why wireless? >

> Annual Report / 2001

Computer Systems, Inc.
MERCURY

199 Riverneck Road,
Chelmsford, MA 01824

978-256-1300
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the answer is simple >

Directory >>

This document contains certain forward-looking statements including those dealing with overall business and segment growth. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Factors that could cause or contribute to such risks and uncertainties include, but are not limited to, general economic and business conditions, competition, changes in technology and methods of marketing, and various other factors beyond the Company's control. These risks and uncertainties include such factors as are described in the Company's recently filed reports with the Securities and Exchange Commission in the USA. The Company wishes to caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made.

_having staked our positions in defense electronics and medical imaging – it's the next frontier.

This is the story of people who are courageous in their pursuit of new frontiers, passionate in their drive for performance, tenacious in wrestling problems to the ground, thoughtful in developing solutions and dedicated to making each customer a living testimony to Mercury's ethos.

What's after wireless? Hard to tell, but one thing is certain – the Mercury team will find it.

A Tribute to a Great Entrepreneur >>

We are honored to dedicate this year's annual report to the memory of Michael Schneider, a Mercury Board Member and a wonderful human being. Michael died in Massachusetts on September 6, 2001.

In 1983, when Mercury was a young start-up, Michael had the foresight to see the potential in our endeavor and to share the vision. As a dynamic Vice President at Data General, he funded the development of our first product and gave us space in his facilities.

His action was characteristic of the foresight and courage he showed throughout his life in pursuit of new business frontiers and his focus on making customers successful.

We are where we are today because Michael saw the potential in Mercury as a company. We will miss his entrepreneurial spirit and his thought-provoking questions and I will personally miss his counsel and deeply valued friendship.

Michael Schneider was the embodiment of the spirit, which continues to propel Mercury. We will all be forever grateful for his role in making Mercury successful.

Jay Bertelli

{ tenacious } in wrestling problems to the ground...

"To win, we need to go into a level of detail that goes beyond pure technology requirements."
John Moore

> Joey Sevin

> Mark Merritt
Director of Core Systems Engineering

> Paul Travers

_Pizza In Moorestown

It's All About Customers >>
Dedication to our customers' success has always been the mantra at Mercury Computer Systems. It is an inherent aspect of our culture that permeates the company at all levels. We believe:

- that our ability to offer comprehensive solutions rather than a single product or technology translates into the reduction of the development risk and systems integration time;
- that our supplier-partnership approach obliterates the line between us and them, helps to lower the overall development and manufacturing costs, and results in shorter time to market for our customers' products;
- that the offer of ongoing technology upgrades translates into top performance and new revenue opportunities;
- that, in order to maintain a competitive edge, many customers need a tailored hardware and/or software solution, matching specific application and environmental constraints;
- that to make sure that our customers are truly successful, we need to understand their business needs as thoroughly as we understand their technology requirements.

Here are a few of the many vignettes that illustrate Mercury's definition of success:

"Focus on details"
{ John Moore } *Applications Engineer,* on helping a customer conduct a difficult benchmark for a naval tracking radar program. "A working lunch with pizza in a customer's Moorestown office reinforced my conviction that to win, we need to go into a level of detail beyond pure technology requirements. We have to fully understand the nature of the customer's application, then predict and show the customer how our technology helps meet current and future needs. The application was very complex, involving a variety of different communication and processing modes, and the goal was to fit the application into a configuration with significantly fewer processors. The first thing we needed to do was to get information on every aspect of the problem before we even began to think about the solution. We allotted a few hours for fact-finding. However, the engineers we met with were rooting for a programmable solution and they ended up answering my questions and analyzing the problem for the better part of the day. Over the next three weeks we kept in touch through e-mail and phone making sure the customer had all the details needed for their business presentation."

"Score one for Mercury"
{ Paul Travers } *Director of Strategic Programs,* who together with Mark Merritt, Director of Core Systems Engineering, worked on a nationally vital radar project for the MIT Lincoln Laboratory, which involved building a 972-processor computer system. "This application needed a lot of processing power, had to be able to process data in real time and had to fit into a very small space. We heard a lot of 'it-cannot-be-done' during that process. I cannot tell you how satisfying it was to make this incredibly complex system work and score one more for the Mercury team." The government's program manager, a longtime radar expert, claimed this to be the most successful advanced radar program he had ever been involved with and one whose results greatly exceeded all expectations.

"The power of listening"
{ Joey Sevin } *Regional Sales Manager,* on helping one of Mercury's major customers put together a successful technology insertion plan that resulted in forging a strategic partnership with Mercury and saving the customer millions of R&D dollars. "A successful sales associate needs to hear first, sell second. Working with different departments at a customer's site, we very often have insights into the various challenges they face. This allows us to develop a common solution. Selling products at Mercury means leveraging our technology expertise and becoming a member of our customer's team."

> John Moore

{ courageous } in their pursuit of new frontiers . . .

"It's like being on the frontier when that frontier keeps moving all the time – to stay ahead you have to leave your house over and over again."
Craig Lund

> Jon Greene

_Failures Move Us Forward

Research and Development >>

Innovation has been the fabric of Mercury's culture for the past 20 years. It permeates all levels of the organization, but is most visible in Mercury's R&D efforts. Mercury's pioneering RACE interconnect fabric makes it possible to build computers ranging from several processors to thousands without sacrificing performance and to do so very cost effectively. This architecture has now evolved into the widely adopted industry standard known as RapidIO.

The list does not stop here. As the semiconductor industry develops more powerful technology, Mercury continues to leverage these developments. The end goal is to bring customers more cost and time savings by constantly improving the performance of our digital signal and image processing systems. In other words, it's all about adhering to standards, preserving the customers' software investment, delivering maximum performance and giving customers a sharp competitive edge. It's also about maintaining Mercury's leadership position in current markets and growing revenue by exploring other opportunities.

{ Craig Lund } *Chief Technology Officer,* who spearheaded many of the company's technology developments, likens this constant pursuit for new solutions to being on the frontier. "We are not attached to one solution or product," says Craig. "It's like being on the frontier when that frontier keeps moving all the time – to stay ahead you have to leave your house over and over again."

This pursuit of the new frontier is not conceived in a vacuum. It requires a thorough firsthand understanding of application requirements and identifying trends and developments in key and adjacent markets.

Mercury's successful R&D track record constantly defies the "it-cannot-be-done" principle. It is not, however, entirely without failures. And at Mercury, that's a good thing. Failures are viewed as a way to move the company forward.

{ Jon Greene } *Technical Director, Performance Algorithm Group,* has seen Mercury at its best. "Over the years, we learned how to buffer the risk of failure and not shy away from challenges that seem totally out of reach," says Jon. "When this company really sets its mind on developing the right technology, there are few, if any, companies that can compete."

So what is the next frontier? At the moment it's wireless communications, where the exploding demands placed on the limited available spectrum by voice, data and video services will require Mercury's powerful signal processing computers to maximize spectrum utilization.

And after that? Anywhere, frankly. Provided the solution requires computers that will be able to process vast amounts of data in real time, frequently meet demanding environmental constraints, and also satisfy the customer's time-to-market goals. Oh, and they will have to be built on an upgradeable architecture that leverages the latest developments in the semiconductor industry – you know the rest.

> Craig Lund

"The salesperson who shoots the breeze doesn't win the customer. We shoot straight with our customers to earn their trust. We are truly concerned about our customers' needs."

Lance Turner
Sales Manager,
GEG Western Regional

"Mercury cares equally about all its associates, regardless of their level. In turn, I'm motivated to perform my best."

Bobbi O'Rourke
Manager,
Human Resources

"We are encouraged to grow and we are heard. If there's a better way to get something done, management wants to hear it from you."

Moses Kalemba
Senior Accounting Manager

"One way to measure Mercury's growth could be the shipping department. When I started here eight years ago, we were shipping 15 packages a day. Now we average 50."

Roger Gagne
Supervisor,
Shipping/Receiving

"My work is very engaging to me – even away from work I find that my mind keeps going back to how to find or create the best solutions."

Alexei Lomakin
Principal Hardware Engineer

"Innovation is encouraged from all levels. Our enthusiasm for staying on the leading edge will continue to be the key to our success."

Ina McAfee
Application Engineer

"Mercury is about reaching full potential. Wireless communications will give us all more freedom and efficiency. And we are determined to make that happen with our technology."

Mirza Cifric
Systems Engineer, Wireless Communications Group

"Our commitment to delivering high-performance products that meet our customers' requirements and schedules keeps us focused on the end goal, resulting in success for everyone."

Mary-Ellen Prescott
Senior Product Manager

_Passion
In Their Own Words

The Ultimate Performance Team >>
There are 556 of them. Every day they take on different challenges. What unites them is passion – for the technology they develop, the company they grow, the people they work with, the new frontiers that await them, the jobs they do. Mercury associates in their own words.

"I'm passionate about making not only our customers happy, but their customers happy as well with our products and services. We want them to know they made the best choice by selecting Mercury."

Rebecca Dowse
Director of Contracts Administration

"At Mercury, you have the space to be creative. We are encouraged to try new ideas and follow our passions."

Robert Klinkhammer
Principal Software Engineer, System OS

{ thoughtful } in developing solutions...

"Continuing advances in digital signal and imaging technology allow us to practice medicine at levels unimaginable even a few years ago."

Dr. Michael Vannier, *Professor of Radiology, University of Iowa's College of Medicine*

> Raul Brauner
Director of Medical Business Development

> Dr. Michael Vannier

> Russ Adamchak
Southeast Regional Sales Manager

_Spy Planes & Patient Care

Making an Impact >>

For many years Mercury Computer Systems has been the technology driver behind new products in the defense electronics and the medical diagnostic imaging markets. This year is no different.

