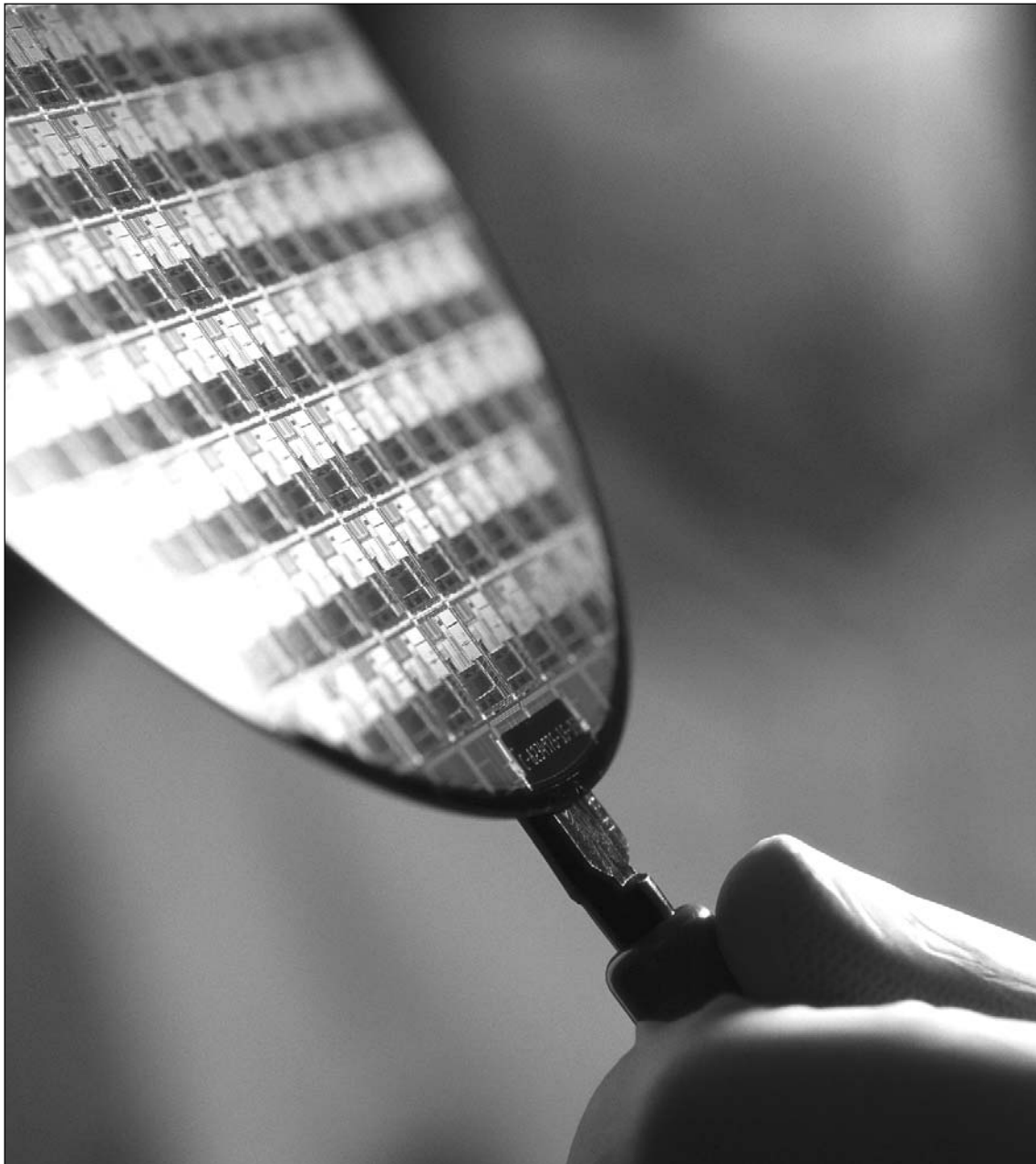




> KEEPING
OUR CUSTOMERS
IN THE LEAD

Computer Systems, Inc.
MERCURY

ANNUAL REPORT 2003



This annual report contains certain forward-looking statements including those dealing with overall business and segments growth, and the Company's markets. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Factors that could contribute to such risks and uncertainties include, but are not limited to, general economic and business conditions, including continuing economic weakness in the Company's markets and the cyclical nature of the semiconductor industry, effects of geo-political unrest and regional conflicts, changes in the amount and timing of funding of defense programs, changes in technology and the inability to deliver technological innovations, changes in customer order patterns, the lack of market acceptance of the Company's products, the failure to locate favorable acquisition and partnership opportunities, the inability to achieve expected results from new products, acquisitions and partnerships, and those listed in the section entitled "Factors That May Affect Future Results" in the Company's Annual Report on Form 10-K included in this report. The Company cautions readers not to place undue reliance upon these forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to update any forward-looking statement.

