating activities	$1,559	$11,028	$ (8,390)	$15,244
Capital expenditures	(746)	(1,925)	(1,726)	(3,571)
Free cash flow	$ 813	$ 9,103	$(10,116)	$11,673

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in our exposure to market risk from June 30, 2012 to December 31, 2012.

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, 2012. 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, 2012 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

The U.S. Department of Justice ("DOJ") conducted an investigation into the conduct of certain former employees of PDI (which was acquired by the Company in connection with the acquisition of KOR Electronics on December 30, 2011) in the 2008-2009 time frame, asserting, among other things, that such conduct may have constituted a violation of the Procurement Integrity Act. On August 31, 2012, the DOJ and PDI entered into a settlement agreement related to the investigation pursuant to which the DOJ released PDI and its affiliates from any civil monetary claims relating to the alleged conduct. PDI did not admit liability for the alleged conduct in the settlement. We were indemnified with respect to this matter by the former shareholders of KOR Electronics pursuant to the Company's merger agreement with KOR dated December 30, 2011.

In addition to the foregoing, 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, 2012. There have been no material changes from the factors disclosed in our 2012 Annual Report on Form 10-K filed on August 22, 2012, 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 September 30, 2012 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.

* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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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 8, 2013.

MERCURY SYSTEMS, INC.

By: /s/ KEVIN M. BISSON

Kevin M. Bisson
Senior Vice President,
Chief Financial Officer, and Treasurer

EXHIBIT 31.1

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 8, 2013

/s/ MARK ASLETT

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

EXHIBIT 31.2

CERTIFICATION

I, Kevin M. Bisson, 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 8, 2013

/s/ KEVIN M. BISSON

Kevin M. Bisson
SENIOR VICE PRESIDENT,
CHIEF FINANCIAL OFFICER, AND TREASURER
[PRINCIPAL FINANCIAL OFFICER]

EXHIBIT 32.1

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. (formerly Mercury Computer Systems, Inc.) (the "Company") on Form 10-Q for the period ended December 31, 2012 as filed with the Securities and Exchange Commission (the "Report"), we, Mark Aslett, President and Chief Executive Officer of the Company, and Kevin M. Bisson, Senior 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 8, 2013

/s/ MARK ASLETT

Mark Aslett
PRESIDENT AND CHIEF EXECUTIVE OFFICER

/s/ KEVIN M. BISSON

Kevin M. Bisson
SENIOR 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.