In the world of national defense, electronics systems are in ascendancy. Whether it's the U.S. Department of Defense or their equivalent among our NATO allies everybody is pushing for more surveillance, greater detail of reconnaissance pictures and farther-reaching radars and sonars. These are all trends that will require more powerful computers in order to satisfy the mission requirements. Mercury has the most advanced computers to handle the vast amounts of data and reduce the signals to useful intelligence for the battlefield commanders.

The debate on patient care witnessed in the Congress of the United States in the last two years is also seen in many other countries. This demand for better care is fortunately matched by advances in the underlying technologies that power the diagnostic imaging systems being developed by the world's leading manufacturers. These companies in Europe and the U.S., all customers of Mercury, are ratcheting up the pace of new developments. In the last year alone we have seen major advances and increased orders from sales of digital cardiology and digital X-ray systems.

"In medical imaging applications we need as much processing power as can be made available to reduce the time between diagnosis and treatment," says Dr. Michael Vannier, Professor of Radiology at the University of Iowa's College of Medicine. "The continuing advances in digital signal and imaging technology today allow us to practice medicine at levels unimaginable even a few years ago. Their impact on patient care has been dramatic."

What kind of impact has this had? Last year alone, Mercury won 53 contracts from the defense industry, including two new applications: software-defined radio and surface radar. Combined with design wins from the previous two years, this brings the number to 137 programs – provided they all progress to completion, this represents a five-year revenue potential of $470 million. In medical diagnostic imaging, Mercury secured two new design wins: for the next generation of MRIs, and for a positron emission tomography machine. This is in addition to the move to production of previous design wins for digital cardiology and digital X-ray systems. In the meantime, we are developing a software-driven visualization and imaging platform that will open new opportunities across multiple modalities.

. . . the Mercury team will find it.

"'First to new frontiers' has become our latest battle cry," says Barry Isenstein, who leads the Wireless Group. "We've been the new kid on the block so many times that once we set our sights on something, we know how to make sure we get it."

Barry Isenstein

> Mark Skalabrin
Director and General Manager, OEM Solutions Group

> Mike Kosmicki
Director of Business Development

_First to New Frontiers

OEM Solutions Group >>

Innovation and a healthy competitive spirit are what Mercury's team thrives on inside and outside the company walls. While much of the financial community's attention has been on our investments in the wireless communications area, our newly formed OEM Solutions Group (OSG) has quickly made great strides. They have initially focused on semiconductor imaging and digital video processing and have secured multiple design wins for both photomask generation and wafer inspection, digital broadcasting, as well as prototype digital cinema and digital video watermarking applications. The current design wins within the semiconductor imaging market alone represent potential new annual revenues of more than $50 million when the current development systems reach production. Thus, as of today, the OEM group can easily adopt the "First to new frontiers!" phrase as an internal battle cry in its attempts to win the revenue race.

Wireless >>

Not to be outflanked, the Wireless Communications Group continues to make progress on both the technology and business development fronts – in spite of the turmoil resulting from the industry's poor financial performance. In fact, because of this turmoil, our value proposition to the base-station manufacturers and their customers, the service providers, is perhaps more compelling than ever. Mercury's communications computers provide a way for them to reduce their internal engineering costs and improve the capability and scalability of their equipment, while significantly increasing coverage and service quality.

Like all frontiers the gold is on the other side. Our estimate of the size of the wireless gold mine is between $500 million and $1 billion annually. And while other business development activities are also under way, this is the largest single new market potential for the company, and we now have to see how much we can mine from this vein. The investments in wireless already led to winning several design contracts for software-defined radio in Mercury's defense electronics business.

> Barry Isenstein
Vice President & General Manager,
Wireless Communications Group

dear shareholders:

The last year has been one of turmoil for many technology firms. Talk of recession, a slowdown in orders for many companies, dotcoms going to the wall, technology stocks taking a beating and pundits signaling the end of the PC era.

So, how did Mercury fare through this period of economic uncertainty?

Well, in a nutshell, we made our numbers, we kept on listening to the customer, we increased our attempts at innovation, and we all worked darned hard at making Mercury a more efficient company and maintaining our record of profitable growth.

Are we satisfied? No, but we do know that some of the hard and smart work of all our associates and the tough decisions we made in the past gave us calmer water this last year and kept our customers coming back for more. And we will continue to innovate, take risks, and venture into unknown technical territories and new markets. Why? Because that's the way we do things at Mercury. That's what has given us the strong market presence in medical imaging and defense electronics, attracted some of the best talent to Mercury and kept our customers competitive and at the leading edge of their industries. We believe this approach will help us to gain a similar advantage in new markets.

Our R&D investments running from 17 to 20 percent are still well above the industry average and we intend to keep them that way. We believe very firmly that our past successes and our future opportunities are directly linked to the R&D investments we make.

Medical Imaging >>

For several years the diagnostic imaging market has been growing steadily. Our own growth in this market has been substantial, reflecting significant design wins in various modalities. What we've seen is that as new technology is brought to market, in both MRI and CT, it leads to better medicine. This in turn raises the demand by physicians and patients for scans for both diagnosis and prevention. A recent report highlighted how the use of MRI systems for brain scans is enabling early detection of multiple sclerosis and bringing an increased level of control to the disease with earlier treatment.

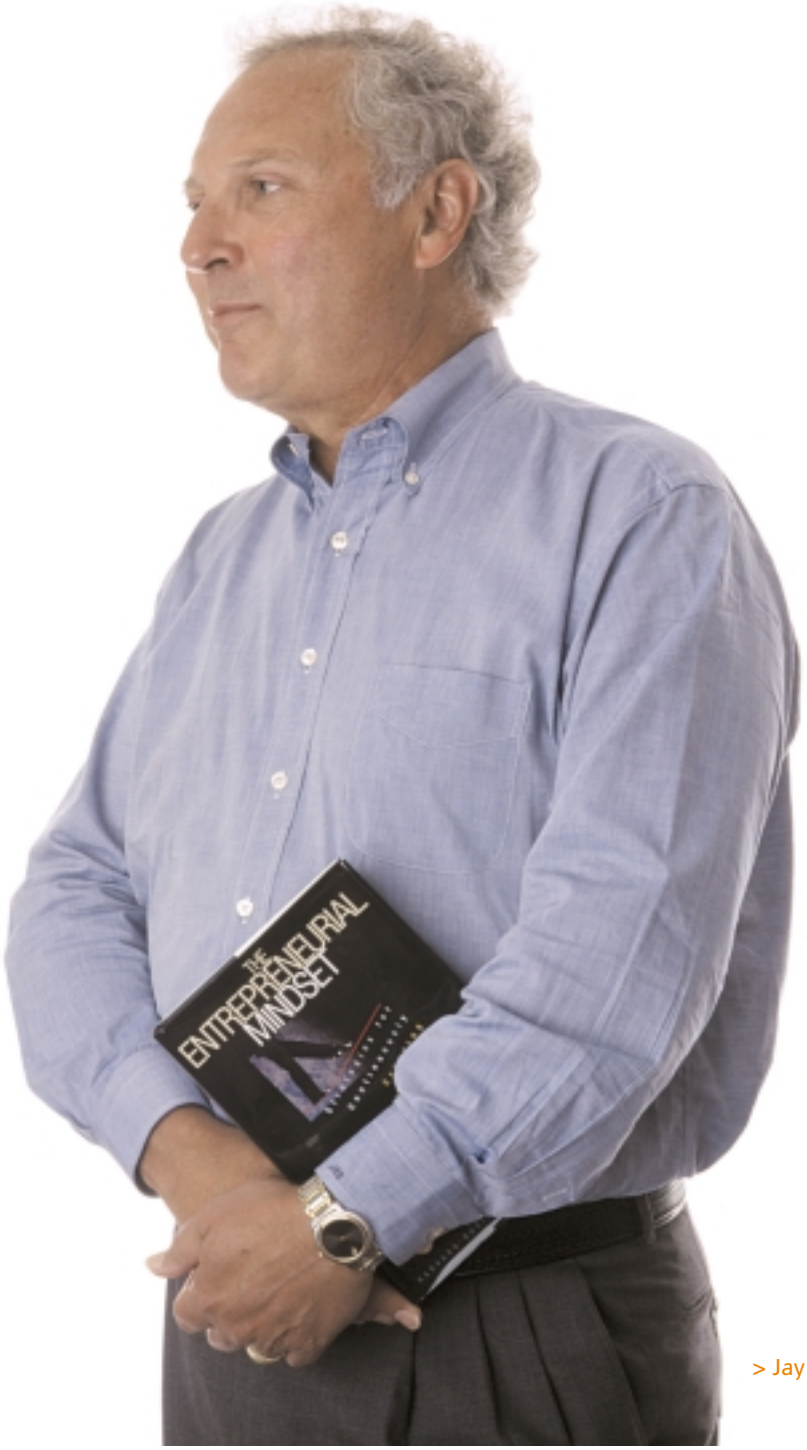
On the digital X-ray front, one of our major customers recently started shipping a new product. It has proven to be more successful than anticipated, and was one of the reasons why our revenues in medical were greater than we had planned for last year.

Our growth in the medical market continued this past year at a good pace of 61 percent. Revenues have gone from $15 to $27 to $43 million in the last two years. While the growth will be minimal in the coming year, we do expect our long-term growth rate to be in the 20+ percent range. Investments we are making, including development of a software-driven visualization and imaging platform, will open new opportunities across multiple modalities. In this $150 million to $200 million served market, we are targeting a 50 percent market share.

In summary, the medical imaging industry is benefiting from the lower-cost and very powerful computers that we have developed in recent years. This has been the driver in creating new generations of MR, CT, PET and digital X-ray systems. We expect the trend to continue.

