SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED JUNE 30, 1999
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
COMMISSION FILE NUMBER - 000-23599

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

MASSACHUSETTS	04-2741391
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
199 RIVERNECK ROAD, CHELMSFORD MASSACHUSETTS	01824
(Address of principal executive offices)	(Zip code)
(978) 256-1300	NASDAQ NATIONAL MARKET
(Registrant's telephone number including area code)	(Name exchange on which registered)

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Aggregate market value of Registrant's voting stock held by non-affiliates of the Registrant as of August 31, 1999: $269,402,562.

Shares of Common Stock outstanding as of August 31, 1999: 10,361,637 shares

DOCUMENTS INCORPORATED BY REFERENCE

Excerpts from the Registrant's Annual Report to Shareholders for the year ended June 30, 1999 is incorporated by reference into parts I and II of this report.

Portions of the Registrant's definitive Proxy Statement for its special meeting in lieu of the 1999 Annual Meeting of Stockholders to be held on November 18, 1999 (the "Proxy Statement") are incorporated by reference into Part III of this report.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. [ ]

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PART I

ITEM 1. BUSINESS

OVERVIEW

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

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

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

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

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

Since July 1996, Mercury has targeted the emerging shared storage market for introduction of a new product which draws on the Company's core competencies in systems engineering and the development of real-time software. This business unit was created to exploit some of Mercury's innovative software developments. It has evolved into software for use in applications and market segments that, while exciting and potentially offering a large return, are outside of Mercury's core businesses and strengths. The Company has therefore issued an offering memorandum seeking alternative ways to fund the continuing development of this business.

INDUSTRY BACKGROUND

Defense Electronics

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

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

Medical Imaging

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

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

MARKETS AND CUSTOMERS

Defense Electronics

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

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

Medical Imaging

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

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

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

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

AgileVision

On September 1, 1999, the Company formed a joint venture with the Sarnoff Corporation referred to as AgileVision. The venture will use Mercury technology to design, develop, and deliver products and solutions expected to dramatically reduce the cost of digital TV infrastructure for the broadcast and cable markets. The many business uncertainties that attend the new venture make revenue projections at this time inappropriate. The joint venture does anticipate it would begin to generate revenues during fiscal 2000. Mercury's share of gains and losses will be reported as a separate line item in its profit and loss statement.

Digital Wireless

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

KEY TECHNOLOGY COMPETENCIES

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

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

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

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

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

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

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

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

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

PRODUCTS

HARDWARE PRODUCTS

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

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

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

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

SOFTWARE PRODUCTS

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

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

MC/OS Version 4.X. The MC/OS runtime operating environment allows maximum use of the RACE heterogeneous multi-computer architecture in a single-system model incorporating a consistent set of system and application programming interfaces, and a common development environment. MC/OS is supported on the high performance, VME and industrial PC classes of Mercury hardware systems. MC/OS is included in Mercury's development software package.

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

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

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

ENGINEERING, RESEARCH AND DEVELOPMENT

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

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

As of June 30, 1999, the Company had 136 people primarily engaged in engineering, research and development, including hardware and software architects, design engineers and engineers with expertise in developing medical, defense and shared storage software systems. During fiscal years 1999, 1998 and 1997, the Company's total research and development costs were approximately $20.7 million, $14.5 million, and $12.8 million, respectively.

CUSTOMER SUPPORT AND INTEGRATION

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

MANUFACTURING AND TESTING

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

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

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

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

COMPETITION

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

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

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

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

INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS

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

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

BACKLOG

As of June 30, 1999, the Company had a backlog of orders aggregating approximately $52.1 million. The Company includes in its backlog, customer orders for products and services for which it has accepted signed purchase orders with assigned delivery dates within twelve months. Orders included in backlog may be canceled or rescheduled by customers without penalty. A variety of conditions, both specific to the individual customer and generally affecting the customer's industry, may cause customers to cancel, reduce or delay orders that were previously made or anticipated. The Company cannot assure the timely replacement of canceled, delayed or reduced orders. Significant or numerous cancellations, reductions or delays in orders by a customer or group of customers could materially adversely affect the Company's business, financial condition and results of operations. Backlog should not be relied upon as indicative of the Company's revenues for any future period.

EMPLOYEES

At June 30, 1999, the Company employed a total of 435 persons, including 136 in research and development, 158 in sales, marketing and customer support, 60 in manufacturing and 81 in general and administration. Nine of the Company's employees are located in Europe, seven in Japan and the remainder in the U.S. None of the Company's employees are represented by a labor organization and the Company believes that its relations with employees are good. Competition for qualified personnel in the engineering fields is intense and the Company is aware that much of its future success will depend on its continued ability to attract and retain qualified personnel. The Company seeks to attract new employees by offering competitive compensation packages, including salary, bonus, stock options and employee benefits. There can be no assurance, however, that the Company will be successful in retaining its key employees or that it will be able to attract skilled personnel for the development of its business.

RISK FACTORS

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

DEPENDENCE ON DEFENSE ELECTRONICS BUSINESS; UNCERTAINTY ASSOCIATED WITH GOVERNMENT CONTRACTS. Sales of the Company's computer systems to the defense electronics market accounted for approximately 77%, 79%, and 81% of the Company's revenues in fiscal 1999, 1998, and 1997, respectively. Reductions in government spending on programs that incorporate the Company's products could have a material adverse effect on the Company's business, financial condition and results of operations. Moreover, the Company's government contracts and subcontracts are subject to special risks, such as: delays in funding; ability of the government agency to unilaterally terminate the prime contract; reduction or modification in the event of changes in government policies or as the result of budgetary constraints or political changes; increased or unexpected costs under fixed price contracts; and other factors that are not under the control of the Company. In addition, consolidation among defense industry contractors has resulted in fewer contractors with increased bargaining power relative to the Company. No assurance can be given that such increased bargaining power will not adversely affect the Company's business, financial condition or results of operations in the future.

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

DEPENDENCE ON KEY CUSTOMERS. The Company is dependent on a small number of customers for a large portion of its revenues. In fiscal 1999, Raytheon Systems Company, Lockheed Martin, and GE Medical accounted for 22%, 16%, and 12%, respectively, of the Company's revenues. In fiscal 1998, Raytheon Systems Company, GE Medical, and Northrup Grumman Corporation accounted for 20%, 10%, and 10%, respectively, of the Company's revenues. In fiscal 1997, Lockheed Martin and Hughes Aircraft accounted for 22% and 10%, respectively, of the Company's revenues. The Company's largest customer in the medical imaging market, GE Medical, accounted for 85%, 76%, and 72% of the Company's aggregate sales to the medical imaging market in fiscal 1999, 1998, and 1997, respectively. Customers in the defense electronics market generally purchase the Company's products in connection with government programs that have a limited duration, leading to fluctuating sales to any particular customer in the defense electronics market from year to year. By contrast, many customers in the medical imaging market historically have purchased the Company's products over a number of years for use in successive generations of medical imaging devices, although there can be no assurance that such past behavior will continue in the future. A significant diminution in the sales to or loss of any of the Company's major customers would have a material adverse effect on the Company's business, financial condition and results of operations. In addition, the Company's revenues are largely dependent upon the ability of its customers to develop and sell products that incorporate the Company's products. No assurance can be given that the Company's customers will not experience financial or other difficulties that could adversely affect their operations and, in turn, the results of operations of the Company.

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

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

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

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

DEPENDENCE ON MEDICAL IMAGING MARKET; POTENTIAL ADVERSE EFFECT OF HEALTH CARE REFORM. Sales of the Company's computer systems to the medical imaging market accounted for approximately 14%, 13%, and 11% of the Company's revenues in fiscal 1999, 1998, and 1997, respectively. These customers are original equipment manufacturers ("OEMs") of medical imaging devices and, as a result, any change in the demand for such devices which renders any of the Company's products unnecessary or obsolete, or any change in the technology in such devices, could have a material adverse effect on the Company's business, financial condition and results of operations. Such OEM customers, the end-users of their products and the health care industry generally are subject to extensive federal, state and local regulation in the U.S. as well as in other countries. Changes in applicable health care laws and regulations or new interpretations of existing laws and regulations could have a material adverse effect on such customers or end-users. There can be no assurance that future health care or budgetary legislation or other changes in the administration or interpretation of governmental health care programs both in the U.S. and abroad will not have a material adverse effect on the Company's business, financial condition or results of operations.

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

RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS. The Company markets and sells its products in certain international markets, and the Company has established offices in the United Kingdom, Japan and France. Foreign revenue is based on the country in which the legal subsidiary is domiciled. Foreign revenue and long-lived assets represent less than 10% of the Company's total revenue and long-lived assets for the fiscal years ended June 30, 1999, 1998, and 1997, respectively. If revenues generated by foreign activities are not adequate to offset the expense of establishing and maintaining these foreign subsidiaries and activities, the Company's business, financial condition and results of operations could be materially adversely affected. In addition, there are certain risks inherent in transacting business internationally, such as changes in applicable laws and regulatory requirements, export and import restrictions, export controls relating to technology, tariffs and other trade barriers, less favorable intellectual property laws, difficulties in staffing and managing foreign operations, longer payment cycles, problems in collecting accounts receivable, political instability, fluctuations in currency exchange rates, expatriation controls and potential adverse tax consequences, any of which could adversely impact the success of the Company's international activities. In the recent past, the financial markets in Asia have experienced significant turmoil. There can be no assurance that such turmoil in the Asian financial markets will not negatively affect the sales by the Company to that region. A portion of the Company's revenues from sales to foreign entities, including foreign governments, is in the form of foreign currencies. There can be no assurance that one or more of such factors will not have a material adverse effect on the Company's future international activities and, consequently, on the Company's business, financial condition or results of operations.

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

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

The design-in process is typically lengthy and expensive, and there can be no assurance that the Company will be able to continue to meet the product specifications of its customers in a timely and adequate manner. In addition, any failure by the Company to anticipate or respond adequately to changes in technology and customer preferences, or any significant delay in product developments or introductions, could have a material adverse effect on the Company's business, financial condition and results of operations. Because of the complexity of its products, the Company has experienced delays from time to time in completing products on a timely basis. If the Company is unable to design, develop or introduce competitive new products on a timely basis, its future operating results would be adversely affected. There can be no assurance that the Company will be successful in developing new products or enhancing its existing products on a timely or cost-effective basis, or that such new products or product enhancements will achieve market acceptance.

