

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

FORM 10-Q

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

For the quarterly period ended December 31, 2021
OR

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

For the transition period from _____ to _____
COMMISSION FILE NUMBER: 0-23599

MERCURY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of
incorporation or organization)

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

50 MINUTEMAN ROAD
ANDOVER MA
(Address of principal executive offices)

01810
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	MRCY	Nasdaq Global Select Market
Preferred Stock Purchase Rights	N/A	Nasdaq Global Select Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

Shares of Common Stock outstanding as of January 31, 2022 56,753,766 shares

MERCURY SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	<u>December 31, 2021</u>	<u>July 2, 2021</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 105,169	\$ 113,839
Accounts receivable, net of allowance for credit losses of \$1,833 and \$1,720 at December 31, 2021 and July 2, 2021, respectively	126,325	128,807
Unbilled receivables and costs in excess of billings	193,803	162,921
Inventory	251,272	221,640
Prepaid income taxes	16,070	782
Prepaid expenses and other current assets	16,153	15,111
Total current assets	<u>708,792</u>	<u>643,100</u>
Property and equipment, net	127,385	128,524
Goodwill	942,346	804,906
Intangible assets, net	376,091	307,559
Operating lease right-of-use assets	71,974	66,373
Other non-current assets	4,186	4,675
Total assets	<u>\$ 2,230,774</u>	<u>\$ 1,955,137</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 59,389	\$ 47,951
Accrued expenses	31,391	24,652
Accrued compensation	37,952	40,043
Deferred revenues and customer advances	34,940	38,177
Total current liabilities	<u>163,672</u>	<u>150,823</u>
Deferred income taxes	29,561	28,810
Income taxes payable	8,160	7,467
Long-term debt	451,500	200,000
Operating lease liabilities	75,108	71,508
Other non-current liabilities	15,652	12,383
Total liabilities	<u>743,653</u>	<u>470,991</u>
Commitments and contingencies (Note N)		
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; 55,583,012 and 55,241,120 shares issued and outstanding at December 31, 2021 and July 2, 2021, respectively	556	552
Additional paid-in capital	1,122,113	1,109,434
Retained earnings	364,720	374,499
Accumulated other comprehensive loss	(268)	(339)
Total shareholders' equity	<u>1,487,121</u>	<u>1,484,146</u>
Total liabilities and shareholders' equity	<u>\$ 2,230,774</u>	<u>\$ 1,955,137</u>

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

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

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Net revenues	\$ 220,380	\$ 210,676	\$ 445,393	\$ 416,297
Cost of revenues	133,158	122,009	269,762	239,511
Gross margin	87,222	88,667	175,631	176,786
Operating expenses:				
Selling, general and administrative	36,810	31,596	73,766	64,500
Research and development	28,335	28,128	57,217	55,545
Amortization of intangible assets	16,002	7,643	29,736	15,374
Restructuring and other charges	3,802	951	16,076	2,248
Acquisition costs and other related expenses	2,660	2,236	4,798	2,236
Total operating expenses	87,609	70,554	181,593	139,903
(Loss) income from operations	(387)	18,113	(5,962)	36,883
Interest income	5	60	14	132
Interest expense	(1,094)	(73)	(1,689)	(73)
Other expense, net	(1,318)	(981)	(2,738)	(1,827)
(Loss) income before income taxes	(2,794)	17,119	(10,375)	35,115
Income tax (benefit) provision	(155)	4,433	(596)	6,631
Net (loss) income	<u>\$ (2,639)</u>	<u>\$ 12,686</u>	<u>\$ (9,779)</u>	<u>\$ 28,484</u>
Basic net (loss) earnings per share	<u>\$ (0.05)</u>	<u>\$ 0.23</u>	<u>\$ (0.18)</u>	<u>\$ 0.52</u>
Diluted net (loss) earnings per share	<u>\$ (0.05)</u>	<u>\$ 0.23</u>	<u>\$ (0.18)</u>	<u>\$ 0.51</u>
Weighted-average shares outstanding:				
Basic	55,520	55,070	55,448	54,976
Diluted	55,520	55,434	55,448	55,385
Comprehensive (loss) income:				
Net (loss) income	\$ (2,639)	\$ 12,686	\$ (9,779)	\$ 28,484
Foreign currency translation adjustments	(269)	(658)	(25)	(759)
Pension benefit plan, net of tax	48	31	96	62
Total other comprehensive (loss) income, net of tax	(221)	(627)	71	(697)
Total comprehensive (loss) income	<u>\$ (2,860)</u>	<u>\$ 12,059</u>	<u>\$ (9,708)</u>	<u>\$ 27,787</u>

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

MERCURY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands)
(Unaudited)

For the Second Quarter Ended December 31, 2021

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance at October 1, 2021	55,501	\$ 555	\$ 1,111,613	\$ 367,359	\$ (47)	\$ 1,479,480
Issuance of common stock under employee stock incentive plans	31	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	54	1	2,515	—	—	2,516
Purchase and retirement of common stock	(3)	—	(183)	—	—	(183)
Stock-based compensation	—	—	8,168	—	—	8,168
Net loss	—	—	—	(2,639)	—	(2,639)
Other comprehensive loss	—	—	—	—	(221)	(221)
Balance at December 31, 2021	55,583	\$ 556	\$ 1,122,113	\$ 364,720	\$ (268)	\$ 1,487,121

For the Second Quarter Ended January 1, 2021

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance at October 2, 2020	55,045	\$ 550	\$ 1,082,044	\$ 328,253	\$ (2,955)	\$ 1,407,892
Issuance of common stock under employee stock incentive plans	38	1	1	—	—	2
Issuance of common stock under employee stock purchase plan	46	—	3,184	—	—	3,184
Stock-based compensation	—	—	7,494	—	—	7,494
Net income	—	—	—	12,686	—	12,686
Other comprehensive loss	—	—	—	—	(627)	(627)
Balance at January 1, 2021	55,129	\$ 551	\$ 1,092,723	\$ 340,939	\$ (3,582)	\$ 1,430,631

For the Six Months Ended December 31, 2021

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance at July 2, 2021	55,241	\$ 552	\$ 1,109,434	\$ 374,499	\$ (339)	\$ 1,484,146
Issuance of common stock under employee stock incentive plans	429	4	(4)	—	—	—
Issuance of common stock under employee stock purchase plan	54	1	2,515	—	—	2,516
Purchase and retirement of common stock	(141)	(1)	(7,498)	—	—	(7,499)
Stock-based compensation	—	—	17,666	—	—	17,666
Net loss	—	—	—	(9,779)	—	(9,779)
Other comprehensive income	—	—	—	—	71	71
Balance at December 31, 2021	55,583	\$ 556	\$ 1,122,113	\$ 364,720	\$ (268)	\$ 1,487,121

For the Six Months Ended January 1, 2021

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance at July 3, 2020	54,702	\$ 547	\$ 1,074,667	\$ 312,455	\$ (2,885)	\$ 1,384,784
Issuance of common stock under employee stock incentive plans	382	4	—	—	—	4
Issuance of common stock under employee stock purchase plan	46	—	3,184	—	—	3,184
Purchase and retirement of common stock	(1)	—	(66)	—	—	(66)
Stock-based compensation	—	—	14,938	—	—	14,938
Net income	—	—	—	28,484	—	28,484
Other comprehensive loss	—	—	—	—	(697)	(697)
Balance at January 1, 2021	55,129	\$ 551	\$ 1,092,723	\$ 340,939	\$ (3,582)	\$ 1,430,631

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

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

	Six Months Ended	
	December 31, 2021	January 1, 2021
Cash flows from operating activities:		
Net (loss) income	\$ (9,779)	\$ 28,484
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization expense	45,556	26,281
Stock-based compensation expense	17,375	14,454
Benefit for deferred income taxes	(4,206)	(3,773)
Other non-cash items	(1,604)	2,217
Changes in operating assets and liabilities, net of effects of businesses acquired:		
Accounts receivable, unbilled receivables, and costs in excess of billings	(17,937)	(6,802)
Inventory	(20,425)	(29,121)
Prepaid income taxes	(13,572)	1,809
Prepaid expenses and other current assets	(245)	1,052
Other non-current assets	1,004	698
Accounts payable, accrued expenses, and accrued compensation	13,294	(1,924)
Deferred revenues and customer advances	(1,148)	13,719
Income taxes payable	(9)	(131)
Other non-current liabilities	(3,486)	(95)
Net cash provided by operating activities	<u>4,818</u>	<u>46,868</u>
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired	(243,255)	(243,637)
Purchases of property and equipment	(13,404)	(24,753)
Other investing activities	(3,231)	—
Proceeds from sale of investment	—	1,538
Net cash used in investing activities	<u>(259,890)</u>	<u>(266,852)</u>
Cash flows from financing activities:		
Proceeds from employee stock plans	2,516	3,188
Borrowings under credit facilities	251,500	160,000
Purchase and retirement of common stock	(7,499)	(66)
Net cash provided by financing activities	<u>246,517</u>	<u>163,122</u>
Effect of exchange rate changes on cash and cash equivalents	(115)	763
Net decrease in cash and cash equivalents	(8,670)	(56,099)
Cash and cash equivalents at beginning of period	113,839	226,838
Cash and cash equivalents at end of period	<u>\$ 105,169</u>	<u>\$ 170,739</u>
Cash paid during the period for:		
Interest	\$ 890	\$ —
Income taxes	\$ 17,808	\$ 7,942
Supplemental disclosures—non-cash activities:		
Non-cash investing activity	\$ 3,230	\$ 427

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 technology company serving the aerospace and defense industry, positioned at the intersection of high-tech and defense. Headquartered in Andover, Massachusetts, the Company delivers products and solutions that power a broad range of aerospace and defense programs, optimized for mission success in some of the most challenging and demanding environments. The Company envisions, creates and delivers innovative technology solutions that are open, purpose-built and uncompromised to meet our customers’ most-pressing high-tech needs, including those specific to the defense community.