> KEEPING OUR CUSTOMERS IN THE LEAD...

At Mercury, keeping our customers in the lead requires a constant drive for innovation, deep industry expertise, and a passion for success. In fiscal year 2003, revenues grew in signals intelligence, semiconductor testing and magnetic resonance imaging to drive overall revenue expansion – with key program wins, technology investments and product introductions building a foundation for future growth.



> DEFENSE ELECTRONICS GROUP

With \$124.1 million in revenues, Mercury's Defense Electronics Group had a strong year. Department of Defense spending in intelligence, surveillance and reconnaissance is expected to increase for the foreseeable future, creating additional growth opportunities for the group.

> MEDICAL BUSINESS GROUP

Revenues for the Medical Business Group were \$35.7 million. An anticipated decline in computed tomography (CT) revenues offset good growth in other modalities. Design wins in digital X-ray, now moving into production, should drive future growth.

> OEM SOLUTIONS GROUP

Fiscal year 2003 was the strongest year to date for Mercury's OEM Solutions Group. Annual revenues grew to \$20.4 million. Growth came from high-end baggage scanning as well as semiconductor inspection and mask generation applications.

> TECHNOLOGY INVESTMENTS

In 2003, Mercury invested 21 percent of revenues toward developing new products and maintaining and improving its core technology.

Computer Systems, Inc.
MERCURY

Mercury Computer Systems, Inc. (NASDAQ: MRCY) is the leading supplier of high-performance embedded, real-time digital signal and image processing computer systems. Mercury's products play a critical role in a wide range of applications, transforming sensor data to information for analysis and interpretation. In military reconnaissance and surveillance platforms the Company's systems process real-time radar, sonar, and signals intelligence data. Mercury's systems are also used in state-of-the-art medical diagnostic imaging devices including MRI, PET, and digital X-ray, and in semiconductor imaging applications including photomask generation and wafer inspection.



JAY BERTELLI, PRESIDENT AND CHIEF
EXECUTIVE OFFICER

“This past year Mercury increased revenues, improved operational effectiveness, made significant advancements in its technology and better organized its business units around profit drivers.”

Dear Shareholders

The last three years have been some of the most challenging in Mercury’s 20-year history. There has been turmoil in the technology markets we serve, a nation traumatized by terrorist attacks, an economy in the doldrums, and wars in Afghanistan and Iraq. While the anemic economy had an impact on our non-defense sectors, war has the effect of shifting some spending from research and development (R&D) and initial production in defense programs – a significant portion of Mercury’s defense electronics business – to ammunition, food, fuel and the many other consumables that support a large theater of military operations.

Despite these challenging conditions, Mercury ended fiscal year 2003 with a strong set of results. The good results were driven by two factors: first, revenues were up significantly from the previous year; second, the Company has successfully implemented a program to increase operational effectiveness by better organizing market developments around profit drivers and creating a leaner, more customer-focused organization.

Mercury is now in position to pursue a course of further growth. Some of this growth will come from our current markets and existing products, and some of it is expected to come from new products now in development. Growth through complementary acquisitions and partnerships is also an important focus. To this latter point, the Company has established teams within each of its business segments to research and evaluate acquisition opportunities.

Mercury’s business units pulled through with impressive achievements during the fiscal year. The Company’s OEM Solutions Group had its strongest year ever, with revenues of \$20.4 million. Design wins for the group over the past five years now total 14, with several large wins moving into production in the next 18 months.

The Defense Electronics Group grew by 26 percent from the previous year, with growth from each of the primary application markets within the segment, which include radar, signals intelligence and emerging applications. New development projects such as the U.S.

military's Multi-Platform Radar Technology Insertion Program (MP-RTIP) and the Joint Strike Fighter could yield significant revenue over the next several years.