Defense Electronics >>

Much of our business in defense electronics is linked to intelligence gathering as a result of reconnaissance and surveillance missions. As a new administration in Washington assesses its strategic imperatives, defense spending related to systems using Mercury's product has slowed and is unlikely to accelerate again



> Jay Bertelli

until the Rumsfeld review is fully digested. While our defense electronics results for last year were below our forecast we expect the medium- and long-term trends to continue in the 20+ percent range. There are three reasons for this expectation: first, in the last three years we have had over 137 program wins with a five-year potential of more than $470 million; second, the early indications from Washington are that intelligence, reconnaissance and surveillance systems are going to be more important elements in any new strategy; and third, the projected new systems for missile defense, advanced reconnaissance and targeting will utilize the most advanced systems for signal and image processing, which should bode well for Mercury.

Software-defined radio represents an interesting and potentially large new market. The problem to be solved is that of military personnel at different command levels being unable to communicate. Radios are not compatible within the U.S. forces, never mind between members of NATO. The communications designer's dream is to have a radio that recognizes a signal from a dissimilar radio and adjusts its operation through software to interpret the foreign signal. In the last year we have received orders from a number of U.S. and international organizations developing solutions to this problem.

Year Ended June 30, (Dollar Amounts in Thousands)	2001	2000	1999	1998	1997
Total Revenues	$ 180,492	$ 140,944	$ 106,571	$ 85,544	$ 64,574
Gross Profit	120,677	101,798	72,334	55,460	42,540
R&D Expense	30,484	28,862	20,709	14,476	12,837
R&D As a Percent of Revenues	16.9%	20.5%	19.4%	16.9%	19.9%
Income From Operations	39,557	33,461	18,623	13,105	7,072
Net Income	30,684	24,896	13,462	8,731	4,611
Total Assets	183,584	144,217	97,511	73,569	44,848
Working Capital	101,391	68,198	42,312	32,794	27,547
Stockholders' Equity	147,788	108,360	77,440	61,040	33,322

_financial highlights

This year our computers were selected by Northrop Grumman as part of their program to upgrade the FAA's airport weather detection systems. These airport surveillance radars detect wind shear and other dangerous weather conditions so that air traffic controllers can warn approaching aircraft. This is a classic case where laboratory development systems we installed many years ago have resulted in substantial production orders today with more expected in future years.

So, while the results we see today and in the first couple of quarters of fiscal 2002 may fall short of our long-term growth goals, we are confident that the defense electronics segment will continue to grow and be a major part of Mercury's future business. The conclusion of the current defense review should provide an indication within the next few months as to the level of spending in the areas of business interest to Mercury.

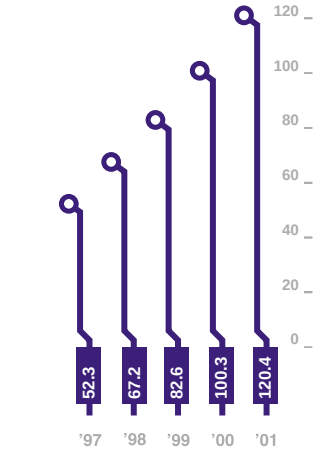
OEM Solutions >>

Just over a year ago we formed the OEM Solutions Group because we saw an opportunity to expand the commercial side of our business. This opportunity arose because of developments in both the semiconductor and digital entertainment industries.

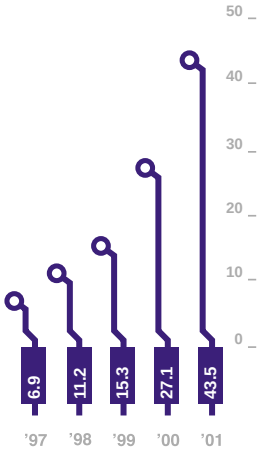
In the semiconductor industry, wafer inspection and mask generation are critical applications that are at the heart of the industry's production efficiency and, of course, its profitability. Inspection systems were traditionally hardwired and built in-house by the semiconductor equipment manufacturers or specialist contractors. With the shrinking of geometries and the shortened cycle between each chip generation it became impractical to develop testing equipment which could keep pace using traditional methods. Mercury's computers, recently installed in the semiconductor industry, are reconfigurable by software and can change to match the pace of chip development. This has the potential to be a $200 million market in the next four years and we expect to gain a substantial share of it.

In the digital entertainment business the transition from film to digital recording is sufficiently advanced that opportunities are appearing that require the advanced signal and image processing that Mercury excels at. Movie images are now captured, processed, transmitted and projected digitally. Because of the volume of data involved, the images are compressed at the outbound end and to avoid piracy are encrypted during transmission, then decompressed and decrypted at the cinema. Mercury's computers, adept at image processing, are ideally suited to increasing the efficiency and lowering the cost of this process. While this market is still a few years away, Mercury's systems are already being used in digital cinema development and demonstration programs. Based upon the National Association of Theater Owners publication of the number of screens in the U.S., this market alone could represent a total available market in excess of $350 million to as much as $1 billion.

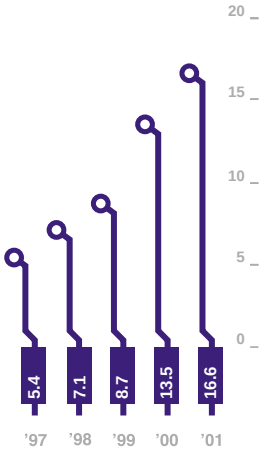
Developments at AgileVision, our joint venture with Sarnoff Corporation, progressed during the year with first orders for their products coming from two Public Broadcasting stations. Their product also won three major awards at the National Association of Broadcasters' 2001 annual convention in Las Vegas. To pursue their product and marketing plans, AgileVision is seeking additional funding from outside investors including corporate partners.



_defense electronics
(revenue growth)



_medical imaging
(revenue growth)



_other commercial
(revenue growth)

Wireless >>

Despite the poor performance of many wireless and telecommunications companies in the past year we believe there are very substantial opportunities for Mercury in this space. As we move to the next level of capability in wireless communications, be it 3G or some other level, there will be a dramatic increase in the number of advanced mobile phones or personal digital assistants (PDAs). Video imagery and high-volume data transmission, in addition to the continuing rapid growth in voice, will put a tremendous demand on the wireless infrastructure – a demand that the present systems are not capable of handling.

To maximize the efficient use of the limited spectrum, new techniques are needed. Many of these techniques are familiar to us from our work in defense electronics. We are now developing systems, software and algorithms and have just reached the stage where we can demonstrate, to the base-station manufacturers, how Mercury's systems will yield better utilization of the bandwidth and allow them to service significantly more customers with the same capital investment. The cost-benefits appear to be substantial and the available market is somewhere between $500 million and $1 billion annually. With these characteristics, it is clearly a major opportunity for Mercury and one in which we will continue to invest.

Technology Leadership >>

Our R&D investment continues to run at 17 to 20 percent of revenue. During the year we continued the rollout of our RACE++® Series of systems. This new generation of high-performance multicomputers quadruples the communications performance between processors within the system to over two gigabytes/second and increases the single-chassis performance to nearly a teraflop of processing capability.

We have also continued in our multiyear investment program developing the next switched-fabric computer hardware and software architecture. Over the coming two years these investments will result in the introduction of several new and exciting products. These products will open new markets and new applications within the company's existing markets, extending the scalability of our systems in both directions along the price/performance spectrum. In fact, these systems will provide as much as ten times the price/performance capability of today's systems.

Of course, the one constant that continues to drive our performance is the dedication of the Mercury associates. I cannot express strongly enough my personal satisfaction gained from working with so many outstanding people in all areas of our company.

Jay Bertelli
President and CEO

2001 financial review >

Mercury Computer Systems, Inc. >>

Mercury Computer Systems, Inc. (NASDAQ: MRCY) is the leading independent producer of high-performance embedded, real-time digital signal and image processing computer systems that transform sensor data to information for analysis and interpretation. Mercury's products play a critical role in a wide range of defense electronics and medical imaging applications. In air-, sea-, and land-based military platforms, these systems process real-time radar, sonar, and signals intelligence data. Mercury's systems are also used in state-of-the-art medical diagnostic devices, including magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), and the rapidly growing field of digital X-ray.

Based in Chelmsford, Massachusetts, Mercury serves customers in North America, Europe and Asia through a network of subsidiaries and distributors.

Directory >>

_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,	2001	2000	1999	1998	1997
Statement of Operations Data:					
Revenues	$ 180,492	$ 140,944	$ 106,571	$ 85,544	$ 64,574
Cost of revenues	59,815	39,146	34,237	30,084	22,034
Gross profit	120,677	101,798	72,334	55,460	42,540
Operating expenses:					
Selling, general and administrative	50,636	39,475	33,002	27,879	22,631
Research and development	30,484	28,862	20,709	14,476	12,837
Total operating expenses	81,120	68,337	53,711	42,355	35,468
Income from operations	39,557	33,461	18,623	13,105	7,072
Interest income	3,977	2,430	1,336	1,084	560
Interest expense	(1,065)	(731)	(51)	—	—
Equity loss in joint venture	(3,310)	(3,721)	—	—	—
Gain on sale of division	6,400	4,820	—	—	—
Other income (expense)	(435)	86	185	(30)	(88)
Income before income taxes	45,124	36,345	20,093	14,159	7,544
Provision for income taxes	14,440	11,449	6,631	5,428	2,933
Net income	$ 30,684	$ 24,896	$ 13,462	$ 8,731	$ 4,611
Net income per common share[1]					
Basic	$ 1.42	$ 1.19	$ 0.66	$ 0.60	$ 0.45
Diluted	$ 1.33	$ 1.10	$ 0.62	$ 0.47	$ 0.29
Weighted average number of common and common equivalent shares outstanding[2,3]					
Basic	21,576	21,000	20,336	14,470	10,282
Diluted	23,104	22,703	21,600	18,540	15,794

June 30,	2001	2000	1999	1998	1997
Balance Sheet Data:					
Working capital	$ 101,391	$ 67,977	$ 42,312	$ 32,794	$ 27,547
Total assets	183,584	144,217	97,511	73,569	44,848
Long-term obligations	13,430	14,052	590	—	—
Convertible preferred stock[2]	—	—	—	—	1,200
Total stockholders' equity	147,788	108,360	77,440	61,040	33,322

(1) Note: Previously published financial data have been restated to give effect to the two-for-one stock split effected in the form of a 100% stock dividend distributed on December 21, 1999.

