MERCURY COMPUTER SYSTEMS INC
Form 10-Q
May 11, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

OR

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

COMMISSION FILE NUMBER: 0-23599

MERCURY COMPUTER SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

978-256-1300

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

Shares of Common Stock outstanding as of April 30, 2009: 22,650,615 shares

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MERCURY COMPUTER SYSTEMS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCURY COMPUTER SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	March 31, 2009	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 40,584	$ 59,045
Marketable securities		60,205
Accounts receivable, net of allowance of $531 and $508 at March 31, 2009 and June 30, 2008, respectively	33,811	29,995
Inventory	18,890	24,202
Prepaid expenses and other current assets	3,261	7,862
Current assets of discontinued operations	1,742	4,534
Total current assets	98,288	185,843
Marketable securities	44,981	47,231
Put option to sell auction rate securities	5,194	
Property and equipment, net	8,539	10,053
Goodwill	57,653	57,653
Acquired intangible assets, net	3,371	4,718
Other non-current assets	3,874	5,520
Non-current assets of discontinued operations	7,989	27,532
Total assets	$ 229,889	$ 338,550
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 13,607	$ 13,647
Accrued expenses	6,391	8,674
Accrued compensation	8,581	8,249
Notes payable	5,312	125,000
Borrowings under line of credit and current capital lease obligations	33,426	277
Income taxes payable	1,020	580
Deferred revenues and customer advances	7,048	10,521
Current liabilities of discontinued operations	7,816	12,810
Total current liabilities	83,201	179,758
Notes payable and non-current portion of capital lease obligations	7	18
Accrued compensation		1,709
Deferred tax liabilities, net	83	285
Deferred gain on sale-leaseback	8,159	9,027
Other non-current liabilities	1,187	919
Non-current liabilities of discontinued operations	9	322

Total liabilities	92,646	192,038
Commitments and contingencies (Note J)		
Shareholders equity:		
Preferred stock, $.01 par value; 1,000,000 shares authorized; no shares issued or outstanding		
Common stock, $.01 par value; 85,000,000 shares authorized; 22,228,815 and 21,972,158 shares issued and outstanding at March 31, 2009 and June 30, 2008, respectively	222	220
Additional paid-in capital	104,906	100,268
Retained earnings	30,357	40,575
Accumulated other comprehensive income	1,758	5,449
Total shareholders equity	137,243	146,512
Total liabilities and shareholders equity	$ 229,889	$ 338,550

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

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MERCURY COMPUTER SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	Three months ended March 31,		Nine months ended March 31,	
	2009	**2008**	**2009**	**2008**
Net revenues	$ 50,563	$ 50,674	$ 140,497	$ 140,572
Cost of revenues	21,380	22,308	60,983	57,611
Gross profit	29,183	28,366	79,514	82,961
Operating expenses:				
Selling, general and administrative	12,584	16,685	38,666	49,097
Research and development	11,118	11,992	33,001	34,548
Amortization of acquired intangible assets	498	1,291	1,955	3,871
Restructuring	239	1,054	713	1,253
Total operating expenses	24,439	31,022	74,335	88,769
Income (loss) from operations	4,744	(2,656)	5,179	(5,808)
Interest income	239	1,541	1,920	5,753
Interest expense	(497)	(839)	(2,280)	(2,522)
Other income, net	317	476	120	995
Income (loss) from continuing operations before income taxes	4,803	(1,478)	4,939	(1,582)
Income tax expense	101	732	101	1,916
Income (loss) from continuing operations	4,702	(2,210)	4,838	(3,498)
Loss from discontinued operations, net of income tax benefit of $112 and $758 for the three months ended March 31, 2009 and 2008, respectively, and income tax (benefit) expense of ($112) and $1,288 for the nine months ended March 31, 2009 and 2008, respectively	(704)	(3,429)	(19,696)	(11,536)
Gain on sale of discontinued operations, net of income tax expense of $0	4,152		4,640	
Net income (loss)	$ 8,150	$ (5,639)	$ (10,218)	$ (15,034)
Basic net earnings (loss) per share:				
Earnings (loss) from continuing operations	$ 0.21	$ (0.10)	$ 0.22	$ (0.16)
Loss from discontinued operations	(0.03)	(0.16)	(0.89)	(0.54)
Gain on sale of discontinued operations	0.19		0.21	
Net earnings (loss)	$ 0.37	$ (0.26)	$ (0.46)	$ (0.70)
Diluted net earnings (loss) per share:				
Earnings (loss) from continuing operations	$ 0.21	$ (0.10)	$ 0.22	$ (0.16)
Loss from discontinued operations	(0.03)	(0.16)	(0.88)	(0.54)
Gain on sale of discontinued operations	0.18		0.20	
Net earnings (loss)	$ 0.36	$ (0.26)	$ (0.46)	$ (0.70)

