

MERCURY SYSTEMS INC
Form 10-Q
May 03, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2018

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

50 MINUTEMAN ROAD 01810
ANDOVER, MA
(Address of principal executive offices) (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, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

Edgar Filing: MERCURY SYSTEMS INC - Form 10-Q

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

Shares of Common Stock outstanding as of April 30, 2018: 48,190,006 shares

MERCURY SYSTEMS, INC.
INDEX

	PAGE NUMBER
PART I. FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (unaudited)</u>	<u>3</u>
<u>Consolidated Balance Sheets as of March 31, 2018 and June 30, 2017</u>	<u>3</u>
<u>Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended March 31, 2018 and 2017</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the nine months ended March 31, 2018 and 2017</u>	<u>5</u>
<u>Notes to Consolidated Financial Statements</u>	<u>6</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>34</u>
Item 4. <u>Controls and Procedures</u>	<u>34</u>
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>35</u>
Item 1A. <u>Risk Factors</u>	<u>35</u>
Item 6. <u>Exhibits</u>	<u>35</u>
<u>Signatures</u>	<u>36</u>

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCURY SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	March 31, 2018	June 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$44,217	\$41,637
Accounts receivable, net of allowance for doubtful accounts of \$52 and \$83 at March 31, 2018 and June 30, 2017, respectively	101,400	76,341
Unbilled receivables and costs in excess of billings	40,177	37,332
Inventory	117,075	81,071
Prepaid income taxes	2,487	1,434
Prepaid expenses and other current assets	7,802	8,381
Total current assets	313,158	246,196
Property and equipment, net	51,291	51,643
Goodwill	499,292	380,846
Intangible assets, net	186,391	129,037
Other non-current assets	6,814	8,023
Total assets	\$1,056,946	\$815,745
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$32,857	\$27,485
Accrued expenses	16,655	20,594
Accrued compensation	20,288	18,406
Deferred revenues and customer advances	9,537	6,360
Total current liabilities	79,337	72,845
Deferred income taxes	14,161	4,856
Income taxes payable	855	855
Long-term debt	195,000	—
Other non-current liabilities	11,797	11,772
Total liabilities	301,150	90,328
Commitments and contingencies (Note M)		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.01 par value; 85,000,000 shares authorized; 46,840,575 and 46,303,075 shares issued and outstanding at March 31, 2018 and June 30, 2017, respectively	468	463
Additional paid-in capital	584,855	584,795
Retained earnings	169,867	139,085
Accumulated other comprehensive income	606	1,074
Total shareholders' equity	755,796	725,417
Total liabilities and shareholders' equity	\$1,056,946	\$815,745

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

MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2018	2017	2018	2017
Net revenues	\$116,336	\$107,317	\$340,317	\$292,980
Cost of revenues	63,570	56,534	182,717	155,364
Gross margin	52,766	50,783	157,600	137,616
Operating expenses:				
Selling, general and administrative	21,138	19,229	62,928	56,093
Research and development	15,021	14,198	43,950	40,192
Amortization of intangible assets	7,104	4,732	18,568	14,222
Restructuring and other charges	1,384	459	1,792	825
Acquisition costs and other related expenses	1,281	470	2,265	1,889
Total operating expenses	45,928	39,088	129,503	113,221
Income from operations	6,838	11,695	28,097	24,395
Interest income	—	137	14	187
Interest expense	(999)	(1,893)	(1,101)	(5,613)
Other income (expense), net	66	279	(1,065)	792
Income before income taxes	5,905	10,218	25,945	19,761
Tax provision (benefit)	2,209	3,170	(4,837)	3,690
Net income	\$3,696	\$7,048	\$30,782	\$16,071
Basic net earnings per share	\$0.08	\$0.16	\$0.66	\$0.40
Diluted net earnings per share	\$0.08	\$0.16	\$0.65	\$0.39
Weighted-average shares outstanding:				
Basic	46,844	43,773	46,685	40,573
Diluted	47,532	44,814	47,473	41,530
Comprehensive income:				
Net income	\$3,696	\$7,048	\$30,782	\$16,071
Foreign currency translation adjustments	(457)	133	(513)	(200)
Pension benefit plan, net of tax	5	—	45	—
Total other comprehensive income, net of tax	(452)	133	(468)	(200)
Total comprehensive income	\$3,244	\$7,181	\$30,314	\$15,871

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

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

	Nine Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	\$30,782	\$16,071
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	30,320	23,139
Stock-based compensation expense	13,045	11,440
Benefit for deferred income taxes	(5,482)	(5,618)
Non-cash interest expense	—	1,362
Other non-cash items	1,243	(628)
Changes in operating assets and liabilities, net of effects of businesses acquired:		
Accounts receivable, unbilled receivables, and costs in excess of billings	(19,827)	2,011
Inventory	(24,931)	(6,615)
Prepaid income taxes	(1,060)	1,913
Prepaid expenses and other current assets	944	(1,134)
Other non-current assets	277	(116)
Accounts payable, accrued expenses, and accrued compensation	2,943	(566)
Deferred revenues and customer advances	2,758	(777)
Income taxes payable	(11,286)	4,443
Other non-current liabilities	(2,046)	4,485
Net cash provided by operating activities	17,680	49,410
Cash flows from investing activities:		
Acquisition of business, net of cash acquired	(185,396)	(36,911)
Purchases of property and equipment	(11,067)	(26,789)
Other investing activities	(375)	(486)
Net cash used in investing activities	(196,838)	(64,186)
Cash flows from financing activities:		
Proceeds from employee stock plans	2,049	2,903
Payments for retirement of common stock	(15,118)	(7,682)
Payments under credit facilities	(15,000)	(7,500)
Borrowings under credit facilities	210,000	—
Proceeds from equity offering, net	—	215,732
Net cash provided by financing activities	181,931	203,453
Effect of exchange rate changes on cash and cash equivalents	(193)	(130)
Net increase in cash and cash equivalents	2,580	188,547
Cash and cash equivalents at beginning of period	41,637	81,691
Cash and cash equivalents at end of period	\$44,217	\$270,238
Cash paid during the period for:		
Interest	\$1,101	\$4,251
Income taxes	\$9,928	\$2,731

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. (the "Company" or "Mercury") is a leading commercial provider of secure sensor and safety critical mission processing subsystems. Optimized for customer and mission success, its solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, Massachusetts, it is pioneering a next-generation defense electronics business model specifically designed to meet the industry's current and emerging technology and business needs. The Company delivers affordable innovative solutions, rapid time-to-value and service and support primarily to defense prime contractor customers. The Company's products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-16 SABR, F-35, E2D Hawkeye, Reaper and Paveway. The Company's organizational structure allows it to deliver capabilities that combine technology building blocks and deep domain expertise in the aerospace and defense sector.

B. Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared by the Company in accordance with Generally Accepted Accounting Principles ("GAAP") in the United States of America 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, 2017 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on August 18, 2017. The results for the three and nine months ended March 31, 2018 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 in consolidation.

USE OF ESTIMATES

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

BUSINESS COMBINATIONS

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

FOREIGN CURRENCY

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

ACCOUNTS RECEIVABLE FACTORING

On December 21, 2017, the Company executed a Master Receivables Purchase Agreement (the “Purchase Agreement”) with Bank of America, N.A. (the “Bank”) for the sale of certain eligible accounts receivable balances of the Company, up to a maximum

6

of \$30,000. Factoring under the Purchase Agreement is treated as a true sale of accounts receivable by the Company. The Company has a continued involvement in servicing accounts receivable under the Purchase Agreement, but has no retained interests related to the factored accounts receivable.

Proceeds from amounts factored by the Company are recorded as an increase to cash and a reduction to accounts receivable outstanding in the consolidated balance sheets. Cash flows attributable to factoring are reflected as cash flows from operating activities in the Company's consolidated statements of cash flows. Factoring fees are included as selling, general, and administrative expenses in the Company's consolidated statements of operations and comprehensive income.

The Company factored accounts receivable and incurred factoring fees of \$18,821 and \$69, respectively, for the nine months ended March 31, 2018. The Company did not factor any accounts receivable or incur any factoring fees for the three months ended March 31, 2018.

REVENUE RECOGNITION

The Company recognizes revenue using three different types of accounting methods: ship and bill, multiple-deliverable arrangements and contract accounting which encompass the percentage of completion, completed contract and time and materials methods. The Company relies upon FASB ASC 605, Revenue Recognition, to account for its revenue transactions. Revenue is recognized upon shipment provided that title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, have been successfully demonstrated. Out-of-pocket expenses that are reimbursable by the customer are included in revenue and cost of revenue.

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

Total revenue recognized under ship and bill revenue arrangements was 47% and 43% of total revenue in the three and nine months ended March 31, 2018, respectively. Total revenue recognized under ship and bill revenue arrangements was 43% and 45% of total revenues in the three and nine months ended March 31, 2017, 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. Additionally, FASB ASU 2009-13 expands the disclosure requirements related to a vendor's multiple-deliverable revenue arrangements.