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

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

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

YEAR 2000 COMPLIANCE. The Company uses a significant number of computer software programs and operating systems in its internal operations, including applications used in manufacturing, product development, financial business systems and various administrative functions. To the extent that these software applications contain source code that is unable to appropriately interpret the upcoming calendar year "2000," some level of modification or even possibly replacement of such source code or applications will be necessary. The Company is still in the preliminary stages of analyzing its software applications and, to the extent they are not fully "Year 2000" compliant, there can be no assurance that the costs necessary to update software, or potential systems interruptions, would not have a material adverse effect on the Company's business, financial condition or results of operations. See "- Year 2000 Compliance."

ITEM 2. PROPERTIES

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

ITEM 3. LEGAL PROCEEDINGS

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

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

No matters were submitted to a vote of stockholders during the fourth quarter of the fiscal year ended June 30, 1999.

PART II

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

The information contained under the heading "Market Information" on page 27 of the Company's Annual Report to Stockholders for the fiscal year ended June 30, 1999 is incorporated herein by reference and is filed herewith as Exhibit 13.1.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The information contained under the heading "Selected Financial Data" on page 17 of the Company's Annual Report to Stockholders for the fiscal year ended June 30, 1999 is incorporated herein by reference and is filed herewith as Exhibit 13.1.

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

The information contained under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 18 through 26 of the Company's Annual Report to Stockholders for the fiscal year ended June 30, 1999 is incorporated herein by reference and is filed herewith as Exhibit 13.1. This information should be read in conjunction with the related consolidated financial statements incorporated by reference under Item 8.

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

The information contained under the heading "Quantitative and Qualitative Disclosure About Market Risk" on page 26 of the Company's Annual Report to Stockholders for the fiscal year ended June 30, 1999 is incorporated herein by reference and is filed herewith as Exhibit 13.1

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information contained in the consolidated financial statements, notes to consolidated financial statements, report of independent accountants and supplementary information (unaudited) on pages 28 through 47 of the Company's Annual Report to Stockholders for the fiscal year ended June 30, 1999 is incorporated herein by reference and is filed herewith as Exhibit 13.1.

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

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

ITEM 11. EXECUTIVE COMPENSATION

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

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

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

PART IV

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

(a) FINANCIAL STATEMENTS, SCHEDULES AND EXHIBITS

The financial statements, schedule, and exhibits listed below are included in or incorporated by reference as part of this report:

1. Financial statements:

   Report of Independent Accountants
   Consolidated Balance Sheets as of June 30, 1999 and 1998
   Consolidated Statements of Operations for the years ended June 30, 1999, 1998, and 1997
   Consolidated Statements of Stockholders' Equity for the years ended June 30, 1999, 1998, and 1997
   Consolidated Statements of Cash Flows for the years ended June 30, 1999, 1998, and 1997
   Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

II. Valuation and Qualifying Accounts

MERCURY COMPUTER SYSTEMS, INC.
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED JUNE 30, 1999, 1998, AND 1997
(IN THOUSANDS)

	BALANCE AT BEGINNING OF PERIOD	CHARGES TO EXPENSES	DEDUCTIONS	BALANCE AT END OF PERIOD
Allowance for Doubtful Accounts				
1999	$218	$249	91	$376
1998	119	99	$--	218
1997	80	40	$ 1	119

	BALANCE AT BEGINNING OF PERIOD	CHARGES TO EXPENSES	DEDUCTIONS	BALANCE AT END OF PERIOD
Inventory Reserve				
1999	$1,857	$2,786	$1,604	$3,039
1998	1,723	1,583	1,449	1,857
1997	1,246	504	27	1,723

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

REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE

To the Board of Directors
of Mercury Computer Systems, Inc.

Our audits of the consolidated financial statements referred to in our report dated July 29, 1999, except for the information in the first and second paragraph of Note L as to which date is August 27, 1999 and September 1, 1999, respectively, in the Annual Report to Shareholders of Mercury Computer Systems, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in item 14 (a)(2) of this Form 10-K. In our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Boston, Massachusetts
July 29, 1999

3. Exhibits:

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index on page 18, which is incorporated herein by reference.

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Chelmsford, Massachusetts, on September 14, 1999.

MERCURY COMPUTER SYSTEMS, INC.

By: /s/ G. MEAD WYMAN

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE(S)	DATE
/s/ JAMES R. BERTELLI JAMES R. BERTELLI	President, Chief Executive Officer and Director (principal executive officer)	September 14, 1999
/s/ G. MEAD WYMAN G. MEAD WYMAN	Senior Vice President, Chief Financial Officer and Treasurer (principal financial and accounting officer)	September 14, 1999
/s/ GORDON B. BATY GORDON B. BATY	Director	September 14, 1999
/s/ R. SCHORR BERMAN R. SCHORR BERMAN	Director	September 14, 1999
/s/ ALBERT P. BELLE ISLE ALBERT P. BELLE ISLE	Director	September 14, 1999
/s/ SHERMAN N. MULLIN SHERMAN N. MULLIN	Director	September 14, 1999
/s/ MELVIN SALLEN MELVIN SALLEN	Director	September 14, 1999

EXHIBIT INDEX

ITEM NO.	DESCRIPTION OF EXHIBIT
3.1	Restated Articles of Organization. (incorporated herein by reference to Exhibit 3.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
3.2	Bylaws. (incorporated herein by reference to Exhibit 3.2 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
3.3	Articles of Amendment to Articles of Organization. (incorporated herein by reference to Exhibit 3.3 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
4.1	Form of Stock Certificate. (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.1	1982 Stock Option Plan, as amended. (incorporated herein by reference to Exhibit 10.1 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.2	1991 Stock Option Plan, as amended. (incorporated herein by reference to Exhibit 10.2 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.3	1993 Stock Option Plan for Non-Employee Directors. (incorporated herein by reference to Exhibit 10.3 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.4	1997 Stock Option Plan. (incorporated herein by reference to Exhibit 10.4 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.5	1997 Stock Purchase Plan. (incorporated herein by reference to Exhibit 10.5 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.6	Purchase and Sale Agreement, dated November 8, 1996 between Corcoran Chelmsford & Associates and Northland Development Corporation. (incorporated herein by reference to Exhibit 10.7 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.7#	Term Purchase Agreement, dated July 25, 1995 between the Company and Analog Devices, Inc. (incorporated herein by reference to Exhibit 10.8 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.8#	Risk Reproduction Agreement, dated March 20, 1996, between the Company and LSI Logic Corporation. (incorporated herein by reference to Exhibit 10.9 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.9#	Purchase Offer Agreement for OEM Manufacturer, dated February 16, 1995, between the Company & IBM Microelectronics Division. (incorporated herein by reference to Exhibit 10.10 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.10	Quitclaim Deed, dated October 1, 1997, executed by Corcoran Chelmsford & Associates Limited Partnership. (incorporated herein by reference to Exhibit 10.15 of the Company's Registration Statement on Form S-1 (File No. 333-41139))
10.11*	1998 Stock Option Plan
13.1*	Pages 17 through 47 of the 1999 Annual Report to Stockholders of Mercury Computer Systems, Inc., a copy of which is furnished for the information of the Securities and Exchange Commission. Portions of the Annual Report not incorporated herein by reference are not deemed "filed" with the Commission.
21.1*	Subsidiaries of the Registrant
23.1*	Consent of PricewaterhouseCoopers L.L.P.
27.1*	Financial Data Schedule.

* Filed with this Form 10-K.   # Confidential treatment granted.

EXHIBIT 10.1

MERCURY COMPUTER SYSTEMS, INC.
1998 STOCK OPTION PLAN
FOR NON-EMPLOYEE DIRECTORS

1. PURPOSE

The purpose of this Mercury Computer Systems, Inc. 1998 Stock Option Plan for Non-Employee Directors (the "Plan") is to attract and retain the services of experienced and knowledgeable independent directors who are not employees (sometimes referred to herein collectively as "Participants") of Mercury Computer Systems, Inc. ("Mercury") for the benefit of Mercury and its stockholders and to provide additional incentive for such Participants to continue to work in the best interests of Mercury and its stockholders through continuing ownership of its common stock.

2. SHARES SUBJECT TO THE PLAN

The total number of shares of common stock, par value $.01 per share ("Shares"), of Mercury for which options may be granted under the Plan shall not exceed 50,000 in the aggregate, subject to adjustment in accordance with Section 9 hereof.

3. ELIGIBILITY; GRANT OF OPTION

On September 30 of each of 1998, 1999, 2000, 2001 and 2002, each person who is then a member of the Board of Directors of Mercury (the "Board") and who is not then an employee of Mercury or any subsidiary shall be granted an option to acquire the Formula Number of Shares under the Plan. Any options granted prior to stockholder approval of this Plan shall become effective as of their date of grant only upon stockholder approval of this Plan in accordance with Section 13 hereof. The options shall be non-qualified options not intended to meet the requirements of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code").

The Formula Number shall be that number equal to one percent (1%) of the net income of Mercury for the most recent fiscal year ending prior to the grant date as shown on Mercury's audited financial statements divided by the fair market value of a share of Mercury common stock, as determined under Section 5 hereof, on the first day of such most recent fiscal year, divided by the number of the non-employee Directors of Mercury granted options hereunder on such grant date. No fractional shares shall be issued.

4. OPTION AGREEMENT

Each option granted under the Plan shall be evidenced by an option agreement (the "Agreement") duly executed on behalf of Mercury and by the director to whom such option is granted, which Agreements shall comply with and be subject to the terms and conditions of the Plan.