Investors and others should note that the Company announces material financial information using its website (www.mrcy.com), Securities and Exchange Commission (“SEC”) filings, press releases, public conference calls, webcasts, and social media, including Twitter (twitter.com/mrcy and twitter.com/mrcy_CEO) and LinkedIn (www.linkedin.com/company/mercury-systems). Therefore, the Company encourages investors and others interested in Mercury to review the information the Company posts on the social media and other communication channels listed on its website.

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 July 2, 2021 which are contained in the Company’s Annual Report on Form 10-K filed with the SEC on August 17, 2021. The results for the second quarter and six months ended December 31, 2021 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.

All references to the second quarter of fiscal 2022 are to the quarter ended December 31, 2021. There were 13 weeks during the second quarters ended December 31, 2021 and January 1, 2021, respectively. There were 26 weeks during the six months ended December 31, 2021 and January 1, 2021, respectively.

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

FOREIGN CURRENCY

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

REVENUE RECOGNITION

The Company recognizes revenue in accordance with ASC 606, *Revenue from Contracts with Customers*, ("ASC 606"). Revenues are derived from the sales of products that are grouped into one of the following three categories: (i) components; (ii) modules and sub-assemblies; and (iii) integrated subsystems. The Company also generates revenues from the performance of services, including systems engineering support, consulting, maintenance and other support, testing and installation. Each promised good or service within a contract is accounted for separately under the guidance of ASC 606 if they are distinct. Promised goods or services not meeting the criteria for being a distinct performance obligation are bundled into a single performance obligation with other goods or services that together meet the criteria for being distinct. The appropriate allocation of the transaction price and recognition of revenue is then determined for the bundled performance obligation.

Revenue recognized at a point in time generally relates to contracts that include a combination of components, modules and sub-assemblies, integrated subsystems and related system integration or other services. Contracts with distinct performance obligations recognized at a point in time, with or without an allocation of the transaction price, totaled 52% and 49% of revenues for the second quarter and six months ended December 31, 2021, respectively. Contracts with distinct performance obligations recognized at a point in time, with or without an allocation of the transaction price, totaled 61% and 62% of revenues for the second quarter and six months ended January 1, 2021, respectively.

The Company also engages in long-term contracts for development, production and service activities and recognizes revenue for performance obligations over time. These long-term contracts involve the design, development, manufacture, or modification of complex modules and sub-assemblies or integrated subsystems and related services. Long-term contracts include both fixed-price and cost reimbursable contracts. The Company's cost reimbursable contracts typically include cost-plus fixed fee and time and material contracts.

Total revenue recognized under long-term contracts over time was 48% and 51% of total revenues for the second quarter and six months ended December 31, 2021, respectively. Total revenue recognized under long-term contracts over time was 39% and 38% of total revenues for the second quarter and six months ended January 1, 2021, respectively.

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

All revenues are reported net of government assessed taxes (e.g., sales taxes or value-added taxes). Refer to Note M for disaggregation of revenue for the period.

ACCOUNTS RECEIVABLE

Accounts receivable, net, represents amounts that have been billed and are currently due from customers. The Company maintains an allowance for credit losses to provide for the estimated amount of receivables that will not be collected. The Company provides credit to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended as necessary. The allowance is based upon an assessment of the customer's credit worthiness, reasonable forecasts about the future, history with the customer, and the age of the receivable balance. The Company typically invoices a customer upon shipment of the product (or completion of a service) for contracts where revenue is recognized at a point in time. For contracts where revenue is recognized over time, the invoicing events are typically based on specified performance obligation deliverables or milestone events, or quantifiable measures of performance.

CONTRACT BALANCES

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

The contract asset balances were \$193,803 and \$162,921 as of December 31, 2021 and July 2, 2021, respectively. The contract asset balance increased due to growth in revenue recognized over time and timing of milestone billings under long-term contracts during the six months ended December 31, 2021. The contract liability balances were \$34,410 and \$35,201 as of December 31, 2021 and July 2, 2021, respectively. The decrease was due to timing of milestone billings across multiple programs.

Revenue recognized for the second quarter and six months ended December 31, 2021 that was included in the contract liability balance at July 2, 2021 was \$5,151 and \$18,288, respectively. Revenue recognized for the second quarter and six months ended January 1, 2021 that was included in the contract liability balance at July 3, 2020 was \$4,336 and \$13,366, respectively.

REMAINING PERFORMANCE OBLIGATIONS

The Company includes in its computation of remaining performance obligations customer orders for which it has accepted signed sales orders. The definition of remaining performance obligations excludes contracts with original expected durations of less than one year, as well as those contracts that provide the customer with the right to cancel or terminate the order with no substantial penalty, even if the Company's historical experience indicates the likelihood of cancellation or termination is remote. As of December 31, 2021, the aggregate amount of the transaction price allocated to remaining performance obligations was \$441,675. The Company expects to recognize approximately 59% of its remaining performance obligations as revenue in the next 12 months and the balance thereafter.

WEIGHTED-AVERAGE SHARES

Weighted-average shares were calculated as follows:

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Basic weighted-average shares outstanding	55,520	55,070	55,448	54,976
Effect of dilutive equity instruments	—	364	—	409
Diluted weighted-average shares outstanding	55,520	55,434	55,448	55,385

Equity instruments to purchase 408 and 434 shares of common stock were not included in the calculation of diluted net earnings per share for the second quarter and six months ended December 31, 2021, respectively, because the equity instruments were anti-dilutive. Equity instruments to purchase 114 and 2 shares of common stock were not included in the calculation of diluted net earnings per share for the second quarter and six months ended January 1, 2021, respectively, because the equity instruments were anti-dilutive.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU provide optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. The amendments in this ASU are elective and apply to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The amendments in this Update are effective for all entities as of March 12, 2020 through December 31, 2022. The Company does not expect this adoption to have a material impact to the Company's consolidated financial statements or related disclosures.

In August 2020, the FASB issued ASU No. 2020-06, *Debt - Debt with conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU simplify the accounting for convertible debt securities. The ASU is effective for fiscal years beginning after December 15, 2021, with early adoption permitted, including adoption in an interim period. The Company does not expect this adoption to have a material impact to the Company's consolidated financial statements or related disclosures.

In October 2021, the FASB issued ASU No. 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU address diversity and inconsistency related to the recognition and measurement of contract assets and contract liabilities acquired in a business combination and require that an acquirer recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with ASC 606, Revenue from Contracts with Customers. Under current U.S. GAAP, an acquirer generally recognizes assets and liabilities assumed in a business combination, including contract assets and liabilities arising from revenue contracts with customers, at fair value on the acquisition date. ASU No. 2021-08 will result in the acquirer recording acquired contract assets and liabilities on the same basis that would have been recorded by the acquiree before the acquisition under ASC 606. This ASU is effective for fiscal years beginning after December 15, 2022, with early adoption permitted, including adoption in an interim period. The Company is currently evaluating the effect that this standard may have on its consolidated financial statements and related disclosures.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 3, 2021 the Company adopted ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, an amendment of the FASB Accounting Standards Codification. The amendments in this ASU simplify the accounting for income taxes by removing certain exceptions for intraperiod tax allocations and deferred tax liabilities for equity method investments and add guidance as to whether a step-up in tax basis of goodwill relates to a business combination or a separate transaction. This adoption did not have a material impact to the Company's consolidated financial statements or related disclosures.

C. Acquisitions

ATLANTA MICRO ACQUISITION

On November 29, 2021, the Company acquired Atlanta Micro, Inc. ("Atlanta Micro") for a purchase price of \$90,000, subject to net working capital and net debt adjustments. Based in Norcross, Georgia, Atlanta Micro is a leading designer and manufacturer of high-performance RF modules and components, including advanced monolithic microwave integrated circuits (MMICs) which are critical for high-speed data acquisition applications including electronic warfare, radar and weapons. The Company funded the acquisition through the Company's existing revolving credit facility (the "Revolver").

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

	<u>Amounts</u>
Consideration transferred	
Cash paid at closing	\$ 91,438
Working capital and net debt adjustment	(474)
Less cash acquired	(1,782)
Net purchase price	<u>\$ 89,182</u>
Fair value of tangible assets acquired and liabilities assumed	
Cash	\$ 1,782
Accounts receivable	1,568
Inventory	4,044
Fixed assets	547
Other current and non-current assets	2,043
Accounts payable	(529)
Accrued expenses	(661)
Other current and non-current liabilities	(9,733)
Fair value of net tangible assets acquired	(939)
Fair value of identifiable intangible assets	30,263
Goodwill	61,640
Fair value of net assets acquired	90,964
Less cash acquired	(1,782)
Net purchase price	<u>\$ 89,182</u>

The amounts above represent the preliminary fair value estimates as of December 31, 2021 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimate includes customer relationships of \$18,450 with a useful life of 11 years, completed technology of \$9,450 with a useful life of 10 years and backlog of \$2,363 with a useful life of two years. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The estimated goodwill of \$61,640 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 and is not deductible for tax purposes. The goodwill from this acquisition is reported in the Microelectronics reporting unit. The revenues and loss before income taxes from Atlanta Micro included in the Company's consolidated results for the second quarter ended December 31, 2021 were \$1,617 and \$(220), respectively.