(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.

(3) 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.

_management's discussion & analysis of financial condition and results of operations

Certain Factors That May Affect Future Results

In this report, as well as oral statements made by the Company, phrases 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 anticipated. 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 filed with the Securities and Exchange Commission.

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), computed tomography (CT), positron emission tomography (PET), and digital cardiology imaging machines. The remaining revenues are derived from computer systems used in such commercial applications as baggage scanning, seismic analysis and automatic testing equipment for the semiconductor industry.

Mercury uses a direct sales force to sell its computer systems to the defense electronics markets in the U.S., Japan, and Europe. 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 sells its products to OEMs, value-added resellers and end-users. Over the past three fiscal years, the Company has expanded its sales force to support growing revenues, made significant expenditures to recruit additional technical and professional staff, invested in information technology, and improved the Company's financial, administrative and management infrastructure.

Revenues include 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 related to products is recognized upon shipment provided that title and risk of loss has passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed and determinable, collection of the related receivable is reasonably assured and customer acceptance criteria have been successfully demonstrated. The Company accrues for anticipated warranty costs upon shipment. Service revenue is recognized ratably over applicable contract periods or as the services are performed. For certain contracts eligible under American Institute of Certified Public Accountants (AICPA) Statement of Position No. 81-1, revenue is recognized using the percentage-of-completion accounting method based on contract costs incurred to date compared with total estimated contract costs. 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. Mercury invested $20.7 million, $28.9 million and $30.5 million in fiscal years 1999, 2000 and 2001, 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, medical imaging systems, and other commercial applications. 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,	2001	2000	1999
Revenues	100.0%	100.0%	100.0%
Cost of revenues	33.1	27.8	32.1
Gross profit	66.9	72.2	67.9
Operating expenses:			
Selling, general and administrative	28.1	28.0	31.0
Research and development	16.9	20.5	19.4
Total operating expenses	45.0	48.5	50.4
Income from operations	21.9	23.7	17.5
Other income, net	3.1	2.1	1.4
Income before income taxes	25.0	25.8	18.9
Provision for income taxes	8.0	8.1	6.3
Net income	17.0%	17.7%	12.6%

Fiscal 2000 Vs. Fiscal 2001

Revenues

Total revenues increased 28% from $140.9 million during the year ended June 30, 2000 to $180.5 million during the year ended June 30, 2001.

Defense electronics revenues increased 20% from $100.3 million or 71% of total revenues during the year ended June 30, 2000 to $120.4 million or 67% of total revenues during the year ended June 30, 2001. This increase in revenue was primarily due to the increased unit demand for defense electronics products, largely comprised of advanced military applications in radar and airborne surveillance.

Medical imaging revenues increased 61% from $27.1 million or 19% of total revenues during the year ended June 30, 2000 to $43.5 million or 24% of total revenues during the year ended June 30, 2001. The increase in medical imaging revenues reflects the increase in production volume of product for magnetic resonance imaging (MRI), computed tomography (CT) and Positron Emissions Tomography (PET) imaging systems, along with the first production shipments of product for digital cardiology imaging systems.

Other commercial revenues increased 23% from $13.5 million or 10% of total revenues during the year ended June 30, 2000 to $16.6 million or 9% of total revenues during the year ended June 30, 2001. The increase in other commercial revenues was due primarily to the expansion into existing markets, particularly semiconductor photomask generation and mask inspection, offset in part by the loss of the Shared Storage Business Unit (SSBU) revenues.

Cost of Revenues

Cost of revenues increased 53% from $39.1 million during the year ended June 30, 2000 to $59.8 million during the year ended June 30, 2001. Cost of revenues as a percentage of total revenues increased from 28% during the year ended June 30, 2000 to 33% during the year ended June 30, 2001. The increase in costs as a percentage of total revenues was primarily due to an increase in external processing and component costs, a shift from higher-margin defense products to lower-margin commercial products, and costs associated with reestablishing certain discontinued standard parts.

Selling, General and Administrative

Selling, general and administrative expenses increased 28% from $39.5 million during the year ended June 30, 2000 to $50.6 million during the year ended June 30, 2001. Selling, general and administrative expenses as a percentage of total revenues were 28% for the years ended June 30, 2000 and 2001. The increase in expenses year over year was primarily due to expenses associated with the ongoing cost of implementing a new financial, manufacturing, and administrative computer system. Additionally, commissions associated with higher sales volume and the ongoing development of the Company's sales and management infrastructure to support the Company's growth contributed to the increased expenses.

Research and Development

Research and development expenses increased 6% from $28.9 million during the year ended June 30, 2000 to $30.5 million during the year ended June 30, 2001. Research and development expenses as a percentage of total revenues were 20% during the year ended June 30, 2000 and 17% during the year ended June 30, 2001. 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 core products and a significant investment in the research and development activities of the Wireless Communications Group. Even with the increase in research and development expenses as compared with a year ago, expenses are running lower than management's expectations due to the delay in certain prototyping activities.

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, from time to time, 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 18% from $33.5 million during the year ended June 30, 2000 to $39.6 million during the year ended June 30, 2001. This increase is associated with higher sales volume, offset in part by lower gross margins.

Included in income from operations during the year ended June 30, 2000 were $1.8 million in hardware and software revenues and $2.4 million in direct expenses related to SSBU. The direct expenses include expenses from marketing and engineering activities, primarily related to compensation, trade shows, prototype development and direct costs related to the sale of the product. SSBU was sold in FY 2000.

Gain on Sale of Division

On January 18, 2000, the Company completed the sale of SSBU to International Business Machines Corporation (IBM). Payments are structured with an initial payment of $4.5 million (excluding $1.0 million to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of $1.5 million plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The Company recorded $6.4 million and $4.8 million gains during the years ended June 30, 2001 and 2000, respectively. During the year ended June 30, 2000, the $4.8 million gain consisted of $6.1 million of cash received (initial $4.5 million plus first quarterly payment of $1.6 million) less legal and advisory costs of $581,000, compensation costs of $499,000, and net book value of equipment and inventories sold of $200,000.

Equity Loss in Joint Venture

In September 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television (DTV). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's investment in AgileVision during the year ended June 30, 2000 and 2001 amounted to $3.5 million and $3.4 million, respectively. The Company recognized $3.7 million and $3.3 million of losses on the equity-basis of accounting related to the operations of AgileVision during the years ended June 30, 2000 and 2001, respectively. On July 13, 2001, the Company's board of directors approved an additional investment of up to $1 million for the purpose of continuing to fund the AgileVision operations.

Interest Income, Net

The Company earned $1.7 million in interest income, net, during the year ended June 30, 2000 and $2.9 million during the year ended June 30, 2001. This increase is primarily due to higher average cash balances offset in part by lower interest rates.

Provision for Income Taxes

The Company's provision for income taxes was $11.4 million during the year ended June 30, 2000 and $14.4 million during the year ended June 30, 2001. The Company's effective tax rate was 31.5% during the year ended June 30, 2000 and 32.0% during the year ended June 30, 2001. The tax rates for both years ended June 30, 2000 and 2001 were lower than the federal statutory rate of 35% primarily due to the utilization of research and development credits and tax-exempt interest income, offset partially by state income tax.

Fiscal 1999 Vs. Fiscal 2000

Revenues

Total revenues increased 32% from $106.6 million during the year ended June 30, 1999 to $140.9 million during the year ended June 30, 2000.

Defense electronics revenues increased 21% from $82.6 million or 77% of total revenues during the year ended June 30, 1999 to $100.3 million or 71% of total revenues during the year ended June 30, 2000. This increase in revenue was primarily due to the increased unit demand for defense electronics products, largely comprised of advanced military applications in radar, sonar, and airborne surveillance.

Medical imaging revenues increased 77% from $15.3 million or 14% of total revenues during the year ended June 30, 1999 to $27.1 million or 19% of total revenues during the year ended June 30, 2000. The increase in medical imaging revenues reflects the increase in production volume of product for our customers' CT imaging systems.

Other revenues increased 55% from $8.7 million or 8% of total revenues during the year ended June 30, 1999 to $13.5 million or 10% of total revenues during the year ended June 30, 2000. The increase in other revenues was due primarily to the addition of a new commercial customer, offset in part by the sale of SSBU in January 2000.

Cost of Revenues

Cost of revenues increased 14% from $34.2 million during the year ended June 30, 1999 to $39.1 million during the year ended June 30, 2000. Cost of revenues as a percentage of total revenues decreased from 32% during the year ended June 30, 1999 to 28% during the year ended June 30, 2000. 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 20% from $33.0 million during the year ended June 30, 1999 to $39.5 million during the year ended June 30, 2000. Selling, general and administrative expenses as a percentage of total revenues were 31% during the year ended June 30, 1999 and 28% during the year ended June 30, 2000. The increase in expense dollars reflects the hiring of additional sales and administrative personnel, increased commissions related to increased revenues, investment in an enterprise resource planning system, 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 increased 39% from $20.7 million during the year ended June 30, 1999 to $28.9 million during the year ended June 30, 2000. Research and development expenses as a percentage of total revenues were 19% during the year ended June 30, 1999 and 20% during the year ended June 30, 2000. 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 and an increased level of introduction of new products in response to a high demand for next-generation products.

