

FINAL TRANSCRIPT

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MRCY - Mercury Computer Systems 11th Annual Investors Conference

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PRESENTATION

Unidentified Speaker

Mercury Computer Systems, where challenges drive innovation. For over two decades, Mercury's been providing powerful, rugged, high-bandwidth, real-time computing solutions for imaging and electronic warfare applications.

We've been a trusted partner to America's defense primes, developing and delivering innovative technology to support signal and image processing for defense programs, on land, on sea and in the air, for 25 years, and counting.

Today, the platforms are more sophisticated, the operations more demanding. They require the most powerful and embedded solutions to support critical missions. Mercury's real-time computing subsystems deliver the speed and precision needed to meet the compass of challenges.

On the new generation of defense platforms, our subsystems are the processing engines powering today's cutting-edge radar, electro-optical, electronic warfare, C4ISR and satellite communication applications. Tomorrow, we're preparing to deliver the next-generation of deployable real-time computing solutions that make sensors smarter, able to accept unrelenting streams of data, then extract and deliver crucial information to the war fighters that need it most.

Our experience goes beyond what's simply new, to architect the very best solution for your most difficult computing challenges. Mercury Computer Systems challenges drive innovation.

Mark Aslett - Mercury Computer Systems - President and Chief Executive Officer

Every time I hear that, it makes me feel like I'm Jack Bauer from 24. Anyway, good morning everyone. My name is Mark Aslett. I'm the president of Mercury Computer Systems. I'd like to welcome you to our 11th Annual Investor Conference here today in New York. The presentation is being webcast and we'll simultaneously, so for those of you that are online, we'd like to welcome you also.

The presentation itself does contain some forward-looking statements. The actual results that we deliver may differ materially from what you see here today. So, please take the opportunity of reviewing our Safe Harbor Statement, traditional information, you can look at our recently filed forms 10Q and 10K or visit our Investor Relations website at www.mc.com.



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We've got a pretty busy agenda here this morning. I'm going to kick things off. I'm going to talk about the Company. A little bit of a historic perspective, but more importantly, we're going to focus on Mercury, our strategy going forward, how it is that we're positioning ourselves in a landscape that we think is changing pretty dramatically.

We think the change in the landscape is going to provide great opportunity for Mercury going forward. I'm going to talk about how it is that we're positioning ourselves and the growth strategies of the organization.

Following myself, we're very pleased to have a very distinguished guest here today, Admiral Giambastiani, who is the former Vice Chair of the US Joint Chiefs of Staff. Admiral Giambastiani is going to talk to us about the defense landscape. What's happening from a budget perspective? He's going to talk to us about procurement reform and the changes that's likely to drive at an industry level.

He's then going to give us a perspective on the way in which the threats are evolving in the defense market place and kind of focus in on a few key market segments, in particular, the ISR market. We've let a little bit of time to Q&A, with the Admiral, depending on how long his comments go.

Following that we've got Dave Martinez, who is the President of Mercury Federal Systems. Dave recently joined the business back in March, so this is his first investor conference. Treat him gently from a Q&A perspective. Dave brings a tremendous amount of experience to the business. We really are thrilled to have been able to recruit someone with his background and his reputation in the defense ISR marketplace. He'll give you more perspective on that with the start of his presentation.

Following Dave, we've got Didier Thibaud who runs Advanced Computing Solutions. Didier is going to talk to us about how it is that we're positioning ACS in both the commercial, but more importantly, in the majority of the presentation is focusing on the defense market place. His particular emphasis is around growth in terms of how it is we're positioning the business and the important programs that we believe are going to provide Mercury with the growth potential that we see today.

Following that, Bob's going to do a brief financial review. We'll then close the formal part of the presentation down and then we'll open it up to your questions.

Many of you know Mercury. We've been around for 30 years. Today, we're positioning ourselves as the best-of-breed provider of application-ready and ISR subsystems solutions for the defense, as well as the intelligence market place. Our particular area of expertise is in providing very, very high-performance digital image, signal and sensor processing solutions. The business today is organized around two different business units; ACS, stands for Advance Computing Solutions and MFS is Mercury Federal Systems.

We're a June-ending company. Revenues in our last fiscal year, financial year '10 ended at \$200 million, which was up for the first year of growth since financial year '05. 80% of the revenues that the company generates today is coming from defense, with the remaining 20% from commercial. Our Defense business has actually grown over 40% since I joined the Company, 12% percent on a compounded rate.

Last year, we delivered a 15% adjusted EBITDA, which is slightly shy of the low end of our pro forma target business model, which is focusing on producing a 17% to 18% adjusted EBIDA. We're closing in on the model itself.

A brief perspective on the team, I'm not going to go through everyone here because I don't have the time, but I am going to drive a few individuals and a few key highlights. Gerry Haines, who's with us here today, joined us quite recently.

Gerry and I have worked together in the past. He actually worked with me at my last company. Gerry has joined Mercury to lead our corporate development activities. As you'll hear, we have a focus and an emphasis on mergers and acquisitions and Gerry's going to lead that effort.