The Company enters into multiple-deliverable arrangements that may include a combination of hardware components, related integration or other services. These arrangements generally do not include any performance-, cancellation-, termination- or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements was 30% and 35% of total revenue in the three and nine months ended March 31, 2018, respectively. Total revenue recognized under multiple-deliverable revenue arrangements was 37% and 32% of total revenues in the three and nine months ended March 31, 2017, respectively.

In accordance with the provisions of FASB ASU 2009-13, the Company allocates arrangement consideration to each deliverable in an arrangement based on its relative selling price. The Company generally expects that it will not be able to establish VSOE or TPE due to limited single element transactions and the nature of the markets in which the Company competes, and, as such, the Company typically determines its relative selling price using BESP. The objective of BESP is to determine the price at which the Company would transact if the product or service were sold by the Company on a standalone basis.

The Company's determination of BESP involves the consideration of several factors based on the specific facts and circumstances of each arrangement. Specifically, the Company considers the cost to produce the deliverable, the

anticipated margin on that deliverable, the selling price and profit margin for similar parts, the Company's ongoing pricing strategy and policies (as evident from the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable and the characteristics of the varying markets in which the deliverable is sold.

The Company analyzes the selling prices used in its allocation of arrangement consideration at a minimum on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in the Company's business necessitates a more timely analysis or if the Company experiences significant variances in its selling prices. Each deliverable within the Company's multiple-deliverable revenue arrangements is accounted for as a separate unit of accounting under the guidance of FASB ASU 2009-13 if both of the following criteria are met: the delivered item or items have value to the customer on a standalone basis; and for an arrangement that includes a general right of return relative to the delivered

item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. The Company's revenue arrangements generally do not include a general right of return relative to delivered products. The Company considers a deliverable to have standalone value if the item is sold separately by the Company or another vendor or if the item could be resold by the customer.

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

The Company also engages in long-term contracts for development, production and services activities which it accounts for consistent with FASB ASC 605-35, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, and other relevant revenue recognition accounting literature. The Company considers the nature of these contracts and the types of products and services provided when determining the proper accounting for a particular contract. Generally for fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method or, for certain short-term contracts, by the completed contract method. Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate input or output methods to measure service provided, and contract costs are expensed as incurred. The Company establishes billing terms at the time project deliverables and milestones are agreed. The risk to the Company on a fixed-price contract is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. For all types of contracts, the Company recognizes anticipated contract losses as soon as they become known and estimable.

The Company also considers whether contracts should be combined or segmented in accordance with the applicable criteria under GAAP, and combines closely related contracts when all the applicable criteria under GAAP are met. The combination of two or more contracts requires judgment in determining whether the intent of entering into the contracts was effectively to enter into a single project, which should be combined to reflect an overall profit rate. Similarly, the Company may separate a project, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria under GAAP are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement was negotiated and the performance criteria. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period.

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

Contract costs also may include estimated contract recoveries for matters such as contract changes and claims for unanticipated contract costs. The Company records revenue associated with these matters only when the amount of recovery can be estimated reliably and realization is probable.

Total revenue recognized under contract accounting revenue arrangements was 23% and 22% of total revenue in the three and nine months ended March 31, 2018, respectively. Total revenue recognized under contract accounting revenue arrangements was 20% and 23% of total revenues in the three and nine months ended March 31, 2017, respectively.

The Company defines service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold. Examples of the Company's service revenues include: analyst services and systems engineering support, consulting, maintenance and

other support, testing and installation. The Company combines its product and service revenues into a single class as service revenues are less than 10 percent of total revenues.

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

WEIGHTED-AVERAGE SHARES

Weighted-average shares were calculated as follows:

	Three Months		Nine Months	
	Ended March		Ended March	
	31,	31,	31,	31,
	2018	2017	2018	2017
Basic weighted-average shares outstanding	46,844	43,773	46,685	40,573
Effect of dilutive equity instruments	688	1,041	788	957
Diluted weighted-average shares outstanding	47,532	44,814	47,473	41,530

Equity instruments to purchase 33 and 302 shares of common stock were not included in the calculation of diluted net earnings per share for the three and nine months ended March 31, 2018, respectively, because the equity instruments were anti-dilutive. Equity instruments to purchase 9 and 13 shares of common stock were not included in the calculation of diluted net earnings per share for the three and nine months ended March 31, 2017, respectively, because the equity instruments were anti-dilutive.

C. Acquisitions

THEMIS COMPUTER AQUISITION

On December 21, 2017, the Company and Thunderbird Merger Sub, Inc., a newly formed, wholly-owned subsidiary of the Company (the "Merger Sub"), entered into a Merger Agreement (the "Merger Agreement") with Ceres Systems ("Ceres"), the holding company that owned Themis Computer ("Themis", and together with Ceres, collectively the "Acquired Company"). On February 1, 2018, the Company closed the transaction and the Merger Sub merged with and into Ceres with Ceres continuing as the surviving company and a wholly-owned subsidiary of Mercury (the "Merger").

By operation of the Merger, the Company acquired both Ceres and its wholly-owned subsidiary, Themis.

Based in Fremont, California, Themis is a leading designer, manufacturer and integrator of commercial, SWaP-optimized rugged servers, computers and storage systems for U.S. and international markets. Under the terms of the Merger Agreement, the merger consideration (including payments with respect to outstanding stock options) consisted of an all cash purchase price of approximately \$180,000. The merger consideration is subject to post-closing adjustments based on a determination of closing net working capital, transaction expenses and net debt (all as defined in the Merger Agreement). The Company funded the acquisition with borrowings obtained under its existing revolving credit facility.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$ 187,089
Working capital and net debt adjustment	(574)
Less cash acquired	(6,810)
Net purchase price	\$ 179,705
Estimated fair value of tangible assets acquired and liabilities assumed	
Cash	\$ 6,810
Accounts receivable	7,713
Inventory	6,742
Fixed assets	479
Other current and non-current assets	2,896
Accounts payable	(3,287)
Accrued expenses	(6,267)
Other current and non-current liabilities	(1,180)
Deferred tax liability	(14,778)
Estimated fair value of net tangible assets acquired	(872)
Estimated fair value of identifiable intangible assets	72,870
Estimated goodwill	114,517
Estimated fair value of net assets acquired	186,515
Less cash acquired	(6,810)
Net purchase price	\$ 179,705

The amounts above represent the preliminary fair value estimates as of March 31, 2018 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimates include customer relationships of \$53,420 with a useful life of 12.5 years, developed technology of \$17,150 with a useful life of 9.5 years and backlog of \$2,300 with a useful life of 1 year. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$114,517 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the Mercury Defense Systems ("MDS") reporting unit and is not tax deductible.

The revenues and income before income taxes from Themis included in the Company's consolidated results for the three months ended March 31, 2018 were \$9,501 and \$267, respectively.

Pro Forma Financial Information

The following table summarizes the supplemental statements of operations information on an unaudited pro forma basis, excluding the pro forma impact of the Richland ("RTL"), Delta Microwave, LLC ("Delta") and CES Creative Electronic Systems, S.A. ("CES"), as if the Merger had occurred on July 1, 2016. The Company has not furnished pro forma financial information relating to RTL, Delta and CES because such information is not material to the Company's financial results.

	Three months		Nine months Ended	
	Ended March 31,		March 31,	
	2018	2017	2018	2017
Pro forma net revenues	\$122,176	\$118,826	\$377,473	\$325,367
Pro forma net income	\$1,191	\$6,573	\$26,811	\$3,069
Basic pro forma net earnings per share	\$0.03	\$0.15	\$0.57	\$0.08
Diluted pro forma net earnings per share	\$0.03	\$0.15	\$0.56	\$0.07

RICHLAND TECHNOLOGIES ACQUISITION

On July 3, 2017, the Company entered into a membership interest purchase agreement with RTL, pursuant to which, the Company acquired RTL on a cash-free, debt-free basis for a total purchase price of \$5,798. RTL specializes in safety-critical and high integrity systems, software and hardware development as well as safety-certification services for mission-critical applications. The acquisition had an immaterial impact to the Company's results of operations (contributed less than one percent of net revenue for the three and nine months ended March 31, 2018), and accordingly the disclosures required per FASB ASC 805 have been excluded from this Form 10-Q filing. The Company recognized primarily intangible assets including customer relationships, developed technology and goodwill based on its preliminary purchase price allocation.

DELTA ACQUISITION

On April 3, 2017, the Company entered into a membership interest purchase agreement with Delta, pursuant to which the Company acquired Delta on a cash-free, debt-free basis for a total purchase price of \$40,500, subject to net working capital and net debt adjustments. Delta is a designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace and space markets. The acquisition and transaction related expenses were funded with cash on hand.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$40,500
Net purchase price	\$40,500
Fair value of tangible assets acquired and liabilities assumed	
Accounts receivable and cost in excess of billings	\$957
Inventory	4,452
Fixed assets	1,918
Other current and non-current assets	77
Current liabilities	(2,055)
Fair value of net tangible assets acquired	5,349
Fair value of identifiable intangible assets	17,000
Goodwill	18,151
Fair value of net assets acquired	40,500
Net purchase price	\$40,500

On April 2, 2018, the measurement period for Delta expired. The identifiable intangible assets include customer relationships of \$8,000 with a useful life of 9 years, developed technology of \$5,900 with a useful life of 7 years and backlog of \$3,100 with a useful life of 2 years.