Income from Operations

Income from operations increased 80% from $18.6 million during the year ended June 30, 1999 to $33.5 million during the year ended June 30, 2000. This increase is associated with higher sales volume and lower cost of goods sold.

Included in income from operations during the year ended June 30, 2000 were $1.8 million in hardware and software revenues and $2.4 million in direct expenses related to the SSBU. 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 SSBU. The direct expenses include expenses from marketing and engineering activities, primarily related to compensation, trade shows, prototype development and direct costs related to the sale of the product.

Gain on Sale of Division

On January 18, 2000, the Company completed the sale of SSBU to IBM. Payments are structured with an initial payment of $4.5 million (excluding $1.0 million to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of $1.5 million plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The Company recorded a $4.8 million gain on the sale of SSBU which includes cash received of $6.1 million less legal and advisory costs of $581,000, compensation costs of $499,000, and the net book value of equipment and inventories sold of $200,000.

Equity Loss in Joint Venture

In September 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television (DTV). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. During the year ended June 30, 2000, the Company's contribution to AgileVision was $3.5 million in cash. During the year ended June 30, 2000, the Company recognized $3.7 million of losses on the equity-basis of accounting related to the operation of AgileVision. No expenses were recognized during the year ended June 30, 1999.

Interest Income, Net

The Company earned $1.3 million in interest income, net, during the year ended June 30, 1999 and $1.7 million during the year ended June 30, 2000. This increase primarily reflects higher average cash balances.

Provision for Income Taxes

The Company's provision for income taxes was $6.6 million during the year ended June 30, 1999 and $11.4 million during the year ended June 30, 2000. The Company's effective tax rate was 33% during the year ended June 30, 1999 and 31.5% during the year ended June 30, 2000. During fiscal 2000, the tax rate was reduced primarily due to a reduction in state taxes.

Liquidity and Capital Resources

As of June 30, 2001, the Company had cash and marketable securities of approximately $95.6 million. During the year ended June 30, 2001, the Company generated approximately $26.1 million in cash from operations compared to $30.7 million generated during the year ended June 30, 2000. The decrease in cash generated from operations is attributable primarily to the Company's increase in current assets, particularly trade receivables. Trade receivables increased significantly at June 30, 2001 due to a large percentage of the fourth quarter shipments delivered during the last few weeks of the year. Overall, the Company's days sales, based on revenues of each calendar quarter, decreased from 70 days at the end of 2000 to 64 days at the end of 2001.

In September 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television (DTV). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's investment in AgileVision during the year ended June 30, 2001 and 2000 amounted to $3.4 million and $3.5 million, respectively. On July 13, 2001, the Company's board of directors approved an additional investment of up to $1 million for the purpose of continuing to fund the AgileVision operations.

The Company used approximately $21.8 million in investing activities during the year ended June 30, 2001 compared to $45.9 million during the year ended June 30, 2000. During the year ended June 30, 2001, the Company's investing activities consisted of $19.1 million for the purchase of marketable securities (net of sales), $1.7 million of cash investment in AgileVision, and $7.4 million for computers, furniture and equipment. These payments were partially offset by the receipt of $6.4 million from the sale of a division. During the year ended June 30, 2000, the Company's investing activities consisted of $40.8 million for the purchase of marketable securities (net of sales), $3.5 million for investment in AgileVision, $1.1 million for the purchase of land adjacent to its existing headquarters and $5.5 million for computers, furniture and equipment. These payments were partially offset by the receipt of $5.0 million from the sale of a division.

The Company generated approximately $3.1 million in cash from financing activities during the year ended June 30, 2001 compared to $17.4 million during the year ended June 30, 2000. During the year ended June 30, 2001, the Company's financing activities consisted primarily of $4.3 million in cash generated from the employee stock purchase plan and the exercise of stock options. These cash inflows were partially offset by the payment of debt and capital lease obligations amounting to approximately $1.2 million. During the year ended June 30, 2000 the Company's financing activities consisted primarily of $14.5 million in proceeds received upon the issuance of two 7.3% senior secured financing notes. These notes are due November 2014. In addition, $3.7 million in cash was generated from the employee stock purchase plan and the exercise of stock options. These cash inflows were partially offset by the payment of debt and capital lease obligations amounting to approximately $828,000.

Management believes that the Company's available cash, marketable securities, and cash generated from operations, will be sufficient to provide for the Company's working capital and capital expenditure requirements for at least the next 24 months. 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.

Recent Accounting Pronouncements

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition." SAB 101 summarizes the staff's view in applying generally accepted accounting principles to revenue recognition. The Company adopted SAB 101 in fiscal year 2001. The adoption did not have a material effect on its financial statements.

The Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS No. 137 and SFAS No. 138 in the first fiscal quarter of 2001. SFAS No. 133 requires the Company to recognize all derivatives on the balance sheet at fair value. Adoption of SFAS No. 133 did not have an impact on the Company's financial position or results of operations.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS No. 142 requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. The provisions of SFAS No. 142 are required to be adopted for fiscal years beginning after December 15, 2001, however, the Company has, as permitted, adopted SFAS No. 142 early, as of July 1, 2001. The adoption of SFAS No. 142 had no impact on the Company's financial position or results of operations.

Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk Management

Due to the short-term duration, the fair value of the Company's cash and investment portfolio at June 30, 2001 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, the high and low transactions per share during such periods. Such over-the-counter market quotations reflect interdealer prices without retail markup, markdown or commission.

		High	Low
2000	First quarter	17 1/4	11 3/8
	Second quarter	35	16
	Third quarter	68 1/8	27 7/8
	Fourth quarter	48 7/8	24 1/4
2001	First quarter	31 13/16	19 13/16
	Second quarter	50	26 1/8
	Third quarter	54 1/8	34 15/16
	Fourth quarter	54 5/9	30 1/4

As of August 31, 2001 the Company had approximately 12,000 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,	2001	2000
Assets		
Current assets:		
Cash and cash equivalents	$ 13,307	$ 5,850
Marketable securities	54,135	36,784
Trade accounts receivable, net of allowance for doubtful accounts of $600 and $308 at June 30, 2001 and 2000, respectively	34,928	25,046
Inventory	12,840	15,975
Deferred income taxes	3,206	1,909
Income tax receivable	—	722
Prepaid expenses and other current assets	5,341	3,496
Total current assets	123,757	89,782
Marketable securities	28,166	25,705
Property and equipment, net	28,793	27,574
Deferred income taxes	2,207	787
Other assets	661	369
Total assets	$ 183,584	$144,217
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 6,638	$ 9,231
Accrued expenses	4,263	2,486
Accrued compensation	7,427	6,143
Capital lease – short term	292	580
Notes payable – short term	621	577
Billings in excess of revenues and customer advances	1,060	2,788
Income taxes payable	2,065	—
Total current liabilities	22,366	21,805
Commitments and Contingencies (Note F)	—	—
Deferred compensation – long term	337	—
Capital lease – long term	108	447
Notes payable – long term	12,985	13,605
Stockholders' Equity		
Common stock, $.01 par value; 40,000,000 shares authorized; 21,811,738 and 21,395,137 shares issued and outstanding at June 30, 2001 and 2000, respectively	218	214
Additional paid-in capital	42,575	34,446
Retained earnings	104,525	73,841
Accumulated other comprehensive income	470	(141)
Total stockholders' equity	147,788	108,360
Total liabilities and stockholders' equity	$ 183,584	$144,217

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,	2001	2000	1999
Net revenues	$ 180,492	$ 140,944	$ 106,571
Cost of revenues	59,815	39,146	34,237
Gross profit	120,677	101,798	72,334
Operating expenses:			
Selling, general and administrative	50,636	39,475	33,002
Research and development	30,484	28,862	20,709
Total operating expenses	81,120	68,337	53,711
Income from operations	39,557	33,461	18,623
Interest income	3,977	2,430	1,336
Interest expense	(1,065)	(731)	(51)
Equity loss in joint venture	(3,310)	(3,721)	—
Gain on sale of division, net	6,400	4,820	—
Other income (expense), net	(435)	86	185
Income before income tax provision	45,124	36,345	20,093
Income tax provision	14,440	11,449	6,631
Net income	$ 30,684	$ 24,896	$ 13,462
Net income per common share:			
Basic	$ 1.42	$ 1.19	$ 0.66
Diluted	$ 1.33	$ 1.10	$ 0.62
Weighted average number of common and common equivalent shares outstanding:			
Basic	21,576	21,000	20,336
Diluted	23,104	22,703	21,600

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, 2001, 2000, and 1999 (In Thousands)

	Common Stock Shares	Common Stock Amount	Add'l Paid-In Capital	Retained Earnings	Accumulated Other Compre-hensive Income	Compre-hensive Income	Subscriptions and Related Parties Notes Receivable	Total Stock-holders' Equity
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
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
Exercise of common stock options	169	1	1,148					1,149
Two-for-one stock split	10,480	105	(105)					—
Exercise of common stock options	396	4	1,851					1,855
Issuance of common stock in conjunction with employee stock purchase plan	39	1	736					737
Tax benefit from disqualified dispositions			1,877					1,877
Stock compensation			424					424
Comprehensive income:								
Net income				24,896		24,896		24,896
Unrealized loss on securities					(41)	(41)		(41)
Foreign currency translation					23	23		23
Comprehensive income						24,878		
Balance June 30, 2000	21,395	214	34,446	73,841	(141)		—	108,360
Exercise of common stock options	386	4	3,366					3,370
Issuance of common stock in conjunction with employee stock purchase plan	31	—	950					950
Tax benefit from disqualified dispositions			3,402					3,402
Stock compensation			411					411
Comprehensive income:								
Net income				30,684		30,684		30,684
Unrealized gain on securities					705	705		705
Foreign currency translation					(94)	(94)		(94)
Comprehensive income						$ 31,295		
Balance June 30, 2001	21,812	$ 218	$ 42,575	$ 104,525	$ 470		—	$ 147,788