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Dave Martinez, who I mentioned, joined us back in March from the MIT Lincoln Labs. MIT Lincoln Labs is the government's go-to-place for next-generation ISR capabilities. We're very, very pleased to have someone again, with Dave's expertise and reputation in the market place, join Mercury.

Steve Anderson and Leon Woo, again, both worked with me at my last company. They've been really busily fixing the internal operations of the business. Steve is -- runs manufacturing and product management. He's done a great job improving the working capital position in the Company, as well as creating what we believe to be a very scalable operating platform going forward. We believe we've got a lot of operating leverage built into our model.

Leon Woo who runs engineering I think has done an amazing job introducing a tremendous amount of very, differentiated products to the market place that we're continuing to do. Not only that though, I think what Leon's done has been pretty substantial; has dramatically shrunk the time that it takes Mercury to bring you new products to market place. We believe that's a very significant differentiator, an advantage for us, particularly, as the government is looking for better solutions, more cost-effectively and much more quickly.

Our most recent addition is Chip Speicher. Chip joined us as our Controller, as well as our Chief Accounting Officer. We've also seen substantial change at the Board level. This is kind of a third round of change that we've seen within Mercury's Board since I joined the Company. Let me draw on three highlights. George Muellner joined us recently. George ran a large part of Boeing's Defense business. Prior to that, he actually was the Assistant Secretary of the Air Force for Acquisition.

He brings a great perspective in terms of what's it like working for a major prime from a Defense business perspective, but is also been on the procurement side, which is particularly important, given what's happening within the defense industry currently.

The two most recent additions, that were elected as apart of our recent proxy, Jim Bass and Mike Daniels. Both of them are former CEOs, who have actually ran and grown and scaled significant businesses. I feel really good right now in terms of the Board that we have that is particularly focused and given the strategy that the Company is pursuing.

A little brief look backwards before we focus really on the strategy of the business going forward. November is actually my third year anniversary at Mercury. It feels like it's been a year, but it's literally been three years since I joined.

When I joined the Company we laid out a three-phase transformation and turn-around program. We're through the first two phases. So the turn-around phase is absolutely complete. Brief perspective on that though, so it started out with really getting back to what we call the economic core of the business, which is largely is our ACS Defense business which generates the majority of the Company's revenues and profits. The way in which we did that was by divesting five, non-core assets. We literally sold a business a quarter in the first five quarters that I joined.

Not only did we set the business back on the core, but we also changed the emphasis and the focus of the Defense business in parts of the market place that we believe would continue to see robust funding in growth going forward, which is really, really important, given what's happening now. The areas of the market that we're focused on were the ISR market, the intelligence surveillance recognizance market, EW; which stands for electronic warfare, as well as missile defense.

As you'll hear later, what we also did is we started at two different businesses within Mercury, because we saw coming down the line a change in the defense industry from a procurement perspective. We started our ACS service and system integration business and we started Mercury Federal Systems. Both of those are critical elements in the Company's strategy going forward. I'll talk a little bit about those in a minute.

The second phase, which is really what Steve and Leon were all about, was improving the manufacturing operations, the scalability of the platform, reducing the working capital needs. Leon, as I said, has done a great job refreshing the product portfolio.



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Then as we look forward, given that M&A is an important part of our strategy. We also significantly improved our balance sheet. We paid down the \$125 million convertible debenture that we have, or we had at this point, we've got zero short-term and long-term debt and we've got \$82 million of cash on the balance sheet. Why that's important is that we're now very much focused on the third phase, which is transforming, growing and scaling the business.

Much of the presentation going forward is focused on that. Growing the business organically through more design wins, strengthening and growing our relationship with our primes as they look to outsource more through our services and systems integrations business, becoming much more of a pure-play company in the ISR market place which is really where Mercury Federal Systems plays. And then, supplementing our organic growth through acquisitions.

Very brief financial perspective, I'm not going to spend too much time on the slide because Bob's going to take us through a lot more numbers in his part of the presentation.

There's really two major takeaways. Starting with a revenue perspective, financial year '10 was the year in which we restored growth back into the Company. It was modest growth at 6%, but growth nonetheless. The last time that Mercury grew was financial year '05, just to put things in perspective. We did the turn-around in roughly two years and we restored growth back to the Company in the third year. The way in which we did that was actually by continuing to grow our defense business, which, as I mentioned before, we've grown it over 40% since I joined the Company in financial year '08. We also stabilized our commercial business.

From a profitability perspective, I think we've made tremendous strides. Whether you look at it on a GAAP basis in terms of EPS or operating income, or using our non-GAAP measure, which is adjusted EBITDA, we've seen substantial improvement from a profitability perspective.

We ended financial year '10 at 15% adjusted EBITDA, chasing a long-term pro forma target business model of 17% to 18% on an adjusted EBITDA basis. In fact, if you look it up, Q1 results, which were reported a couple of weeks ago, our Q1 adjusted EBITDA level was actually 17%, so we have closed the gap towards the pro-forma model.