5. OPTION EXERCISE PRICE

Subject to the provisions of Section 9 hereof, the option exercise price for an option granted under the Plan shall be the fair market value of the Shares of the common stock of Mercury covered by the option on the date of grant of the option. For the purposes hereof, the fair market value of the Shares of the common stock of Mercury shall be determined as follows. If such shares are then listed on any national securities exchange, the fair market value shall be the mean between the high and low sales prices, if any, on the largest such exchange on the date of the grant of the option or, if none, shall be determined by taking a weighted average of the means between the highest and lowest sales prices on the nearest date before and the nearest date after the date of grant in accordance with Treasury Regulations Section 25.2512-2. If the shares are not then listed on any such exchange, the fair market value of such shares shall be the mean between the high and low sales prices, if any, as reported in the National Association of Securities Dealers Automated Quotation System National Market System ("NASDAQ/NMS") for the date of the grant of the option, or, if none, shall be determined by taking a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the date of grant in accordance with Treasury Regulations Section 25.2512-2. If the shares are not then either listed on any such exchange or quoted in NASDAQ/NMS, the fair market value shall be the mean between the average of the "Bid" and the average of the "Ask" prices, if any, as reported in the National Daily Quotation Service for the date of the grant of the option, or, if none, shall be determined by taking a weighted average of the means between the highest and lowest sales prices on the nearest date before and the nearest date after the date of grant in accordance with Treasury Regulations Section 25.2512-2. If the fair market value cannot be determined under the preceding three sentences, it shall be determined by the Company's independent auditors.

6. TIME AND MANNER OF EXERCISE OF OPTION

(a) Options granted under the Plan shall, subject to the provisions of Section 7, be exercisable as provided in this Section 6(a). The options granted under this Plan shall vest 1/3 on each of the first, second, and third anniversaries of the date of grant. Following the third anniversary of the date of grant, all options granted pursuant to a particular grant shall be exercisable in full.

(b) To the extent that the right to exercise an option has accrued and is in effect, the option may be exercised in full at one time or in part from time to time by giving written notice, signed by the person or persons exercising the option, to Mercury, stating the number of Shares with respect to which the option is being exercised, accompanied by payment in full for such Shares, which payment must be in cash or certified check payable to the order of the Company; provided, however, that there shall be no such exercise at any one as to fewer than Two Hundred Fifty (250) Shares or all of the remaining Shares then purchasable by the person or persons exercising the option, if fewer than Two Hundred Fifty (250) Shares. Upon such exercise, delivery of a certificate for paid-up non- assessable Shares shall be made at the principal Massachusetts office of Mercury to the person or persons exercising the option at such time, during ordinary business hours, not more than thirty (30) days from the date of receipt of the notice by Mercury, as shall be designated in such notice, or at such time, place and manner as may be agreed upon by Mercury and the person or persons exercising the option.

7. TERM OF OPTIONS

(a) Each option shall expire ten (10) years from the date of the granting thereof, but shall be subject to earlier termination as herein provided.

(b) In the event of the death of an optionee, the option granted to such optionee may be exercised, to the extent the optionee was entitled to do so on the date of such

(c) optionee's death, by the estate of such optionee or by any person or persons who acquired the right to exercise such

(d) option by bequest or inheritance or otherwise by reason of the death of such optionee. Such option may be exercised at any time within one (1) year after the date of death of such optionee, at which time the option shall terminate, or prior to the date on which the option otherwise expires by its terms, whichever is earlier.

(c) In the event that an optionee ceases to be a director of Mercury, the option granted to such optionee may be exercised by him, but only to the extent that under Section 6 hereof the right to exercise the option has accrued and is in effect. Such option may be exercised at any time within one (1) month after the date such optionee ceases to be a director of Mercury, at which time the option shall terminate, but in any event prior to the date on which the option expires by its terms, whichever is earlier, unless termination as a director (a) was by Mercury for cause, in which case the option shall terminate immediately at the time the optionee ceases to be a director of Mercury, (b) was because the optionee has become disabled (within the meaning of Section 22(e)(3) of the Code), or (c) was by reason of the death of the optionee. In the case of death, see Section 7(b) of the Plan. In the case of disability, the option may be exercised, to the extent then exercisable under Section 6 hereof, at any time within one (1) year after the date of termination of the optionee's directorship with Mercury, at which time the option shall terminate, but in any event prior to the date on which the option otherwise expires by its terms, whichever is earlier.

8. OPTIONS NOT TRANSFERABLE

The right of any optionee to exercise an option granted to him under the Plan shall not be assignable or transferable by such optionee otherwise than by will or the laws of descent and distribution, or pursuant to a qualified domestic relations order as defined by the Code or Title I of the Employee Retirement Income Security Act, or the rules thereunder. Any option granted under the Plan shall be exercisable during the lifetime of such optionee only by him. Any option granted under the Plan shall be null and void and without effect upon the bankruptcy of the optionee, or upon any attempted assignment or transfer, except as herein provided, including without limitation any purported assignment, whether voluntary or by operation of law, pledge, hypothecation or other disposition, attachment, trustee process or similar process, whether legal or equitable, upon such option.

9. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION

In the event that the outstanding Shares of the common stock of Mercury are changed into or exchanged for a different number or kind of shares or other securities of Mercury or of another corporation by reason of any reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, combination of shares or dividends payable in capital stock, appropriate adjustment shall be made in the number and kind of shares as to which outstanding options, or portions thereof then unexercised, shall be exercisable, to the end that the proportionate interest of the optionee shall be maintained as before the occurrence of such event, and such adjustment in outstanding options shall be made without change in the total price applicable to the unexercised portion of such options and with a corresponding adjustment in the option price per share.

10. RESTRICTIONS ON ISSUE OF SHARES

Notwithstanding the provisions of Section 6 hereof, Mercury may delay the issuance of Shares covered by the exercise of any option and the delivery of a certificate for such Shares until one of the following conditions shall be satisfied:

(i) the Shares with respect to which an option has been exercised are at the time of the issue of such Shares effectively registered under applicable Federal and state securities acts now in force or hereafter amended; or

(ii) counsel for Mercury shall have given an opinion, which opinion shall not be unreasonably conditioned or withheld, that such Shares are exempt from registration under applicable Federal and state securities acts now in force or hereafter amended.

It is intended that all exercises of options shall be effective. Accordingly, Mercury shall use its best efforts to bring about compliance with the above conditions within a reasonable time, except that Mercury shall be under no obligation to cause a registration statement or a post-effective amendment to any registration statement to be prepared at its expense solely for the purpose of covering the issue of Shares in respect of which any option may be exercised, except as otherwise agreed to by Mercury in writing.

11. RIGHTS OF HOLDER ON PURCHASE FOR INVESTMENT; SUBSEQUENT REGISTRATION

Unless the Shares to be issued upon exercise of an option granted under the Plan have been effectively registered under the Securities Act of 1933, as now in force or hereafter amended, Mercury shall be under no obligation to issue any Shares covered by any option unless the person who exercises such option, in whole or in part, shall give a written representation and undertaking to Mercury which is satisfactory in form and scope to counsel to Mercury and upon which, in the opinion of such counsel, Mercury may reasonably rely, that he is acquiring the Shares issued to him pursuant to such exercise of the option for his own account as an investment and not with a view to, or for sale in connection with, the distribution of any such Shares, and that he will make no transfer of the same except in compliance with any rules and regulations in force at the time of such transfer under the Securities Act of 1933, or any other applicable law, and that if Shares are issued without such registration a legend to this effect may be endorsed upon the securities so issued. In the event that Mercury shall, nevertheless, deem it necessary or desirable to register under the Securities Act of 1933 or other applicable statutes any Shares with respect to which an option shall have been exercised, or to qualify any such Shares for exemption from the Securities Act of 1933 or other applicable statutes, then Mercury shall take such action at its own expense and may require from each optionee such information in writing for use in any registration statement, prospectus, preliminary prospectus or offering circular as is reasonably necessary for such purpose and may require reasonable indemnity to Mercury and its officers and directors from such holder against all losses, claims, damages and liabilities arising from such use of the information so furnished and caused by any untrue statement of any material fact therein or caused by the omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances under which they were made.

12. LOANS PROHIBITED

Mercury shall not, directly or indirectly, lend money to an optionee or to any person or persons entitled to exercise an option by reason of the death of an optionee for the purpose of assisting him or them in the acquisition of Shares covered by an option granted under the Plan.

13. APPROVAL OF STOCKHOLDERS

The Plan shall be subject to approval by the vote of stockholders holding at least a majority of the voting stock of Mercury voting in person or by proxy at a duly held stockholders' meeting, or by written consent of all of the stockholders, and shall take effect immediately as of its date of adoption upon such approval.

14. EXPENSES OF THE PLAN

All costs and expenses of the adoption and administration of the Plan shall be borne by Mercury, and none of such expenses shall be charged to any optionee.

15. TERMINATION AND AMENDMENT OF PLAN

Unless sooner terminated as herein provided, the Plan shall terminate ten (10) years from the date upon which the Plan was duly approved by the stockholders. The Board may at any time terminate the Plan or make such modification or amendment thereof as it deems advisable, provided however that, except as provided in Section 9 hereof, no modification or amendment to the provisions of the Plan may be made more than once every six (6) months other than to comport with changes in the Code, the Employee Retirement Income Security Act, or the rules thereunder, if the effect of such amendment or modification would be to change (i) the requirements for eligibility under the Plan, (ii) the timing of the grants of options to be granted under the Plan or the exercise price or vesting schedule thereof, or (iii) the number of Shares subject to options to be granted under the Plan either in the aggregate or to one director. Any amendment to the provisions of the Plan which (i) materially increases the number of Shares which may be subject to options granted under the Plan, (ii) materially increases the benefits accruing to Participants under the Plan, or (iii) materially modifies the requirement for eligibility to participate in the Plan, shall be subject to approval by the stockholders of Mercury obtained in the manner stated in Section 13 hereof. Termination or any modification or amendment of the Plan shall not, without the consent of an optionee, affect his rights under an option previously granted to him.

16. LIMITATION OF RIGHTS IN THE OPTION SHARES

An optionee shall not be deemed for any purpose to be a stockholder of Mercury with respect to any of the options except to the extent that the option shall have been exercised with respect thereto and, in addition, a certificate shall have been issued theretofore and delivered to the optionee.

17. NOTICES

Any communication or notice required or permitted to be given under the Plan shall be in writing, and mailed by registered or certified mail or delivered by hand, if to Mercury, to its principal place of business, attention: President, and, if to an optionee, to the address as appearing on the records of Mercury.