Weighted-average shares outstanding:				
Basic	22,208	21,689	22,113	21,590
Diluted	22,486	21,689	22,374	21,590

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

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MERCURY COMPUTER SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Cash flows from operating activities:		
Net loss	$ (10,218)	$ (15,034)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,493	12,132
Stock-based compensation	4,630	9,412
Impairment of goodwill and long-lived assets	14,555	
Deferred income taxes	(176)	2,948
Non-cash interest	780	634
Gross tax windfall from stock-based compensation	(601)	(226)
Gain on sale of discontinued operations	(4,640)	
Other non-cash income	(868)	(796)
Changes in operating assets and liabilities, net of effects of businesses acquired and disposed of:		
Accounts receivable	(4,334)	(830)
Inventory	5,305	(6,012)
Prepaid expenses and other current assets	5,141	3,767
Other assets	386	358
Accounts payable and accrued expenses	(4,267)	(1,991)
Deferred revenues and customer advances	(3,313)	5,860
Income taxes payable	(258)	780
Other long term liabilities	(1,759)	259
Net cash provided by operating activities	7,856	11,261
Cash flows from investing activities:		
Purchases of marketable securities	(138,583)	(122,776)
Sales and maturities of marketable securities	198,878	178,325
Purchases of property and equipment	(3,188)	(3,016)
Acquisition of businesses, net of cash acquired		(2,400)
Proceeds from life insurance policies redemption	831	324
Proceeds from sale of discontinued operations	819	
Net cash provided by investing activities	58,757	50,457
Cash flows from financing activities:		
Proceeds from employee stock plans	413	1,146
Borrowings under line of credit	33,316	
Gross tax windfall from stock-based compensation	601	226
Repurchases of common stock	(404)	(516)
Payments of principal under notes payable	(119,688)	
Payments of capital lease obligations	(178)	(91)
Net cash (used in) provided by financing activities	(85,940)	765

Effect of exchange rate changes on cash and cash equivalents	866	218
Net (decrease) increase in cash and cash equivalents	(18,461)	62,701
Cash and cash equivalents at beginning of period	59,045	51,293
Cash and cash equivalents at end of period	$ 40,584	$ 113,994
Cash (received) paid during the period for:		
Interest	$ 1,868	$ 1,252
Income taxes, net	(3,911)	98
Supplemental disclosures non-cash activities:		
Issuance of restricted stock awards to employees	$ 51	$ 3,155

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

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MERCURY COMPUTER SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

A. Description of Business

Mercury Computer Systems, Inc. (the Company or Mercury) designs, manufactures and markets high-performance computer signal and image processing systems and software for embedded and other specialized computing markets. The Company s primary market segments are aerospace and defense which includes systems for radar, electronic warfare, sonar, C4I (Command, Control, Communications, Computers, and Intelligence) and electro-optical; life sciences which includes systems for medical diagnostic imaging & visualization; semiconductor which includes systems for semiconductor wafer inspection, reticle inspection and mask writing; and telecommunications applications.

B. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to the Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures, normally included in annual consolidated financial statements have been condensed or omitted pursuant to those rules and regulations; however, in the opinion of management the financial information reflects all adjustments, consisting of adjustments of a normal recurring nature, necessary for fair presentation. These consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended June 30, 2008 which are contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC). The results for the three and nine months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full fiscal year.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated. For the three- and nine-month periods ending March 31, 2008, the consolidated financial statements, excluding the statement of cash flows, were reclassified to reflect the discontinuation and sale of the Biotech business (Biotech), the Embedded Systems and Professional Services (ES/PS) businesses and the Visage Imaging (VI) business, as well as the expected sale of the Visualization Sciences Group (VSG) business, in accordance with Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long-Lived Asset* (see Note M).