From a vision perspective, there's a pretty subtle, but yet fundamental shift that's occurring within the Company. We're becoming much more of a pure play, ISR subsystems company. We believe that we can play at a much higher level in the industry. Kind of moving beyond just being a commercial item vendor to the primes, to becoming a critical component of the industrial base for affordable ISR subsystems solutions. If you look at our tag line at the bottom, we're looking to become and continuing to build upon the theme of being the best-of-breed provider of commercially developed application ready and ISR subsystem solutions.

One of the things that really attracted me to Mercury was the fact that we've been in business for over 30 years and we're deployed on over 300 different programs with 26 different primes. If you look here, it's kind of the who's who in terms of the primes within the industry, but also from a program and a platform perspective we are involved in some very, very significant programs. It provides a tremendous amount of foundational revenue and growth potential for the Company as we look forward. I'll just give you some highlights. The F-35 is the next-generation Joint Strike Fighter, very important program. We think it's going to provide some good growth potential.

We're also on the F-16 and they're potentially looking to upgrade the radars on the F-16 platform going forward. We believe that we're well positioned with one of the primes there.

From a naval perspective, we're actually at the centerpiece of two of the largest upgrade programs that's occurring in the Navy today. One is AEGIS, which is the ballistic missile defense capability, which actually is the centerpiece of the new administration's ballistic missiles defense strategy. Then, the design win that we announced, I think it was in the fall quarter, is SEWIP, which stands for the Surface Electronic Warfare Improvement Program. It's a pretty important program for us. It's a next-generation



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electronic warfare upgrade capability for the Navy, is they're looking to start to counteract some of the anti-ship missiles that are now coming online. We're actually at the heart of that and Didier is going to talk about it in a second.

From a UAV perspective, we're also seeing good growth there. We're on the most important platforms, Global Hawk, Predator, BAMS, Reaper the largest program that we have in Mercury Federal Systems is focused on wide area airborne surveillance using UAVs.

Then, there's one particular program that we think could be pretty transformational in terms of our organic growth in our plans and that's JCREW3.3. You may have seen on Friday that the government actually awarded the third phase of the development contract for the JCREW3.3 program to ITT. We feel really pleased that ITT won. We're actually working with two of the different primes.

ITT was the prime, where we actually have got a lot more content on that program. We talked about that in the past. If this rolls out, to the Marine Corps and the Army, it could be, by far, the largest single program that Mercury's won in its history. So we feel really good about that and Didier is going to talk to it, a little bit in his presentation. I don't want to steal too much of his thunder.

In terms of what we do -- we're typically solving problems that can't be solved with off-the-shelf commercial computing technology. We're building very high performance digital image signal and sensor processing solutions that combine together different types of silicon from SPGA to general purpose processes to graphical processing units into a single heterogeneous multi-computing subsystem solution. We're actually packaging those for the constraints that we see in the military platforms, such as size, weight and power. We're ruggedizing those solutions given the applications which they're focused upon.

One of the things that really differentiates Mercury vis-a-vis, the competition in the market place today, is our software capability. We haven't talked too much about this, but I believe it's a critical differentiator and a way in which we're going to win as we shift towards to the subsystem solutions focus. Our software provides for application portability for the primes. That's critically important as the primes are looking at managing the life-cycle of the technology within these platforms. They're looking for ways in which they can protect that investment and to migrate their applications onto new subsystem solutions rapidly and cost-effectively.

Mercury's always been the high performance, embedded computing subsystems company. Our middleware that provides scalability is a tremendous asset to the primes. It allows us to actually parallelize their application into multi-core and many-core environments. We can scale up their application pretty dramatically using the software capability, whilst hiding the complexity of the programming architecture.

The last one, virtualization, you hear a lot of that in the enterprise domain. We're actually taking the concepts of virtualization into the embedded systems space. We're pretty excited about the capability that we have which is about virtualizing our application ready subsystem solutions. Think of it as a software development environment that allows us to do much more concurrent engineering with the primes. It'll dramatically speed up the time-to-market for their solutions, as well as reducing the overall costs and hence making solutions more affordable.

The other thing that I think is important, and you're going to hear this from Admiral Giambastiani is the shift towards more open systems architectures. We believe that's a pretty important push by the government, however, it does create some challenges. When you shift towards more open systems architectures within the embedded systems domain, typically, it degrades the performance. The applications that Mercury works on, you simply can't deal with a reduced performance from a subsystem perspective.

One of the things that Mercury's particularly good at is actually what we're calling performance migration to open systems architecture. We can still maintain, if not improve the level of performance of subsystems while embracing and driving the move towards more open systems technology.



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Looking forward, we believe that the threats are much more challenging in the ISR market place and are causing much greater demand for Mercury solutions and capabilities. You step back and look at what's happening in the ISR market at large; there are now many more sensors on and over the battlefield that's collecting actually an overwhelming amount of data. The challenge from a war fighter perspective is how do you actually turn that data into information in real-time and get it to the troops as a tactical edge; probably one of the biggest challenges that the military faces right now from an ISR perspective.