The goodwill of \$18,151 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The Delta acquisition expands the scale and breadth of the Company's RF, microwave and millimeter wave capabilities, provides a highly complementary program portfolio in missiles and munitions, deepens market penetration in core radar, electronic warfare ("EW"), and precision-guided munitions markets, and opens new growth opportunities in space launch, GPS, satellite communications and datalinks. The goodwill from this acquisition is reported under the Advanced Microelectronic Solutions ("AMS") reporting unit.

Since Delta was a limited liability company, the acquisition is treated as an asset purchase for tax purposes. As of March 31, 2018, the Company had \$17,298 of goodwill deductible for tax purposes. The Company has not furnished pro forma financial information relating to Delta because such information is not material to the Company's financial results.

CES ACQUISITION

On November 4, 2016, the Company and the shareholders of CES entered into a Stock Purchase Agreement pursuant to which Mercury acquired CES for a total purchase price of \$39,123, subject to net working capital and net debt

adjustments. The acquisition and associated transaction expenses were funded with cash on hand. Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission-critical computing applications. CES specializes in the design,

development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as the several types of unmanned platforms.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$ 39,123
Working capital adjustment	(330)
Net purchase price	\$ 38,793
Fair value of tangible assets acquired and liabilities assumed	
Accounts receivable and cost in excess of billings	\$ 2,698
Inventory	8,950
Fixed assets	1,480
Other current and non-current assets	748
Current liabilities	(3,154)
Non-current liabilities	(6,140)
Deferred tax liabilities	(1,148)
Fair value of net tangible assets acquired	3,434
Fair value of identifiable intangible assets	14,722
Goodwill	20,637
Fair value of net assets acquired	38,793
Net purchase price	\$ 38,793

On November 3, 2017, the measurement period for CES expired. The identifiable intangible assets include customer relationships of \$9,060 with a useful life of 9 years and developed technology of \$5,662 with a useful life of 7 years. The goodwill of \$20,637 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. CES provides the Company with capabilities in mission computing, safety-critical avionics and platform management that are in demand from its customers. These new capabilities will also substantially expand Mercury's addressable market into commercial aerospace, defense platform management, command, control, communications, computers, and intelligence ("C4I") and mission computing markets that are aligned to Mercury's existing market focus. The acquisition is directly aligned with the Company's strategy of expanding its capabilities, services and offerings along the sensor processing chain. The goodwill from this acquisition is reported under the Sensor and Mission Processing ("SMP") reporting unit. The Company has not furnished pro forma financial information relating to CES because such information is not material to the Company's financial results.

D. Fair Value of Financial Instruments

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at March 31, 2018:

	Fair Value Measurements			
	March 31, 2018	Level 1	Level 2	Level 3
Assets:				
Certificates of deposit	\$ 1,051	\$ —	\$ 1,051	\$ —
Total	\$ 1,051	\$ —	\$ 1,051	\$ —

The carrying values of cash and cash equivalents, including money market funds, restricted cash, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The fair value of the Company's certificates of deposit are determined through quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable. The cost-method investment, which is presented within other non-current assets in the accompanying consolidated balance sheets, does not have a readily determinable fair value, as such the Company recorded the investment at cost and will continue to evaluate the asset for impairment on a quarterly basis.

E. Inventory

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

	March 31, 2018	June 30, 2017
Raw materials	\$63,290	\$48,645
Work in process	29,910	22,567
Finished goods	23,875	9,859
Total	\$117,075	\$81,071

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

F. Goodwill

The following table sets forth the changes in the carrying amount of goodwill by reporting unit for the nine months ended March 31, 2018:

	SMP	AMS	MDS	Total
Balance at June 30, 2017	\$116,003	\$217,956	\$46,887	\$380,846
Goodwill adjustment for the CES acquisition	291	—	—	291
Goodwill adjustment for the Delta acquisition	—	191	—	191
Goodwill arising from the RTL acquisition	3,447	—	—	3,447
Goodwill arising from the Themis acquisition	—	—	114,517	114,517
Balance at March 31, 2018	\$119,741	\$218,147	\$161,404	\$499,292

In the nine months ended March 31, 2018, there were no triggering events, as defined by FASB ASC 350, Intangibles - Goodwill and Other, which required an interim goodwill impairment test. The Company performs its annual goodwill impairment test in the fourth quarter of each fiscal year.

G. Restructuring

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

	Severance & Facilities Related	& Other	Total
Restructuring liability at June 30, 2017	\$ 1,365	\$ —	\$1,365
Restructuring and other charges	1,665	127	1,792
Cash paid	(1,656)	(127)	(1,783)
Restructuring liability at March 31, 2018	\$ 1,374	\$ —	\$1,374

During the nine months ended March 31, 2018, the Company incurred net restructuring and other charges of \$1,792. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

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

H. Income Taxes

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

The Tax Act also includes items that the Company expects will increase its tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on executive compensation. In addition, the actual effective tax rate may be materially different than the statutory Federal tax rate (including being higher) based on the availability and impact of various other adjustments including but not limited to state taxes, Federal research and development credits, discrete tax benefits related to stock compensation, and the inclusion or exclusion of various items in taxable income which may differ from GAAP income.

To transition to the reduced U.S. corporate tax rate, an adjustment is required to be made to our U.S. deferred tax assets and liabilities. For the nine months ended March 31, 2018, the adjustment to the U.S. deferred tax assets and liabilities resulted in a tax benefit of \$905. The Tax Act includes a transition tax, which is a one-time tax charge on accumulated, undistributed foreign earnings. The calculation of accumulated foreign earnings requires an analysis of each foreign entity's financial results going back to 1986, including historical tax information that is not yet available to management. The Company has not recorded any transition tax associated with its accumulated, undistributed foreign earnings given its current U.S. tax attributes, including the availability of foreign tax credits. The Company recorded a provisional tax expense of \$415 in the second quarter of fiscal 2018, as it no longer expects to utilize certain foreign tax credits. The Company continues to evaluate its transition tax obligation and expects to finalize its conclusions by the end of fiscal 2018. The Company does not expect the final amounts to be materially different than those previously recorded. As of March 31, 2018, the Company has recorded all known and estimable impacts of the Tax Act that are effective for fiscal year 2018. In accordance with SEC Staff Accounting Bulletin 118 ("SAB 118"), future adjustments to the provisional numbers will be recorded as discrete adjustments to income tax expense in the period in which those adjustments become estimable and finalized.

The Company recorded an income tax provision of \$2,209 and \$3,170 on income from operations before income taxes of \$5,905 and \$10,218 for the three months ended March 31, 2018 and 2017, respectively. The Company recorded an income tax benefit of \$4,837 and an income tax provision of \$3,690 on income from operations before income taxes of \$25,945 and \$19,761 for the nine months ended March 31, 2018 and 2017, respectively.

The effective tax rate for the three months ended March 31, 2018 and 2017 differed from the Federal statutory rate primarily due to Federal research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, and state taxes. During the three months ended March 31, 2018 and 2017, the Company recognized a discrete benefit of \$96 and \$184, respectively, related to excess tax benefits on stock-based compensation. The excess tax benefit related to stock-based compensation is the result of an increase in value from the stock award between the grant date and the vest date.

The effective tax rate for the nine months ended March 31, 2018 and 2017 differed from the Federal statutory rate primarily due to Federal research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, state taxes and the impact of discrete items. During the nine months ended March 31, 2018 and 2017, the Company recognized a discrete tax benefit of \$7,675 and \$3,001, respectively, related to excess tax benefits on stock-based compensation. The discrete tax benefit for the nine months ended March 31, 2018 included the enactment of the Tax Act which revalued the excess tax benefit previously recorded in the three months ended September 30, 2017. The benefit is the result of the increase in value from the stock award between the grant date and the vest date. The nine months ended March 31, 2018 also included discrete tax benefits of \$3,716, derived from new information obtained about net operating loss carry-forwards of the entities acquired from Microsemi Corporation in May 2016. The discrete items disclosed above for the nine months ended March 31, 2018 included the

effect of the Tax Act.

No material changes in the Company's unrecognized tax positions occurred during the nine months ended March 31, 2018.

I. Debt

REVOLVING CREDIT FACILITY

On June 27, 2017, the Company amended its revolving credit facility to increase and extend the borrowing capacity of its existing revolving credit facility into a \$400,000, 5-year revolving credit line expiring in June 2022 ("the Revolver").

As of

14

March 31, 2018, the Company's outstanding balance of unamortized deferred financing costs was \$5,659, which is being amortized to other income (expense), net on a straight line basis over the new term of the Revolver. The Company drew \$195,000 from the Revolver to facilitate the completion of the Merger Agreement for the acquisition of both Ceres and its wholly-owned subsidiary, Themis.