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

_consolidated statements of cash flows

(In Thousands) Year Ended June 30,	2001	2000	1999
Cash flows from operating activities:			
Net income	$ 30,684	$ 24,896	$ 13,462
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization of property and equipment	6,128	4,786	3,916
Gain on sale of division	(6,400)	(4,820)	—
Amortization of capitalized software development costs	—	313	602
Equity loss in joint venture	3,310	3,721	—
Stock option compensation expense	411	424	46
Provision for doubtful accounts	324	—	249
Deferred income taxes	(2,717)	590	(1,187)
Changes in assets and liabilities:			
Trade accounts receivable	(11,560)	3,866	(11,871)
Inventory	3,060	(3,661)	(3,262)
Prepaid expenses and other current assets	(1,678)	(2,831)	(108)
Other assets	(297)	(150)	(98)
Accounts payable	(2,585)	3,654	2,216
Accrued expenses and compensation	2,565	674	1,874
Deferred compensation – long term	337	—	—
Billings in excess of revenues and customer advances	(1,693)	(366)	2,151
Income taxes payable	6,189	(434)	1,110
Net cash provided by operating activities	26,078	30,662	9,100
Cash flows from investing activities:			
Purchase of marketable securities	(113,652)	(127,019)	(114,574)
Sale of marketable securities	94,544	86,230	121,768
Purchases of property and equipment	(7,387)	(6,637)	(19,440)
Investment in joint venture	(1,700)	(3,500)	—
Proceeds from sale of division, net of selling costs	6,400	5,032	—
Capitalized software development costs	—	—	(810)
Note receivable from related parties	—	—	325
Net cash used in investing activities	(21,795)	(45,894)	(12,731)
Cash flows from financing activities:			
Proceeds from employee stock purchase program	950	737	469
Proceeds from exercise of stock options	3,370	3,004	1,216
Proceeds from issuance of notes	—	14,500	—
Payments of debt	(577)	(318)	—
Principal payments under capital lease obligations	(627)	(510)	(303)
Net cash provided by financing activities	3,116	17,413	1,382
Net increase (decrease) in cash and cash equivalents	7,399	2,181	(2,249)
Effect of exchange rate changes on cash and cash equivalents	58	(7)	(129)
Cash and cash equivalents at beginning of year	5,850	3,676	6,054
Cash and cash equivalents at end of year	$ 13,307	$ 5,850	$ 3,676
Cash paid during the period for:			
Interest	$ 1,068	$ 685	$ 51
Income taxes	$ 13,389	$ 12,692	7,155
Non-cash transactions:			
Investment in joint venture from conversion of account receivable	$ 1,700	$ —	$ —
Equipment acquired under capital leases	$ —	$ 513	$ 1,327

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 that 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 primary markets for the Company's products are defense electronics, medical diagnostic imaging, and other commercial applications. 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 related to products is recognized upon shipment provided that title and risk of loss has passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed and determinable, collection of the related receivable is reasonably assured and customer acceptance criteria have been successfully demonstrated. For products with acceptance criteria that are not successfully demonstrated prior to shipment, revenue is recognized upon customer acceptance. The Company accrues for anticipated warranty costs upon shipment. Service revenue is recognized ratably over applicable contract periods or as the services are performed.

For certain contracts eligible under AICPA Statement of Position No. 81-1, revenue is recognized using the percentage-of-completion accounting method based on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated costs and anticipated losses, if any, are recognized in the period in which determined. Approximately $1,789,000 of revenue was recognized for the year ended June 30, 2001 under the percentage-of-completion method, and no revenue was recognized for the year ended June 30, 2000 or 1999 under the percentage-of-completion method.

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 market 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 reevaluates such classification. There were no securities classified as trading or held-to-maturity as of June 30, 2001 and 2000. 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 accumulated other comprehensive income 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, 2001 and 2000, marketable securities were classified as follows:

	2001 Available-For-Sale	2000 Available-For-Sale
Short-term marketable securities:		
Tax-exempt municipal notes and bonds and money market instruments	$ 54,135	$ 36,784
Long-term marketable securities:		
Tax-exempt municipal notes and bonds, taxable corporate bonds, government agencies	$ 28,166	$ 25,705

Concentration of Credit Risk

Financial instruments that 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, 2001 and 2000, the Company had approximately $5,613,000 and $3,088,000, respectively, on deposit or invested with its primary financial and lending institution.

At June 30, 2001 and 2000, only one customer comprised 10% or more of the Company's receivables. Customer "A" represented 25% of the Company's receivables at June 30, 2001 and 2000.

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 betterment 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. The Company uses an estimated life of two years or less for all capitalized software costs.

Research and Development Costs

Research and development costs are expensed as incurred.

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. Euros are used as the functional currency for subsidiaries in France and the Netherlands, while local currency is used as functional currency in the United Kingdom and Japan. 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 December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition." SAB 101 summarizes the staff's view in applying generally accepted accounting principles to revenue recognition. The Company adopted SAB 101 in fiscal year 2001. The adoption did not have a material effect on its financial statements.

The Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS No. 137 and SFAS No. 138 in the first fiscal quarter of 2001. SFAS No. 133 requires the Company to recognize all derivatives on the balance sheet at fair value. Adoption of SFAS No. 133 did not have an impact on the Company's financial position or results of operations.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS No. 142 requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. The provisions of SFAS No. 142 are required to be adopted for fiscal years beginning after December 15, 2001, however, the Company has adopted SFAS No. 142 early, as of July 1, 2001. The adoption of SFAS No. 142 had no impact on the Company's 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,	2001	2000	1999
Net income	$ 30,684	$ 24,896	$ 13,462
Shares used in computation of net income per share – basic	21,576	21,000	20,336
Effect of dilutive securities:			
Stock options	1,528	1,703	1,264
Shares used in computation of diluted net income per share	23,104	22,703	21,600
Net income per share – basic	$ 1.42	$ 1.19	$ 0.66
Net income per share – dilutive	$ 1.33	$ 1.10	$ 0.62

Options to purchase 110,538 shares of common stock in 2001, 141,000 shares in 2000, and 222,000 in 1999 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,	2001	2000
Raw materials	$ 6,109	$ 4,252
Work in process	4,301	7,415
Finished goods	2,430	4,308
Total	$ 12,840	$ 15,975

E_ Property and Equipment:

Property and equipment consists of the following:

June 30,	2001	2000
Computer equipment and software	$ 28,599	$ 22,406
Buildings	15,832	15,819
Land	2,985	2,985
Machinery and equipment	661	605
Furniture and fixtures	4,462	3,709
Building and leasehold improvements	1,865	1,585
	54,404	47,109
Less: accumulated depreciation and amortization	(25,611)	(19,535)
	$ 28,793	$ 27,574

F_ Commitments and Contingencies:

Long-Term Debt Financing Arrangement

Long-term debt at June 30, 2001 and 2000 consisted of the following:

	2001	2000
Notes payable	$ 13,606	$ 14,182
Less current maturities	621	577
	$ 12,985	$ 13,605

On November 3, 1999, the Company completed a lending agreement with a commercial financing company, issuing two 7.30% senior secured financing notes ("the Notes"), due November 2014. The original principal value of the Notes amounted to $14,500,000. The Notes are collateralized by the Company's corporate headquarters which consists of two buildings. The Notes' agreements contain certain covenants, which, among other provisions, require the Company to maintain a minimum net worth. As of June 30, 2001, the Company was in compliance with the covenants of the Notes' agreements.

Maturities of long-term debt are as follows:

Year Ending June 30,	
2002	$ 621
2003	667
2004	718
2005	772
2006	830
Thereafter	9,998
	$ 13,606

Legal

In July 1999, a former employee brought a wrongful termination action against the Company and certain officers of the Company. The plaintiff seeks severance pay, the right to purchase 60,000 shares of the Company's common stock at a price of $2.00 per share, the right to exercise 96,000 stock options at an exercise price of $2.00 per share, and other financial consideration. Binding arbitration has commenced but no ruling has been decided. The position of the Company's management, after consultation with external counsel, is that a loss from this action is not probable. Accordingly, no loss accrual has been recorded. If the plaintiff were to prevail on its claims, depending on the price of the Company's common stock, a judgement for a material amount could be awarded against the Company. The Company has objected to the claims and is aggressively defending the matter.

Lease Commitments

The Company leases certain facilities, and machinery and equipment under capital and operating leases expiring in various years through 2004 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:

Year Ending June 30,	Operating Lease Real Estate	Operating Lease Equipment	Capital Lease Equipment
2002	$ 526	—	$ 325
2003	296	—	95
2004	242	—	—
Total minimum lease payments	$ 1,064	—	$ 420
Less: amounts representing interest			20
Present value of minimum lease payments			400
Less: current portion			292
Long-term portion			$ 108

Rental expense during the fiscal years ended June 30, 2001, 2000 and 1999 was approximately $506,000, $524,000 and $1,116,000, respectively.

G_ Stockholders' Equity:
The Company is authorized to issue 1,000,000 shares of preferred stock with a par value of $.01 per share.