Much of the processing today is actually being done on the ground. The transformation of data to information is being literally processed in ground-based systems. What we've been focused on is actually enabling the onboard, real-time processing of massive amounts of data onboard the platform. It can transform and dramatically shorten the time that it takes to give information to our troops as a tactical edge.

Let me give you a couple of examples of some of innovations that we've made quite recently. I think a couple of weeks ago, we came out with a next-generation Intel product that literally is taking an enterprise class server, which if you look at enterprise server, it's a big beast. We've condensed it down into a six-inch by six-inch footprint. It's an enormous, no one in the industry thought that we could do it. Ten of these products together, provide over one teraflop of compute capacity onboard a next-generation platform. It's got 80 cores and over 240 gigabytes of RAM. That's a mini-super computer onboard these platforms. It's a tremendous feat from an engineering perspective.

Let me give you another example, looking at the data issue. There's an explosion in the amount of data that's being generated by these next-generation sensors. The growth in the data in the military world is far outpacing the growth in the data in the commercial world.

We've just brought to market a next-generation digital storage subsystem that's got over 90 terabytes of digital storage capacity for these next-generation, wide area, optical networks and sensors. Let me put that in perspective for you. The Library of Congress has got 530 miles of shelves. It's got 130 million items in its collection. All of that information can be distilled down into 10 terabytes of data.

We've just brought out a next-generation digital storage sub-system that actually can store real-time, on a platform, nine times the amount of information that's stored in the Library of Congress today. It's a huge, huge amount of information.

From a budget perspective, if you look at the budget in financial year '10, including the supplementals, as well as the OCOs, its \$693 billion projected to grow to \$708 billion in 2011.

The area of the market place in which Mercury participates is the Q4ISR market which is \$42.7 billion in '10, projected to grow to \$43.3 billion in '11. In total, the C4ISR market place has a 6% of the total DoD spending on an annual basis. We believe that the ISR market place is a pretty well funded part of the budget going forward. I'm sure Admiral Giambastiani is going to talk about that.

However, there's definitely challenges. Overall, we do expect the budget, the total budget to come down over time. What's likely to happen is that the wars in Iraq and Afghanistan, as they wind down, the overseas contingency funding is going to decrease, along with the supplementals. The base budget, itself, is expected to grow in roughly 2%, 3% over the next five years in real terms.

However, the administration has come out and said that they're looking to save over \$100 billion in overhead over that same period. They're not looking to touch the war fighting capability. They're looking to still provide, if not more capability to the war fighter, but they're looking to actually reduce the inefficiency in the procurement of defense services and goods. To actually apply those savings back to providing more, war fighting capability.

Secretary Gates and Undersecretary Carter have actually come out and issued guidance in five major areas across 23 principle actions. Starting first with targeting the affordability, can we really afford this system that we're focused on? As the Admiral will



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tell you, I think there's a major shift occurring from major new weapon systems development to upgrades of existing programs and platforms, targeting again, the affordability. They're looking to maintain or actually rein in the growth in costs of those major new weapons systems developments and upgrades over time.

They're also looking to incent productivity and to ask the primes to innovate at a faster rate. What that translates into, in the primes, is there is a major shift occurring, where the government is going to shift risk from the government to the primes. The way in which they're going to do that is by moving from more cost plus to more, firm-fixed-price contract awards.

We think that this is probably one of the biggest challenges that the primes face. They're also going to look to actually promote competition at each and every stage of the procurement cycle. Whilst they start to look internally, at improving their own trade craft from an acquisition perspective, as well as eliminating bureaucracy in non-productive processes that are currently increasing the overall defense budget spend.

What you see on the right here is a selection of the 23 principle actions. I haven't put them all down, but it's the ones that we think that Mercury has a role to play in. I have highlighted three that we think are particularly important. Starting with the increased use of firm-fixed price contract awards, it becomes a major challenge for the primes. They are absolutely shifting the risk from the government to the primes when this occurs. What that happens is that it elevates the risk levels in the primes from a technical, from a programmatic, from a business and from a financial perspective.

The second one is the shift towards shorter program timelines. The government are asking the primes to deliver more capability, much more faster than they have ever done before. If you think of the existing development model, it's typically three years of research, five years of development and 15 years of production. The government is asking the primes to deliver more war fighting capability in 12 and 18-month upgrade spirals. They're simply not set up to be able to deal with it. We think that provides an opportunity for Mercury going forward.

Finally, the use of more open systems architectures is both an opportunity, but also a major challenge. To solve today's challenges from a technical perspective, the actual sub-systems themselves need to be designed at a sub-system level. You simply can't take commercial off-the-shelf commodity catalogue products, put them together into a chassis and expect it to solve the problems. Having commodity boards and putting them into the chassis is not an open systems architecture. So the primes are going to face challenges with that.

So as a direct result of procurement reform, our customers, the major primes are absolutely seeking ways for them to be able to buy down risks within their business; from a technical, from a programmatic and from a financial perspective. In addition, if you think of -- and given the budget environment in which we're in, with less dollars to go around, the degree of competition for each major award or program that's up for bid, whether it be a major new weapons systems development or an upgrade to an existing programs, it's going to increase.