18. COMPLIANCE WITH RULE 16b-3

It is the intention of Mercury that the Plan comply in all respects with Rule 16b-3 promulgated under Section 16(b) of the Securities Exchange Act of 1934 (the "Act") and that Participants remain disinterested persons for purposes of administering other employee benefit plans of Mercury and having transactions under such other plans be exempt from Section 16(b) of the Act. Therefore, if any Plan provision is found not to be in compliance with Rule 16b-3 or if any Plan provisions would disqualify Participants from remaining disinterested persons, that provisions shall be deemed null and void, and in all events the Plan shall be construed in favor of its meeting the requirements of Rule 16b-3.

SELECTED FINANCIAL DATA

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

YEAR ENDED JUNE 30,	1999	1998	1997	1996	1995
STATEMENT OF OPERATIONS DATA:					
Revenues	$106,571	$85,544	$64,574	$58,300	$54,323
Cost of revenues	34,237	30,084	22,034	24,688	21,221
Gross profit	72,334	55,460	42,540	33,612	33,102
Operating expenses:					
Selling, general and administrative	33,002	27,879	22,631	16,927	15,798
Research and development	20,709	14,476	12,837	9,776	8,586
Total operating expenses	53,711	42,355	35,468	26,703	24,384
Income from operations	18,623	13,105	7,072	6,909	8,718
Interest income, net	1,285	1,084	560	548	240
Other income (expense), net	185	(30)	(88)	(77)	22
Income before income taxes	20,093	14,159	7,544	7,380	8,980
Provision for income taxes	6,631	5,428	2,933	2,952	2,636
Net income	$ 13,462	$ 8,731	$ 4,611	$ 4,428	$ 6,344
Net income per common share:					
Basic	$ 1.32	$ 1.21	$ 0.90	$ 0.88	$ 1.27
Diluted	$ 1.25	$ 0.94	$ 0.58	$ 0.55	$ 0.80
Weighted average number of common and common equivalent shares outstanding(1):					
Basic	10,168	7,235	5,141	5,050	4,992
Diluted	10,800	9,270	7,897	7,983	7,977

June 30,	1999	1998	1997	1996	1995
BALANCE SHEET DATA:					
Working capital	$ 42,312	$32,794	$27,547	$23,554	$20,156
Total assets	97,511	73,569	44,848	33,264	33,543
Convertible preferred stock(2)	--	--	1,200	1,200	1,200
Total stockholders' equity	77,440	61,040	33,322	28,529	24,003

(1) See Note B of Notes to Consolidated Financial Statements for an explanation of the determination of the weighted average common and common equivalent shares used to compute basic and diluted net income per common share.
(2) Upon completion of the Company's initial public offering on January 29, 1998, the Company's series A convertible preferred stock was converted into 2,556,792 shares of common stock.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this report, as well as oral statements made by the Company, that are prefaced with the words "may," "will," "expect," "anticipate," "continue," "estimate," "project," "intend," "designed" and similar expressions, are intended to identify forward-looking statements regarding events, conditions and financial trends that may affect the Company's future plans of operations, business strategy, results of operations and financial position. These statements are based on the Company's current expectations and estimates as to prospective events and circumstances about which the Company can give no firm assurance. Further, any forward-looking statement speaks only as of the date on which such statement is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made. As it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of actual future financial condition or results. These forward-looking statements, like any forward-looking statements, involve risks and uncertainties that could cause actual results to differ materially from those projected or unanticipated. Such risks and uncertainties include certain factors identified in the following discussion as well as the risk factors reported in the Company's Form 10-K.

OVERVIEW

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

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

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

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

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

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

Mercury has made significant investments in research and development in an effort to maintain its technology leadership in digital signal processing and to create new software products for the shared storage market. Mercury invested $12.8 million, $14.5 million and $20.7 million in fiscal years 1997, 1998 and 1999, respectively, in development activities associated with the Company's key technology competencies as well as in activities that are targeted at developing new technologies and products. The Company expects research and development expenses to continue to increase as the Company continues to develop products to serve its markets, all of which are subject to rapidly changing technology, frequent product performance improvements and evolving industry standards. The ability to deliver superior technological performance on a timely and cost-effective basis is a critical factor in securing design wins for future generations of defense electronics and medical imaging systems. Significant research and development spending by the Company does not ensure that the Company's computer systems will be designed into a customer's system. Because future production orders are usually contingent upon securing a design win, the Company's operating results may fluctuate due to either obtaining or failing to obtain design wins for significant customer systems.

RESULTS OF OPERATIONS

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

YEAR ENDED JUNE 30,	1999	1998	1997
Revenues	100.0%	100.0%	100.0%
Cost of revenues	32.1	35.2	34.1
Gross profit	67.9	64.8	65.9
Operating expenses:			
Selling, general and administrative	31.0	32.6	35.0
Research and development	19.4	16.9	19.9
Total operating expenses	50.4	49.5	54.9
Income from operations	17.5	15.3	11.0
Other income, net	1.4	1.3	0.7
Income before income taxes	18.9	16.6	11.7
Provision for income taxes	6.3	6.4	4.6
Net income	12.6%	10.2%	7.1%

FISCAL 1998 VS. FISCAL 1999

REVENUES

Total revenues increased 25% from $85.5 million during the year ended June 30, 1998 to $106.6 million during the year ended June 30, 1999. Revenues from defense electronics, medical imaging and other commercial markets increased, as described below.

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

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

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

COST OF REVENUES

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

SELLING, GENERAL AND ADMINISTRATIVE

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

RESEARCH AND DEVELOPMENT

Research and development expenses, excluding capitalized software expenditures, increased 43% from $14.5 million during the year ended June 30, 1998 to $20.7 million during the year ended June 30, 1999. Research and development expenses as a percentage of total revenues were 17% during the year ended June 30, 1998 and 19% during the year ended June 30, 1999. The increase in research and development expenses was due primarily to the hiring of additional software and hardware engineers to develop and enhance the features and functionality of the Company's products in response to increased demand for next generation products. Engineering expenses currently are running higher than management's target levels as the Company is working on some major development programs to deliver important new technology to its customers. Management believes that higher engineering spending will continue through fiscal 2000.

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

INCOME FROM OPERATIONS

Income from operations increased 42% from $13.1 million during the year ended June 30, 1998 to $18.6 million during the year ended June 30, 1999. Included in income from operations during the year ended June 30, 1999 were $2.2 million in hardware and software revenues and $4.0 million in direct expenses related to the shared storage business. The expenses include direct expenses from marketing and engineering activities, primarily related to compensation, trade shows, prototype development and direct costs related to the sale of the product. Included in income from operations during the year ended June 30, 1998 were $885,000 in hardware and software revenues and $4.3 million in direct expenses related to the shared storage business. Revenues from the shared storage business increased substantially year over year due primarily to the expanding distribution base and the availability of fiber channel interconnect technology. Refer to separate discussion below in the liquidity and capital resource section of this management discussion and analysis regarding the alternative ways to fund the continuing development of the shared storage business unit.

INTEREST INCOME, NET

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

PROVISION FOR INCOME TAXES

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

FISCAL 1997 VS. FISCAL 1998

REVENUES

Total revenues increased 32% from $64.6 million during the year ended June 30, 1997 to $85.5 million during the year ended June 30, 1998. Revenues from defense electronics, medical imaging and other commercial markets increased, as described below.

Defense electronics revenues increased 29% from $52.3 million or 81% of total revenues during the year ended June 30, 1997 to $67.2 million or 79% of total revenues during the year ended June 30, 1998. The increase in revenues was due primarily to increased unit demand for defense electronics products.

Medical imaging revenues increased 62% from $6.9 million or 11% of total revenues during the year ended June 30, 1997 to $11.2 million or 13% of total revenues during the year ended June 30, 1998. The increase in revenues was due primarily to increased unit demand for medical imaging products.

Other revenues increased 31% from $5.4 million or 8% of total revenues during the year ended June 30, 1997 to $7.1 million or 8% of total revenues during the year ended June 30, 1998. This increase in other revenues was due primarily to an increase in unit demand from new and existing commercial customers, partially offset by a decrease in revenues from the shared storage business.

COST OF REVENUES

Cost of revenues increased 37% from $22.0 million during the year ended June 30, 1997 to $30.1 million during the year ended June 30, 1998. Cost of revenues as a percentage of total revenues increased from 34% during the year ended June 30, 1997 to 35% during the year ended June 30, 1998. This increase in costs relative to revenue was due to a price reduction put in place during 1998 and increased manufacturing operating costs. These increases were offset, partially, by a decline in material costs.

SELLING, GENERAL AND ADMINISTRATIVE
Selling, general and administrative expenses increased 23% from $22.6 million during the year ended June 30, 1997 to $27.9 million during the year ended June 30, 1998. Selling, general and administrative expenses as a percentage of total revenues were 35% during the year ended June 30, 1997 and 33% during the year ended June 30, 1998. The increase, in expense dollars, reflects the hiring of additional sales and administrative personnel, increased commissions and the development of the Company's financial, administrative and management infrastructure to support the Company's growth.

RESEARCH AND DEVELOPMENT
Research and development expenses, excluding capitalized software expenditures, increased 13% from $12.8 million during the year ended June 30, 1997 to $14.5 million during the year ended June 30, 1998. Research and development expenses as a percentage of total revenues were 20% during the year ended June 30, 1997 and 17% during the year ended June 30, 1998. The increase in research and development expenses reflects increased investments in the Company's core technological competencies, as well as in new medical, shared storage and other technologies and products.

INCOME FROM OPERATIONS
Income from operations increased 85% from $7.1 million during the year ended June 30, 1997 to $13.1 million during the year ended June 30, 1998. Included in income from operations during the year ended June 30, 1998 were $885,000 in hardware and software revenues and $4.3 million in direct expenses related to the shared storage business. The expenses include direct expenses from marketing and engineering activities, primarily related to compensation, trade shows, prototype development and direct costs related to the sale of the product. Included in income from operations during the year ended June 30, 1997 were $2.1 million in hardware and software revenues and $3.8 million in direct expenses related to the shared storage business. Revenues from the shared storage business declined year over year due primarily to the inclusion in 1997 revenue of one large non-recurring order.