Common Stock
On November 18, 1999, the Company's Board of Directors authorized a two-for-one stock split effected in the form of a 100% stock dividend distributed on December 21, 1999 to shareholders of record as of December 6, 1999. As a result of the stock split, the accompanying consolidated financial statements reflect an increase in the number of outstanding shares of common stock and the transfer of the par value of these additional shares from paid-in capital. All share and per share amounts have been restated to reflect the retroactive effect of the stock split, except the capitalization of the Company.

H_ Stock-Based Compensation:
At June 30, 2001, the Company had both stock option plans and a stock purchase plan. The Company has 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 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 $411,000, $424,000, and $46,000 for the fiscal years ended June 30, 2001, 2000, and 1999, 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 2,650,000 shares, adjusted for a two-for-one stock split, 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. In 1999, an amendment to the plan was adopted by the Board of Directors of the Corporation, which provided for an increase in the number of shares reserved for issuance under the Plan from 2,650,000 shares, adjusted for a two-for-one stock split, of common stock to 4,650,000 shares, adjusted for a two-for-one stock split, and a reduction in the vesting period for future options from five to four 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 100,000 shares, adjusted for a two-for-one stock split, 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. In August 2001, the 1998 Plan was terminated.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value of Options Granted
Outstanding at June 30, 1998	2,189,124	$ 3.06	
Granted	1,271,410	9.65	$ 6.04
Exercised	(618,324)	1.97	
Canceled	(76,454)	5.18	
Outstanding at June 30, 1999	2,765,756	6.27	
Granted	928,684	26.42	$ 19.03
Exercised	(734,592)	4.09	
Canceled	(258,000)	8.67	
Outstanding at June 30, 2000	2,701,848	13.56	
Granted	920,870	34.07	$ 24.49
Exercised	(386,032)	8.79	
Canceled	(192,647)	17.35	
Outstanding at June 30, 2001	3,044,039	20.10	

Information related to the stock options outstanding as of June 30, 2001, is as follows:

	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable Number of Options	Exercisable Weighted Average Exercise Price
$1.25 –$4.00	516,802	5.74	$ 3.02	291,962	$ 2.87
$5.00 –$8.84	446,970	7.13	7.99	115,578	7.99
$9.56 –$14.50	455,534	7.71	11.87	102,956	11.79
$14.94–$23.44	447,950	8.31	21.24	76,716	21.49
$24.25–$30.06	602,433	9.19	28.16	19,000	25.57
$33.13–$48.00	517,650	9.15	41.02	58,450	39.86
$51.30–$52.00	56,700	9.90	51.89	—	—
	3,044,039	7.96	20.10	664,662	11.19

There were 409,029 and 605,612 options exercisable at June 30, 2000 and 1999, respectively, with weighted average exercise prices of $5.32 and $2.77. The fair value of each option granted during fiscal years ended June 30, 2001, 2000 and 1999 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 4.97% in 2001, 6.34% in 2000 and 4.90% in 1999; (2) expected option life of six years; (3) expected stock volatility of 80% for June 30, 2001, 77% for June 30, 2000 and 63% for June 30, 1999; 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 500,000 shares, adjusted for a two-for-one stock split, 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 2001, the Company issued 16,949 and 14,115 shares of common stock to employees who participated in the plan at prices of $27.04 and $34.85, respectively. Shares available for future purchase under the ESPP totaled 373,697at June 30, 2001.

The weighted-average fair value of purchase rights granted in fiscal 2001, 2000, and 1999 was $13.52, $8.40, and $3.23, respectively.The fair value of the employees' purchase rights was estimated using the Black-Scholes model with the following assumptions: (1) dividend yield of 0.0%; (2) an expected life of six months; (3) expected volatility of 80% for June 30, 2001, 77% for June 30, 2000, and 63% for June 30, 1999; and (4) risk-free interest rate of 3.63% for June 30, 2001, 5.25% for June 30, 2000, and 4.90% for June 30, 1999.

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, 2001, 2000 and 1999 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:			
2001	$ 30,684	$ 1.42	$ 1.33
2000	$ 24,896	$ 1.19	$ 1.10
1999	$ 13,462	$ 0.66	$ 0.62
Pro forma:			
2001	$ 22,214	$ 1.03	$ 0.96
2000	$ 20,791	$ 0.99	$ 0.92
1999	$ 11,950	$ 0.59	$ 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.

I_ Income Taxes:

Income tax expense consisted of the following:

Year Ended June 30,	2001	2000	1999
Federal:			
Current	$15,642	$10,081	$ 6,377
Deferred	(2,382)	544	(479)
	13,260	10,625	5,898
State:			
Current	1,374	755	1,295
Deferred	(335)	46	(708)
	1,039	801	587
Foreign – current	141	23	146
	$14,440	$11,449	$ 6,631

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

Year Ended June 30,	2001	2000	1999
Income taxes at federal statutory rates	35.0%	35.0%	35.0%
State income tax, net of federal tax benefit	1.5	1.3	1.9
Research and development credits	(2.1)	(3.4)	(3.8)
Tax-exempt interest income	(1.9)	(1.6)	(1.8)
Other	(0.5)	0.2	1.7
	32.0%	31.5%	33.0%

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

June 30,	2001	2000
Receivable allowances and inventory valuations	$ 1,698	$ 1,083
Accrued vacation	1,126	402
Property and equipment	112	167
State tax credit carryforwards	811	620
Deferred compensation	126	—
Joint venture loss allocation	1,157	—
Other temporary differences	383	424
Total deferred tax asset, net	$ 5,413	$ 2,696

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

At June 30, 2001, the Company had state research and development tax credit carryforwards of approximately $1,247,000 which begin to expire in 2014.

J_ Employee Benefit Plans:

The Company maintains a qualified 401(k) Plan and up until December 31, 1999, maintained a qualified profit sharing 401(a) Plan. The 401(k) Plan covers 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. Effective January 1, 2000, the Company began matching up to 3% of compensation. Previously, the company matched up to 2% of compensation. The Company may also make optional contributions to the plan for any plan year at its discretion. The Company terminated its 401(a) Plan as of December 31, 1999.

Expense recognized by the Company under the 401(a) and 401(k) Plans was approximately $1,048,000, $788,000 and $1,000,000 during the years ended June 30, 2001, 2000 and 1999, respectively.

The Company maintains a bonus plan, which provides cash awards to employees based upon operating results and employee performance. Bonus expense to employees was approximately $6,416,000, $4,499,000, and $2,753,000 during the years ended June 30, 2001, 2000 and 1999, 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 six principal operating segments: North American Defense, Medical Imaging, Commercial, International Defense and Commercial, Wireless Communications, and Research and Development. These operating 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. The Company has five reportable segments: North American Defense, Medical Imaging segment, Commercial segment, Other Defense and Commercial segment, and Research and Development segment. The Other Defense and Commercial segment is comprised of International Defense, Wireless Communications, and Other Commercial businesses unrelated to the defense or medical businesses. These operating segments are not separately reported, as they do not meet any of Statement No. 131's quantitative thresholds. A new commercial operating segment was established during the first quarter of fiscal 2000. Previously, most commercial businesses were included within the North American and international operating segments. Historical information was not restated to reflect this business reorganization because it is impractical to obtain the necessary information.

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

	North American Defense Segment[2]	Medical Imaging Segment	Commercial Segment	Other Defense and Commercial Segment[2]	Research and Development Segment	Corporate	Consolidated
Twelve Months Ended June 30, 2001							
Sales to unaffiliated customers	$107,998	$43,456	$15,361	$13,677	$ —	$ —	$ 180,492
Income (loss) before taxes[1]	74,238	14,208	7,310	905	(27,605)	(23,932)	45,124
Depreciation/amortization expense	829	66	13	264	1,733	3,223	6,128
Twelve Months Ended June 30, 2000							
Sales to unaffiliated customers	$ 96,901	$ 27,093	$ —	$ 16,950	$	$ —	$ 140,944
Income (loss) before taxes[1]	66,889	10,510	—	4,145	(27,740)	(17,459)	36,345
Depreciation/amortization expense	427	41	—	332	1,218	3,081	5,099
Twelve Months Ended June 30, 1999							
Sales to unaffiliated customers	$ 79,906	$ 15,295	$ —	$ 11,370	$ —	$ —	$ 106,571
Income (loss) before taxes[1]	53,174	6,353	—	972	(19,639)	(20,767)	20,093
Depreciation/amortization expense	191	70	—	113	1,263	2,881	4,518

(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 the Other Defense and Commercial segment differ 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 the Other Defense and Commercial are operating segments as defined by Statement No. 131, and are subsets of the worldwide defense market discussed in the MD&A.

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 total long-lived assets for the fiscal years ended June 30, 2001, 2000 and 1999 respectively.

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

Year Ended June 30,	2001	2000	1999
Customer E	18%	14%	16%
Customer B	14%	19%	22%
Customer D	13%	12%	12%
Customer A	—	12%	—

L_ Sale of Division:

On January 18, 2000, the Company completed the sale of the SSBU to IBM. Payments are structured with an initial payment of $4,500,000 (excluding $1,000,000 to be held in escrow and payable on a contingent basis), followed by 12 quarterly contingent payments of $1,500,000 plus interest. The quarterly payments are contingent upon IBM's continued use of the technology. If IBM defaults, Mercury has the right to recover the assets, including the patent and other intellectual property. The contingency payments of $1,500,000 per quarter are recognized when collected. During the 12-month period ended June 30, 2001, the Company recorded a $6,400,000 gain on the sale of this division. During the 12 months ended June 30, 2000, the Company recorded a $4,820,000 gain on the sale of this division which includes cash received of $6,100,000 less legal and advisory costs of $581,000, costs reimbursable to IBM of $499,000, and the net book value of equipment and inventories sold of $200,000.