The challenge in a lower budget environment is the primes are going to have less internal R&D dollars to differentiate their solutions on the front end of the process. What we're seeing is with shorter timescales, with less money to go around, with less opportunity to differentiate, the primes are really seeking ways in which they can address the challenges that they now face.

If you step back and look at that business model, it's a very, very high-fixed cost model, because we've been living in increased budget scenarios for the last ten years or so. The primes today, now have very high fixed-costs operating models. They're all looking for ways in which they can turn those high fixed-cost operating models into much more variable operating models from a period expense perspective. We're seeing kind of a big uptake in terms of interest by the primes to outsource more of their capability to best-of-breed companies, such as Mercury.

They've utilized different approaches in the past, so look at the in-house model, which is typically, who we probably compete with the most in the market place. They've all got in-house groups. This is the high fixed-cost model that I talked about. Typically, the primes have got engineers that work for the life of the single program.



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One of the benefits of Mercury's business model is that we typically leverage our technology and our capabilities across 15 to 20 programs on an annual basis. We've got a huge amount of leverage in the model.

The catalogue or the cost solutions or commodity level products is also -- the primes have embraced that. The challenge is that many of the vendors today are simply providing lower cost commodity catalogue-type solutions. They really don't get the job done in terms of the applications and the problems that the primes are looking to solve going forward. So we're seeing this shift towards more best-of-breed, open, subsystems solutions from best-of-breed outsourcing partners.

When you evaluate those alternative approaches from a prime's perspective in terms of how do they lower the risk? How do they reduce the cost and make the subsystems themselves more affordable. How do they deliver more capabilities more quickly, while differentiating themselves in terms of the new programs that they're looking to win.

The best-of-breed subsystem approach wins hands down. We know that we are orders of magnitude, more efficient in terms of producing subsystems than the primes can do it themselves. We're actually seeing more opportunity with that as a result. We actually saw this coming in financial year '08. Go back to one of the things we talked about in terms of the first phase, how do we reposition the business? We did a couple of things that we think were important.

One is we started the ACS Service and Systems integration business. We did that for two reasons. The first is we wanted to be the outsourcing partner to the prime. And the second is we wanted to migrate up and provide more complete subsystems solutions to those same customers.

Mercury Federal Systems is also important. Mercury Federal Systems actually builds upon what we're calling white box, application-ready, sub-system solutions that's coming from ACSs Service and Systems Integration business. Think of those as generic subsystem solutions that the primes can rapidly port their applications to. However, what some primes are asking us for is more complete black-box or ISR subsystem solutions.

Mercury Federal Systems allows us to make that one next step into the ISR market place. It allows us to actually deal with classified IP and start to combine that classified IP with the commercially developed application-ready subsystems that are coming from ACS.

When you look to the right, what you see is the focus of the Company on the market. We're very much focused on what's called a TCPED cycle, the tasking, the collection, the processing and the exploitation dissemination. Our particular focus from a new point of development perspective is basically taking -- innovating to allow more of the processing to occur onboard the platform.

Longer term, we see the opportunity of growing a multi-end software and services business around Mercury Federal Systems. We're becoming much more of an ISR subsystem company. You may say, what's an application ready subsystem? Well, it's not just simply packaged COTS. It's not taking commercial or commodity level boards that are typically single-board computing, putting them into a chassis and expect that to be an ISR subsystem solution. It's not. If you want to solve a problem in the ISR space, you've got to architect that subsystem solution from the outset.

What we're doing is basically, combining the best-of-breed products that are available from Mercury today, as well as products that are available from third parties in the market place. We're spanning the entire signal processing spectrum from RF right through the visualization. We're optimizing those solutions for size, weight and power, as well as for the performance and the ruggedization requirements.

Again, one of our differentiators is the actual software capabilities that we provide and not only do these subsystem solutions provide very high-technology readiness levels, but in a budget environment, when the focus on affordability across the entire life-cycle of the project, what becomes critically important is the manufacturing readiness levels of those systems as well.



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I think this is a really important slide. It kind of describes what we see occurring within Mercury, but then also what we see occurring within the industry. It's kind of a proxy of the way in which we think things are evolving. Starting with the left hand side of the model, which is what we're calling the traditional approach. It's the COTS modular model, where the primes basically take commodity products, package them together into subsystem solutions.

That's fine when the application is relatively simple. However, as the degree of complexity goes up in terms of the challenges that we face based upon these next-generation sensors and the fact that the standards for the embedded systems industry is somewhat fractured, that approach we're now calling plug-and-pray. It's a really, really hard thing for the primes to do cost-effectively.

We saw this coming and again, the reason that we started our ACS Service and Systems Integration business was to be able to provide to the primes white-box application ready subsystem solutions. Solutions that would allow them to very rapidly port their applications onto that would solve the challenges that they face. And at best, goes one step further. It starts to package together, classified IP onto the application ready subsystems that coming from ACS to turn that application-ready subsystem into a platform-ready ISR subsystem solution.

The takeaway to the primes, I think they really see it, is if you want to buy a system, you better buy it from a systems vendor. Many of our competition today is kind of stuck at that commodity board level, which we think is going to be a challenge for them going forward.