AVALEX ACQUISITION

On September 27, 2021, the Company signed a definitive agreement to acquire Avalex Technologies (“Avalex”) for a purchase price of \$155,000, subject to net working capital and net debt adjustments. On November 5, 2021, the transaction closed and the Company acquired Avalex. Based in Gulf Breeze, Florida, Avalex is a provider of mission-critical avionics, including rugged displays, integrated communications management systems, digital video recorders, and warning systems. The Company funded the acquisition with the Company's Revolver.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$ 157,367
Working capital and net debt adjustment	(1,185)
Less cash acquired	(2,188)
Net purchase price	\$ 153,994
Fair value of tangible assets acquired and liabilities assumed	
Cash	\$ 2,188
Accounts receivable and unbilled receivables	5,317
Inventory	6,055
Fixed assets	1,245
Other current and non-current assets	5,195
Accounts payable	(1,700)
Accrued expenses	(1,147)
Other current and non-current liabilities	(4,787)
Fair value of net tangible assets acquired	12,366
Fair value of identifiable intangible assets	61,360
Goodwill	82,456
Fair value of net assets acquired	156,182
Less cash acquired	(2,188)
Net purchase price	\$ 153,994

The amounts above represent the preliminary fair value estimates as of December 31, 2021 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimate includes customer relationships of \$41,880 with a useful life of 9 years, completed technology of \$14,430 with a useful life of 7 years and backlog of \$5,050 with a useful life of one year. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The estimated goodwill of \$82,456 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 in the Processing reporting unit. The Company has estimated the tax value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. As of December 31, 2021, the Company had \$82,700 of goodwill deductible for tax purposes. The revenues and loss before income taxes from Avalex included in the Company's consolidated results for the second quarter ended December 31, 2021 were \$4,427 and \$(1,097), respectively.

PENTEK ACQUISITION

On May 27, 2021, the Company acquired Pentek Technologies, LLC and Pentek Systems, Inc. (collectively, "Pentek"). for a purchase price of \$65,000, subject to net working capital and net debt adjustments. Based in Upper Saddle River, New Jersey, Pentek is a leading designer and manufacturer of ruggedized, high-performance, commercial off-the-shelf software-defined radio and data acquisition boards, recording systems and subsystems for high-end commercial and defense applications. The acquisition and associated transaction expenses were funded through a combination of cash on hand and the Company's Revolver. On October 13, 2021, the Company and former owners of Pentek agreed to post closing adjustments totaling \$79, which increased the Company's net purchase price.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$ 65,668
Working capital and net debt adjustment	79
Less cash acquired	(746)
Net purchase price	<u>\$ 65,001</u>
Estimated fair value of tangible assets acquired and liabilities assumed	
Cash	\$ 746
Accounts receivable	1,370
Inventory	6,575
Fixed assets	152
Other current and non-current assets	2,864
Accounts payable	(1,016)
Accrued expenses	(520)
Other current and non-current liabilities	(4,097)
Estimated fair value of net tangible assets acquired	6,074
Estimated fair value of identifiable intangible assets	24,110
Estimated goodwill	35,563
Estimated fair value of net assets acquired	65,747
Less cash acquired	(746)
Net purchase price	<u>\$ 65,001</u>

The amounts above represent the preliminary fair value estimates as of December 31, 2021 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimate includes customer relationships of \$15,560 with a useful life of 21 years, completed technology of \$6,340 with a useful life of seven years and backlog of \$2,210 with a useful life of one year. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$35,563 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 included in the Microelectronics reporting unit. The transaction was a combination of asset and stock, with the asset portion of goodwill being deductible for tax purposes. The Company has estimated the tax value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. As of December 31, 2021, the Company had \$29,216 of goodwill deductible for tax purposes.

PHYSICAL OPTICS CORPORATION ACQUISITION

On December 7, 2020, the Company signed a definitive agreement to acquire Physical Optics Corporation ("POC") for a purchase price of \$310,000, subject to net working capital and net debt adjustments. On December 30, 2020, the transaction closed and the Company acquired POC. Based in Torrance, California, POC expands the Company's global avionics business and its collective footprint in the platform and mission management market. The Company funded the acquisition through a combination of cash on hand and the Company's Revolver. On May 28, 2021, the Company and representative of the former owners of POC agreed to post closing-adjustments totaling \$2,641, which increased the Company's net purchase price.

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

	Amounts
Consideration transferred	
Cash paid at closing	\$ 251,229
Cash paid post closing	61,626
Working capital and net debt adjustment	(2,096)
Less cash acquired	(2,855)
Net purchase price	<u>\$ 307,904</u>
Fair value of tangible assets acquired and liabilities assumed	
Cash	\$ 2,855
Accounts receivable and unbilled receivables	31,255
Inventory	11,125
Fixed assets	23,236
Other current and non-current assets	18,173
Accounts payable	(3,777)
Accrued expenses	(6,266)
Other current and non-current liabilities	(30,107)
Fair value of net tangible assets acquired	46,494
Fair value of identifiable intangible assets	116,000
Goodwill	148,265
Fair value of net assets acquired	310,759
Less cash acquired	(2,855)
Net purchase price	<u>\$ 307,904</u>

On December 30, 2021, the measurement period for POC expired. The identifiable intangible assets include customer relationships of \$83,000 with a useful life of 11 years, completed technology of \$25,000 with a useful life of 9 years and backlog of \$8,000 with a useful life of one year.

The goodwill of \$148,265 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 and is not deductible for tax purposes. The goodwill from this acquisition is reported in the Processing reporting unit.

D. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, including money market funds, restricted cash, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The Company determined the carrying value of long-term debt approximated fair value due to variable interest rates charged on the borrowings, which reprice frequently. As of December 31, 2021, the Company had no material financial instruments required to be measured at fair value.

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, historical usage, product mix and possible alternative uses. Inventory was comprised of the following:

	As of	
	December 31, 2021	July 2, 2021
Raw materials	\$ 159,780	\$ 141,774
Work in process	64,706	58,087
Finished goods	26,786	21,779
Total	\$ 251,272	\$ 221,640

F. Goodwill

On August 3, 2021, Mercury announced a companywide effort, called 1MPACT, to lay the foundation for the next phase of the Company's value creation at scale. The goal of 1MPACT is to achieve Mercury's full growth, margin expansion and adjusted EBITDA potential over the next five years. In connection with 1MPACT, the Company realigned its internal organizational structure in the first quarter of fiscal 2022 shifting to two divisions, Processing and Microelectronics. The Mission division has now merged under the Processing division. There was no change to the Microelectronics division.

In accordance with FASB ASC 350, *Intangibles-Goodwill and Other* ("ASC 350"), the Company determines its reporting units based upon whether discrete financial information is available, if management regularly reviews the operating results of the component, the nature of the products offered to customers and the market characteristics of each reporting unit. A reporting unit is considered to be an operating segment or one level below an operating segment also known as a component. Component level financial information is reviewed by management across two divisions: Processing and Microelectronics. Accordingly, these were determined to be the Company's new reporting units.

The internal reorganization and change in reporting units qualified as a triggering event and required goodwill to be tested for impairment. As required by ASC 350, the Company tested goodwill for impairment immediately before and after the reorganization. As a result of these analyses, it was determined that goodwill was not impaired before or after the reorganization.

In the first quarter ended October 1, 2021, the Company assigned goodwill to the new reporting units based on the relative fair value of transferred operations.

The following table sets forth the changes in the carrying amount of goodwill for the six months ended December 31, 2021:

	Total
Balance at July 2, 2021	\$ 804,906
Goodwill adjustment for the POC acquisition	(6,994)
Goodwill adjustment for the Pentek acquisition	338
Goodwill arising from the Avalex acquisition	82,456
Goodwill arising from the Atlanta Micro acquisition	61,640
Balance at December 31, 2021	\$ 942,346

The Company performs its annual goodwill impairment test in the fourth quarter of each fiscal year.

G. Restructuring

During the six months ended December 31, 2021, the Company incurred \$16,076 of restructuring and other charges. Restructuring and other charges of \$8,667 related to third-party consulting costs associated with 1MPACT. The remaining \$7,409 related to severance costs associated with the elimination of approximately 100 employees in manufacturing, SG&A and R&D based on changes in the business environment and to align with the internal organizational changes completed under 1MPACT.

All of the restructuring and other charges are classified as Operating expenses in the Consolidated Statements of Operations and Comprehensive (Loss) Income 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.

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

	Severance & Related
Balance at July 2, 2021	\$ 1,006
Restructuring charges	7,409
Cash paid	(2,710)
Balance at December 31, 2021	<u>\$ 5,705</u>

H. Income Taxes

The Company recorded an income tax (benefit) provision of \$(155) and \$4,433 on a (loss) income before income taxes of \$(2,794) and \$17,119 for the second quarters ended December 31, 2021 and January 1, 2021, respectively. The Company recorded an income tax (benefit) provision of \$(596) and \$6,631 on (loss) income before income taxes of \$(10,375) and \$35,115 for the six months ended December 31, 2021 and January 1, 2021, respectively.

During the second quarters ended December 31, 2021 and January 1, 2021, the Company recognized a discrete tax provision (benefit) of \$163 and \$(130) related to stock-based compensation shortfalls and windfalls, respectively. During the six months ended December 31, 2021 and January 1, 2021, the Company recognized a discrete tax provision (benefit) of \$878 and \$(2,610) related to stock-based compensation shortfalls and windfalls, respectively.

The effective tax rate for the second quarters and six months ended December 31, 2021 and January 1, 2021 differed from the Federal statutory rate primarily due to Federal and State research and development credits, non-deductible compensation, stock-based compensation, and state taxes. In addition, during the second quarter ended December 31, 2021, the Company had certain unbenefited deferred tax assets.

During the second quarter ended December 31, 2021, the Company recorded an unrecognized tax benefit of \$693 related to acquired research and development carryforward credits.

Within the calculation of the Company's annual effective tax rate, the Company has used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service ("IRS").

I. Debt

REVOLVING CREDIT FACILITY

On September 28, 2018, the Company amended the Revolver to increase and extend the borrowing capacity to a \$750,000, 5-year revolving credit line, with the maturity extended to September 28, 2023. As of December 31, 2021, the Company's outstanding balance of unamortized deferred financing costs was \$2,353, which is being amortized to Other expense, net in the Consolidated Statements of Operations and Comprehensive (Loss) Income on a straight line basis over the term of the Revolver.