INTEREST INCOME, NET
The Company earned $560,000 in interest income, net, during the year ended June 30, 1997 and $1.1 million during the year ended June 30, 1998. This increase reflects an increase in the Company's average cash balances primarily as a result of cash received from the Company's initial public offering in mid fiscal 1998. Offsetting the effect of higher average cash balances were lower yields achieved on the Company's cash. These lower yields were the result of a shift in investment strategy from taxable money market instruments to non-taxable securities.

PROVISION FOR INCOME TAXES
The Company's provision for income taxes was $2.9 million during the year ended June 30, 1997 and $5.4 million during the year ended June 30, 1998. The Company's effective tax rate was 39% during the year ended June 30, 1997 and 38% during the year ended June 30, 1998.

LIQUIDITY AND CAPITAL RESOURCES
As of June 30, 1999 the Company had cash and marketable securities of approximately $25.4 million. During the year ended June 30, 1999 the Company generated $9.1 million in cash from operations compared to $7.1 million generated during the year ended June 30, 1998. The increase in cash generated from operations is attributable primarily to the Company's improved profitability and an

increase in liabilities. These positive factors were partially offset by an increase in accounts receivable and inventory balances. The Company's days sales, based on revenues of each calendar quarter, increased from 66 days at the end of 1998 to 88 days at the end of 1999. This increase in days sales was due to a disproportionate amount of revenue being recorded at the end of the accounting period. This disproportion occurred during the fourth quarter of fiscal 1999 and was caused by intermittent failure in a major supplier's component part. The situation was ultimately resolved but delayed shipments until the last few weeks of the quarter. Consequently, the Accounts Receivable balance at the end of the fiscal year was inflated.

The Company used $12.7 million in investing activities during the year ended June 30, 1999 compared to $35.4 million during the year ended June 30, 1998. The reduction in investing activities year-over-year was primarily due to the increased net sale of marketable securities amounting to $36.2 million, partially offset by $15.1 million associated with the purchase of the Company's corporate headquarters and completed construction of an adjacent building.

The Company generated $1.4 million in cash from financing activities during the year ended June 30, 1999 compared to $19.1 million during the year ended June 30, 1998. This significant reduction year over year was primarily due to the fact that during fiscal 1998, the Company completed its initial public offering, which resulted in net proceeds amounting to $18.6 million. In addition, $303,000 was paid under a capital lease obligation during fiscal 1999 and none was paid during fiscal 1998. These reductions were partially offset by the implementation during fiscal 1999 of the employee stock purchase plan ("ESPP"). During fiscal 1999, 28,224 additional shares of common stock were issued through the ESPP for a total value of $469,000. In addition, 309,162 stock options were exercised during fiscal 1999 compared to 204,468 stock options exercised during fiscal 1998. Proceeds received from stock option exercises were $708,000 greater in fiscal 1999 than in fiscal 1998.

On August 27, 1999, the Company signed a commitment letter with a commercial financing company to issue two 7.30%, senior secured financing notes ("the Notes"), due September 2014. The total principal value of the Notes amount to $14,500,000. The Company's corporate headquarters and an adjacent building, with a combined cost basis of $17,670,000, secure the Notes.

Management believes that the Company's available cash, cash generated from operations, and cash received from the financing arrangement described above will be sufficient to provide for the Company's working capital and capital expenditure requirements for the foreseeable future. If the Company acquires one or more businesses or products, the Company's capital requirements could increase substantially. In the event of such an acquisition or in the event that unanticipated circumstances arise which significantly increase the Company's capital requirements, there can be no assurance that necessary additional capital will be available on terms acceptable to the Company, if at all.

SHARED STORAGE BUSINESS UNIT

On March 1st, 1999, the Company issued a Confidential Information Memorandum seeking alternative ways to fund the continuing development of the Shared Storage business unit. This business unit was created to exploit some of Mercury's innovative software developments. It has evolved into software for use in applications and market segments that, while exciting and potentially offering large returns, is outside of Mercury's core businesses and strengths. There can be no assurances that the Company will obtain such funding.

CORPORATE DEVELOPMENT

On September 1, 1999, Mercury formed a new joint venture company ("AgileVision") with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television ("DTV"). Combining the intellectual property of both companies, this new venture is expected to provide the broadcast and cable industries with products and solutions that will significantly increase the flexibility of a digital television broadcast infrastructure. The new company will provide products and services that allow an economical entry point to DTV services, with the option of expanding performance and features to meet the high-bandwidth digital signal processing demands of the evolving DTV market. The Company is initially required to contribute $2.5 million in cash in addition to technology to the joint venture.

YEAR 2000 COMPLIANCE

The Company is aware of the potential for industry wide business disruption which could be caused by computer systems, software products and embedded micro-processing chips which may be coded to accept only two-digit entries in the date code field and may not be able to distinguish 20th century dates from 21st century dates. The Company believes it has a prudent plan in place to address these issues within our Company and our supply chain.

STATE OF READINESS. The Company is engaged in a process of evaluating the Year 2000 readiness of hardware and software products sold by the Company ("Products"), information technology systems used in its operations ("IT Systems"), and its non-IT Systems such as building security, voice mail and other systems. The Company anticipates that the project will cover the following phases: (i) identification of all Products, IT Systems, and non-IT Systems; (ii) assessment of repair or replacement requirements; (iii) repair or replacement; (iv) testing; (v) implementation; and (vi) creation of contingency plans in the event of Year 2000 failures.

PRODUCTS. The Company has completed a review of the source code for all versions of its Products sold after January 1, 1997 and based on such review, the Company believes that such Products are "Year 2000 Compliant," meaning that when used properly and in conformity with the product information provided by the Company, the product furnished by the Company will accurately store, display, process, provide, and/or receive data from, into, and between 1999 and 2000, including leap year calculations, provided that all technology used in combination with the Company product properly exchanges date data with the Company product. In general, software provided by the Company does not require the user to input date fields and depends instead on date information supplied by host operating systems not manufactured by the Company. Therefore, the assessment of whether a complete system or device in which a Product is embedded will operate correctly for an end-user depends in large part on the Year 2000 Compliance of the system's other components, most of which are supplied by parties other than the Company. For this reason, end-users must consult with the manufacturers of host operating systems and test such systems in their entirety for Year 2000 Compliance. The Company has determined that it is not feasible to test versions of its Products sold prior to January 1, 1997. However, based on similarities in source code between prior and current Product versions, the Company believes that versions of its Products sold prior to January 1, 1997 are Year 2000 Compliant.

IT AND NON-IT SYSTEMS. The Company has compiled a comprehensive list of the Company's IT and non-IT systems. Based on the Company's internal assessment, the Company believes that most of these systems are Year 2000 Compliant. The source code underlying the Company's financial and accounting software has been reprogrammed and tested using the Company's internal technical resources. The Company has determined to its satisfaction that its financial and accounting systems are Year 2000 Compliant. The Company has identified three IT Systems which are not Year 2000 Compliant and the Company expects to purchase, install and test upgrades for such non-compliant systems by the end of October, 1999. The Company is dependent in part upon Microsoft software products to ensure completion of this task in a timely fashion.

THIRD PARTIES. The Company relies, both domestically and internationally, upon various vendors, governmental agencies, utility companies, telecommunications service companies, delivery service companies and other service providers who are outside of Mercury's control. The Company has completed a questionnaire-based assessment of its primary vendors to assess their ability to continue to provide goods and services to the Company from, into and between 1999 and 2000. While the Company has received assurances from vendors regarding their Year 2000 Compliance status, the Company may never be able to know with certainty whether its vendors are compliant. Failure of critical vendors to achieve Year 2000 Compliance could result in delayed deliveries of products and services to the Company. If such delays are extensive, they could have a material adverse effect on the Company's business.

COSTS. Most of the Company's effort toward Year 2000 readiness is funded as ongoing operating expense. The Company is in the process of determining the total cost of Year 2000 relevant upgrading. Expenditures directly related to the Year 2000 readiness program, consisting of dedicated staff and consulting services, are estimated to be less than $1,000,000.

RISKS. The failure to correct a material Year 2000 problem could result in an interruption in, or a failure of, certain normal business activities. Such failures could materially and adversely affect the Company's results of operations, liquidity and financial condition. Due to the general uncertainty inherent with the Year 2000 issue, resulting in large part from the uncertainty of the Year 2000 readiness of third-parties outside of the Company's control, the Company is unable to determine at this time whether the consequences of a Year 2000 failure will have a material impact on the Company's results of operations, liquidity, or financial position. The Year 2000 Compliance project is expected to reduce, but not eliminate, the Company's level of uncertainty about the Year 2000 issue and in particular, about the Year 2000 Compliance and readiness of its critical vendors. The Company believes that, with the completion of the Year 2000 Compliance project as scheduled, the possibility of significant interruptions to normal operations should be reduced.

CONTINGENCY PLAN. The Company is developing a contingency plan for its information technology infrastructure as well as non-IT elements. The Company expects that this plan will include provisions for additional customer and facility support. The contingency plan may also include obtaining component parts in December, 1999 rather than January, 2000 in the event vendors encounter Year 2000 problems. The Company expects that its contingency plan will be developed in greater detail if and when specific issues are identified.

RECENT ACCOUNTING PRONOUNCEMENTS

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK MANAGEMENT

Due to its short-term duration, the fair value of the Company's cash and investment portfolio at June 30, 1999 approximated carrying value. Interest rate risk is estimated as the potential decrease in fair value resulting from a hypothetical 10% increase in interest rates for issues contained in the investment portfolio. The resulting hypothetical fair value was not materially different from the year-end carrying value.

MARKET INFORMATION

The Company's Common Stock is traded in the over-the-counter market and is quoted on the Nasdaq National Market under the symbol MRCY. The following table sets forth, for the periods indicated since the Company's initial public offering on January 29, 1998, the high and low transactions per share during such periods. Such over-the-counter market quotations reflect inter-dealer prices without retail markup, markdown or commission.

		HIGH	LOW
1998	Third quarter (from January 29, 1998)	19 1/8	9 3/8
	Fourth quarter	19	12 1/4
1999	First quarter	17 3/8	9 3/4
	Second quarter	28 5/8	12 1/2
	Third quarter	28 1/4	17 1/8
	Fourth quarter	33 3/8	15 1/16

As of August 31, 1999 the Company had approximately 4,000 shareholders including record and nominee holders.