Here's a great example of a white box success story. It's actually the Patriot Program. It's interesting for a number of reasons. The first is that if you look at this particular program, it's actually a program with Raytheon. The prime did 80% of the work in-house last time around. This time around, they're actually outsourcing 80% to best-of-breed companies. Mercury was chosen to provide the next-generation radar processing subsystem for the platform.

In less than a year, we actually produced for them, the highest performing ground-based radar missile defense radar processing subsystem that's available in the market place today. What's also interesting is, the business model. It started out as a services-led engagement with our services and system integration business. We actually got paid \$12 million to actually do some of the engineering development and the integration work up front. However, what we're interested in is the actual subsystem annuity stream that we actually benefit from as a result of the work we've done. We'll continue to generate significant revenues from this program, well beyond the time after which those initial services were delivered.

Great example of a black box success story is the wide area persistent ISR program that is Mercury Federal Systems' largest program. This capability is going to provide real-time, full motion video direct to our troops at the tactical edge day and night. So, this is a great example of the more of the processing moving to onboard the platform. It started out as a QRC, a quick reaction capability, where the prime basically -- the government went to a prime and said, look, we'd like you to actually develop this new capability, very rapidly, by assembling together a best-of-breed set of partners. Mercury Federal Systems was chosen as the best-of-breed-provider to provide the image processing subsystem for the platform.

It subcontracted the design and the development work of the white box application-ready, subsystem to ACS on commercial terms. It then actually was responsible for integrating the classified IP and algorithms, as well as integrating the sensor into the image processing subsystem. It's a great example of kind of the hybrid business model that we created.

In summary, you look at the ACS business it's a commercial item business model that's looking to become the outsourcing partner to the primes as they're looking at procuring more best-of-breed, open subsystem solutions. It's leveraging heavily our investment our own investment in internal R&D, that we're actually bringing to market some very, very differentiated products.

The business model is a services-led engagement that leads to long-term production subsystem annuity streams over time. Basically, it's helping the primes with that very high fixed-cost model.



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Mercury Federal Systems is a different type of business model. It's a DCAA auditable defense -- more traditional defense services business. It contracts with the primes, with the government in ways in which ways it's much more familiar to them. We're doing much more classified work in MFS than what we typically do in ACS. But, it's still leveraging heavily the product and the subsystems and investments that we're making, transitioning generic application ready subsystems into more platform-ready ISR subsystem solutions.

Moving to our acquisitions strategy, we've got really two major goals. The first is strengthening and growing our core ACS defense business. The way in which we're looking to do that is by expanding and enhancing our current product portfolio to include more of the subsystem solution.

Mercury Federal Systems is looking at deepening our domain expertise from a capabilities and from a personnel perspective in the ISR market. It's all about acquiring companies with the personnel, the know-how, the clearances and the contract vehicles and the customer access in that ISR market place.

Given our strategy, the likely characteristics of the companies that we're looking for are businesses that are profitable and are growing. They're probably going to be in the low 10s of millions of revenue to start, which means that they probably going to be privately held. As a result of the size that we're going after the acquisitions themselves, we are likely going to be able to be executed with the assets that we have on hand and that are available. We're focused on making sure the deals are accretive within a reasonable period of time.

In summary, I think we successfully turned the Company around. We've positioned Mercury in the right areas that the defense market place in terms of intelligence, surveillance, recognizance, missile defense, electronic warfare. We set ourselves up to be the outsourcing partner for the primes as they're looking at procuring more subsystems solutions. Our business model is absolutely in line with defense procurement reform. With the strong organic growth that we have in our business right now, we're looking to supplement that growth through acquisitions. With that, I'd like to hand it over to Admiral Giambastiani for his thoughts and comments.

ADM Edmund P. Giambastiani - (USN Ret) US Joint Chiefs of Staff - Former Vice Chair

Good morning. Thank you Mark. I'm pleased to be here at the Mercury Computer Investor's conference today. And what I'd like to do is start out by providing you with some background, if you will, on me. Just talking for a second, normally, I don't like talking about myself, but I think it would be important and I'm not going to go through my whole career, but only the portions that I think you'd be interested. I am career nuclear submarine officer with 41 years in uniform.

As Mark said in my last job, was as the Vice Chairman of the Joint Chiefs of Staff, but more importantly, as Vice Chairman during that period, I chaired the Joint Requirements Oversight Council. Now, what's the significance of that? That's the group that actually approves military requirements for the Armed Forces of the United States. That's significant and I would approve all of those for the JROC.

In addition, I was the co-Chair of the Defense Acquisition Board. Now, step from the requirements side to acquisition; I co-Chaired with that the Undersecretary of Defense for Acquisition and of course, this is the place where we do all the milestone approvals and approve all programs across the Defense Department.