Effective July 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), for financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. As permitted by FASB Staff Position (FSP) No. SFAS 157-2, *Effective Date of FASB Statement No.* 157, the Company has elected to defer implementation of SFAS 157 as it relates to its non-financial assets and non-financial liabilities that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis until July 1, 2009. Such adoption did not have a material impact on the Company s financial position or results of operations. See Note R for disclosures regarding the fair value of the Company s financial instruments.

Effective July 1, 2008, the Company adopted the provisions of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates (the fair value option) and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The Company chose not to elect the fair value option for its financial assets and liabilities existing on July 1, 2008, and did not elect the fair value option for any

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financial assets and liabilities transacted during the nine months ended March 31, 2009, except for a put option related to the Company s auction rate securities (ARS) that was recorded in conjunction with a settlement agreement with UBS (see Note R).

Effective October 2008, the Company adopted the provisions of the FASB issued FSP SFAS 157-3, *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active* (FSP 157-3), which clarifies how an entity would determine fair value in an inactive market. The application of the provisions of FSP 157-3 did not materially impact the Company s financial position or results of operations.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures the identifiable assets and goodwill acquired, liabilities assumed and noncontrolling interests. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R will be effective for the Company on July 1, 2009, and will be applied to any business combination with an acquisition date, as defined therein, that is subsequent to the effective date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). The new standard requires enhanced disclosures to enable investors to better understand the effects of derivative instruments and hedging activities on an entity s financial position, results of operations and cash flows. SFAS 161 will be effective for the Company on July 1, 2009. The Company does not believe that the adoption of SFAS 161 will have a material effect on its financial position or results of operations.

In April 2008, the FASB issued FSP 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). FSP 142-3 improves the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R and other applicable accounting literature. FSP 142-3 will be effective for the Company on July 1, 2009. The Company does not believe that the adoption of FSP 142-3 will have a material effect on its financial position or results of operations.

In April 2009, the FASB issued FSP SFAS 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly* (FSP 157-4). FSP 157-4 affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The FSP provides guidance for estimating fair value when the volume and level of market activity for an asset or liability have significantly decreased and determining whether a transaction was orderly. This FSP applies to all fair value measurements when appropriate. FSP 157-4 is effective for the Company for the quarterly period beginning April 1, 2009. The Company does not expect that the adoption of FSP 157-4 will have a material impact on its financial position or results of operations.

In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2). FSP 115-2 amends existing guidance for determining whether an other-than-temporary impairment of debt securities has occurred. Additionally, FSP 115-2 changes the amount of an other-than-temporary impairment that is recognized in earnings when there are credit losses on a debt security for which management does not intend to sell and for which it is more-likely-than-not that the entity will not have to sell prior to recovery of the noncredit impairment. FSP 115-2 is effective for the Company for the quarterly period beginning April 1, 2009. The Company does not expect the adoption of FSP 115-2 will have a material impact on its financial position or results of operations.

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C. Stock-Based Compensation

Stock Option Plans

The number of shares authorized for issuance under the Company s 2005 Stock Incentive Plan, as amended and restated (the 2005 Plan) is 2,592,264 shares, which will be increased by any future cancellations, forfeitures or terminations (other than by exercise) under the Company s 1997 Stock Option Plan (the 1997 Plan). The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company s common stock at the date of grant and the options generally have a term of seven or ten years. There were 1,379,878 shares available for future grant under the 2005 Plan at March 31, 2009.

The number of shares authorized for issuance under the 1997 Plan was 8,650,000 shares, of which 100,000 shares could be issued pursuant to restricted stock grants. The 1997 Plan provided for the grant of non-qualified and incentive stock options and restricted stock to employees and non-employees. All stock options were granted with an exercise price of not less than 100% of the fair value of the Company s common stock at the date of grant. The options vest over periods of zero to six years and have a maximum term of 10 years. Following shareholder approval of the 2005 Plan on November 14, 2005, the Company s Board of Directors directed that no further grants of stock options or other awards would be made under the 1997 Plan, and the 1997 Plan subsequently expired in June 2007. The foregoing does not affect any outstanding awards under the 1997 Plan, which remain in full force and effect in accordance with their terms.