Revenues from the Medical Business Group were down for the year, driven largely by the predicted decline in CT revenues. Mercury's new multicomputer system for digital X-ray machines, which produces diagnostic images 20-40 times faster than conventional systems, is being developed and tested by a customer. We believe this development is another important step toward capturing a larger share of our served market within medical imaging.

THE NUMBERS

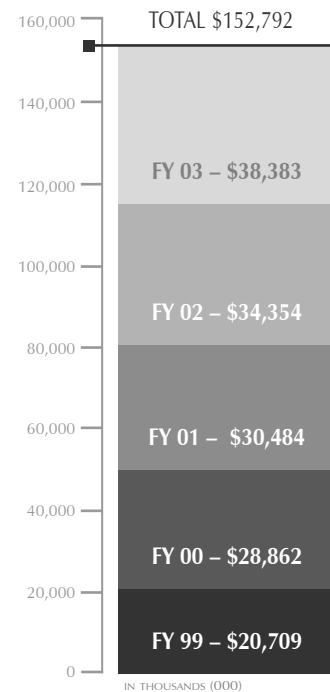
For the 2003 fiscal year, revenues were \$180.2 million, up 20 percent over the 2002 fiscal year. June 2003 marked the Company's 50th consecutive quarter of profitable performance. Full-year operating income was \$25.8 million, or 14.3 percent of revenue, an increase of \$11.3 million over 2002. Net income was \$22.7 million, or 12.6 percent of revenue, versus \$15.8 million and 10.5 percent in the prior year. Cash flow from operating activities generated \$50.5 million for the fiscal year, compared to \$15.9 million in fiscal 2002.

OPERATIONAL EFFECTIVENESS

This past year Mercury made good progress in operational effectiveness when measured against its value-creation metrics. Our continued focus on value-creation drivers, including process efficiency and supply chain management, are evaluated by leading performance indicators such as inventory turns and days sales outstanding. The results were good: process efficiency increased inventory turns by one full turn to 4.9, and days sales outstanding were reduced to 43 days, a 21-day improvement. Continuing process improvements will also further strengthen working capital management.

INNOVATION

Keeping customers in the lead requires development of solutions through our strong commitment to R&D. Over the past five years, Mercury has invested more than \$150 million in R&D and in 2003 the Company invested 21 percent of revenues to maintain and improve core technologies and develop new products. We unveiled new solutions to drive future revenue, including the world's first fully operational system based on the RapidIO® interconnect architecture and Mercury's latest Intel® Architecture-based offering. Both products strengthen the Company's position with existing customers and expand Mercury's reach into new markets. Going forward, we are committed to fund R&D investment levels that will keep customers at the forefront of their industries.



MERCURY R&D INVESTMENTS
SINCE FISCAL YEAR 1999

Over the past five years, Mercury has invested more than \$150 million in research and development.

ORGANIZATIONAL DEVELOPMENT

We made strategic changes to Mercury's organizational structure this year to help concentrate the Company's talent around high-potential business opportunities and to improve operational effectiveness. A sharper focus on specific customer applications has led to even closer alignment of the Company's engineering and marketing teams with its three business groups. And, the valuable foundational work in wireless communications is being applied to products under development in the OEM Solutions and Defense Electronics groups.

OUTLOOK

With the increasing emphasis on research, development, testing and evaluation (RDT&E) from the Department of Defense aimed at intelligence, surveillance and reconnaissance (ISR), we anticipate selective growth in our Defense Electronics Group, particularly around applications such as signals intelligence. As forecast last year, the Medical Business Group is expected to produce another year of flat or reduced revenues, with new growth still anticipated in FY05. The OEM Solutions Group is positioned for continued growth this year based on a strong pipeline of design wins and pending production orders.

While optimistic about the future, we remain prudently cautious regarding the immediate twelve-month outlook. It is still possible that unforeseeable events in today's volatile geo-political landscape and economy could threaten the timing of revenue flows from our key industry segments. Revenue from defense applications is historically vulnerable to funding timelines. To reduce this risk and broaden the Company's market opportunities, we are investing in new products and searching for complementary acquisitions, strategic alliances and partnerships.