As of December 31, 2021, the Company was in compliance with all covenants and conditions under the Revolver and there were outstanding borrowings of \$451,500 against the Revolver, resulting in interest expense of \$1,094 and \$1,689 for the second quarter and six months ended December 31, 2021, respectively. There were outstanding letters of credit of \$963 as of December 31, 2021.

J. Employee Benefit Plan

PENSION PLAN

The Company maintains 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 ASC 715, *Compensation—Retirement Benefits* (“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 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 December 31, 2021 was a net liability of \$9,833, which is recorded in Other non-current liabilities on the Consolidated Balance Sheet. The Company recorded a net gain of \$48 and \$96 in AOCL during the second quarter and six months ended December 31, 2021. The Company recorded a net gain of \$31 and \$62 in AOCL during the second quarter and six months ended January 1, 2021. The Company recognized net periodic benefit costs of \$269 and \$538 associated with the Plan for the second quarter and six months ended December 31, 2021. The Company recognized net periodic benefit costs of \$420 and \$833 associated with the Plan for the second quarter and six months ended January 1, 2021, respectively. The Company’s total expected employer contributions to the Plan during fiscal 2022 are \$1,165.

K. Shareholders’ Equity

STOCKHOLDER RIGHTS PLAN

On December 27, 2021, the Company’s Board of Directors authorized and declared a dividend of one preferred share purchase right (a “Right”), payable on January 10, 2022, for each outstanding share of common stock par value \$0.01 per share to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company a unit of Series A Junior Preferred Stock, par value \$0.01 per share, of the Company at a designated price per unit, subject to adjustment. The Rights will initially trade with, and will be inseparable from, the shares of common stock.

The Rights will generally become exercisable if any person or group, other than certain exempt persons, acquires beneficial ownership of 7.5% (or 10% in the case of certain passive investors) or more of common stock outstanding (an “Acquiring Person”). If a person or group becomes an Acquiring Person, then each Right, other than those held by the Acquiring Person, will entitle its holder to purchase units of Series A Junior Preferred Stock (or, in certain circumstances, cash, assets or other securities of the Company) having a market value equal to twice the then-current market price per unit of Preferred Stock. In certain other circumstances including consolidation or merger with the Company, each Right, other than those held by the Acquiring Person, will entitle its holder to receive common stock of the person acquiring the Company or its ultimate parent entity, as applicable, having a value equal to two times then-current market price per share of common stock.

Each Unit of Preferred Stock, if issued:

- will entitle holders to certain dividend and liquidation payments;
- will not be redeemable;
- will entitle holders to one vote, voting together with shares of common stock;
- will entitle holders, if shares of common stock are exchanged via merger, consolidation, or a similar transaction, to a per share payment equal to the payment made on one share of Company Common Stock; and
- will be protected by customary anti-dilution provisions with respect to dividends, liquidation and voting rights, and in the event of mergers and consolidations.

The Rights Agreement will continue in effect until December 26, 2022, or unless earlier redeemed or terminated by the Company’s Board of Directors, as provided in the Rights Agreement. The Board of Directors shall have the right to adjust, among other things, the exercise price, as well as the number of Units of Preferred Stock issuable, and the number of outstanding Rights to prevent dilution that may occur from a share dividend, a share split, or a reclassification of the Preferred Stock. The Rights have no voting or dividend privileges, and, unless and until they become exercisable, have no dilutive effect on the earnings of the Company.

Additional details about the Rights Agreement are contained in the Current Report on Form 8-K filed by the Company with the SEC on December 29, 2021.

L. Stock-Based Compensation

STOCK INCENTIVE PLANS

At December 31, 2021, the aggregate number of shares authorized for issuance under the Company's Amended and Restated 2018 Stock Incentive Plan (the "2018 Plan") is 6,782 shares, including 710 shares rolled into the 2018 Plan that were available for future grant under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan") and 3,000 shares approved by the Company's shareholders on October 28, 2020. The 2018 Plan replaced the 2005 Plan. The shares authorized for issuance under the 2018 Plan will continue to be increased by any future cancellations, forfeitures or terminations (other than by exercise) of awards under the 2005 Plan. The foregoing does not affect any outstanding awards under the 2005 Plan, which remain in full force and effect in accordance with their terms. The 2018 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. Stock options must be granted with an exercise price of not less than 100% of the fair value of the Company's common stock on the date of grant and the options generally have a term of seven years. There were 3,380 shares available for future grant under the 2018 Plan at December 31, 2021.

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

EMPLOYEE STOCK PURCHASE PLAN

At December 31, 2021, the aggregate number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 2,300 shares, including 500 shares approved by the Company's shareholders on October 28, 2020. 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 54 and 46 shares issued under the ESPP during the six months ended December 31, 2021 and January 1, 2021, respectively. Shares available for future purchase under the ESPP totaled 374 at December 31, 2021.

STOCK AWARD ACTIVITY

The following table summarizes the status of the Company's non-vested restricted stock awards and deferred stock awards since July 2, 2021:

	Non-vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at July 2, 2021	1,013	\$ 70.77
Granted	828	51.37
Vested	(429)	52.91
Forfeited	(157)	68.62
Outstanding at December 31, 2021	<u>1,255</u>	<u>\$ 64.31</u>

STOCK-BASED COMPENSATION EXPENSE

The Company recognizes expense for its share-based payment plans in the Consolidated Statements of Operations and Comprehensive (Loss) Income in accordance with ASC 718, *Compensation - Stock Compensation* ("ASC 718"). The Company had \$1,087 and \$796 of capitalized stock-based compensation expense on the Consolidated Balance Sheets for the periods ended December 31, 2021 and July 2, 2021, respectively. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period, net of estimated forfeitures.

The following table presents share-based compensation expenses included in the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income:

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Cost of revenues	\$ 322	\$ 369	\$ 881	\$ 664
Selling, general and administrative	6,032	5,619	13,593	11,295
Research and development	1,494	1,282	2,901	2,495
Stock-based compensation expense before tax	7,848	7,270	17,375	14,454
Income taxes	(2,040)	(1,890)	(4,691)	(3,758)
Stock-based compensation expense, net of income taxes	<u>\$ 5,808</u>	<u>\$ 5,380</u>	<u>\$ 12,684</u>	<u>\$ 10,696</u>

M. 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. During the first quarter of fiscal 2022, the Company announced its 1MPACT value creation initiative to promote scale as the organization continues to grow. The Company evaluated this internal reorganization under FASB ASC 280, *Segment Reporting* ("ASC 280") to determine whether this change has impacted the Company's single operating and reportable segment. The Company concluded this change had no effect given the CODM continues to evaluate and manage the Company on the basis of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with ASC 280.

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

	U.S.	Europe	Asia Pacific	Eliminations	Total
SECOND QUARTER ENDED DECEMBER 31, 2021					
Net revenues to unaffiliated customers	\$ 209,495	\$ 10,808	\$ 77	\$ —	\$ 220,380
Inter-geographic revenues	1,588	599	—	(2,187)	—
Net revenues	<u>\$ 211,083</u>	<u>\$ 11,407</u>	<u>\$ 77</u>	<u>\$ (2,187)</u>	<u>\$ 220,380</u>
SECOND QUARTER ENDED JANUARY 1, 2021					
Net revenues to unaffiliated customers	\$ 197,773	\$ 12,812	\$ 91	\$ —	\$ 210,676
Inter-geographic revenues	636	564	—	(1,200)	—
Net revenues	<u>\$ 198,409</u>	<u>\$ 13,376</u>	<u>\$ 91</u>	<u>\$ (1,200)</u>	<u>\$ 210,676</u>
SIX MONTHS ENDED DECEMBER 31, 2021					
Net revenues to unaffiliated customers	\$ 423,236	\$ 21,995	\$ 162	\$ —	\$ 445,393
Inter-geographic revenues	3,147	1,328	—	(4,475)	—
Net revenues	<u>\$ 426,383</u>	<u>\$ 23,323</u>	<u>\$ 162</u>	<u>\$ (4,475)</u>	<u>\$ 445,393</u>
SIX MONTHS ENDED JANUARY 1, 2021					
Net revenues to unaffiliated customers	\$ 393,620	\$ 22,475	\$ 202	\$ —	\$ 416,297
Inter-geographic revenues	876	908	—	(1,784)	—
Net revenues	<u>\$ 394,496</u>	<u>\$ 23,383</u>	<u>\$ 202</u>	<u>\$ (1,784)</u>	<u>\$ 416,297</u>

The Company offers a broad family of products designed to meet the full range of requirements in compute-intensive, signal processing, image processing and command and control applications. To maintain a competitive advantage, the Company seeks to leverage technology investments across multiple product lines and product solutions.

The Company's products are typically compute-intensive and require extremely high bandwidth and high throughput. These systems often must also meet significant SWaP constraints for use in aircraft, unmanned aerial vehicles, ships and other platforms and be ruggedized for use in harsh environments. The Company's products transform the massive streams of digital data created in these applications into usable information in real time. The systems can scale from a few processors to thousands of processors.

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's proportion of revenue derived from the sale of components in different technological areas, and modules, sub-assemblies and integrated subsystems which combine technologies into more complex diverse products has shifted. 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, product grouping and/or platform is attained, the categorization of these products can vary over time. When this occurs, the Company reclassifies revenue by end user, application, product grouping and/or platform for prior periods. Such reclassifications typically do not materially change the underlying trends of results within each revenue category.

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

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Domestic ⁽¹⁾	\$ 186,592	\$ 181,095	\$ 375,840	\$ 359,838
International/Foreign Military Sales ⁽²⁾	33,788	29,581	69,553	56,459
Total Net Revenue	\$ 220,380	\$ 210,676	\$ 445,393	\$ 416,297

- (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.