Employee Stock Purchase Plan

During 1997, the Company adopted the 1997 Employee Stock Purchase Plan (ESPP) and authorized 500,000 shares for future issuance. In November 2006, the Company s shareholders approved an increase in the number of authorized shares under the ESPP to 800,000 shares. Under the plan, 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. There were 46,220 and 40,882 shares issued under the ESPP during the nine months ended March 31, 2009 and 2008, respectively. Shares available for future purchase under the ESPP totaled 98,104 at March 31, 2009.

Stock Option and Award Activity

The following table summarizes activity of the Company s stock option plans since June 30, 2007:

	Options Outstanding		
	Number of Shares	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (Years)**
Outstanding at June 30, 2007	**2,984,211**	**$ 19.39**	**6.26**
Grants	1,154,400	10.05	
Exercises	(100,828)	7.73	
Cancellations	(305,112)	18.32	
Outstanding at June 30, 2008	**3,732,671**	**$ 16.88**	**6.20**
Grants	612,464	6.44	
Exercises	(21,790)	7.68	
Cancellations	(877,371)	18.23	
Outstanding at March 31, 2009	**3,445,974**	**$ 14.73**	**5.73**

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The following table summarizes the status of the Company s nonvested restricted stock awards since June 30, 2007:

	Nonvested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2007	**1,291,212**	**$ 13.53**
Granted	264,035	12.44
Vested	(464,381)	13.23
Forfeited	(224,743)	14.18
Outstanding at June 30, 2008	**866,123**	**$ 13.18**
Granted	8,200	6.22
Vested	(246,908)	13.04
Forfeited	(173,680)	13.53
Outstanding at March 31, 2009	**453,735**	**$ 13.00**

Stock-based Compensation Assumptions and Expense

The Company recognized the full impact of its share-based payment plans in the consolidated statements of operations for the three and nine months ended March 31, 2009 and 2008 in accordance with SFAS No. 123R (SFAS 123R), *Share-Based Payment*, and did not capitalize any such costs on the consolidated balance sheets, as such costs that qualified for capitalization were not material. Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period. The following table presents share-based compensation expenses included in the Company s consolidated statements of operations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Cost of revenues	$ 69	$ 228	$ 278	$ 475
Selling, general and administrative	877	1,919	3,391	5,999
Research and development	276	573	1,001	1,655
Share-based compensation expense before tax	1,222	2,720	4,670	8,129
Income tax benefit				
Net compensation expense	$ 1,222	$ 2,720	$ 4,670	$ 8,129

The following table sets forth the weighted-average key assumptions and fair value results for stock options granted during the three and nine month periods ended March 31, 2009 and 2008:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Weighted-average fair value of options granted	$ 3.67	$ 2.80	$ 3.68	$ 4.53
Option life(1)	5.5 years	5.0 years	5.5 years	5.0 years
Risk-free interest rate(2)	1.5%	2.6%	2.4%	3.2%
Stock volatility(3)	77%	44%	64%	41%
Dividend rate	0%	0%	0%	0%

(1) The option life was determined based upon historical option activity.

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(2) The risk-free interest rate for each grant is equal to the U.S. Treasury yield curve in effect at the time of grant for instruments with a similar expected life.

(3) The stock volatility for each grant is measured using the weighted average of historical daily price changes of the Company s common stock over the most recent period equal to the expected option life of the grant, the historical short-term trend of the option and other factors, such as expected changes in volatility arising from planned changes in the Company s business operations.

The following table sets forth the weighted-average key assumptions and fair value results for employees stock purchase rights during the three and nine month periods ended March 31, 2009 and 2008:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Weighted-average fair value of stock purchase rights granted	$ 3.19	$ 6.10	$ 3.04	$ 4.23
Option life	6 months	6 months	6 months	6 months
Risk-free interest rate	0.3%	1.5%	1.4%	3.3%
Stock volatility	122%	85%	105%	54%
Dividend rate	0%	0%	0%	0%

D. Net Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted net earnings (loss) per share (in thousands, except share and per share data):