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

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE DATA) JUNE 30,	1999	1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,676	$ 6,054
Marketable securities	12,762	10,077
Trade accounts receivable, net of allowance for doubtful accounts of $376 and $218 at June 30, 1999 and 1998, respectively	28,915	17,143
Inventory	12,431	9,125
Deferred income taxes, net	2,617	1,669
Prepaid expenses and other current assets	1,392	1,255
Total current assets	61,793	45,323
Marketable securities	8,978	18,889
Property and equipment, net	25,325	8,466
Deferred income taxes, net	668	429
Other assets	747	462
Total assets	$97,511	$73,569
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,580	$ 3,368
Accrued expenses	3,694	2,804
Accrued compensation	4,292	3,316
Capital lease - short term	434	--
Billings in excess of revenues and customer advances	3,169	1,017
Income taxes payable	2,312	2,024
Total current liabilities	19,481	12,529
Commitments and contingencies (Note F)	--	--
Capital lease - long term	590	--
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; 25,000,000 shares authorized; 10,310,877 and 9,973,491 shares issued and outstanding at June 30, 1999 and 1998, respectively	103	100
Additional paid-in capital	28,515	25,961
Retained earnings	48,945	35,483
Accumulated other comprehensive income	(123)	(179)
Subscriptions and related parties notes receivable	--	(325)
Total stockholders' equity	77,440	61,040
Total liabilities and stockholders' equity	$97,511	$73,569

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA) YEAR ENDED JUNE 30,	1999	1998	1997
Revenues	$106,571	$85,544	$64,574
Cost of revenues	34,237	30,084	22,034
Gross profit	72,334	55,460	42,540
Operating expenses:			
Selling, general and administrative	33,002	27,879	22,631
Research and development	20,709	14,476	12,837
Total operating expenses	53,711	42,355	35,468
Income from operations	18,623	13,105	7,072
Interest income, net	1,285	1,084	560
Other income (expense), net	185	(30)	(88)
Income before income tax provision	20,093	14,159	7,544
Income tax provision	6,631	5,428	2,933
Net income	$ 13,462	$ 8,731	$ 4,611
Net income per common share:			
Basic	$ 1.32	$ 1.21	$ 0.90
Diluted	$ 1.25	$ 0.94	$ 0.58
Weighted average number of common and common equivalent shares outstanding:			
Basic	10,168	7,235	5,141
Diluted	10,800	9,270	7,897

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED June 30, 1999, 1998 AND 1997 (IN THOUSANDS)	Series A Convertible Preferred Stock		Common Stock		Add'l Paid-In Capital	Retained Earnings	Accumulated Other Compre-hensive Income	Compre-hensive Income	Subscriptions and Related Parties Notes Receivable	Total Stock-holder's Equity
	Shares	Amount	Shares	Amount						
Balance, June 30, 1996	852	$1,200	5,083	$ 51	$ 5,434	$22,141	$ 3		$(300)	$28,529
Issuance of notes receivable to related parties									(25)	(25)
Exercise of common stock options			86	1	137					138
Issuance of common stock			33		132					132
Comprehensive income:										
Net income						4,611		$ 4,611		4,611
Foreign currency translation							(63)	(63)		(63)
Comprehensive income								$ 4,548		
Balance, June 30, 1997	852	1,200	5,202	52	5,703	26,752	(60)		(325)	33,322
Exercise of common stock options			204	2	506					508
Issuance of common stock pursuant to initial public offering, net of issuance costs of $952			2,000	20	18,558					18,578
Conversion of series A convertible preferred stock into common stock	(852)	(1,200)	2,557	26	1,174					
Exercise of common stock warrants			10		20					20
Comprehensive income:										
Net income						8,731		8,731		8,731
Foreign currency translation							(119)	(119)		(119)
Comprehensive income								$ 8,612		
Balance June 30, 1998	--	--	9,973	100	25,961	35,483	(179)		(325)	61,040
Exercise of common stock options			309	3	1,213					1,216
Issuance of common stock in conjunction with employee stock purchase plan			29		469					469
Tax benefit from disqualified dispositions					826					826
Employee based stock compensation					46					46
Payment of notes by related parties									325	325
Comprehensive income:										
Net income						13,462		13,462		13,462
Unrealized loss on securities							(30)	(30)		(30)
Foreign currency translation							86	86		86
Comprehensive income								$13,518		
Balance June 30, 1999	--	--	10,311	$103	$28,515	$48,945	$(123)		--	$77,440

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS) YEAR ENDED JUNE 30,	1999	1998	1997
Cash flows from operating activities:			
Net income	$ 13,462	$ 8,731	$ 4,611
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property and equipment	3,916	2,829	2,855
Amortization of capitalized software development costs	602	490	438
Provision for inventory write-downs	2,786	1,583	504
Provision for doubtful accounts	249	99	40
Deferred income taxes	(1,187)	(1,133)	(596)
Tax benefit from disqualified dispositions	826	--	--
Other non-cash items	46	--	87
Changes in assets and liabilities:			
Trade accounts receivable	(11,871)	(4,596)	(2,710)
Trade notes receivable	--	--	296
Contracts in progress	--	1,096	(1,096)
Inventory	(6,048)	(2,398)	(1,662)
Prepaid expenses and other current assets	(108)	(560)	(246)
Other assets	(98)	(69)	(101)
Accounts payable	2,216	570	1,081
Accrued expenses and compensation	1,874	1,908	1,846
Billings in excess of revenues and customer advances	2,151	(1,847)	2,472
Income taxes payable	284	411	1,403
Net cash provided by operating activities	9,100	7,114	9,222
Cash flows from investing activities:			
Purchase of marketable securities	(114,574)	(73,571)	--
Sale of marketable securities	121,768	44,605	--
Purchases of property and equipment	(19,440)	(6,336)	(3,457)
Capitalized software development costs	(810)	(111)	(550)
Notes receivable from related parties	325	--	(25)
Net cash used in investing activities	(12,731)	(35,413)	(4,032)
Cash flows from financing activities:			
Proceeds from employee stock purchase program	469	--	--
Proceeds from exercise of stock options	1,216	508	--
Proceeds from issuance of common stock	--	18,578	270
Proceeds from exercise of stock warrants	--	20	--
Principal payments under capital lease obligations	(303)	--	--
Net cash provided by financing activities	1,382	19,106	270
Net increase in cash and cash equivalents	(2,249)	(9,193)	5,460
Effect of exchange rate changes on cash and cash equivalents	(129)	54	29
Cash and cash equivalents at beginning of year	6,054	15,193	9,704
Cash and cash equivalents at end of period	$ 3,676	$ 6,054	$15,193
Cash paid during the period for:			
Interest	$ 51	$ --	$ 22
Income taxes	7,155	6,166	2,133
Non-cash transactions:			
Equipment acquired under capital leases	$ 1,327	$ --	$ --
Series A convertible preferred stock converted to common stock	--	1,200	--

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

A. DESCRIPTION OF BUSINESS:

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

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

BASIS OF PRESENTATION

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

USE OF ESTIMATES

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

REVENUE RECOGNITION

Revenue from product sales is recorded upon completion of delivery obligations provided customer acceptance is reasonably assured and collectability is deemed probable. The Company accrues for anticipated warranty costs upon shipment. Service revenue is recognized ratably over applicable contract periods or as the services are performed. Revenue from contracts involving significant product modification or customization that are eligible for the percentage-of-completion accounting method are recognized on an efforts-expended basis. Changes to total estimated costs and anticipated losses, if any, are recognized in the period in which determined. There was no revenue recognized for year ended June 30, 1999 under the percentage-of-completion method while $3,835,000 and $2,102,000 of revenue was recognized under the percentage-of-completion method for the fiscal years ended June 30, 1998 and 1997, respectively. There were no retainages at June 30, 1999, 1998 or 1997.

BILLINGS IN EXCESS OF REVENUES AND CUSTOMER ADVANCES

Billings in excess of revenues and customer advances include amounts billed on uncompleted contracts and amounts billed on annual maintenance contracts.

CASH AND CASH EQUIVALENTS

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

MARKETABLE SECURITIES

The Company classifies investments in marketable securities as either trading, available-for-sale or held-to-maturity at the time of purchase and periodically re-evaluates such classification. There were no securities classified as trading or held-to-maturity as of June 30, 1999 and 1998. Securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at cost with corresponding premiums or discounts amortized over the life of the investment to interest income. Securities classified as available-for-sale are reported at fair market value. Unrealized gains or losses on available-for-sale securities are included, net of tax, in shareholders' equity until disposition. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in other income. The cost of securities sold is based on the specific identification method.

The fair market value of cash equivalents and short-term and long-term investments in marketable securities represents the quoted market prices at the balance sheet dates. The short-term marketable securities have original maturities greater than 90 days and remaining maturities less than one year. Long-term marketable securities have remaining maturities greater than one year. Long-term marketable securities have maturities of one to three years. At June 30, 1999 and 1998, marketable securities were classified as follows:

	1999 Available-For-Sale	1998 Available-For-Sale
Short-term marketable securities:		
Municipal/tax free bonds & money market instruments	$12,762	$10,077
Long-term marketable securities:		
Municipal/tax free bonds	$ 8,978	$18,889

CONCENTRATION OF CREDIT RISK

Financial instruments which potentially expose the Company to concentrations of credit risk consist principally of cash, marketable securities and trade accounts receivable. The Company places its cash and cash equivalents with financial institutions which management believes are of high credit quality. At June 30, 1999 and 1998, the Company had approximately $2,904,000 and $5,552,000, respectively, on deposit or invested with its primary financial and lending institution.

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

YEAR ENDED JUNE 30,	1999	1998
Customer A	--	32%
Customer B	27%	15%
Customer C	17%	13%
Customer D	11%	--

INVENTORY

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

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Equipment under capital lease is recorded at the present value of the minimum lease payments required during the lease period. Depreciation is based on the following estimated useful lives of the assets using the straight-line method:

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

Expenditures for additions, renewals and betterments of property and equipment are capitalized. Expenditures for repairs and maintenance are charged to expense as incurred. As assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations.