This past year Mercury increased revenues, improved operational effectiveness, made significant advancements in its technology and better organized its business units around profit drivers. In the end, our success as a company is the result of the collective imagination, intelligence and hard work of Mercury associates. This past year's successes were wholly a result of their efforts and determination to keep our customers in the lead. And, as always, we thank our valued customers for their business and their demonstrated confidence in Mercury as a valuable partner.



James R. Bertelli
President and CEO



TOP ROW: **DIDIER THIBAUD**, GENERAL MANAGER, MEDICAL BUSINESS GROUP
MARK SKALABRIN, GENERAL MANAGER, OEM SOLUTIONS GROUP
JOE HARTNETT, CONTROLLER AND INTERIM CHIEF FINANCIAL OFFICER
BOTTOM ROW: **JAY BERTELLI**, PRESIDENT AND CHIEF EXECUTIVE OFFICER
BARRY ISENSTEIN, GENERAL MANAGER, DEFENSE ELECTRONICS GROUP



Barry Isenstein, Vice President and General Manager, Defense Electronics Group

“Our customers develop the advanced algorithms and applications, while Mercury, as the premier commercial supplier of high-performance embedded computing systems, enables the applications to work in the most demanding of environments.”

DEFENSE ELECTRONICS GROUP

With \$124.1 million in revenues, Mercury’s Defense Electronics Group (DEG) had a strong year. Design wins, production orders and a surge in development programs in signals intelligence and radar contributed to increased revenues.

During the year DEG made two organizational changes that will better position Mercury to exploit the defense market. The first change was to organize around primary application markets: radar, signals intelligence (including software-defined radio), sonar, smart tactical weapons, and data exploitation. These markets are covered by three Mercury market development teams staffed with senior business development managers and technical experts who are responsible for growing the DEG business.

Secondly, we placed significant product and system engineering resources in the DEG organization in the form of Mercury engineers who understand our customers’ challenges and real-time computing architecture. DEG now has more flexibility and muscle to pursue the strategies developed by its market development teams.

We believe DEG’s opportunity for growth is fueled by two themes in the U.S. military transformation: the continued requirement for better and faster intelligence, surveillance, and reconnaissance (ISR); and network-centric warfare (NCW). Each of these objectives increases the opportunity for placing more computing power, in more places, closer to and in the battle space. ISR is becoming more "intelligent" and proliferating to all echelons. NCW also increases requirements for smarter sensors and computers to perform communication functions. Our customers develop the advanced algorithms and applications, while Mercury, as the premier commercial supplier of high-performance embedded computing systems, enables the applications to work in the most demanding of environments. With our customers, we deliver the superior ISR and NCW capabilities to ensure the war fighter’s success.

Another powerful trend supporting Mercury’s business model is the Department of Defense’s endorsement of "spiral development." This is a deployment strategy that allows programs to plan several functional stages or "spirals" to reach the ultimate war fighter’s goal. As opposed to a single, static, multi-year development plan, spiral development enables emerging capabilities to reach the war fighter more quickly with later spirals meeting newer, challenging threats. Spiral development complements Mercury’s ongoing investment in delivering the latest technology to meet evolving requirements.

Taken together – DEG organization, military transformation, and spiral development – these factors are driving fundamental changes in how Mercury addresses the market. Look for more new products and services, new application spaces, and new computing capabilities to be introduced into the DEG lineup. DEG is positioned to capitalize on the growth opportunities, both organic and through acquisition and partnerships.



Defense Solutions

From manned aircraft in the 1990s to the Global Hawk unmanned aerial vehicle today, defense contractors have leveraged Mercury's high-performance embedded multicomputer solutions in ever smaller-sized systems to maintain overwhelming advantages in ISR systems.

The advantages in ISR delivered by the new generation of network-centric combat systems can already be witnessed. During Operation Iraqi Freedom, Global Hawk flew only three percent of the high-altitude reconnaissance missions but it provided about 55 percent of the time-sensitive targeting data to the Combined Forces Air Component Command in Saudi Arabia. During the year, Mercury shipped to Raytheon Company six additional embedded multicomputers – representing a total of 504 processors – for U.S. Air Force and Navy Global Hawks.

The success of Global Hawk exemplifies the power of Mercury's embedded signal and image processing. Mercury's leadership in the development of high-performance, rugged and compact computing solutions places the Company in an excellent position to support the networked combat systems on ground-, air- and sea-based platforms that will be important for national defense in the decades ahead.