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Income (loss) from continuing operations basic	$ 4,702	$ (2,210)	$ 4,838	$ (3,498)
Loss from discontinued operations	(704)	(3,429)	(19,696)	(11,536)
Gain on sale of discontinued operations	4,152		4,640	
Net income (loss)	$ 8,150	$ (5,639)	$ (10,218)	$ (15,034)
Shares used in computation of net earnings (loss) per share basic	22,208	21,689	22,113	21,590
Effect of dilutive stock options and restricted stock	278		261	
Shares used in computation of net earnings (loss) per share diluted	22,486	21,689	22,374	21,590
Net earnings (loss) per share basic				
Continuing operations	$ 0.21	$ (0.10)	$ 0.22	$ (0.16)
Loss from discontinued operations	(0.03)	(0.16)	(0.89)	(0.54)
Gain on sale of discontinued operations	0.19		0.21	
Net earnings (loss)	$ 0.37	$ (0.26)	$ (0.46)	$ (0.70)
Net earnings (loss) per share diluted				
Continuing operations	$ 0.21	$ (0.10)	$ 0.22	$ (0.16)
Loss from discontinued operations	(0.03)	(0.16)	(0.88)	(0.54)
Gain on sale of discontinued operations	0.18		0.20	
Net earnings (loss)	$ 0.36	$ (0.26)	$ (0.46)	$ (0.70)

Weighted average equity instruments to purchase 3,626,011 and 3,922,518 shares of common stock were not included in the calculation of diluted net loss per share for the three and nine months ended March 31, 2009, 10

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respectively, because the equity instruments were antidilutive. Weighted average equity instruments to purchase 4,242,879 and 4,141,780 shares of common stock were not included in the calculation of diluted net loss per share for the three and nine months ended March 31, 2008, respectively, because the equity instruments were antidilutive. Additionally, the 1,715,439 and 3,328,480 shares which represent the securities that were contingently issuable under the Company s outstanding Convertible Senior Notes were not included in the diluted net earnings (loss) per share for the three and nine months ended March 31, 2009, respectively, because the equity instruments were antidilutive. The 4,135,000 shares which represent the securities that were contingently issuable under the Company s outstanding Convertible Senior Notes were not included in the diluted net loss per share for the three and nine months ended March 31, 2008, because the equity instruments were antidilutive.

E. Marketable Securities

The Company s investments consist mainly of treasury bills and student loan auction rate securities (ARS). The ARS debt securities are all highly rated investments with AAA/Aaa ratings and are supported by the federal government as part of the Federal Family Education Loan Program (FFELP) and by private insurance companies. The ARS investments have contractual terms from 30 to 40 years, but generally have interest rate reset dates that occur every seven to 30 days. The auction mechanism generally allows existing investors to roll over their holdings and continue to own their securities or liquidate their holdings by selling their securities at par value.

Beginning in mid-February 2008, auctions held for the Company s auction rate securities failed. As a result, the Company was not able to access these funds, and therefore, the ARS investments were determined to lack short-term liquidity and were classified as non-current in the consolidated balance sheet. In October 2008, the Company received a rights offering from UBS (the offering) in which the Company elected to participate. By electing to participate in the offering, the Company (1) received the right (put option) to sell these ARS back to UBS at par plus interest, at its sole discretion, during a two-year period beginning on June 30, 2010, and (2) received an option to borrow up to 75% of the fair value of the ARS at no net cost. Upon borrowing against the ARS, the Company would forgo the interest income on the underlying ARS, while the borrowings are outstanding and in return would not be charged any interest expense. The ARS had a par value of approximately $50,250 at March 31, 2009.

The Company elected to measure the put option under the fair value option of SFAS No. 159, and recorded expense of $2,809 and income of $5,194 pre-tax in the three and nine months ended March 31, 2009, respectively. The Company also transferred these ARS from available-for-sale to trading investment securities. As a result of this transfer, the Company recognized an other-than-temporary impairment gain of $2,882 and a loss of $5,270 pre-tax in the three and nine months ended March 31, 2009, respectively. The recording of the put option and the recognition of the other-than-temporary impairment loss resulted in an immaterial impact to the consolidated statement of operations for the three and nine month periods ended March 31, 2009. The put option will continue to be measured at fair value utilizing Level 3 inputs until the earlier of its maturity or exercise.

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The following table summarizes the marketable securities of the Company as of March 31, 2009 and June 30, 2008:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-Sale Securities				
JUNE 30, 2008				
Short-term marketable securities:				
Government and agency securities	$ 60,217	$	$ (12)	$ 60,205
Long-term marketable securities:				
Auction rate securities	$ 50,265	$	$ (3,034)	$ 47,231

	Amortized Cost	Gross Realized Gains	Gross Realized Losses	Fair Market Value
Trading Securities				
MARCH 31, 2009				
Long-term marketable securities:				
Auction rate securities	$ 50,282	$	$ (5,301)	$ 44,981

The Company s investments in long-term marketable securities, which consist entirely of auction rate securities, had remaining maturities up to 40 years as of March 31, 2009 and June 30, 2008. For the year ended June 30, 2008, realized gains and losses from the sale of available-for-sale securities were immaterial.