As of March 31, 2018, the Company was in compliance with all covenants and conditions under the Revolver and there was outstanding borrowings of \$195,000 against the Revolver, resulting in interest expense of \$999 and \$1,101 for the three and nine months ended March 31, 2018, respectively. There were outstanding letters of credit of \$2,771 as of March 31, 2018.

J. Stock-Based Compensation

STOCK OPTION PLANS

The aggregate number of shares authorized for issuance under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan"), is 15,252 shares at March 31, 2018. 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 1,610 shares available for future grant under the 2005 Plan at March 31, 2018.

As part of the Company's ongoing annual equity grant program for employees, the Company grants performance-based restricted stock awards to certain executives and employees pursuant to the 2005 Plan. Performance awards vest based on the requisite service period subject to the achievement of specific financial performance targets. Based on the performance targets, some of these awards require graded vesting which results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company monitors the probability of achieving the performance targets on a quarterly basis and may adjust periodic stock compensation expense accordingly based on its determination of the likelihood for reaching targets. The performance targets include: (i) the achievement of internal performance targets only, and (ii) the achievement of internal performance targets in relation to a peer group of companies.

EMPLOYEE STOCK PURCHASE PLAN

The aggregate number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,800 shares. Under the ESPP, rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six-month offering period. The ESPP permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the ESPP. There were 39 and 50 shares issued under the ESPP during the nine months ended March 31, 2018 and 2017, respectively. Shares available for future purchase under the ESPP totaled 263 at March 31, 2018.

STOCK OPTION AND AWARD ACTIVITY

The following table summarizes activity of the Company's stock option plans since June 30, 2017:

	Options Outstanding		Weighted Average
	Number of	Weighted Average	Remaining
	Shares	Exercise Price	Contractual Term
			(Years)
Outstanding at June 30, 2017	51	\$ 13.53	0.60
Granted	—	—	
Exercised	(47)	14.12	
Canceled	—	—	
Outstanding at March 31, 2018	4	\$ 5.52	3.38

The following table summarizes the status of the Company's non-vested restricted stock awards since June 30, 2017:

	Non-vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2017	1,564	\$ 18.93
Granted	516	47.40
Vested	(769)	17.09
Forfeited	(121)	31.40
Outstanding at March 31, 2018	1,190	\$ 31.19

STOCK-BASED COMPENSATION EXPENSE

The Company recognizes expense for its share-based payment plans in the consolidated statements of operations for the nine months ended March 31, 2018 and 2017 in accordance with FASB ASC 718, Compensation - Stock Compensation ("FASB ASC 718"). The Company had \$265 and \$177 of capitalized stock-based compensation expense on the consolidated balance sheets as of March 31, 2018 and 2017, respectively. Under the fair value recognition provisions of FASB ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period, net of estimated forfeitures. The following table presents share-based compensation expenses included in the Company's consolidated statements of operations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Cost of revenues	\$169	\$150	\$364	\$373
Selling, general and administrative	2,929	3,270	11,175	9,848
Research and development	499	295	1,506	1,219
Stock-based compensation expense before tax	3,597	3,715	13,045	11,440
Income taxes	(1,187)	(1,418)	(4,305)	(4,381)
Stock-based compensation expense, net of income taxes	\$2,410	\$2,297	\$8,740	\$7,059

K. Employee Benefit Plan

PENSION PLAN

With the acquisition of CES on November 4, 2016, the Company assumed a defined benefit pension plan (the "Plan") for its Swiss employees, which is administered by an independent pension fund. The Plan is mandated by Swiss law and meets the criteria for a defined benefit plan under FASB ASC 715, Compensation—Retirement Benefits ("FASB ASC 715"), because participants of the Plan are entitled to a defined rate of return on contributions made. The independent pension fund is a multi-employer plan with unrestricted joint liability for all participating companies for which the Plan's overfunding or underfunding is allocated to each participating company based on an allocation key determined by the Plan.

The Company recognizes a net asset or liability for the Plan equal to the difference between the projected benefit obligation of the Plan and the fair value of the Plan's assets as required by FASB ASC 715. The funded status may vary from year to year due to changes in the fair value of the Plan's assets and variations on the underlying assumptions of the projected benefit obligation of the Plan. The Plan's funded status at March 31, 2018 was a net liability of \$6,991, which is recorded in other non-current liabilities on the consolidated balance sheet. The Company recorded a net gain of \$5 and \$45 in accumulated other comprehensive income during the three and nine months ended March 31, 2018, respectively. The Company did not record any gains or losses related to the Plan in accumulated other comprehensive income during the three and nine months ended March 31, 2017. The Company recognized net periodic benefit costs of \$213 and \$620 associated with the Plan for the three and nine months ended March 31, 2018, respectively. The Company recognized net periodic benefit costs of \$130 and \$199 associated with the Plan for the three and nine months ended March 31, 2017, respectively. The Company's total expected employer contributions to the Plan during fiscal 2018 are \$516.

L. Operating Segment, Geographic Information and Significant Customers

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

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

	U.S.	Europe	Asia Pacific	Eliminations	Total
THREE MONTHS ENDED MARCH 31, 2018					
Net revenues to unaffiliated customers	\$ 105,989	\$ 8,611	\$ 1,736	\$ —	\$ 116,336
Inter-geographic revenues	1,621	235	—	(1,856)) —
Net revenues	\$ 107,610	\$ 8,846	\$ 1,736	\$ (1,856)) \$ 116,336
THREE MONTHS ENDED MARCH 31, 2017					
Net revenues to unaffiliated customers	\$ 98,599	\$ 8,085	\$ 633	\$ —	\$ 107,317
Inter-geographic revenues	1,745	21	—	(1,766)) —
Net revenues	\$ 100,344	\$ 8,106	\$ 633	\$ (1,766)) \$ 107,317
NINE MONTHS ENDED MARCH 31, 2018					
Net revenues to unaffiliated customers	\$ 309,391	\$ 25,506	\$ 5,420	\$ —	\$ 340,317
Inter-geographic revenues	6,537	300	—	(6,837)) —
Net revenues	\$ 315,928	\$ 25,806	\$ 5,420	\$ (6,837)) \$ 340,317
NINE MONTHS ENDED MARCH 31, 2017					
Net revenues to unaffiliated customers	\$ 273,054	\$ 14,747	\$ 5,179	\$ —	\$ 292,980
Inter-geographic revenues	6,925	36	—	(6,961)) —
Net revenues	\$ 279,979	\$ 14,783	\$ 5,179	\$ (6,961)) \$ 292,980

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

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

	Three Months		Nine Months Ended	
	Ended March 31, 2018	2017	2018	2017
Domestic (1)	\$ 94,369	\$ 87,765	\$ 274,016	\$ 244,343
International/Foreign Military Sales (2)	21,967	19,552	66,301	48,637
Total Net Revenue	\$ 116,336	\$ 107,317	\$ 340,317	\$ 292,980

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

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

Edgar Filing: MERCURY SYSTEMS INC - Form 10-Q

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

	Three Months		Nine Months Ended	
	Ended March 31,		March 31,	
	2018	2017	2018	2017
Radar (1)	\$37,262	\$33,017	\$118,480	\$115,308
Electronic Warfare (2)	19,531	35,920	76,950	78,204
Other Sensor & Effector (3)	14,403	7,697	35,144	17,004
Total Sensor & Effector	71,196	76,634	230,574	210,516
C4I (4)	26,593	10,242	52,981	21,194
Other (5)	18,547	20,441	56,762	61,270
Total Net Revenue	\$116,336	\$107,317	\$340,317	\$292,980

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

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

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

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

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

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

	Three Months		Nine Months Ended	
	Ended March 31,		March 31,	
	2018	2017	2018	2017
Components (1)	\$30,022	\$26,920	\$102,742	\$74,126
Modules and Sub-assemblies (2)	42,121	43,330	131,581	115,744
Integrated Subsystems (3)	44,193	37,067	105,994	103,110
Total Net Revenue	\$116,336	\$107,317	\$340,317	\$292,980

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

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

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

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

	U.S.	Europe	Asia Pacific	Eliminations	Total
March 31, 2018	\$49,503	\$1,777	\$ 11	\$	—\$51,291
June 30, 2017	\$50,340	\$1,288	\$ 15	\$	—\$51,643

Identifiable long-lived assets exclude goodwill and intangible assets.

18

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

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017	Nine Months Ended March 31, 2018	Nine Months Ended March 31, 2017
Raytheon Company	21 %	14 %	19 %	17 %
Lockheed Martin Corporation	17 %	27 %	19 %	22 %
Northrop Grumman Corporation	* 38 %	* 41 %	10 %	* 39 %

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

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

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017	Nine Months Ended March 31, 2018	Nine Months Ended March 31, 2017
SEWIP (1)	* 18 %	* 18 %	* — %	* — %

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

(1) SEWIP includes 16% and 2% of revenues during the three months ended March 31, 2017 related to the SEWIP Block II and SEWIP Block III, respectively.

M. Commitments and Contingencies

LEGAL CLAIMS

The Company is subject to litigation, claims, investigations and audits arising from time to time in the ordinary course of its 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 March 31, 2018, 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 \$57,067.