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

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Radar ⁽¹⁾	\$ 51,172	\$ 84,760	\$ 110,076	\$ 157,169
Electronic Warfare ⁽²⁾	32,369	28,672	66,310	65,560
Other Sensor & Effector ⁽³⁾	22,164	24,005	53,606	47,100
Total Sensor & Effector	105,705	137,437	229,992	269,829
C4I ⁽⁴⁾	90,931	58,359	174,332	112,140
Other ⁽⁵⁾	23,744	14,880	41,069	34,328
Total Net Revenue	\$ 220,380	\$ 210,676	\$ 445,393	\$ 416,297

- (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 presents the Company's net revenue by product grouping for the periods presented:

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Components ⁽¹⁾	\$ 31,471	\$ 40,679	\$ 66,536	\$ 90,975
Modules and Sub-assemblies ⁽²⁾	65,332	34,993	124,362	52,459
Integrated Subsystems ⁽³⁾	123,577	135,004	254,495	272,863
Total Net Revenue	\$ 220,380	\$ 210,676	\$ 445,393	\$ 416,297

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

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

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

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

	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Airborne ⁽¹⁾	\$ 110,990	\$ 91,662	\$ 227,554	\$ 178,911
Land ⁽²⁾	25,976	58,004	61,833	95,555
Naval ⁽³⁾	34,236	36,559	74,213	82,841
Other ⁽⁴⁾	49,178	24,451	81,793	58,990
Total Net Revenues	\$ 220,380	\$ 210,676	\$ 445,393	\$ 416,297

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

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

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

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

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

	U.S.	Europe	Asia Pacific	Eliminations	Total
December 31, 2021	\$ 122,708	\$ 4,672	\$ 5	\$ —	\$ 127,385
July 2, 2021	\$ 123,009	\$ 5,509	\$ 6	\$ —	\$ 128,524

Identifiable long-lived assets exclude right-of-use assets, goodwill, and intangible assets.

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

	Second Quarters Ended				Six Months Ended			
	December 31, 2021		January 1, 2021		December 31, 2021		January 1, 2021	
Raytheon Technologies	15	%	25	%	15	%	24	%
U.S. Navy	14	%	*		15	%	*	
Northrop Grumman Corporation	10	%	*		*		*	
Lockheed Martin Corporation	*		12	%	10	%	15	%
	39	%	37	%	40	%	39	%

* Indicates that the amount is less than 10% of the Company's revenue 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. There were no programs comprising 10% or more of the Company's revenues for the second quarter and six months ended December 31, 2021 and January 1, 2021.

N. 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.

On June 23, 2021, Embedded Reps of America, LLC ("ERA"), a former sales representative, and James Mazzola, a principal of ERA, filed for binding arbitration related to the termination of ERA's sales representative agreement raising multiple claims that aggregate to approximately \$9,000 in direct damages, with treble damages requested on a number of those claims. ERA was a sales representative of Themis when Themis was acquired by Mercury. The sales representative agreement provided for termination by either party upon 30 days written notice with ERA entitled to commissions for orders obtained by ERA with product shipment occurring prior to termination. The Company responded to the complaint on July 28, 2021. The Company believes the claims in the complaint are without merit and intends to defend itself vigorously.

On December 7, 2021, counsel for National Technical Systems, Inc. ("NTS") sent the Company an environmental demand letter pursuant to Massachusetts General Laws Chapter 21E, Section 4A, and CERCLA 42 U.S.C. Section 9601, related to a site that NTS formerly owned at 533 Main Street, Acton, Massachusetts. NTS received a Notice of Responsibility from the Massachusetts Department of Environmental Protection ("MassDEP") alleging trichloroethene, freon and 1,4-dioxane contamination in the groundwater emanating from NTS's former site. NTS alleges in its demand letter that the operations of a predecessor company to Mercury that was acquired in the Company's acquisition of the Microsemi carve-out business that once owned and operated a facility at 531 Main Street, Acton, Massachusetts contributed to the groundwater contamination. NTS is seeking payment by the Company of NTS's costs for any required environmental remediation. In November 2021, the Company responded to a request for information from MassDEP regarding the detection of PFAS (per- and polyfluoroalkyl substances) in the Acton, Massachusetts Water District's Conant public water supply wells near the former facility at 531 Main Street, Acton, Massachusetts at a level above the standard that MassDEP published for PFAS in October 2020. It is too early to determine what responsibility, if any, the Company may have for these matters.

INDEMNIFICATION OBLIGATIONS

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

PURCHASE COMMITMENTS

As of December 31, 2021, 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 \$183,942.

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 Consolidated Statements of Cash Flows.

O. Subsequent Events

On February 7, 2022, the Board of Directors approved an equity retention plan for Mercury's executive leadership team and over 100 additional leaders. Employees participating in the equity retention plan will be granted equity awards on February 15, 2022.

Consistent with the Company's prior practice for granting equity awards, the number of shares to be granted on February 15, 2022 will be determined by dividing the target value for grantees by the average closing price of Mercury's common stock during the 30 calendar days prior to February 15, 2022. However, if the average closing price is lower than \$55.00 per share, then a minimum of \$55.00 per share will be used to calculate the number of shares to be granted.

Additional details about the equity retention plan are contained in the Current Report on Form 8-K filed by the Company with the SEC on February 8, 2022.

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," "likely," "forecast," "probable," "potential," and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company's markets, effects of epidemics and pandemics such as COVID, effects of any U.S. Federal government shutdown or extended continuing resolution, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government's interpretation of, federal export control or procurement rules and regulations, changes in, or in the interpretation or enforcement of environmental rules and regulations, market acceptance of the Company's products, shortages in or delays in receiving components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions, restructurings and value creation initiatives such as 1MPACT, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, effects of shareholder activism, increases in interest rates, changes to industrial security and cyber-security regulations and requirements, changes in tax rates or tax regulations, changes to interest rate swaps or other cash flow hedging arrangements, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as set forth under Part I-Item 1A (Risk Factors) in the Company's Annual Report on Form 10-K for the fiscal year ended July 2, 2021. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

OVERVIEW

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

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

Mercury's transformational business model accelerates the process of making new technology profoundly more accessible to our customers by bridging the gap between commercial technology and aerospace and defense applications. Our long-standing deep relationships with leading high-tech companies, coupled with our high level of R&D investments and industry-leading trusted and secure design and manufacturing capabilities, are the foundational tenets of this highly successful model. We are leading the development and adaptation of commercial technology for aerospace and defense solutions. From chip-scale to system scale and from RF to digital, we make mission-critical technologies safe, secure, affordable and relevant for our customers.

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

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

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

As of December 31, 2021, we had 2,316 employees. We employ hardware and software architects and design engineers, primarily engaged in engineering and research and product development activities to achieve our objectives to fully capitalize upon and maintain our technological leads in the high-performance, real-time sensor processing industry and in mission computing, platform management and other safety-critical applications. Our talent attraction, engagement and retention is critical to execute on our long-term strategy. We invest in our culture and values to drive employee engagement that turns ideas into action, delivering trusted and secure solutions at the speed of innovation. We believe that our success depends on our ability to embrace diversity company-wide and realize the benefits of a diverse workforce that includes a greater variety of solutions to problems, a broader collection of skills and experiences and an array of viewpoints to consider. Mercury is strongly focused on providing an inclusive environment that respects the diversity of the world. We believe that the workforce required to grow our business and deliver creative solutions must be rich in diversity of thought, experience and culture. Our diversity and inclusion initiatives focus on building and maintaining the talent that will create cohesive and collaborative teams that drive innovation. We believe that these values will help our employees realize their full potentials at work to provide Innovation That Matters®.

Our consolidated revenues, acquired revenues, net loss, diluted net loss per share, adjusted earnings per share ("adjusted EPS"), and adjusted EBITDA for the second quarter ended December 31, 2021 were \$220.4 million, \$37.5 million, \$(2.6) million, \$(0.05), \$0.39, and \$38.1 million, respectively. Our consolidated revenues, acquired revenues, net loss, diluted net loss per share, adjusted earnings per share ("adjusted EPS"), and adjusted EBITDA for the six months ended December 31, 2021 were \$445.4 million, \$78.8 million, \$(9.8) million, \$(0.18), \$0.80, and \$76.4 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

OUR RESPONSE TO COVID

We continue to monitor the COVID pandemic and adapt our policies and programs as needed to protect the health, safety and livelihoods of our people. In September 2021, the White House announced that certain contractors would need to create COVID-19 vaccination programs for their employees in order to work on certain U.S. government contracts. We announced our COVID-19 U.S. Vaccination Policy in October 2021 to comply with these federal requirements. In December 2021, a federal judge temporarily blocked the government from enforcing their vaccine mandate while lawsuits were being resolved. We suspended our vaccine policy pending the resolutions of these lawsuits, similar to other contractors in the aerospace and defense industry.

1MPACT

On August 3, 2021, we announced a companywide effort, called 1MPACT, to lay the foundation for the next phase of the Company's value creation at scale. The goal of 1MPACT is to achieve our full growth, margin expansion and adjusted EBITDA potential over the next five years. Since fiscal year 2014 and through the second quarter ended December 31, 2021, we have completed 15 acquisitions, deploying \$1.4 billion of capital and, as a result, dramatically scaled and transformed the business. Over this time, we have extracted substantial revenue and cost synergies from each of these individual acquisitions. Now, as we approach the milestone of \$1 billion of revenue, we believe there is significant opportunity to realize further scale through consolidating and streamlining our internal organizational structure which will improve visibility, speed of decision making and accountability. 1MPACT is led by our new Chief Transformation Officer, Thomas Huber, and focuses on six major areas: organization efficiency and scalability; procurement and supply chain; facilities optimization; R&D investment; capital and asset efficiency; and scalable common processes and systems.