M_ Equity Loss in Joint Venture:

In September 1999, the Company formed AgileVision as a joint venture with Sarnoff Corporation, the developer of color television and a pioneer in the creation of digital television (DTV). AgileVision provides broadcasters and cable providers equipment to optimize their DTV investment and develop new broadband media commerce revenue streams, including master control systems that permit broadcasters to perform multiple functions on a single platform that previously would have required the engineering and integration of numerous discrete products and systems. The Company's investment in AgileVision amounted to $3,400,000 and $3,500,000 during the years ended June 30, 2001 and 2000, respectively. The Company recognized $3,310,000 and $3,721,000 of losses on the equity-basis of accounting related to the operations of AgileVision during the years ended June 30, 2001 and 2000, respectively.

Summarized Income Statement results for AgileVision during the years ended June 30, 2001 and 2000 are as follows:

Year Ended June 30,	2001	2000
Expenses	$ (4,733)	$ (6,723)
Loss from continuing operations	$ (4,733)	$ (6,723)
Net loss	$ (4,733)	$ (6,723)

Summarized Statement of Financial Position of AgileVision as of June 30, 2001 and 2000:

Year Ended June 30,	2001	2000
Current assets	$ 471	$ 1,009
Noncurrent assets	37	12
Total assets	$ 508	$ 1,021
Current liabilities	$ 6,864	$ 2,744
Shareholders' equity	(6,356)	(1,723)
Total liabilities and equity	$ 508	$ 1,021

_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, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States of America. 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 auditing standards generally accepted in the United States of America, 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 our opinion.

Boston, Massachusetts

July 27, 2001

_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.

2001	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$ 41,469	$ 43,325	$ 46,953	$ 48,745
Cost of revenues	13,124	14,189	15,274	17,228
Gross profit	28,345	29,136	31,679	31,517
Operating expenses:				
Selling, general and administrative	12,123	12,779	12,607	13,127
Research and development	6,743	7,954	8,047	7,740
Total operating expenses	18,866	20,733	20,654	20,867
Income from operations	9,479	8,403	11,025	10,650
Interest income	928	1,004	995	1,050
Interest expense	(275)	(268)	(263)	(259)
Equity loss in joint venture	(1,235)	(476)	(1,356)	(243)
Gain on sale of division, net	1,600	1,600	1,600	1,600
Other income (expense), net	(43)	(104)	(323)	35
Income before taxes	10,454	10,159	11,678	12,833
Provision for income taxes	3,345	3,251	3,737	4,107
Net income	$ 7,109	$ 6,908	$ 7,941	$ 8,726
Net income per common share:				
Basic	$ 0.33	$ 0.32	$ 0.37	$ 0.40
Diluted	$ 0.31	$ 0.30	$ 0.34	$ 0.37

2000	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$ 37,863	$ 35,405	$ 32,351	$ 35,325
Cost of revenues	10,037	9,333	9,388	10,388
Gross profit	27,826	26,072	22,963	24,937
Operating expenses:				
Selling, general and administrative	9,105	10,144	10,060	10,166
Research and development	5,537	6,851	7,445	9,029
Total operating expenses	14,642	16,995	17,505	19,195
Income from operations	13,184	9,077	5,458	5,742
Interest income	322	574	751	783
Interest expense	(18)	(106)	(282)	(325)
Equity loss in joint venture	(515)	(926)	(1,136)	(1,144)
Gain on sale of division, net	—	—	3,220	1,600
Other income (expense), net	(16)	93	53	(44)
Income before taxes	12,957	8,712	8,064	6,612
Provision for income taxes	4,665	2,876	1,974	1,934
Net income	$ 8,292	$ 5,836	$ 6,090	$ 4,678
Net income per common share:				
Basic	$ 0.40	$ 0.28	$ 0.29	$ 0.22
Diluted	$ 0.37	$ 0.26	$ 0.26	$ 0.20

_directors & management

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Partner of Zero Stage Capital
Director of several technology companies

Albert P. Belle Isle
Independent investor in
technology-based companies

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President
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Analog Devices, Inc.

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Retired President
Lockheed Advanced Development Company

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Consultant, Komon International
Director of several technology companies

Michael I. Schneider
Retired Vice President
Data General Corporation
(Deceased 9.6.01)

Clerk and General Counsel

Anthony J. Medaglia, Jr.
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Boston, MA 02110

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James R. Bertelli

Senior Vice President

G. Mead Wyman
Chief Financial Officer and Treasurer

Vice Presidents

Robert D. Becker
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David L. Bertelli
Organization Development

Edmund L. Burke

Steven M. Chasen
Special Projects

Randall W. Dean
Software Engineering

Douglas F. Flood
Corporate Development

Robert C. Frisch
Advanced Development

Barry S. Isenstein
Wireless Systems Group

Vincent A. Mancuso
Government Electronics Group

Stephen C. Patterson
Product Planning / Hardware Development

Robert W. Perry
Manufacturing

Alfred L. Simensen
International Operations

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Medical Business Group

Senior Management

Richard A. Jaenicke
Director, Product Marketing

Craig Lund
Chief Technology Officer

Gerald P. Nadeau
Chief Information Officer

Gary E. Olin
Director, Corporate Communications / Investor Relations

Yogesh B. Parikh
Chief Quality Officer

Mark Skalabrin
OEM Solutions Group

_corporate information

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France
Israel
Japan
Korea
United Kingdom
Taiwan / Republic of China
Turkey

Auditors

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Stockholder Information
The Company's Form 10-K as filed with the Securities and Exchange Commission, and other published information is available, free of charge on request by writing or phoning: Investor Relations, Mercury Computer Systems, Inc., 199 Riverneck Rd., Chelmsford, MA 01824-2820, phone: 978-256-1300.

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Annual Meeting
The annual meeting of stockholders will be held at 10:00 a.m. on Thursday, November 15, 2001, at the Museum of Science, Science Park, O'Brien Highway, Boston, MA.

Common Stock
Mercury Computer Systems' common stock is traded on the NASDAQ National Market System under the symbol MRCY.

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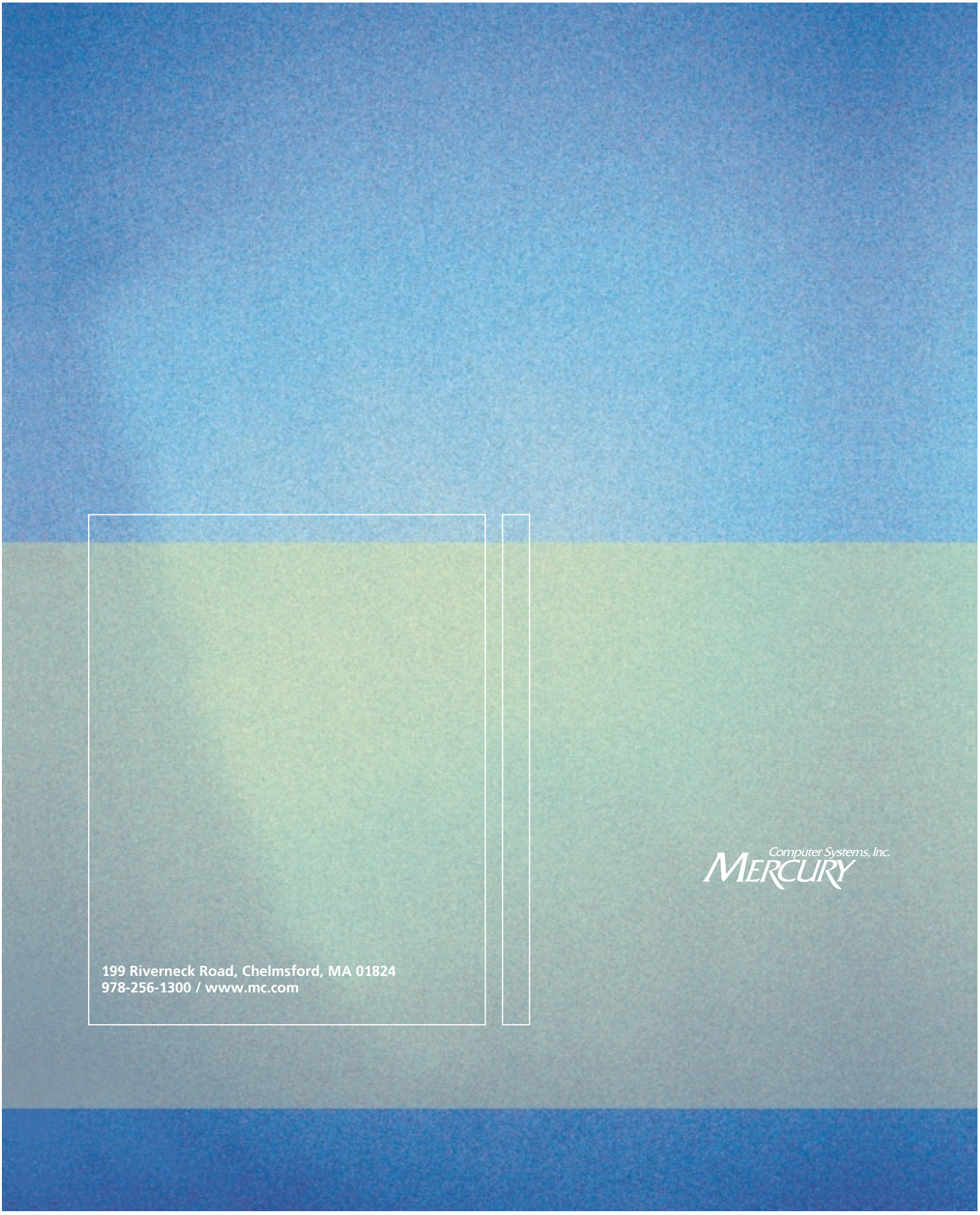

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