OTHER

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

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

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 ("SEC") may contain statements that are not historical facts but that are "forward-looking statements," which involve risks and uncertainties. You can identify these statements by the use of the words "may," "will," "could," "should," "would," "plans," "expects," "anticipates," "continue," "estimate," "project," "intend," "probable," "potential," and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of any U.S. Federal government shutdown or extended continuing resolution, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, federal export control or procurement rules and regulations, market acceptance of the Company's products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to cyber-security regulations and requirements, changes in tax rates or tax regulations, changes to 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, 2017. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made.

OVERVIEW

Mercury Systems, Inc. is a leading commercial provider of secure sensor and safety critical mission processing subsystems. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, Massachusetts, we are pioneering a next-generation defense electronics business model designed to meet the industry's current and emerging business needs. We deliver affordable innovative solutions, rapid time-to-value and service and support primarily to defense prime contractor customers. Our products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program ("SEWIP"), Gorgon Stare, Predator, F-35, F-16 SABR, E2D Hawkeye, Reaper, and Paveway. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector. Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, safety-critical avionics, radio frequency ("RF") components, multi-function assemblies and subsystems. We utilize leading edge, high performance computing technologies architected by leveraging open standards and open architectures to address highly data-intensive applications that include data signal, sensor and image processing while addressing the packaging challenges, often referred to as "SWaP" (size, weight, and power), that are common in military applications. We have design, development, and manufacturing capabilities in mission computing, safety-critical avionics and platform management. In addition, we design and manufacture RF, microwave and millimeter wave components and subsystems to meet the needs of the radar, electronic warfare ("EW"), signals intelligence ("SIGINT") and other high bandwidth communications requirements and applications. We also provide significant capabilities relating to pre-integrated electronic warfare, electronic attack ("EA") and electronic counter measure ("ECM") subsystems, SIGINT and electro-optical/infrared ("EO/IR") processing technologies, and radar environment test and simulation systems. We deploy these solutions on behalf of defense prime contractors and the Department of Defense ("DoD"), leveraging commercially available technologies and solutions (or "building

blocks”) from our business and other commercial suppliers. We leverage this technology to design and build integrated sensor processing subsystems, often including classified application-specific software and intellectual property (“IP”) for the C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ECM markets. We bring significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

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

As of March 31, 2018, we had 1,304 employees. During the three months ended March 31, 2018, the growth in our headcount resulted in us exceeding the threshold for qualifying as a "small business" for government contract purposes. The revenues received as a result of small business set aside funding are not considered material.

Our consolidated revenues, net income, net earnings per share, adjusted earnings per share ("adjusted EPS"), and adjusted EBITDA for the three months ended March 31, 2018 were \$116.3 million, \$3.7 million, \$0.08, \$0.30, and \$25.8 million, respectively. Our consolidated revenues, net income, net earnings per share, adjusted earnings per share ("adjusted EPS"), and adjusted EBITDA for the nine months ended March 31, 2018 were \$340.3 million, \$30.8 million, \$0.65, \$0.95, and \$77.7 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

RESULTS OF OPERATIONS:

Results of operations for the three and nine month period ended March 31, 2017 do not include results for Delta Microwave, LLC ("Delta"), Richland Technologies, L.L.C. ("RTL"), or Themis Computer ("Themis") since these businesses were acquired subsequent to March 31, 2017. The results of operations for the nine month period ended March 31, 2017 includes approximately five months of results for CES Creative Electronic Systems, S.A. ("CES"), which was acquired on November 4, 2016. Accordingly, the periods presented below are not directly comparable.

Three months ended March 31, 2018 compared to the three months ended March 31, 2017

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

(In thousands)	March 31, 2018	As a % of Total Net Revenue	March 31, 2017	As a % of Total Net Revenue
Net revenues	\$116,336	100.0 %	\$107,317	100.0 %
Cost of revenues	63,570	54.6	56,534	52.7
Gross margin	52,766	45.4	50,783	47.3
Operating expenses:				
Selling, general and administrative	21,138	18.2	19,229	17.9
Research and development	15,021	12.9	14,198	13.2
Amortization of intangible assets	7,104	6.1	4,732	4.4
Restructuring and other charges	1,384	1.2	459	0.4
Acquisition costs and other related expenses	1,281	1.1	470	0.4
Total operating expenses	45,928	39.5	39,088	36.3
Income from operations	6,838	5.9	11,695	11.0
Interest income	—	—	137	0.1
Interest expense	(999)	(0.9)	(1,893)	(1.8)
Other income, net	66	0.1	279	0.3
Income before income taxes	5,905	5.1	10,218	9.6
Tax provision	2,209	1.9	3,170	3.0
Net income	\$3,696	3.2 %	\$7,048	6.6 %

REVENUES

(In thousands)	March 31, 2018	As a % of Total Net Revenue	March 31, 2017	As a % of Total Net Revenue	\$ Change	% Change
Organic revenue	\$100,625	86 %	\$107,317	100 %	\$(6,692)	(6)%
Acquired revenue	15,711	14 %	—	— %	15,711	100 %
Total revenues	\$116,336	100 %	\$107,317	100 %	\$9,019	8 %

Total revenues increased \$9.0 million, or 8%, to \$116.3 million during the three months ended March 31, 2018 as compared to the same period in fiscal 2017 including "Acquired revenue" which represents net revenue from acquired businesses that have been part of Mercury for completion of four full quarters or less (and excludes any intercompany transactions). After the completion of four fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenues is primarily attributed to the Aegis, F-35 and E2D Hawkeye programs and the increase of \$15.7 million of Acquired revenue. These increases were partially offset by lower revenues from the SEWIP Block II and Patriot programs and a large ground based radar program.

International revenues, which consist of foreign military sales through the U.S. government, sales to prime defense contractor customers where the end user is known to be outside of the U.S., and direct sales to non-U.S. based customers, increased \$2.4 million to \$22.0 million during the three months ended March 31, 2018, compared to \$19.6 million in the same period in the prior fiscal year. International revenues represented 19% and 18% of total revenues during the three months ended March 31, 2018 and 2017, respectively.

Revenues from C4I, Other Sensor and Effector, and Radar increased by \$16.4 million, \$6.7 million and \$4.2 million, respectively, during the three months ended March 31, 2018 as compared to the same period in fiscal 2017. The C4I increase was driven primarily by the acquired revenue from the Themis acquisition as well as the F-35 program, partially offset by lower revenue from the ProVision program. The increase in Other Sensor and Effector was primarily driven by the AMRAAM, Paveway and Precision Guidance Kit ("PGK") programs. The increase in Radar was primarily due to higher revenue from the Aegis and E2D Hawkeye programs, partially offset by lower revenue from a large ground based radar program and the Patriot program. Revenues from EW decreased by \$16.4 million during the three months ended March 31, 2018 as compared to the same period in fiscal 2017. The EW decrease was driven primarily by the SEWIP Block II program.

Revenues from integrated subsystems and components increased by \$7.1 million and \$3.1 million, respectively, during the three months ended March 31, 2018 as compared to the same period in fiscal 2017. The integrated subsystems increase was driven primarily by acquired revenue from the Themis acquisition as well as significant increases in the Aegis and E2D Hawkeye programs. The increase in components was driven primarily by the F-35 and PGK programs. Revenues from modules and sub-assemblies decreased by \$1.2 million during the three months ended March 31, 2018 as compared to the same period in fiscal 2017. The decrease in modules and sub-assemblies was primarily due to lower revenue from the SEWIP Block II program.

GROSS MARGIN

Gross margin was 45.4% for the three months ended March 31, 2018, a decrease of 190 basis points from the 47.3% gross margin achieved during the same period in fiscal 2017. The lower gross margin between years was primarily driven by a shift in program mix compared to the same period in fiscal 2017 and the increased impact of the inventory step-up related to the Themis acquisition. Lower gross margins for the three months ended March 31, 2018 were partially offset by increased revenue in higher margin programs compared to the same period in fiscal 2017.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$1.9 million, or 10%, to \$21.1 million during the three months ended March 31, 2018, compared to \$19.2 million in the same period in fiscal 2017. The increase was primarily related to higher compensation related costs due to added headcount from the acquisitions of Delta, RTL, and Themis. Selling, general and administrative expenses as a percentage of revenues was consistent for the three months ended March 31, 2018 as compared to the same period in fiscal 2017.

RESEARCH AND DEVELOPMENT

Research and development expenses increased approximately \$0.8 million, or 6%, to \$15.0 million during the three months ended March 31, 2018, compared to \$14.2 million during the same period in fiscal 2017. The increase was primarily due to increased headcount from our recent acquisitions driving higher compensation related costs, offset by increased customer funded development. Research and development expenses as a percentage of revenues were consistent for the three months ended March 31, 2018 as compared to the same period in fiscal 2017.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges increased \$0.9 million to \$1.4 million during the three months ended March 31, 2018, compared to \$0.5 million during the same period in fiscal 2017. The increase was primarily driven by higher severance costs compared to the same period in fiscal 2017. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$1.3 million of acquisition costs and other related expenses during the three months ended March 31, 2018, compared to \$0.5 million during the same period in fiscal 2017. The increase was primarily due to acquisition costs of \$1.0 million incurred during the three months ended March 31, 2018 related to the acquisition of Themis, while \$0.3 million of acquisition costs were related to the acquisition of Delta during the same period in fiscal 2017. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our capabilities and new end markets within the sensor processing chain. Transaction costs incurred by the acquiree prior to the consummation of an acquisition would not be reflected in our historical results of operations.