RESULTS OF OPERATIONS:

Results of operations for the second quarter and six months ended December 31, 2021 includes full period results from the acquisitions of Physical Optics Corporation ("POC") and Pentek Technologies, LLC and Pentek Systems, Inc. (collectively, "Pentek") and only results from the acquisition date for Avalex Technologies ("Avalex") and Atlanta Micro which were acquired on November 5, 2021 and November 29, 2021, respectively. Results of operations for the second quarter and six months ended January 1, 2021 includes only results from the December 30, 2020 acquisition date for POC and do not include results from Pentek, Avalex, or Atlanta Micro. Accordingly, the periods presented below are not directly comparable.

The second quarter ended December 31, 2021 compared to the second quarter ended January 1, 2021

The following table sets forth, for the second quarter ended indicated, financial data from the Consolidated Statements of Operations and Comprehensive (Loss) Income:

(In thousands)	December 31, 2021	As a % of Total Net Revenue	January 1, 2021	As a % of Total Net Revenue
Net revenues	\$ 220,380	100.0 %	\$ 210,676	100.0 %
Cost of revenues	133,158	60.4	122,009	57.9
Gross margin	87,222	39.6	88,667	42.1
Operating expenses:				
Selling, general and administrative	36,810	16.7	31,596	15.0
Research and development	28,335	12.9	28,128	13.4
Amortization of intangible assets	16,002	7.3	7,643	3.6
Restructuring and other charges	3,802	1.7	951	0.5
Acquisition costs and other related expenses	2,660	1.2	2,236	1.0
Total operating expenses	87,609	39.8	70,554	33.5
(Loss) income from operations	(387)	(0.2)	18,113	8.6
Interest income	5	—	60	—
Interest expense	(1,094)	(0.5)	(73)	—
Other expense, net	(1,318)	(0.6)	(981)	(0.5)
(Loss) income before income taxes	(2,794)	(1.3)	17,119	8.1
Income tax (benefit) provision	(155)	(0.1)	4,433	2.1
Net (loss) income	\$ (2,639)	(1.2) %	\$ 12,686	6.0 %

REVENUES

Total revenues increased \$9.7 million, or 4.6%, to \$220.4 million during the second quarter ended December 31, 2021, as compared to \$210.7 million during the second quarter ended January 1, 2021, 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 full fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenue was primarily due to an additional \$37.3 million of acquired revenues primarily from the POC business, partially offset by \$27.6 million less organic revenues. These increases were driven by modules and sub-assemblies, which increased \$30.3 million which was partially offset by decreases in integrated subsystems of \$11.5 million and components of \$9.2 million. The increase in total revenue was primarily from the C4I and EW markets which increased \$32.6 million and \$3.7 million, respectively, and were partially offset by a decrease of \$33.6 million from the radar application market. The increase was primarily across the airborne platform which grew \$19.3 million during the second quarter ended December 31, 2021. The largest program increases were related to a classified C2 program, MH-60, P8, CDS, AARGM and F-16. There were no programs comprising 10% or more of our revenues for the second quarters ended December 31, 2021 or January 1, 2021. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

GROSS MARGIN

Gross margin was 39.6% for the second quarter ended December 31, 2021, a decrease of 250 basis points from the 42.1% gross margin achieved during the second quarter ended January 1, 2021. The lower gross margin was primarily driven by program mix, including the acquisition of POC, which carries lower margins than the organic business, and a higher volume of Customer Funded Research and Development (“CRAD”). CRAD, including POC, increased \$5.6 million in the quarter. CRAD primarily represents engineering labor associated with long-term contracts for customized development, production and service activities. Due to the nature of these efforts, they typically carry a lower margin but serve as a precursor to higher margin production orders over time. These products are predominately grouped within integrated subsystems and to a lesser extent modules and sub-assemblies. In addition to this, these gross margin decreases were also driven by \$0.4 million less net margin benefit from fair value adjustments from purchase accounting during the second quarter ended December 31, 2021. These gross margin decreases were partially offset by \$2.9 million less direct COVID expenses during the second quarter ended December 31, 2021.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$5.2 million, or 16.5%, to \$36.8 million during the second quarter ended December 31, 2021, as compared to \$31.6 million in the second quarter ended January 1, 2021. The increase was primarily related to the recent acquisitions of POC, Pentek, Avalex, and Atlanta Micro which contributed \$3.9 million of incremental cost. Selling, general and administrative expenses increased as a percentage of revenue to 16.7% for the second quarter ended December 31, 2021 from 15.0% for the second quarter ended January 1, 2021.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$0.2 million, or 0.7%, to \$28.3 million during the second quarter ended December 31, 2021, as compared to \$28.1 million during the second quarter ended January 1, 2021. The increase was primarily related to \$1.9 million of incremental expenses from the recent acquisitions of POC, Pentek, Avalex, and Atlanta Micro as well as continued investment in internal R&D to promote future growth, including new opportunities in secure processing, trusted custom microelectronics and open mission systems. These increases were partially offset by greater CRAD of \$5.6 million over the prior period. Research and development expenses accounted for 12.9% and 13.4% of our revenues for the second quarters ended December 31, 2021 and January 1, 2021, respectively.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased \$8.4 million to \$16.0 million during the second quarter ended December 31, 2021, as compared to \$7.6 million during the second quarter ended January 1, 2021 due to the acquisitions of POC, Pentek, Avalex and Atlanta Micro.

RESTRUCTURING AND OTHER CHARGES

During the second quarter ended December 31, 2021, the Company incurred \$3.8 million of restructuring and other charges, as compared to \$1.0 million during the second quarter ended January 1, 2021. Restructuring and other charges during the second quarter ended December 31, 2021 related to third-party consulting costs associated with 1MPACT while costs during the second quarter ended January 1, 2021 primarily related to severance costs associated with the elimination of 23 positions, predominantly in the manufacturing, SG&A and R&D functions. The Company expects restructuring and other charges of \$3.7 million related to 1MPACT during the third quarter of fiscal 2022.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

Acquisition costs and other related expenses were \$2.7 million during the second quarter ended December 31, 2021, as compared to \$2.2 million during the second quarter ended January 1, 2021. Acquisition costs and other related expenses during the second quarter ended December 31, 2021 primarily related to the acquisitions of Avalex and Atlanta Micro which closed during the second quarter. The second quarter ended January 1, 2021 included expenses related to the acquisition of POC which was completed on December 30, 2020. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our technological capabilities and especially within the sensor and effector and C4I markets. Transaction costs incurred by the acquiree prior to the consummation of an acquisition would not be reflected in our historical results of operations.

INTEREST EXPENSE

We incurred \$1.1 million of interest expense during the second quarter ended December 31, 2021 as a result of \$451.5 million of total borrowings on our Revolver used to facilitate the acquisitions of POC, Pentek, Avalex, and Atlanta Micro during fiscal 2021 and 2022.

OTHER EXPENSE, NET

Other expense, net increased to \$1.3 million during the second quarter ended December 31, 2021, as compared to \$1.0 million during the second quarter ended January 1, 2021. The second quarter ended December 31, 2021 includes net foreign currency translation losses of \$0.2 million as well as additional litigation and settlement costs of \$0.3 million. The second quarter ended January 1, 2021 includes loss on sale of a cost-method investment of \$0.4 million.

INCOME TAXES

We recorded an income tax (benefit) provision of \$(0.2) million and \$4.4 million on a (loss) income before income taxes of \$(2.8) million and \$17.1 million for the second quarters ended December 31, 2021 and January 1, 2021, respectively.

During the second quarters ended December 31, 2021 and January 1, 2021, we recognized a discrete tax provision (benefit) of \$0.2 million and \$(0.1) million related to stock-based compensation shortfalls and windfalls, respectively.

The effective tax rate for the second quarters ended December 31, 2021 and January 1, 2021 differed from the Federal statutory rate primarily due to Federal and State research and development credits, non-deductible compensation, stock-based compensation, and state taxes. In addition, during the second quarter ended December 31, 2021, we had certain unbenefited deferred tax assets.

During the second quarter ended December 31, 2021, we recorded an unrecognized tax benefit of \$0.7 million related to acquired research and development carryforward credits.

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 ("IRS").

Six months ended December 31, 2021 compared to the six months ended January 1, 2021

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

(In thousands)	December 31, 2021	As a % of Total Net Revenue	%	January 1, 2021	As a % of Total Net Revenue	%
Net revenues	\$ 445,393	100.0	%	\$ 416,297	100.0	%
Cost of revenues	269,762	60.6		239,511	57.5	
Gross margin	175,631	39.4		176,786	42.5	
Operating expenses:						
Selling, general and administrative	73,766	16.5		64,500	15.5	
Research and development	57,217	12.8		55,545	13.3	
Amortization of intangible assets	29,736	6.7		15,374	3.7	
Restructuring and other charges	16,076	3.6		2,248	0.6	
Acquisition costs and other related expenses	4,798	1.1		2,236	0.5	
Total operating expenses	181,593	40.7		139,903	33.6	
(Loss) income from operations	(5,962)	(1.3)		36,883	8.9	
Interest income	14	—		132	—	
Interest expense	(1,689)	(0.4)		(73)	—	
Other expense, net	(2,738)	(0.6)		(1,827)	(0.5)	
(Loss) income before income taxes	(10,375)	(2.3)		35,115	8.4	
Income tax (benefit) provision	(596)	(0.1)		6,631	1.6	
Net (loss) income	\$ (9,779)	(2.2)	%	\$ 28,484	6.8	%