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

The Company capitalizes software development costs incurred after a product's technological feasibility has been established and before it is available for general release to customers. Amortization of capitalized software costs is computed on an individual product basis and is the greater of a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or b) the straight-line method over the estimated economic life of the product. Currently, the Company uses an estimated economic life of 24 months or less for all capitalized software costs.

RESEARCH AND DEVELOPMENT COSTS

All research and development costs are expensed as incurred except for capitalized software development costs.

INCOME TAXES

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the Company's consolidated financial statements. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using currently enacted tax rates for the year in which the differences are expected to reverse. The Company records a valuation allowance against net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

NET INCOME PER COMMON SHARE

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

FOREIGN CURRENCY
The accounts of foreign subsidiaries are translated using exchange rates in effect at period-end for assets and liabilities and at average exchange rates during the period for results of operations. The local currency for all foreign subsidiaries is the functional currency. The related translation adjustments are reported in accumulated other comprehensive income in stockholders' equity. Gains (losses) resulting from foreign currency transactions are included in other income (expense) and are immaterial for all periods presented.

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

NEW ACCOUNTING PRONOUNCEMENTS
In March 1998, the American Institute of Certified Public Accountants issued SOP 98-1, "Internal Use Software," which provides guidance on the accounting for the costs of software developed or obtained for internal use. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. The Company will adopt this statement's provisions for its fiscal year 2000 which commences on July 1, 1999. Management does not expect the statement to have a material impact on its financial position or results of operations.

In June 1999, the Financial Accounting Standards Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which was issued in June 1998. SFAS No. 137 defers the effective date of SFAS No. 133 to all fiscal quarters beginning after June 15, 2000. Accordingly, the Company will adopt the provisions of SFAS No. 133 for its fiscal year 2001 which commences on July 1, 2000. SFAS No. 133 requires that all derivative instruments must be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or accumulated other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and the type of hedge transaction. Management of the Company anticipates that, due to its limited use of derivative instruments, the adoption of SFAS No. 133 will not have a material impact on its financial position or results of operations.

C. NET INCOME PER COMMON SHARE:
The following table sets forth the computation of basic and diluted net income per common share:

FOR THE YEARS ENDED JUNE, 30	1999	1998	1997
Net Income	$13,462	$8,731	$4,611
Shares used in net income per common share-basic	10,168	7,235	5,141
Effect of dilutive securities:			
Convertible Preferred Stock	--	1,492	2,557
Stock options	632	542	194
Warrants	--	1	5
Dilutive potential common shares	632	2,035	2,756
Shares used in net income per common share - diluted	10,800	9,270	7,897
Net income per common share - basic	$ 1.32	$ 1.21	$ 0.90

Net income per common share - diluted	$ 1.25	$ 0.94	$ 0.58
	=======	======	======

Options to purchase 111,000 shares of common stock in 1999, 29,000 shares in 1998, and 36,000 in 1997 were outstanding during the years then ended but were not included in the year-to-date calculation of diluted net income per share because the options' exercise price was greater than the average market price of the common shares during those periods.

D. INVENTORY:
Inventory consists of the following:

JUNE 30,	1999	1998
Raw materials	$ 3,508	$4,707
Work in process	6,841	2,814
Finished goods	2,082	1,604
	-------	------
	$12,431	$9,125
	=======	======

E. PROPERTY AND EQUIPMENT:
Property and equipment consists of the following:

JUNE 30,	1999	1998
Computer equipment	$17,280	$14,027
Buildings	15,819	--
Land	1,852	--
Machinery and equipment	404	310
Furniture and fixtures	3,365	2,391
Building and leasehold improvements	1,334	1,159
Construction in progress	--	2,737
	-------	-------
	40,054	20,624
Less: accumulated depreciation and amortization	(14,729)	(12,158)
	-------	-------
	$25,325	$ 8,466
	=======	=======

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

F. COMMITMENTS AND CONTINGENCIES:
FINANCING ARRANGEMENT

During the fiscal years ended June 30, 1997 and 1998, the Company had a credit agreement with a commercial bank to borrow up to $5,000,000 at an interest rate equal to the prime rate or, at the election of the Company, two and one-quarter percentage points above the London InterBank Offered Rate, payable monthly. The credit agreement contained certain covenants, including restrictions on incurrence of additional indebtedness and liens on its assets, capital expenditures, disposition of assets, investments and acquisitions, limitations on distributions, and required the Company to meet certain financial tests pertaining to current and debt ratios and income before tax provision. There were no borrowings outstanding at June 30, 1998 or June 30, 1997. During the fiscal year ended June 30, 1999, the Company terminated this financing arrangement. Accordingly, there were no borrowings outstanding at June 30, 1999.

LEASE COMMITMENTS

The Company leases certain of its facilities and machinery and equipment under capital and operating leases expiring in various years through 2003 and thereafter. The leases contain various renewal options. Rental charges are subject to escalation for increases in certain operating costs of the lessor.

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

	Operating lease		Capital Lease
YEAR ENDING JUNE 30,	Real Estate	Equipment	Equipment
2000	$408	$363	492
2001	191	264	492
2002	175	--	137
2003	40	--	--
Thereafter	--	--	--
Total minimum lease payments	$814	$627	$1,121
Less: amounts representing interest			97
Present value of minimum lease payments			1,024
Less: current portion			434
Long term portion			$ 590

Rental expense during the fiscal years ended June 30, 1999, 1998 and 1997 was approximately $1,116,000, $1,029,000 and $642,000, respectively.

INTERNAL REVENUE SERVICE AUDIT

On December 12, 1997, the Internal Revenue Service ("IRS") concluded an audit of the Company's tax returns for the years ended June 30, 1992 through June 30, 1995, and issued a formal report reflecting proposed adjustments with respect to the years under audit. The proposed IRS adjustments primarily related to the disallowance of research and experimental tax credits claimed by the Company, as well as the treatment of certain other items. In June, 1999 the Company agreed to a final settlement with the IRS amounting to $585,000, including an estimated interest amount of $220,000. The Company had previously accrued a liability for this settlement and accordingly, no charge was recorded during the fiscal year ended June 30, 1999.

G. STOCKHOLDERS' EQUITY:

COMMON STOCK
On January 29, 1998, 3,500,000 shares of the Company's common stock were sold in the Company's initial public offering ("IPO") of which 2,000,000 shares were sold by the Company and 1,500,000 shares were sold by certain stockholders of the Company. The Company received $18,578,000 in net proceeds from the IPO after deducting underwriting discounts and commissions of $1,470,000 and $952,000 in offering expenses.

PREFERRED STOCK

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

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

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

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

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

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

RE-PRICING STOCK OPTIONS

On July 30, 1996, the Board approved a plan (the "Re-pricing Plan") to re-price employee stock options under the Plans to restore the long-term employee retention and performance incentives of the stock options outstanding. In accordance with the Re-pricing Plan, all stock options with exercise prices above $4.00 per share and approved by the individual option holder were canceled and replaced by the same number of options exercisable at $4.00 per share, the fair value of the Company's common stock as determined by the Board on the date of the re-pricing. In reaching this determination, the Board considered a broad range of factors including the illiquid nature of an investment in the Company's common stock, transactions of the Company's common stock with third parties, the Company's historical financial performance relative to that of comparable companies and its future prospects. Fifty percent of those options which were vested prior to the re-pricing vested immediately under the Re-pricing Plan. All remaining stock options, previously vested and unvested, had the same term as the original option grants but with the vesting schedule commencing July 30, 1996.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value of Options Granted
Outstanding at June 30, 1996	709,376	$ 4.02	
Granted	526,292	4.00	$ 1.64
Exercised	(85,850)	1.61	
Canceled	(305,226)	6.15	
Outstanding at June 30, 1997	844,592	3.41	
Granted	471,131	9.41	$ 5.27
Exercised	(204,468)	2.48	
Canceled	(16,693)	7.11	
Outstanding at June 30, 1998	1,094,562	6.11	
Granted	635,705	19.29	$12.07
Exercised	(309,162)	3.93	
Canceled	(38,227)	10.36	
Outstanding at June 30, 1999	1,382,878	12.54	

Information related to stock options outstanding as of June 30, 1999, is as follows:

Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable Number of Options	Exercisable Weighted Average Exercise Price
$ 2.00-$ 3.50	64,500	2.72	$ 2.64	64,300	$ 2.64
$ 4.00	306,243	7.37	4.00	142,909	4.00
$ 5.00-$ 7.50	11,900	4.58	7.35	11,500	7.35
$ 8.00	276,030	8.31	8.00	59,180	8.00
$10.00-$15.25	242,020	9.16	14.23	10,860	12.30
$15.63-$26.38	482,185	9.46	21.15	14,057	17.42
$ 2.00-$26.38	1,382,878	8.36	12.54	302,806	5.54

There were 377,240 and 473,890 options exercisable at June 30, 1998 and 1997, respectively, with weighted average exercise prices of $3.57 and $2.89. The fair value of each option granted during fiscal years ended June 30, 1999, 1998 and 1997, is estimated on the date of grant using the Black-Scholes option-pricing model utilizing the following weighted-average assumptions: (1) expected risk-free interest rate of 4.90% in 1999, 6.25% in 1998 and 6.80% in 1997; (2) expected option life of 6 years in 1999 and 1998 and 8 years in 1997; (3) expected stock volatility of 63% for June 30, 1999, 50% for June 30, 1998 and none for June 30, 1997; and (4) expected dividend yield of 0.0%.

EMPLOYEE STOCK PURCHASE PLAN

During 1997, the Company adopted the 1997 Employee Stock Purchase Plan ("ESPP") and authorized 250,000 shares for future issuance under which rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six month offering period. The plan permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the plan. During the two offerings in fiscal 1999, the Company issued 16,213 and 12,011 shares of common stock to employees who participated in the plan at prices of $11.90 and $22.95, respectively. Shares available for future purchase under the ESPP totaled 221,776 at June 30, 1999.

The weighted-average fair value of purchase rights granted in fiscal 1999 was $6.46. The fair value of the employees' purchase rights was estimated using the Black-Scholes model with the following assumptions; dividend yield of 0.0%, an expected life of 6 months, expected volatility of 63%, and risk-free interest rate of 4.90%.