INTEREST EXPENSE

Interest expense decreased \$0.9 million, or 47%, to \$1.0 million during the three months ended March 31, 2018 compared to \$1.9 million during the same period in fiscal 2017. The three months ended March 31, 2017 included \$1.5 million cash interest expense and \$0.4 million of non-cash interest expense from the amortization of debt issuance costs related to our former term loan, which was repaid in the fourth quarter of fiscal 2017. During the three months ended March 31, 2018, we incurred \$1.0 million in cash interest expense on the revolving credit facility ("the Revolver") in order to facilitate the acquisition of Themis.

OTHER INCOME, NET

Other income, net decreased \$0.2 million to \$0.1 million during the three months ended March 31, 2018, as compared to \$0.3 million in the same period in fiscal 2017. The decrease was primarily due to \$0.6 million in financing and registration fees during the three months ended March 31, 2018 compared to \$0.1 million for the same period in fiscal 2017. The decrease was also driven by a \$0.3 million gain related to the amortization of the gain on the sale leaseback of our former headquarters in fiscal 2017, which was fully amortized in fiscal 2017. These decreases were partially offset by a \$0.7 million foreign exchange gain during the three months ended March 31, 2018, as compared to \$0.1 million foreign exchange gain during the same period in fiscal 2017.

INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted by the U.S. government. The Tax Act has impacted the statutory Federal tax rate that we will use going forward, which has been reduced to 21% from 35%. As we have a June 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a U.S. statutory Federal rate of approximately 28% for our fiscal year ending June 30, 2018, and 21% for subsequent fiscal years. In addition to the reduced corporate rate we also expect to benefit from the immediate deduction for certain new investments. The Tax Act also includes items that we expect will increase our tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on executive compensation. In addition, the actual effective tax rate may be materially different than the statutory Federal tax rate (including being higher) based on the availability and impact of various other adjustments including but not limited to state taxes, Federal research and development credits, discrete tax benefits related to stock compensation, and the inclusion or exclusion of various items in taxable income which may differ from GAAP income.

During the three months ended March 31, 2018 and 2017, we recognized a discrete tax expense and benefit of \$0.1 million and \$0.2 million, respectively, related to excess tax benefits on stock-based compensation. The excess tax benefit related to stock-based compensation is the result of an increase in value from the stock award between the grant date and the vest date.

Our effective tax rate for the three months ended March 31, 2018 differed from the Federal statutory tax rate of 28% primarily due to the one-time impact of the Tax Act, Federal research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, and state taxes. Our effective tax rate for the three months ended March 31, 2017 differed from the Federal statutory tax rate of 35% primarily due to Federal

research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, and state taxes.

Within the calculation of our annual effective tax rate we have used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service, the SEC, and the FASB. The Tax Act contains many significant changes to the U.S. tax laws, the consequences of which have not yet been fully determined. Changes in corporate tax rates, the net deferred tax assets and/or liabilities relating to our U.S. operations, the taxation of foreign earnings, and the deductibility of expenses contained in the Tax Act could have a material impact on the Company's future U.S. tax expense.

Edgar Filing: MERCURY SYSTEMS INC - Form 10-Q

Nine months ended March 31, 2018 compared to the nine months ended March 31, 2017

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

(In thousands)	March 31, 2018	As a % of Total Net Revenue	March 31, 2017	As a % of Total Net Revenue
Net revenues	\$340,317	100.0 %	\$292,980	100.0 %
Cost of revenues	182,717	53.7	155,364	53.0
Gross margin	157,600	46.3	137,616	47.0
Operating expenses:				
Selling, general and administrative	62,928	18.5	56,093	19.2
Research and development	43,950	12.9	40,192	13.7
Amortization of intangible assets	18,568	5.5	14,222	4.9
Restructuring and other charges	1,792	0.5	825	0.3
Acquisition costs and other related expenses	2,265	0.7	1,889	0.6
Total operating expenses	129,503	38.1	113,221	38.7
Income from operations	28,097	8.2	24,395	8.3
Interest income	14	—	187	0.1
Interest expense	(1,101)	(0.3)	(5,613)	(1.9)
Other (expense) income, net	(1,065)	(0.3)	792	0.3
Income before income taxes	25,945	7.6	19,761	6.8
Tax (benefit) provision	(4,837)	(1.4)	3,690	1.3
Net income	\$30,782	9.0 %	\$16,071	5.5 %

REVENUES

(In thousands)	March 31, 2018	As a % of Total Net Revenue	March 31, 2017	As a % of Total Net Revenue	\$ Change	% Change
Organic revenue	\$312,400	92 %	\$292,980	100 %	\$19,420	7 %
Acquired revenue	27,917	8 %	—	— %	27,917	100 %
Total revenues	\$340,317	100 %	\$292,980	100 %	\$47,337	16 %

Total revenues increased \$47.3 million, or 16%, to \$340.3 million during the nine months ended March 31, 2018 as compared to the same period in fiscal 2017. The increase in total revenues is primarily attributed to \$27.9 million of higher Acquired revenue during the nine months ended March 31, 2018. The \$19.4 million organic revenue increase was primarily attributed to the F-35, PGK, E2D Hawkeye and F-16 SABR programs, partially offset by lower revenues from a large ground based radar program and the Digital Electronic Warfare System ("DEWS") and Miniature Air-Launched Decoy ("MALD") programs.

International revenues, which consist of foreign military sales through the U.S. government, sales to prime defense contractor customers where the end user is known to be outside of the U.S., and direct sales to non-U.S. based customers, increased \$17.7 million to \$66.3 million during the nine months ended March 31, 2018, compared to \$48.6 million in the same period in the prior fiscal year. International revenues represented 19% and 17% of total revenues during the nine months ended March 31, 2018 and 2017, respectively.

Revenues from C4I, Other Sensor and Effector and Radar increased by \$31.8 million, \$18.1 million and \$3.2 million, respectively, during the nine months ended March 31, 2018 as compared to the same period in fiscal 2017. The C4I increase was driven primarily by the F-35 program as well as acquired revenue from the Themis acquisition, partially offset by lower revenue from the ProVision program. The Other Sensor and Effector increase was driven primarily by the PGK and AMRAAM programs. The Radar increase was primarily driven by the E2D Hawkeye and F-16 SABR programs, partially offset by lower revenues from a large ground based radar program and the Patriot program. These increases to revenue were partially offset by a \$1.3 million decrease in EW revenue primarily driven by the DEWS and MALD programs compared to the same period in fiscal 2017.

Revenues from components, modules and sub-assemblies, and integrated subsystems increased by \$28.6 million, \$15.8 million, and \$2.9 million, respectively, during the nine months ended March 31, 2018 as compared to the same period in fiscal

2017. The components increase was driven primarily by the PGK and Falcon Edge programs. The increase in modules and sub-assemblies was driven by the Aegis, Buzzard and E2D Hawkeye programs, partially offset by the DEWS program. The increase in integrated subsystems was primarily due to acquired revenue from the Themis acquisition, partially offset by a large ground based radar program and the Patriot program.

GROSS MARGIN

Gross margin was 46.3% for the nine months ended March 31, 2018, a decrease of 70 basis points from the 47.0% gross margin achieved during the same period in fiscal 2017. The slight decrease to gross margin during the nine months ended March 31, 2018 was impacted by lower margin product mix, which was offset by lower inventory step-up amortization of \$2.1 million related to our acquired businesses compared to the same period in fiscal 2017.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$6.8 million, or 12%, to \$62.9 million during the nine months ended March 31, 2018, compared to \$56.1 million in the same period in fiscal 2017. The increase was primarily related to higher compensation related costs due to added headcount from the acquisitions of Delta, RTL, and Themis. Selling, general and administrative expenses decreased as a percentage of revenues to 18.5% during the nine months ended March 31, 2018 from 19.2% during the same period in fiscal 2017. The slight decrease was primarily due to higher revenues in the nine months ended March 31, 2018, as compared to the same period in fiscal 2017.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$3.8 million, or 9%, to \$44.0 million during the nine months ended March 31, 2018, compared to \$40.2 million during the same period in fiscal 2017. The increase was primarily due to increased headcount from our recent acquisitions, driving higher compensation related costs. Research and development expenses decreased as a percentage of revenues to 12.9% during the nine months ended March 31, 2018 from 13.7% during the same period in fiscal 2017. The slight decrease was primarily due to higher revenues in the nine months ended March 31, 2018, as compared to the same period in fiscal 2017.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges were \$1.8 million for the nine months ended March 31, 2018, compared to \$0.8 million during the same period in fiscal 2017. The increase was primarily driven by higher severance costs compared to the same period in fiscal 2017. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$2.3 million of acquisition costs and other related expenses during the nine months ended March 31, 2018, compared to \$1.9 million during the same period in fiscal 2017. The acquisition costs and other related expenses we incurred during the nine months ended March 31, 2018 were primarily related to \$1.6 million and \$0.3 million for the acquisitions of Themis and RTL, respectively. The fiscal 2017 acquisition costs and other related expenses were primarily related to \$1.3 million and \$0.3 million for the acquisitions of CES and Delta, respectively. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our capabilities and new end markets within the sensor processing chain. Transaction costs incurred by the acquiree prior to the consummation of an acquisition would not be reflected in our historical results of operations.