REVENUES

Total revenues increased \$29.1 million, or 7.0%, to \$445.4 million during the six months ended December 31, 2021, as compared to \$416.3 million during the six months ended January 1, 2021. The increase in total revenue was primarily due to an additional \$78.6 million of acquired revenues, partially offset by \$49.5 million less organic revenues. These increases were driven by higher demand for modules and subassemblies of \$71.9 million which was partially offset by decreases in components and integrated subsystems of \$24.4 million and \$18.4 million, respectively, during the six months ended December 31, 2021. The increase in total revenue was primarily from the C4I end applications which increased \$62.2 million and was

partially offset by decreases of \$47.1 million from the radar applications. The increase was primarily across the airborne and other platforms which grew \$48.6 million and \$22.8 million, respectively, and were partially offset by decreases to the land and naval platforms of \$33.7 million and \$8.6 million, respectively, during the six months ended December 31, 2021. The largest program increases were related to a classified C2 program, MH-60, P8, F-35 and F-18 programs. There were no programs comprising 10% or more of our revenues for the six months ended December 31, 2021 or January 1, 2021. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

GROSS MARGIN

Gross margin was 39.4% for the six months ended December 31, 2021, a decrease of 310 basis points from the 42.5% gross margin achieved during the six months ended January 1, 2021. The lower gross margin was primarily driven by program mix, including the acquisition of POC, which carries lower margins than the organic business and increased CRAD of \$19.2 million. These gross margin decreases were partially offset by \$4.6 million less direct COVID expenses and a \$1.4 million increased gross margin benefit associated with fair value adjustments from purchase accounting for recent acquisitions.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$9.3 million, or 14.4%, to \$73.8 million during the six months ended December 31, 2021, as compared to \$64.5 million during the six months ended January 1, 2021. The increase was primarily related to our acquisitions driving an incremental \$7.4 million of expense during the six months ended December 31, 2021. These increases were partially offset by \$0.5 million less direct COVID expenses. Selling, general and administrative expenses as a percentage of revenues increased to 16.5% for the six months ended December 31, 2021 from 15.5% for the six months ended January 1, 2021.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$1.7 million, or 3.1%, to \$57.2 million during the six months ended December 31, 2021, as compared to \$55.5 million during the six months ended January 1, 2021. The increase was primarily related to our acquisitions driving incremental \$2.9 million of expense, partially offset by increased volume of CRAD of \$19.2 million. Research and development expenses accounted for 12.8% and 13.3% of our revenues for the six months ended December 31, 2021 and January 1, 2021, respectively.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges were \$16.1 million during the six months ended December 31, 2021, as compared to \$2.2 million during the six months ended January 1, 2021. Restructuring and other charges during the six months ended December 31, 2021 primarily related to \$8.7 million of third-party consulting costs associated with 1MPACT and \$7.4 million of severance costs associated with the elimination of approximately 100 positions based on changes in the business environment and alignment with internal organization changes completed under 1MPACT. Charges during the second quarter ended January 1, 2021 primarily related to severance costs associated with the elimination of 23 positions, predominantly in the manufacturing, SG&A and R&D functions as well as additional talent shifts and resource redundancy resulting from the internal reorganization in August of fiscal 2021. The Company expects restructuring and other charges of \$3.7 million related to 1MPACT during the third quarter of fiscal 2022.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

Acquisition costs and other related expenses were \$4.8 million during the six months ended December 31, 2021, as compared to \$2.2 million during the six months ended January 1, 2021. The acquisition costs and other related expenses we incurred during the six months ended December 31, 2021 were primarily related to the acquisitions of Avalex and Atlanta Micro, which closed during the quarter while those incurred during the six months ended January 1, 2021 were related to the acquisition of POC. Both periods include costs associated with our evaluation of potential acquisition opportunities. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our technological capabilities, especially within the sensor and effector and C4I markets. Transaction costs incurred by the acquiree prior to the consummation of an acquisition would not be reflected in our historical results of operations.

INTEREST EXPENSE

We incurred \$1.7 million of interest expense during the six months ended December 31, 2021, related to the \$451.5 million of total borrowings on our Revolver used to facilitate the acquisitions of POC, Pentek, Avalex and Atlanta Micro during fiscal 2021 and 2022.

OTHER EXPENSE, NET

Other expense, net, increased to \$2.7 million during the six months ended December 31, 2021 as compared to \$1.8 million for the six months ended January 1, 2021. There were \$0.7 million of foreign currency translation losses during the six months ended December 31, 2021 as compared to \$0.6 million of foreign currency translation gains during the six months ended January 1, 2021. The six months ended January 1, 2021 also included a \$0.4 million loss on the sale of a cost-method investment.

INCOME TAXES

We recorded an income tax (benefit) provision of \$(0.6) million and \$6.6 million on a (loss) income before income taxes of \$(10.4) million and \$35.1 million for the six months ended December 31, 2021 and January 1, 2021, respectively.

During the six months ended December 31, 2021 and January 1, 2021, we recognized a discrete tax provision (benefit) of \$0.9 million and \$(2.6) million related to stock-based compensation shortfalls and windfalls, respectively.

The effective tax rate for the six months ended December 31, 2021 and January 1, 2021 differed from the Federal statutory rate primarily due to Federal and State research and development credits, stock-based compensation, non-deductible compensation, and state taxes.

During the six months ended December 31, 2021, we recorded an unrecognized tax benefit of \$0.7 million related to acquired research and development carryforward credits.

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 IRS.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity come from existing cash and cash generated from operations, our Revolver and our ability to raise capital under our universal shelf registration statement. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments. We plan to continue to invest in improvements to our facilities, continuous evaluation of potential acquisition opportunities and internal R&D to promote future growth, including new opportunities in avionics mission computers, secure processing, radar modernization and trusted custom microelectronics. Our facilities improvements include expansion of our trusted custom microelectronics and mission computing businesses during fiscal 2022.

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

Shelf Registration Statement

On September 14, 2020, 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.

Revolving Credit Facility

On September 28, 2018, we amended the Revolver to increase and extend the borrowing capacity to a \$750.0 million, 5-year revolving credit line, with the maturity extended to September 2023. As of December 31, 2021, we had \$451.5 million of outstanding borrowings on the Revolver. See Note I in the accompanying consolidated financial statements for further discussion of the Revolver.

CASH FLOWS

(In thousands)	As of and For the Six Months Ended,	
	December 31, 2021	January 1, 2021
Net cash provided by operating activities	\$ 4,818	\$ 46,868
Net cash used in investing activities	\$ (259,890)	\$ (266,852)
Net cash provided by financing activities	\$ 246,517	\$ 163,122
Net decrease in cash and cash equivalents	\$ (8,670)	\$ (56,099)
Cash and cash equivalents at end of period	\$ 105,169	\$ 170,739

Our cash and cash equivalents decreased by \$8.7 million to \$105.2 million from July 2, 2021 to December 31, 2021, primarily due to acquisition activity, \$13.4 million invested in purchases of property and equipment, and \$7.5 million share repurchase and retirement of common stock used to settle individual tax liabilities, partially offset by \$251.5 million of borrowings on our Revolver and \$4.8 million generated from operating activities.

Operating Activities

During the six months ended December 31, 2021, we generated \$4.8 million in cash from operating activities, as compared to \$46.9 million of cash generated from operating activities for the six months ended January 1, 2021. The decrease was primarily due to the net loss of \$9.8 million, including cash outflows for restructuring and other charges associated with IMPACT as well as acquisition costs primarily associated with the Avalex and Atlanta Micro acquisitions. In addition, the decrease was due to lower deferred revenue and customer advances, higher unbilled receivables and costs in excess of billings, as well as income tax payments. As a result of the Company's content expansion strategy, revenues associated with modules and sub-assemblies or integrated subsystems and related services has increased over the last several years and especially with the acquisition of POC on December 30, 2020. These revenues are typically recognized over time and can include milestone billing structures which drive higher unbilled balances. These decreases were partially offset by lower cash outflows for inventory and timing of payments for accounts payable, accrued expenses and accrued compensation.

Investing Activities

During the six months ended December 31, 2021, we invested \$259.9 million, a decrease of \$7.0 million, as compared to the six months ended January 1, 2021. The decrease was driven by \$11.3 million lower purchases of property and equipment, partially offset by \$4.8 million of other investing activities during the six months ended December 31, 2021.

Financing Activities

During the six months ended December 31, 2021, we had \$246.5 million in cash provided by financing activities as compared to \$163.1 million in the six months ended January 1, 2021. The \$83.2 million increase was driven by \$91.5 million of additional borrowings on our Revolver to facilitate the acquisitions of Avalex and Atlanta Micro, partially offset by \$7.4 million of additional payments related to the purchase and retirement of common stock used to settle employees' tax liabilities associated with vesting of restricted stock awards as compared to the six months ended January 1, 2021.

COMMITMENTS, CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The following is a schedule of our commitments and contractual obligations outstanding at December 31, 2021:

(In thousands)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Purchase obligations	\$ 183,942	\$ 183,942	\$ —	\$ —	\$ —
Operating leases	105,212	15,529	27,313	22,648	39,722
	<u>\$ 289,154</u>	<u>\$ 199,471</u>	<u>\$ 27,313</u>	<u>\$ 22,648</u>	<u>\$ 39,722</u>

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 \$183.9 million at December 31, 2021.

We have a liability at December 31, 2021 of \$8.2 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 or amount, if any, related to this liability. Accordingly, these amounts are not included in the above table.

Our standard product sales and license agreements entered into in the ordinary course of business typically contain an indemnification provision pursuant to which we indemnify, hold harmless, and agree to reimburse the indemnified party for

losses suffered or incurred in connection with certain intellectual property infringement claims by any third party with respect to our products. Such provisions generally survive termination or expiration of the agreements. The potential amount of future payments we could be required to make under these indemnification provisions is, in some instances, unlimited.

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

We may elect from time to time to purchase and subsequently retire shares of common stock in order to settle employees' tax liabilities associated with vesting of a restricted stock award. These transactions are treated as a use of cash in financing activities in our Consolidated Statements of Cash Flows.

OFF-BALANCE SHEET ARRANGEMENTS

Other than certain indemnification provisions in the normal course of business, 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 EPS, free cash flow, organic revenue and acquired revenue.