This year, the U.S. Department of Defense selected Mercury to help determine standards for software-defined radio as part of the Joint Tactical Radio Systems (JTRS) program. The program's goal is to use the flexibility of software-defined radio to eliminate the many obstacles of radio incompatibility both between coalition forces and within the U.S. military. Mercury is evaluating these applications for civilian use, such as new radio capabilities to ensure that fire, police and other public safety officials always have an open channel to communicate.



Didier Thibaud, Vice President and General Manager, Medical Business Group

“The market for digital X-ray systems offers a high-growth area for Mercury. Overall there is an estimated \$150 million annual potential for the Company’s portfolio of medical imaging products.”

MEDICAL BUSINESS GROUP

In fiscal year 2003, Mercury’s Medical Business Group (MBG) posted good growth in key business areas and invested for future growth across strategic segments within the medical imaging industry. Computed tomography (CT) revenues declined as previously projected, offsetting growth from other modalities. In total, medical imaging revenues were \$35.7 million, down from last year’s \$41.4 million.

Looking ahead, design wins in several medical imaging areas, including digital X-ray, will move into production in FY04. During the year MBG formalized a business development team to pursue opportunities to acquire products and companies that will complement Mercury’s product line for medical imaging and provide profitable growth for the group. And, as we stated in last year’s report, encouraging growth potential exists with Mercury’s 3-D digital X-ray solutions. We will continue our research and development investments to create specialized products for digital X-ray, including 4-D X-rays, which offer real-time image reconstruction.

Mercury’s ability to build such high-performance computers enables our customers to develop diagnostic imaging equipment that can handle larger data loads and scan for signs of disease in much finer detail. For instance, small tumors that may not have been picked up by earlier imaging equipment can now be detected. The market for digital X-ray systems offers a high-growth area for Mercury. Overall there is an estimated \$150 million annual potential for the Company’s portfolio of medical imaging products.

While advancements in design help our medical imaging customers succeed, the additional focus from the Medical Business Group on design-to-cost to satisfy our customers’ requirement for excellent price-to-performance helped all of Mercury’s business segments become more competitive. During the year the group also leveraged Mercury’s common technology platform by adapting a CompactPCI-based solution from Mercury’s OEM Solutions Group. This type of synergy between business units exemplifies Mercury’s ability to continually explore new markets for development opportunities and revenue growth.



Medical Imaging Solutions

Computing power used to be a limiting factor in medicine, restraining technologies that promised better and more accurate diagnosis. But developments based on the Mercury RACE++[®] system and field-programmable gate arrays (FPGAs) are providing the power to turn raw data into images that pinpoint disease and trauma.

After a century of relying on film, doctors now are beginning to use electronic detectors to record X-rays. The results are images unlike anything seen before. Rather than looking at a chest X-ray cluttered with ribs, heart and spine, doctors examining a patient complaining of shortness of breath can look just at the lungs, having instantly "subtracted" everything else. With this image of the lungs, doctors can quickly spot the injury or pathology causing a collapsed lung, early stage emphysema, or the first signs of cancer.

Another digital imaging machine is looking at the body's intricate system of blood vessels.

The digital detector and X-ray source arc across the body, relaying individual frames of data, like a video camera, to a computer. But rather than compiling and running the images like a movie, the data are reconstructed into three dimensions showing the exact shape and size of bulging aneurysms or malformed vessels that, left untreated, could cripple or kill.

These are among the latest, but not the only technological advances supported by pioneering efforts such as Mercury's in computing technology. Magnetic resonance imaging and computed tomography are becoming ever more compute intensive. The amount of data coming off these scanners threatens to overwhelm doctors. Computer reconstructions that assemble hundreds of images into 3-D models give doctors a powerful tool to quickly and more accurately diagnose diseases and treat patients.



Mark Skalabrin, Vice President and General Manager, OEM Solutions Group

“OSG is well positioned for continued growth as existing design wins move into production and the semiconductor industry recovers from its current downturn.”

OEM SOLUTIONS GROUP

Mercury’s OEM Solutions Group (OSG) achieved significant results during FY03. Revenues grew by 94 percent to \$20.4 million. The growth came from increased revenues of signal and image processing solutions to applications for high-end baggage scanning and semiconductor inspection and mask generation.