INTEREST EXPENSE

Interest expense decreased \$4.5 million, or 80%, to \$1.1 million during the nine months ended March 31, 2018 compared to \$5.6 million during the same period in fiscal 2017. The nine months ended March 31, 2017 included \$4.2 million cash interest expense and \$1.4 million of non-cash interest expense from the amortization of debt issuance costs related to our former term loan, which was repaid in the fourth quarter of fiscal 2017. During the nine months ended March 31, 2018, we incurred \$1.0 million in cash interest expense on the revolving credit facility ("the Revolver") in order to facilitate the acquisition of Themis.

OTHER (EXPENSE) INCOME, NET

Other (expense) income, net was \$(1.1) million during the nine months ended March 31, 2018, compared to \$0.8 million during the same period in fiscal 2017. The increase in other expense was primarily due to \$1.9 million in financing and registration fees during the nine months ended March 31, 2018 compared to \$0.3 million for the same

period in fiscal 2017. The nine months ended March 31, 2017 also includes \$0.9 million of income related to the amortization of the gain on the sale leaseback of our former corporate headquarters. These decreases were partially offset by increased foreign exchange gains of \$0.3 million during the nine months ended March 31, 2018, compared to the same period in fiscal 2017.

INCOME TAXES

On December 22, 2017, the Tax Act was enacted by the U.S. government. The Tax Act has impacted the statutory Federal tax rate that we will use going forward, which has been reduced to 21% from 35%. As we have a June 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a U.S. statutory Federal rate of approximately 28% for our fiscal year ending June 30, 2018, and 21% for subsequent fiscal years. In addition to the reduced corporate rate we also expect to benefit from the immediate deduction for certain new investments. The Tax Act also includes items that we expect will increase our tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on executive compensation. In addition, the actual effective tax rate may be materially different than the statutory Federal tax rate (including being higher) based on the availability and impact of various other adjustments including but not limited to state taxes, Federal research and development credits, discrete tax benefits related to stock compensation, and the inclusion or exclusion of various items in taxable income which may differ from GAAP income.

We recorded an income tax benefit of \$4.8 million during the nine months ended March 31, 2018 as compared to an income tax provision of \$3.7 million for the same period in fiscal 2017. During the nine months ended March 31, 2018 and 2017, we recognized discrete tax benefits of \$7.7 million and \$3.0 million, respectively, related to excess tax benefits on stock-based compensation. The discrete tax benefit for the nine months ended March 31, 2018 included the enactment of the Tax Act which revalued the excess tax benefit previously recorded in the three months ended September 30, 2017. The benefit is the result of the increase in value from the stock award between the grant date and the vest date. The nine months ended March 31, 2018 also included a discrete tax benefit of \$3.7 million derived from new information obtained about net operating loss carry-forwards of the entities acquired from Microsemi Corporation (the "Carve-Out Business") in May 2016. The discrete items disclosed above for the nine months ended March 31, 2018 included the effect of the Tax Act.

Our effective tax rate for the nine months ended March 31, 2018 differed from the Federal statutory tax rate of 28% primarily due to the one-time impact of the Tax Act, Federal research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, and state taxes. Our effective tax rate for the nine months ended March 31, 2017 differed from the Federal statutory tax rate of 35% primarily due to Federal research and development credits, domestic manufacturing deduction, excess tax benefits related to stock compensation, and state taxes.

Within the calculation of our annual effective tax rate we have used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service, the SEC, and the FASB. The Tax Act contains many significant changes to the U.S. tax laws, the consequences of which have not yet been fully determined. Changes in corporate tax rates, the net deferred tax assets and/or liabilities relating to our U.S. operations, the taxation of foreign earnings, and the deductibility of expenses contained in the Tax Act could have a material impact on the Company's future U.S. tax expense.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity come from existing cash and cash generated from operations, our revolving credit facility and our ability to raise capital under our universal shelf registration statement. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments. We do not currently have any material commitments for capital expenditures.

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

Shelf Registration Statement

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

- the acquisition of other companies or businesses;
- the repayment and refinancing of debt;

- capital expenditures;
- working capital; and
- other purposes as described in the prospectus supplement.

We have an unlimited amount available under the shelf registration statement. Additionally, as part of the shelf registration statement, we have entered into an equity distribution agreement which allows us to sell an aggregate of up to \$200.0 million of our common stock from time to time through our agents. The actual dollar amount and number of shares of common stock we

27

sell pursuant to the equity distribution agreement will be dependent on, among other things, market conditions and our fund raising requirements. The agents may sell the common stock by any method deemed to be an “at the market offering” as defined in Rule 415 of the Securities Act of 1933, as amended, including without limitation sales made directly on NASDAQ, on any other existing trading market for the common stock or to or through a market maker. In addition, our common stock may be offered and sold by such other methods, including privately negotiated transactions, as we and the agents may agree.

Revolving Credit Facility

In June 2017, we amended our revolving credit facility, increasing and extending the facility into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining outstanding principal of and interest on our term loan using cash on hand. The Revolver had an outstanding balance of \$195.0 million at March 31, 2018. See Note I in the accompanying consolidated financial statements for further discussion of the Revolver.

On February 1, 2018, upon the terms and subject to the conditions set forth in a Merger Agreement, we completed the acquisition of Ceres, the holding company that owns Themis. Under the terms of the Merger Agreement, we paid an aggregate purchase price of \$180.0 million, plus an estimated adjustment for acquired working capital and cash for the Acquired Company, subject to post-closing adjustments based on a determination of closing net working capital, transaction expenses and net debt (all as defined in the Merger Agreement). To facilitate the completion of the Merger Agreement, we drew \$195.0 million from the Revolver, with the higher amount reflecting an estimated adjustment for working capital, including cash, expected to be received with the Acquired Company at closing.

CASH FLOWS

(In thousands)	As of and For the Nine Month Period Ended March 31,	
	2018	2017
Net cash provided by operating activities	\$17,680	\$49,410
Net cash used in investing activities	\$(196,838)	\$(64,186)
Net cash provided by financing activities	\$181,931	\$203,453
Net increase in cash and cash equivalents	\$2,580	\$188,547
Cash and cash equivalents at end of period	\$44,217	\$270,238

Our cash and cash equivalents increased by \$2.6 million from June 30, 2017 to March 31, 2018, primarily as the result of \$17.7 million provided by operating activities and net borrowings under the credit facility of \$195.0 million. These increases were offset by \$185.4 million used in acquisition activities, \$15.1 million used in the retirement of common stock used to settle individual employees' tax liabilities associated with vesting of restricted stock awards and \$11.1 million invested in purchases of property and equipment.

Operating Activities

During the nine months ended March 31, 2018, we generated \$17.7 million in cash from operating activities, a decrease of \$31.7 million when compared to the same period in fiscal 2017. The decrease in cash generated by operating activities was primarily a result of \$21.0 million less collections from accounts receivables, \$18.3 million higher inventory purchases, and a \$15.7 million decrease in income taxes payable. The decrease in cash generated by operating activities was partially offset by generating \$14.7 million of higher net income and \$7.2 million in additional depreciation and amortization compared to the same period in fiscal 2017. The lower cash flow from operating activities during the nine months ended March 31, 2018 was primarily a result of our efforts to insource our manufacturing and continued investment in inventory to support the demands of our organic and acquired growth. Consistent with our integration strategy, we are transitioning to an insourced manufacturing model which has resulted in the purchase of higher amounts of component and safety stock inventory. Also, we continue to observe demand for larger, more complex sub-assemblies and integrated subsystems, which inherently involve more inventory, labor, longer lead times and conversion cycles.

Investing Activities

During the nine months ended March 31, 2018, we used \$196.8 million in investing activities compared to \$64.2 million during the same period in fiscal 2017. The increase was primarily driven by \$185.4 million used in the acquisitions of Themis and RTL during the nine months ended March 31, 2018 compared to \$36.9 million primarily used in the acquisition of CES in the same period of fiscal 2017. The increase was offset by \$15.7 million in lower purchases of property and equipment during fiscal 2018.