Adjusted EBITDA is defined as net income before other non-operating adjustments, interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition, financing and other third party costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, COVID related expenses, and stock-based and other non-cash compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining the portion of bonus compensation for executive officers and other key employees based on operating performance, evaluating short-term and long-term operating trends in our operations and allocating resources to various initiatives and operational requirements. We believe that adjusted EBITDA permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of charges that may vary from period to period without any correlation to underlying operating performance. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making. We believe that trends in our adjusted EBITDA are valuable indicators of our operating performance.

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

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

(In thousands)	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Net (loss) income	\$ (2,639)	\$ 12,686	\$ (9,779)	\$ 28,484
Other non-operating adjustments, net	226	(3)	643	(185)
Interest expense (income), net	1,089	13	1,675	(59)
Income tax (benefit) provision	(155)	4,433	(596)	6,631
Depreciation	8,064	5,641	15,820	10,907
Amortization of intangible assets	16,002	7,643	29,736	15,374
Restructuring and other charges	3,802	951	16,076	2,248
Impairment of long-lived assets	—	—	—	—
Acquisition, financing and other third party costs	3,115	2,969	5,748	3,810
Fair value adjustments from purchase accounting	(70)	—	(1,731)	—
Litigation and settlement expense, net	506	251	882	438
COVID related expenses	274	3,309	457	5,628
Stock-based and other non-cash compensation expense	7,892	7,439	17,465	14,806
Adjusted EBITDA	\$ 38,106	\$ 45,332	\$ 76,396	\$ 88,082

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

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

The following tables reconcile net (loss) income and diluted (loss) earnings per share, the most directly comparable GAAP measures, to adjusted income and adjusted EPS:

(In thousands, except per share data)	Second Quarters Ended							
	December 31, 2021		January 1, 2021					
Net (loss) income and diluted (loss) earnings per share	\$	(2,639)	\$	(0.05)	\$	12,686	\$	0.23
Other non-operating adjustments, net		226		(3)				
Amortization of intangible assets		16,002		7,643				
Restructuring and other charges		3,802		951				
Impairment of long-lived assets		—		—				
Acquisition, financing and other third party costs		3,115		2,969				
Fair value adjustments from purchase accounting		(70)		—				
Litigation and settlement expense, net		506		251				
COVID related expenses		274		3,309				
Stock-based and other non-cash compensation expense		7,892		7,439				
Impact to income taxes ⁽¹⁾		(7,144)		(5,275)				
Adjusted income and adjusted earnings per share	\$	21,964	\$	0.39	\$	29,970	\$	0.54
Diluted weighted-average shares outstanding				55,693				55,434

(1) 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)	Six Months Ended							
	December 31, 2021		January 1, 2021					
Net (loss) income and diluted (loss) earnings per share	\$	(9,779)	\$	(0.18)	\$	28,484	\$	0.51
Other non-operating adjustments, net		643		(185)				
Amortization of intangible assets		29,736		15,374				
Restructuring and other charges		16,076		2,248				
Impairment of long-lived assets		—		—				
Acquisition, financing and other third party costs		5,748		3,810				
Fair value adjustments from purchase accounting		(1,731)		—				
Litigation and settlement expense, net		882		438				
COVID related expenses		457		5,628				
Stock-based and other non-cash compensation expense		17,465		14,806				
Impact to income taxes ⁽¹⁾		(14,973)		(12,299)				
Adjusted income and adjusted earnings per share	\$	44,524	\$	0.80	\$	58,304	\$	1.05
Diluted weighted-average shares outstanding				55,653				55,385

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

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

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

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

(In thousands)	Second Quarters Ended		Six Months Ended	
	December 31, 2021	January 1, 2021	December 31, 2021	January 1, 2021
Cash provided by operating activities	\$ 6,824	\$ 23,939	\$ 4,818	\$ 46,868
Purchase of property and equipment	(8,027)	(13,775)	(13,404)	(24,753)
Free cash flow	\$ (1,203)	\$ 10,164	\$ (8,586)	\$ 22,115

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

The following tables reconcile the most directly comparable GAAP financial measure to the non-GAAP financial measure for the second quarters six months and ended December 31, 2021 and January 1, 2021, respectively:

(In thousands)	December 31, 2021	As a % of Total Net Revenue	January 1, 2021	As a % of Total Net Revenue	\$ Change	% Change
Organic revenue	\$ 182,857	83 %	\$ 210,459	100 %	\$ (27,602)	(13)%
Acquired revenue	37,523	17 %	217	— %	37,306	100 %
Total revenues	\$ 220,380	100 %	\$ 210,676	100 %	\$ 9,704	5 %

(In thousands)	December 31, 2021	As a % of Total Net Revenue	January 1, 2021	As a % of Total Net Revenue	\$ Change	% Change
Organic revenue	\$ 366,589	82 %	\$ 416,080	100 %	\$ (49,491)	(12)%
Acquired revenue	78,804	18 %	217	— %	78,587	100 %
Total revenues	\$ 445,393	100 %	\$ 416,297	100 %	\$ 29,096	7 %

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in our exposure to market risk from July 2, 2021 to December 31, 2021.

ITEM 4. CONTROLS AND PROCEDURES***(a) Evaluation of Disclosure Controls and Procedures***

We conducted an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), regarding the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2021. 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 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2021 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Management is in the process of integrating the Pentek, Avalex and Atlanta Micro businesses 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.

On June 23, 2021, Embedded Reps of America, LLC (“ERA”), a former sales representative, and James Mazzola, a principal of ERA, filed for binding arbitration related to the termination of ERA’s sales representative agreement raising multiple claims that aggregate to approximately \$9 million in direct damages, with treble damages requested on a number of those claims. ERA was a sales representative of Themis when Themis was acquired by Mercury. The sales representative agreement provided for termination by either party upon 30 days written notice with ERA entitled to commissions for orders obtained by ERA with product shipment occurring prior to termination. We responded to the complaint on July 28, 2021. We believe the claims in the complaint are without merit and we intend to defend ourselves vigorously.

On December 7, 2021, counsel for National Technical Systems, Inc. (“NTS”) sent the Company an environmental demand letter pursuant to Massachusetts General Laws Chapter 21E, Section 4A, and CERCLA 42 U.S.C. Section 9601, related to a site that NTS formerly owned at 533 Main Street, Acton, MA. NTS received a Notice of Responsibility from the Massachusetts Department of Environmental Protection (“MassDEP”) alleging trichloroethene, freon and 1,4-dioxane contamination in the groundwater emanating from NTS’s former site. NTS alleges in its demand letter that the operations of a predecessor company to Mercury that was acquired in the Company’s acquisition of the Microsemi carve-out business that once owned and operated a facility at 531 Main Street, Acton, MA contributed to the groundwater contamination. NTS is seeking payment by the Company of NTS’s costs for any required environmental remediation. In November 2021, the Company responded to a request for information from MassDEP regarding the detection of PFAS (per- and polyfluoroalkyl substances) in the Acton, MA Water District’s Conant public water supply wells near the former facility at 531 Main Street, Acton, MA at a level above the standard that MassDEP published for PFAS in October 2020. It is too early to determine what responsibility, if any, the Company may have for these matters.

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 July 2, 2021. The following risk factor should be read in conjunction with the risk factors described in the Annual Report on Form 10-K:

Shareholder activism could cause us to incur significant expense, disrupt our business, result in litigation, and impact our stock price.

We have been subject to shareholder activism and may be subject to such activism in the future, which could result in substantial costs and divert management’s and our Board’s attention and resources from our business. Such shareholder activism could give rise to perceived uncertainties as to our future, adversely affect our relationships with our employees, customers, or suppliers, and make it more difficult to attract and retain qualified personnel. We may be required to incur significant fees and other expenses related to activist shareholder matters, including for third-party advisors. We may be subjected to litigation by activist investors, including litigation related to the shareholder rights agreement or “poison pill” that our Board adopted on December 27, 2021. Our stock price could be subject to significant fluctuation or otherwise be adversely affected by the events, risks, and uncertainties of any shareholder activism.

JANA Partners LLC filed a Schedule 13D on December 23, 2021, and Starboard Value LP filed a Schedule 13D on January 13, 2022. Both JANA and Starboard have indicated that they intend to engage with Mercury’s management. Starboard has also written an open letter to Mercury’s Board of Directors dated January 13, 2022, requesting that the limited duration rights agreement be withdrawn or amended.

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.INS	eXtensible Business Reporting Language (XBRL) Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

- + Furnished herewith. This certificate shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, 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, as amended, or the Securities Exchange Act of 1934, as amended.

CERTIFICATION

I, Mark Aslett, certify that:

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

/s/ MARK ASLETT

Mark Aslett

PRESIDENT AND CHIEF EXECUTIVE OFFICER
[PRINCIPAL EXECUTIVE OFFICER]

Date: February 8, 2022

CERTIFICATION

I, Michael D. Ruppert, certify that:

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

/s/ MICHAEL D. RUPPERT

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

Date: February 8, 2022

Mercury Systems, Inc.

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

In connection with the Quarterly Report of Mercury Systems, Inc. (the "Company") on Form 10-Q for the period ended December 31, 2021 as filed with the Securities and Exchange Commission (the "Report"), we, Mark Aslett, President and Chief Executive Officer of the Company, and Michael D. Ruppert, Executive Vice President, Chief Financial Officer, and Treasurer of the Company, certify, pursuant to Section 1350 of Chapter 63 of Title 18, United States Code, that to our knowledge the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 8, 2022

/s/ MARK ASLETT

Mark Aslett

PRESIDENT AND CHIEF EXECUTIVE OFFICER

/s/ MICHAEL D. RUPPERT

Michael D. Ruppert

**EXECUTIVE VICE PRESIDENT,
CHIEF FINANCIAL OFFICER, AND TREASURER**