F. Comprehensive Income (Loss)

Total comprehensive income (loss) was as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Net income (loss)	$ 8,150	$ (5,639)	$ (10,218)	$ (15,034)
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(525)	2,625	(2,906)	5,903
Recognition of foreign currency gain	(3,894)		(3,894)	
Decrease (increase) in unrealized loss on marketable securities	41	(2,257)	3,109	(2,136)
Other comprehensive (loss) income	(4,378)	368	(3,691)	3,767
Total comprehensive income (loss)	$ 3,772	$ (5,271)	$ (13,909)	$ (11,267)

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G. Inventory

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

	March 31, 2009	June 30, 2008
Raw materials	$ 6,940	$ 8,702
Work in process	8,460	9,488
Finished goods	3,490	6,012
Total	$ 18,890	$ 24,202

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

H. Operating Segment, Significant Customers and Geographic Information

Operating segments are defined as components of an enterprise evaluated regularly by the Company s senior management in deciding how to allocate resources and assess performance. These reportable segments were determined based upon the nature of the products offered to customers, the market characteristics of each operating segment and the Company s management structure:

Advanced Computer Systems (ACS) This segment provides high-performance embedded computer systems as standard products to the defense, semiconductor, telecommunications and life sciences markets by using commercial off-the-shelf (COTS) and selected rugged components. This segment also provides simulation software (commercial and defense) and customized design services to meet the specified requirements of military and commercial applications.

Emerging Businesses Unit (EBU) This segment focuses on cultivation of new business opportunities that benefit from the Company s capabilities across markets. Current areas of focus include services and support work with federal intelligence agencies and homeland security programs. This business unit previously included the Biotech business, which was disposed of in September 2008 (see Note M), and the Avionics and Unmanned Systems Group (AUSG) reporting unit, which has been shut down following the April 2008 licensing of certain intellectual property (see Note Q). This operating segment now consists primarily of the Company s wholly-owned subsidiary, Mercury Federal Systems, Inc. (MFS).

Prior year results have been reclassified for the discontinuation of the Visage Imaging (VI) and Visualization Sciences Group (VSG) operating segments and for sale of the Biotech business. These operating segments were reclassified into the discontinued operations line items on the consolidated balance sheets and consolidated statements of operations (see Note M).

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The accounting policies of the reportable segments are the same as those described in Note B: Summary of Significant Accounting Policies in the Company s Annual Report filed on Form 10-K for the fiscal year ended June 30, 2008. The profitability measure employed by the Company and its chief operating decision maker for making decisions about allocating resources to segments and assessing segment performance is income (loss) from operations prior to stock compensation expense. As such, stock compensation expense has been excluded from each operating segments income (loss) from operations below and reported separately to reconcile the reported segment income (loss) from operations to the consolidated operating income (loss) reported in the consolidated statements of operations. Additionally, asset information by reportable segment is not reported because the Company does not produce such information internally. The following is a summary of the performance of the Company s operations by reportable segment:

	ACS	EBU	Stock Compensation Expense	Eliminations	Total
THREE MONTHS ENDED MARCH 31, 2009					
Net revenues to unaffiliated customers	$ 48,599	$ 1,964	$	$	$ 50,563
Intersegment revenues	736	78		(814)	
Net revenues	49,335	2,042		(814)	50,563
Income (loss) from operations	5,891	116	(1,222)	(41)	4,744
Depreciation and amortization expense	1,855	6			1,861
THREE MONTHS ENDED MARCH 31, 2008					
Net revenues to unaffiliated customers	$ 50,313	$ 361	$	$	$ 50,674
Intersegment revenues					
Net revenues	50,313	361			50,674
Income (loss) from operations	3,292	(3,228)	(2,720)		(2,656)
Depreciation and amortization expense	3,061	61			3,122
NINE MONTHS ENDED MARCH 31, 2009					
Net revenues to unaffiliated customers	$ 137,028	$ 3,469	$	$	$ 140,497
Intersegment revenues	791	219		(1,010)	
Net revenues	137,819	3,688		(1,010)	140,497
Income (loss) from operations	10,725	(817)	(4,670)	(59)	5,179
Depreciation and amortization expense	6,238	19			6,257
NINE MONTHS ENDED MARCH 31, 2008					
Net revenues to unaffiliated customers	$ 139,178	$ 1,394	$	$	$ 140,572
Intersegment revenues					
Net revenues	139,178	1,394			140,572
Income (loss) from operations	7,905	(5,584)	(8,129)		(5,808)
Depreciation and amortization expense	9,436	177			9,613