Had compensation cost for the Company's stock option grants and stock issued in conjunction with the ESPP been determined based on the fair value at the grant dates, as calculated in accordance with SFAS No. 123, the Company's net income and net income per common share for the fiscal years ended June 30, 1999, 1998 and 1997, would approximate the following pro forma amounts as compared to the amounts reported:

	Net Income	Net Income per Common Share -Basic	Net Income per Common Share -Diluted
As reported:			
1999	$13,462	$1.32	$1.25
1998	$ 8,731	$1.21	$0.94
1997	$ 4,611	$0.90	$0.58
Pro forma:			
1999	$11,950	$1.18	$1.11
1998	$ 8,244	$1.14	$0.89
1997	$ 4,345	$0.85	$0.55

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

WARRANTS

At June 30, 1997 a warrant to purchase 10,000 shares of the Company's common stock was outstanding with an exercise price of $2.00 per share and exercisable through June 30, 2000. In September 1997 the warrants were exercised.

I. INCOME TAXES:

Income tax expense consisted of the following:

YEAR ENDED JUNE 30,	1999	1998	1997
Federal:			
Current	$6,377	$5,680	$3,088
Deferred	(479)	(1,172)	(592)
	5,898	4,508	2,496
State:			
Current	1,295	925	301
Deferred	(708)	(111)	(4)
	587	814	297
Foreign - current	146	106	140
	$6,631	$5,428	$2,933

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

YEAR ENDED JUNE 30,	1999	1998	1997
Income taxes at federal statutory rates	35.0%	35.0%	34.0%
State income tax, net of federal tax benefit and credits	1.9	3.7	3.9
Research and development credits utilized	(3.8)	(2.2)	(3.5)
Tax-exempt interest income	(1.8)	--	--
Other	1.7	1.8	4.5
	33.0%	38.3%	38.9%

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

JUNE 30,	1999	1998
Receivables, allowances and inventory reserves	$1,654	$ 810
Accrued vacation	368	620
Property and equipment	301	429
Capitalized software development costs	(125)	(42)
State tax credit carryforwards	491	--
Other temporary differences	596	281
Total deferred tax asset, net	$3,285	$2,098

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

At June 30, 1999, the Company had state research and development and investment tax credit carryforwards of approximately $502,000 and $254,000 respectively. Research and development credit carryforwards begin to expire in 2014 and investment tax credit carryforwards have no expiration.

J. EMPLOYEE BENEFIT PLANS:

The Company maintains a qualified profit sharing 401(a) Plan and 401(k) Plan. The plans cover employees who have attained the age of 21. Employee contributions to the 401(k) Plan may range from 1% to 15% of compensation with a discretionary matching Company contribution. The Company will match up to 2% of compensation. The Company may also make optional contributions to both plans for any plan year at its discretion.

Expense recognized by the Company under the 401(a) and 401(k) plans was approximately $1,000,000, $710,000 and $427,000 during the years ended June 30, 1999, 1998 and 1997, respectively.

The Company maintains a bonus plan which provides cash awards to employees, at the discretion of the Board of Directors, based upon operating results and employee performance. Bonus expense to employees was approximately $2,753,000, $1,988,000, and $1,245,000 during the years ended June 30, 1999, 1998 and 1997, respectively.

K. OPERATING SEGMENT AND GEOGRAPHIC INFORMATION:

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

Operating segments are defined as components of an enterprise evaluated regularly by the Company's senior management in deciding how to allocate resources and in assessing performance. The Company has seven principal operating segments: North American defense and commercial, medical imaging, international defense and commercial, shared storage, digital wireless, research and development, and other commercial businesses. These operating segments were determined based upon the nature of the products offer ed to customers, the market characteristics of each operating segment, and the Company's management structure. The Company has five reportable segments; North American defense and commercial segment, medical imaging segment, shared storage segment, other defense and commercial segment, and research and development segment. The other defense and commercial segment is comprised of international defense and commercial, digital wireless, and other commercial businesses unrelated to the defense, medical imaging or shared storage businesses. These operating segments are not separately reported, as they do not meet any of Statement No. 131's quantitative thresholds.

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

	North American Defense and Commercial Segment(2)	Medical Imaging Segment	Shared Storage Segment	Other Defense and Commercial Segment	Research and Development Segment	Corporate	Consolidated
1999							
Sales to unaffiliated customers	$79,906	$15,295	$ 2,232	$9,138	$ --	$ --	$ 106,571
Income (loss) before taxes(1)	53,174	6,353	(1,775)	2,747	(19,639)	(20,767)	20,093
Depreciation/ amortization expense	191	70	102	11	1,263	2,881	4,518
1998							
Sales to unaffiliated customers	$66,074	$11,232	$ 885	$7,353	$ --	$ --	$ 85,544
Income (loss) before taxes(1)	40,399	4,499	(3,423)	1,542	(12,917)	(15,941)	14,159
Depreciation/ amortization expense	155	68	52	15	924	2,105	3,319
1997							
Sales to unaffiliated customers	$50,921	$ 6,906	$ 2,128	$4,619	$ --	$ --	$ 64,574
Income (loss) before taxes(1)	30,781	2,303	(1,639)	1,318	(11,566)	(13,653)	7,544
Depreciation/ amortization expense	154	51	41	22	1,067	1,958	3,293

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

(2) The North American defense and commercial segment differs in definition from the defense market segment described in the Company's management discussion and analysis ("MD&A"). The defense market segment in the MD&A refers to the worldwide defense market. The North American defense and commercial segment is an operating segment as defined by Statement No. 131 and includes the defense business in North America only with some North American commercial business.

Foreign revenue is based on the country in which the legal subsidiary is domiciled. Foreign revenue and long-lived assets represent less than 10% of the Company's total revenue and long-lived assets for the fiscal years ended June 30, 1999, 1998, and 1997, respectively.

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

YEAR ENDED JUNE 30,	1999	1998	1997
Customer D	12%	10%	--
Customer E	--	--	10%
Customer F	16%	--	22%
Customer B	22%	20%	--
Customer A	--	10%	--

During the fiscal year ended June 30, 1998, Customer E was acquired by Customer B. During the fiscal year ended June 30, 1998, revenues to Customer E, on a stand alone basis, were approximately 5%.

L. SUBSEQUENT EVENTS:

On August 27, 1999, the Company signed a commitment letter with a commercial financing company to issue two 7.30%, senior secured financing notes ("the Notes"), due September 2014. The total principal value of the Notes amount to $14,500,000. The Company's corporate headquarters and an adjacent building with a combined cost basis of $17,670,000, secure the Notes.

On September 1, 1999, Mercury formed a new joint venture company ("AgileVision") with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television ("DTV"). Combining the intellectual property of both companies, this new venture is expected to provide the broadcast and cable industries with products and solutions that will significantly increase the flexibility of a digital television infrastructure. The new company will provide products and services that allow an economical entry point to DTVservices, with the option of expanding performance and features to meet the demands of the evolving DTVaudience. The Company is initially required to contribute $2.5 million in cash in addition to technology to the joint venture.

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Mercury Computer Systems, Inc. and its subsidiaries at June 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1999 in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts
July 29, 1999, except for the information
in the first and second paragraph of Note L
as to which the date is August 27, 1999
and September 1, 1999, respectively

SUPPLEMENTARY INFORMATION (UNAUDITED)

The following sets forth certain unaudited consolidated quarterly statements of operations data for each of the Company's last eight quarters. In management's opinion, this quarterly information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation for the periods presented. Such quarterly results are not necessarily indicative of future results of operations and should be read in conjunction with the audited consolidated financial statements of the Company and the notes thereto included elsewhere herein.

1999	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Revenues	$24,062	$25,598	$27,225	$29,686
Cost of revenues	8,460	8,606	8,229	8,942
Gross profit	15,602	16,992	18,996	20,744
Operating expenses:				
Selling, general and administrative	7,358	8,304	8,668	8,672
Research and development	4,707	4,669	5,373	5,960
Total operating expenses	12,065	12,973	14,041	14,632
Income from operations	3,537	4,019	4,955	6,112
Interest income, net	369	326	313	277
Other income (expense), net	45	261	(24)	(97)
Income before taxes	3,951	4,606	5,244	6,292
Provision for income taxes	1,422	1,572	1,835	1,802
Net income	$ 2,529	$ 3,034	$ 3,409	$ 4,490
Net income per common share:				
Basic	$ 0.25	$ 0.30	$ 0.33	$ 0.44
Diluted	$ 0.24	$ 0.28	$ 0.31	$ 0.41

1998	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Revenues	$19,039	$20,624	$22,364	$23,517
Cost of revenues	6,661	7,283	7,832	8,308
Gross profit	12,378	13,341	14,532	15,209
Operating expenses:				
Selling, general and administrative	6,645	6,846	7,104	7,284
Research and development	3,381	3,405	3,749	3,941
Total operating expenses	10,026	10,251	10,853	11,225
Income from operations	2,352	3,090	3,679	3,984
Interest income, net	231	219	266	368
Other income (expense), net	83	(125)	(10)	22
Income before taxes	2,666	3,184	3,935	4,374
Provision for income taxes	1,060	1,210	1,496	1,662
Net income	$ 1,606	$ 1,974	$ 2,439	$ 2,712
Net income per common share:				
Basic	$ 0.31	$ 0.37	$ 0.29	$ 0.27
Diluted	$ 0.20	$ 0.24	$ 0.24	$ 0.25

EXHIBIT 21.1

SUBSIDIARIES OF THE REGISTRANT

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

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-53291) of Mercury Computer Systems, Inc. of our report dated July 29, 1999, except for the information in the first and second paragraph of Note L as to which date is August 27, 1999 and September 1, 1999, respectively, relating to the consolidated financial statements, which appears in the Annual Report to Shareholders, which is incorporated by reference in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report dated July 29, 1999, relating to the financial statement schedule, which appears in this Form 10-K.

PricewaterhouseCoopers LLP

Boston, Massachusetts
September 24, 1999

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U.S. DOLLARS

12-MOS
JUN-30-1999
JUL-01-1998
JUN-30-1999
1
3,676
21,740
28,915
376
12,431
61,793
40,054
14,729
97,511
19,481
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0
0
103
77,337
97,511
106,571
106,571
34,237
34,237
52,241
0
0
20,093
6,631
13,462
0
0
0
13,462
1.32
1.25