Next, I was the co-Chair of the Deputies Advisory Working Group. This is now on the money or the resource side, budgeting and program side or the palm as we would call it inside the Pentagon, the future year defense plan and I did that with the Deputy Secretary of Defense. In addition, during this time as Vice Chairman, I helped create Joint Improvised Explosive Defeat Organization, which I think is important and also work on the Rapid Acquisition System, if you will, rapid requirements and acquisition system to respond to the war fighters overseas. These were very different than the standard acquisitions, so that



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we could have very quick turn-around cycles, produce capabilities, put them out in the field and get them there as rapidly as possible to support the war fighter.

Now, what's significant about what I just told you is my time as Vice Chairman. That was in a time of budget increases. That whole time the budget was moving on an up slope. Let me now give you another perspective. Earlier in my career, I served as a resource sponsor. What that means in the Pentagon is, I was in charge of putting together the programs for the Submarine Warfare division as a Director of submarine warfare, but later on, near the end of the Clinton Administration, in 2000, I was the director, if you will, of all of the programming for the Navy. It's called Resources, Assessments and Requirements for the Department of the Navy and its entire US Navy budget.

That was significant because during that time, in those positions, we created a couple of programs which are very successful today, but all of these were created in a time of a budget trough, following the end of the Cold War, where budgets were flat and in fact, on a real basis, declining.

This was during the '90s and programs, for example, that I put together as Director of Submarine Warfare with my staff was the Virginia Class Attack Submarine Program, which today is known as one of the most successful major acquisition programs out there. In addition, we did the first large and really important open architecture program; Acoustic Rapid COTS Insertion that was created when I was Director of Submarine Warfare, again. This was an important one because we are trying to change the entire paradigm on how we did combat system, acquisition for, if you will, refining and changing out the combat systems and sonar systems on all of our attack and strategic submarines, numerous ones, at that time, somewhere in the order of 70 submarines, changing out those entire systems, doing it rapidly and changing dramatically the cost factors.

In addition, the Super Hornet Program; we did the first multi-year procurement back in 2000. We're now on the third, which is of significance. So once again, this was at a time of a budget trough and also flat and no real growth. As you recall, we were arguing at that point of time about \$1 billion to \$2 billion supplementals, they're called emergency supplementals. And here we are today dealing with \$50 billion, \$60 billion, \$70 billion supplementals and we're dealing with overseas contingency budgets upwards of \$150 billion to \$160 billion.

In addition, when I became a submarine officer, it was midway through the Vietnam War, so I lived through that period. I lived through the go-go acquisition years of the early '80s where budgets once again were going way up. So, I guess I would tell you, I've ridden the sine wave in a variety of positions here over 41 years.

Now, let me just cover quickly what I want to cover today and I will go with -- let's see here -- page up, now what's going on. No, wrong way. There we go. There we are.

Okay, what I want to cover here today is the following; DoD Efficiency Initiatives. Now, for those of you who have read the memos, this was signed out by the Undersecretary of Defense for Acquisitions in August. The next one, on Acquisition Reform and Affordability, that Mark showed you and talked about, had the 23 items, this was signed out in September and then just on the 3rd of November a third one was signed out and this is the implementing directive to actually implement the prior two, and it was the Implementation Director for Better Buying Productivity and Affordability within the Pentagon.

That was an internal document, unclassified, but it's out there available and I'm sure some of you have seen it already and I'll try to talk a little bit about that. Now, what is the Pentagon trying to do here? What is Secretary Gates, what's Ash Carter trying to? How do you get ahead of flat budgets? How do you get ahead of potentially a declining budget? You don't wait for inevitable cuts to be made by Congress or someone else. What you do is you take the initiative. That's what this effort is all about from the Pentagon side. The goal as they've stated it is not to reduce the top line, but to significantly reduce overhead costs and reap savings to programs to produce capability, if you will, inside the Defense Department.



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Now, changing the way the Pentagon does business has been going on as long as the Pentagon's been around and it will continue to go on, frankly, for a long time. I've seen all types of initiatives in my 41 years. Some have been more successful than others.

What is the current series of initiatives looking at; efficiency in performance culture and process, looking for affordability, as I said to identify savings. Now, what are some of the implications? Mark mentioned one already. Firm fixed-price contracts inside the department are important. We've had a checkered history -- when I say we, I'll talk as during my time in uniform. We've had a checkered history inside the department of having successful firm-fixed-price contracts. What makes the department think they can do better this time around? Once again, there's tremendous numbers of studies that have been done out there on acquisition reform; how to contract for major acquisitions, how to contract for major capabilities.

These studies have been looked at time and time again. I've testified a couple of times, just recently, on a number of these studies and have participated in them. The important thing is what you're trying to do is reduce risks.

Mark talked about that and that's really what's going on with firm-fixed-price contracts as we reduce taxpayer Department of Defense military service risks. And in fact, once again, these buying power directives -- the latest one on the 3rd of November actually mandates the immediate use of firm-fixed-price contracts. You ought to take a look at the words in there and you will see those actually spelled out. There's not a long time line to start executing these. Many of these action dates start as of the 15th of November, so this is now.

You've heard about and Mark has referenced some of them, the reductions in contractor's sizes for services, freezes of 10% over three years and the rest of these. I'm not going to get into all of those. What I'm going to try to do is talk to you on the acquisition side and continue to talk about, not just firm fixed-price, but also use of multi-year contracts, for example, to take risk out and lock in savings so that both the Department and the prime contractors, plus all of the subs understand what the program is about over a longer period of time.