ACS results for the nine months ended March 31, 2009 and for the three and nine months ended March 31, 2008 have been adjusted to include the absorption of corporate costs that were previously allocated to the VI and VSG operating segments.

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The geographic distribution of the Company s revenues from continuing operations is summarized as follows:

	US	Europe	Asia Pacific	Eliminations	Total
THREE MONTHS ENDED MARCH 31, 2009					
Net revenues to unaffiliated customers	$ 46,933	$ 3,080	$ 550	$	$ 50,563
Inter-geographic revenues	2,574	307	42	(2,923)	
Net revenues	49,507	3,387	592	(2,923)	50,563
THREE MONTHS ENDED MARCH 31, 2008					
Net revenues to unaffiliated customers	$ 43,847	$ 2,961	$ 3,866	$	$ 50,674
Inter-geographic revenues	4,369	171	153	(4,693)	
Net revenues	48,216	3,132	4,019	(4,693)	50,674
NINE MONTHS ENDED MARCH 31, 2009					
Net revenues to unaffiliated customers	$ 132,132	$ 6,715	$ 1,650	$	$ 140,497
Inter-geographic revenues	5,952	743	226	(6,921)	
Net revenues	138,084	7,458	1,876	(6,921)	140,497
NINE MONTHS ENDED MARCH 31, 2008					
Net revenues to unaffiliated customers	$ 127,703	$ 5,569	$ 7,300	$	$ 140,572
Inter-geographic revenues	9,123	558	311	(9,992)	
Net revenues	136,826	6,127	7,611	(9,992)	140,572

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

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

	US	Europe	Asia Pacific	Eliminations	Total
March 31, 2009	$ 11,479	$ 44	$ 590		$ 12,113
June 30, 2008	14,994	55	524		15,573

Identifiable long-lived assets exclude deferred tax accounts, marketable securities, put option, goodwill, intangible assets and investments in subsidiaries.

Customers comprising 10% or more of the Company s revenues for the three and nine months ended March 31, 2009 and 2008 as shown in the tables below. Revenues from any significant customer may include revenues related to several different defense programs.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Customer A	10.2%	*%	12.1%	*%
Customer B	17.2	26.3	13.8	15.4
Customer C	11.4	*	14.5	*
Customer D	11.5	*	*	*
	50.3%	26.3%	40.4%	15.4%

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

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I. Goodwill and Acquired Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended March 31, 2009 and the year ended June 30, 2008 were as follows:

	ACS	EBU	Total
JUNE 30, 2007 BALANCE	$ 57,653	$ 561	$ 58,214
Goodwill impairment		(561)	(561)
JUNE 30, 2008 AND MARCH 31, 2009 BALANCE	$ 57,653	$	$ 57,653

In April 2008, the Company determined that it was required to perform an interim evaluation for its AUSG reporting unit which was a component of the Emerging Business Unit. Based on this evaluation an impairment charge of $561 was recorded. The Company also performed its fiscal 2008 annual impairment test as of May 31, 2008, which resulted in the identification of no additional goodwill impairment charges.

Acquired intangible assets consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Average Useful Life
March 31, 2009				
Completed technology	$ 14,030	$ (13,321)	$ 709	3.2 years
Customer relationships	7,270	(5,238)	2,032	5.2 years
Licensing agreements, trademarks and patents	3,506	(3,311)	195	4.6 years
Non-compete agreements	500	(65)	435	5.0 years
	$ 25,306	$ (21,935)	$ 3,371	
June 30, 2008				
Completed technology	$ 14,030	$ (12,761)	$ 1,269	3.2 years
Customer relationships	7,270	(4,195)	3,075	5.2 years
Licensing agreements, trademarks and patents	3,406	(3,032)	374	5.0 years