Of these applications, the most impressive results were in the semiconductor capital equipment space. Despite the industry struggling through the worst downturn in its history, Mercury experienced significant year-over-year growth. The growth was driven primarily from development programs, and to a lesser extent, from production orders through Mercury’s 14 active design wins in this space. OSG is well positioned for continued growth as existing design wins move into production and the semiconductor industry recovers from its current downturn.

Mercury’s solutions have proven to be an excellent fit for the demanding processing required by semiconductor equipment OEMs developing applications such as wafer inspection and photomask generation. These OEMs are in a race to develop solutions that keep pace with the semiconductor industry’s constant drive for advanced technology. Advances in equipment performance are required to produce the faster, cheaper, and lower-power chips needed in everything from workstations to personal digital devices. In many cases, the performance of our customers’ equipment needs to double every two years, or even faster.

Mercury’s products and support services enable customers to cost-effectively solve their most demanding problems. To this end, in FY03 Mercury shipped the first RapidIO-based system to a semiconductor equipment customer. The system provided the substantial leap in processing and data movement required to keep this customer in the lead.

OSG is also targeting other applications in the semiconductor capital equipment space. New target applications include reticle inspection, scanner control, and the emerging space of maskless and direct-write lithography. While maskless lithography is several years from reaching maturity in the marketplace, the extensive processing requirements and expected market size make this an exciting future application for Mercury’s technology.

OSG is also active in the communications market. While a portion of Mercury’s wireless development team shifted to the Defense Electronics Group, a subset of this engineering and marketing group is continuing to work within OSG, positioning Mercury to benefit from a recovery in the commercial communications market.



OEM Solutions

When considering the rapid pace at which computers evolve, it's not surprising that some of the most advanced technology in the world can be found in the equipment that makes computer chips. Micronic Laser Systems AB of Sweden is a pioneer of photomask technology, the process that creates the template design, or reticle, from which the millions of microscopic circuitry patterns comprising a computer chip are formed. The process is somewhat analogous to a daily newspaper being reproduced 100,000 times from a single printing plate.

Leveraging Mercury's real-time signal processing multicomputers, Micronic has developed a new proprietary technology for photomask generation that will enable chip and flat panel display manufacturers to save up to 30 percent in overall mask costs. A crucial goal for Micronic customers is to reduce the time it takes for reticles to be "written" onto photomask material.

The unique spatial light modulation (SLM) process on Micronic's Sigma7100 and Sigma7300 mask generator tools employs

thousands of tiny movable mirrors — each individually programmed to reflect laser light in a precise pattern onto photomask material. The process enables lasers to take up a larger portion of the writing process and reduces overall wafer production to between five and six hours, compared to more than 24 hours with traditional systems. This improved speed increases wafer throughput and reduces total investment in photomasks, which can cost between \$1.5 and \$2 million per set.

Mercury's multicomputer systems are used to prepare the massive, real-time data required to feed Micronic's SLM writers. The system uses an array of high-performance, switch fabric interconnect compute nodes based on PowerPC® processors to meet the processing requirements the application demands.

Mercury's ability to customize solutions for customers like Micronic underscores its strength in solving high-end commercial applications. As the semiconductor industry emerges from its prolonged slump, Mercury is well-positioned for additional growth.

TECHNOLOGY INVESTMENTS

The speed of computer processors has advanced so rapidly in the past decade that, measured one way, they are becoming too fast. Each new generation of processor performs more work in less space, which translates into emitting increasing levels of heat inside ever-shrinking spaces. Expensive liquid-cooling systems are one solution used to pull

heat out of small spaces. However, liquid cooling negatively impacts the price-to-performance ratio of embedded multicomputers and thus likely narrows the range of practical commercial applications that embedded computers can support.

Mercury invested nearly \$40 million in R&D in FY03, a considerable portion of which was devoted to developing patented encasements, or "packaging," for multicomputers that use finely managed air flows (instead of liquid) to cool dense multicomputers. Mercury has initially focused this packaging innovation on high-

end radar systems, and plans to expand this development to smaller systems that are hermetically sealed to keep out contaminants such as dust and moisture. In many ways, Mercury's unique packaging of its high-performance multicomputers is one of the most valuable assets for customers looking to better leverage the increasing clock speeds of commercial processors.