Financing Activities

During the nine months ended March 31, 2018, we had \$181.9 million of net cash provided by financing activities compared to \$203.5 million during the same period in fiscal 2017. The \$21.6 million decrease in net cash provided by financing activities was primarily due to \$215.7 million of net proceeds from the equity offering during the nine months ended March 31, 2017 compared to the \$195.0 million of net borrowings that was drawn against the Revolver for the nine months ended March 31, 2018. The nine months ended March 31, 2018 included \$15.1 million related to the retirement of common stock used to settle employees' tax liabilities associated with vesting of restricted stock awards as compared to \$7.7 million used in the same period of fiscal 2017, primarily driven by the increase in our stock price as of the vesting date. This was offset by the \$7.5 million of debt principal payments on the former term loan during the nine months ended March 31, 2017.

COMMITMENTS, CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The following is a schedule of our commitments and contractual obligations outstanding at March 31, 2018:

(In thousands)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Purchase obligations	\$57,067	\$57,067	\$—	\$—	\$—
Operating leases	61,522	8,356	16,368	13,736	23,062
	\$118,589	\$65,423	\$16,368	\$13,736	\$23,062

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 \$57.1 million at March 31, 2018.

We have a liability at March 31, 2018 of \$0.8 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. We do not know the ultimate resolution on these uncertain tax positions and as such, do not know the ultimate timing of payments related to this liability. Accordingly, these amounts are not included in the above table.

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

As part of our strategy for growth, we continue to explore acquisitions or strategic alliances. The associated acquisition costs incurred in the form of professional fees and services may be material to the future periods in which they occur, regardless of whether the acquisition is ultimately completed. In connection with our recent acquisitions, our operating lease commitments have increased, as expected, to align with our strategic growth initiative.

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

OFF-BALANCE SHEET ARRANGEMENTS

Other than our lease commitments incurred in the normal course of business and certain indemnification provisions, we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity.

We do not have any majority-owned subsidiaries that are not consolidated in the financial statements. Additionally, we do not have an interest in, or relationships with, any special purpose entities.

NON-GAAP FINANCIAL MEASURES

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

Adjusted EBITDA is defined as net income before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and

financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based and other non-cash compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use

adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining a component of bonus and equity compensation for executive officers 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		Nine Months	
	Ended		Ended	
	March 31,		March 31,	
	2018	2017	2018	2017
Net income	\$3,696	\$7,048	\$30,782	\$16,071
Interest expense (income), net	999	1,756	1,087	5,426
Income taxes	2,209	3,170	(4,837)	3,690
Depreciation	4,277	3,233	11,752	8,917
Amortization of intangible assets	7,104	4,732	18,568	14,222
Restructuring and other charges (1)	1,384	459	1,792	825
Impairment of long-lived assets	—	—	—	—
Acquisition and financing costs	1,909	569	4,129	2,236
Fair value adjustments from purchase accounting (2)	539	270	1,132	3,217
Litigation and settlement expense (income), net	—	—	—	100
Stock-based and other non-cash compensation expense	3,669	3,715	13,306	11,440
Adjusted EBITDA	\$25,786	\$24,952	\$77,711	\$66,144

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

(2) Fair value adjustments from purchase accounting for the three months ended March 31, 2018 relate to Themis and CES inventory step-up amortization. The nine months ended March 31, 2018 include adjustments related to Themis, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for the three months ended March 31, 2017 relate to CES inventory step-up amortization. The nine months ended March 31, 2017 include adjustments related to Carve-Out Business and CES inventory step-up amortization.

Adjusted income and adjusted EPS exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. We believe that exclusion of these items assists in providing a more complete understanding of our underlying results and trends and allows for comparability with our peer company index and industry. We use these measures along with the corresponding GAAP financial measures to manage our business and to evaluate our performance compared to prior periods and the marketplace. We define adjusted income as income before amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based and other non-cash compensation expense. The impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision. Adjusted EPS expresses adjusted income on a per share basis using weighted average diluted shares outstanding.

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

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

(In thousands, except per share data)	Three Months Ended			
	March 31,			
	2018	2017		
Net income and diluted earnings per share	\$3,696	\$0.08	\$7,048	\$0.16
Amortization of intangible assets	7,104		4,732	
Restructuring and other charges (1)	1,384		459	
Impairment of long-lived assets	—		—	
Acquisition and financing costs	1,909		569	
Fair value adjustments from purchase accounting (2)	539		270	
Litigation and settlement expenses (income), net	—		—	
Stock-based and other non-cash compensation expense	3,669		3,715	
Impact to income taxes (3)	(4,082)		(3,576)	
Adjusted income and adjusted earnings per share	\$14,219	\$0.30	\$13,217	\$0.29

Diluted weighted-average shares outstanding 47,532 44,814

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

(2) Fair value adjustments from purchase accounting for the three months ended March 31, 2018 relate to Themis and CES inventory step-up amortization. Fair value adjustments from purchase accounting for the three months ended March 31, 2017 relate to CES inventory step-up amortization.

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

(In thousands, except per share data)	Nine Months Ended			
	March 31,			
	2018	2017		
Net income and diluted earnings per share	\$30,782	\$0.65	\$16,071	\$0.39
Amortization of intangible assets	18,568		14,222	
Restructuring and other charges (1)	1,792		825	
Impairment of long-lived assets	—		—	
Acquisition and financing costs	4,129		2,236	
Fair value adjustments from purchase accounting (2)	1,132		3,217	
Litigation and settlement expenses (income), net	—		100	
Stock-based and other non-cash compensation expense	13,306		11,440	
Impact to income taxes (3)	(24,648)		(14,102)	
Adjusted income and adjusted earnings per share	\$45,061	\$0.95	\$34,009	\$0.82

Diluted weighted-average shares outstanding 47,473 41,530

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

(2) Fair value adjustments from purchase accounting for the nine months ended March 31, 2018 relate to Themis, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for the nine months ended March 31, 2017 relate to the Carve-Out Business and CES inventory step-up amortization.

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

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures for property and equipment, which includes capitalized software development costs. We believe free cash flow provides investors with an important perspective on cash available for investments and acquisitions after making capital investments

required to support ongoing business operations and long-term value creation. We believe that trends in our free cash flow can be valuable indicators of our operating performance and liquidity.

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
(In thousands)	2018	2017	2018	2017
Cash provided by operating activities	\$873	\$24,889	17,680	\$49,410
Purchase of property and equipment	(3,475)	(13,036)	(11,067)	(26,789)
Free cash flow	\$(2,602)	\$11,853	\$6,613	\$22,621

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for the Company on July 1, 2018, and we will not early adopt this ASU. The standard permits the use of either the retrospective or cumulative effect transition method. We will use the retrospective transition method upon adoption of the standard. We have made significant investments to date in our data reporting infrastructure, and continue to enhance this infrastructure in order to support the reporting and disclosure requirements of the new standard. In addition, we have extensively reviewed our current accounting policies and practices to evaluate the future impact that adoption of the standard will have on our consolidated financial statements and notes. The significant investments we have made in our data reporting infrastructure to support the reporting requirements of the standard have enhanced our ability to capture each of the specific disclosure requirements detailed in the standard. Based on our review procedures to date, the impact of adopting the new standard on our total sales and operating income is not expected to be material.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for the Company on July 1, 2019. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. We are continuing to evaluate our population of leases to determine the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. We are evaluating the effect that ASU 2016-15 will have on our consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except

transfers of inventory). Under current U.S. GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or annual). We are evaluating the effect that ASU 2016-16 will have on our consolidated financial statements and related disclosures.

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

In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. We are evaluating the effect that ASU 2017-07 will have on our consolidated financial statements and related disclosures.

In March 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects for Accumulated Other Comprehensive Income, an amendment of the FASB Accounting Standards Codification. This ASU permits a company to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act of 2017 on items within AOCI to retained earnings. The amounts applicable for reclassification should include the effect of the change in U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of the enactment of the Tax Cuts and Jobs Act related to the items remaining in accumulated other comprehensive income. The effect of the change in the U.S. federal corporate income tax rate on gross valuation allowance that were originally charged to income from continuing operations shall not be included. For all entities, the new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that annual period. Early adoption is permitted, including adoption in any interim period for public business entities for reporting periods not yet been issued. We are evaluating the effect that ASU 2018-02 will have on our consolidated financial statements and related disclosures.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2017, we adopted FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, an amendment of the FASB Accounting Standards Codification. This ASU changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out or retail inventory method. The ASU also eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximately normal profit margin when measuring inventory. Such adoption has not and will not have any impact to our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in our exposure to market risk from June 30, 2017 to March 31, 2018.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), regarding the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2018. We continue to review our disclosure controls and procedures and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our Company’s business. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

(b) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13c-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, management is in the process of integrating the recently acquired Delta and Themis companies into our overall internal control over financial reporting environment.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017. There have been no material changes from the factors disclosed in our 2017 Annual Report on Form 10-K filed on August 18, 2017, 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 March 31, 2018 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Cash Flows; and (iv) notes to the Consolidated Financial Statements

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

MERCURY SYSTEMS, INC.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Andover, Massachusetts, on May 3, 2018.

MERCURY SYSTEMS, INC.

By: /S/ MICHAEL D. RUPPERT

Michael D. Ruppert

Executive Vice President,

Chief Financial Officer, and Treasurer

36