In addition to maintaining and improving its core technologies in FY03, Mercury made significant progress in the development and commercialization of solutions in five key areas: field-programmable gate arrays (FPGAs), software-defined radio, RapidIO interconnect, open source technologies, and Intel-based architectures.

FPGA technology can significantly improve the performance of critical algorithms that Mercury customers deploy. In many ways, integrating an FPGA-based accelerator into a multicomputer represents a rebirth of array processor technology – the technology that Mercury revolutionized two decades ago. In FY03 Mercury increased its investment into FPGA accelerator tools and infrastructure. The initial focus was the medical market, where Mercury has deployed FPGA-based computing for several years. The Company drove higher levels of integration into a smaller space in FY03 – with a demonstration of a complete back-projection algorithm inside an FPGA subsystem – and launched FPGA acceleration into the defense markets.

During the year, Mercury re-focused a significant percentage of its commercial wireless team on the emerging need for software-defined radio technologies within defense markets. Defense programs increasingly demand flexible radio systems that are built much like small multicomputers. Mercury has already taken a leadership position in defining and implementing the infrastructure software that government programs will demand in future radio



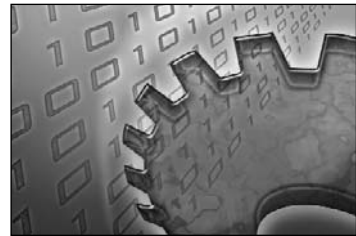
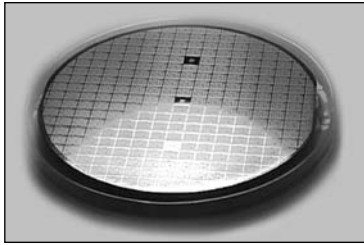
From left:

Stephen C. Patterson,
Vice President, Product
Planning and Core
Technology

Craig Lund, Vice President,
Chief Technology Officer

Robert D. Becker, Senior
Vice President, Engineering
and Operations

Randall W. Dean,
Vice President, Product
Development



"In addition to maintaining and improving its core technologies in FY03, Mercury made significant progress in the development and commercialization of solutions in five key areas."

Robert D. Becker,
Senior Vice President,
Engineering and Operations

procurements. Mercury's signals intelligence business is among the Company's fastest growing applications. Our investments are aimed at adjacent defense radio markets, particularly battlefield communications.

In 2003, Mercury introduced the ImpactRT™ 3100 – the first scalable, high-performance, signal and image processing system based on the open-standard RapidIO interconnect architecture. The new system more than quadruples the performance of the current ImpactRT systems while maintaining backward compatibility with existing application software. Mercury's OEM and medical imaging customers will benefit initially from such RapidIO-based solutions, with defense customers migrating to the next generation of standards-based fabric in the years to come.

During the year Mercury demonstrated working systems with legacy programming models and APIs running above a customized Linux® configuration on Mercury hardware. Moving the basic levels of Mercury's software to open source technologies such as Linux will benefit customers in two important ways: first, open source kernel technologies have a broad user base and deliver high functionality and reliability; second, after a transition period, Mercury will be able to better focus its own software investments on unique value-added solutions, and leave lower-level software to open source codes.

Mercury unveiled its XR product line of scalable open-system rack-mount servers this year to provide customers high-performance signal and image processing using Intel-based architecture and the Linux software environment. The rack-mounted servers bring Mercury's renowned multicomputer performance and integration expertise to a broader set of customers using modular mainstream hardware tailored through software, services and packaging. Mercury's initial market focus for Intel Architecture-based products is sonar on ships and submarines. We are also offering these servers to medical customers, bundled with our FPGA acceleration package of hardware and medical algorithms, with additional market applications expected to follow.

Whether customizing commercial technology for high-performance applications or developing new forms of packaging to help customers cost-effectively develop embedded computing solutions, Mercury engineers continue to maintain a strong position of technology leadership. Mercury has filed 34 patent applications over the past five years, covering various unique hardware or software designs. With an anticipated R&D investment of more than \$200 million over the next five years, we confidently expect to build on our tradition of innovation and stay at the forefront for our defense, OEM and medical customers – right where they expect us to be.

**President and
Chief Executive Officer**

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Senior Vice President,
Engineering and Operations

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Common Stock

Mercury Computer Systems' common stock is traded on NASDAQ
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Stockholder Information

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