As you know, our budget system works on a single year basis. Congress wants to have the right to approve and fund programs to both authorized and appropriate for them. But what's important is multi-year programs take out a lot of risks because they allow suppliers to look ahead two, three, four, five years. This is very important. It locks in savings for stable programs and successful programs and it protects the ones they are working.

In addition, this three November instruction mandates the use of open architecture and I think it's important for you to understand that. If you take a look at it, it says, you will start using this as of the 15th of November. So, once again, it's in a medium. What also do all of these directives talk about? They talk about the following; they get into affordability in three phases here, which is important; affordability in research and development, in science and technology, in other words, the development phase of a program, so, affordability in that area.

The second phase, they talk about affordability in construction or manufacture. The third area that's important is affordability in the operations cycle, in other words, the life-cycle of a platform or a program and the rest. Essentially, this is soup to nuts -- in the end for the entire life of a system, from birth to when it's sunsetted.

These apply to all of the major programs. They're called the ACAP1 Programs, but they apply also to programs less than that. Just to remind you what an ACAP1 means, since it's inside baseball, is essentially, there's programs that are \$2 billion or greater, but many of these requirements apply across the board to the lower ACAP programs and you'll see that.

Let me go to the second piece here. I'm going to talk about DoD budget outlook for a minute. I come at this discussion with you here this morning as I mention from the perspective of having been a resource sponsor during the '90s, but having ridden this sine wave over a number of years where budgets in the '90s were declining and flat, overall. It required us to do some things. Let me tell you how I will couch this budget outlook. I'm going to talk about what's the same today as it was, for example, during the '90s and what's different. Let me start out with what's the same.



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We had a galvanizing event in the end of the Cold War coming on at the beginning of the '90s. We had Desert Shield and Desert Storm and then, of course, we had this Cold War. What's the same today, if you will, we've got a galvanizing event and it's caused a huge budget deficit. What's also the same? I would contend that requirements for military capability will always exceed budget availability, no matter what the budget environment is. No matter what the budget environment is. The difference simply is in the acuteness of the problem. What's the same here?

Let me shift to what's different. We've been in two wars, but one is winding down quickly. That's what's different right now. To give you an idea of how rapidly it's coming down, think back to an announcement from the Defense Department back in February of this year. We had over 100,000 people still in Iraq. You now move to August, the number is under 50,000. That's a pretty sizeable amount -- a large reduction in a fairly short period of time. It is essentially like moving a small American city out of there. That's how quickly it was happening.

What's also different here? The deficits right now, as I said before are very large, but our economy is much different and of course, much larger, that's what's different. Also, our unemployment rate or our jobless rate is exceptionally high right now, compared to what it was, for example, during the '90s. Let me give you a couple of examples. I'll move on from what's the same and what's different, to talk about some of the other impacts on the budget.

Personnel costs are very large. United States Navy over the last eight to nine years has reduced the overall in strength of the active and reserve components by somewhere in the vicinity of 50,000 to 60,000 personnel, 70,000 personnel in there, roughly. And those numbers have gone up and down a little bit, but it's been an overall reduction during this for the in strength of the United States Navy, as an example.

Yet, personnel costs inside, the overall personnel costs inside the navy have actually still increased. That's pretty remarkable, so when you look at increasing the size of the Army and the Marine Corps, you can imagine how personnel costs have grown during that time. These personnel costs are putting significant internal pressure on the budget. Let's go back to the budget Mark pointed out before.

Let me remind you, the base budget for 2011 was just over \$550 billion, that's the base budget. Then you have this thing called the Overseas Contingency Operations budget, which was about \$159 billion, you add that to the base budget.

Then finally, there was a supplemental worth \$50 billion during 2010 for contingency operations above and beyond the Overseas Contingency Operations. You put all that together, it's well over \$700 billion and those were the numbers Mark was talking about. Where will the pressure come into play here in the budget area? In my view, it's going to come across the board in all of these budgets, however, in my view the easiest way to reduce these budgets is in the OCO account, the Overseas Contingency Operations. The fastest way to get them down is the supplemental and that means when you look at the withdrawal rates of the troops, because the burn rate to support those is very big. And, the reason is that we are, essentially, once again, moving large American forces overseas that we have to support. But, the base is still going to be under pressure in this even though we change, and the base will be under pressure because of the required approval for all of those large acquisition programs.

And, in effect, the budget environment will be flat, at best, despite, in my view, the desire of the Defense Department to want to get a 1% real growth, I think it will be flat and it will turn out to be later in the next couple of years, it will probably turn into be much more of a flat and, potentially, slightly declining real growth budget.

Now, let me shift over to the next subject that I have up here, addressing today's wars and tomorrow's potential conflicts. Anyone who attempts to look into the future and predict with accuracy what's going to happen, I think, is sadly mistaken on their accuracy.

Let me give you a prospective on this. In 1990, I was assigned to a fellowship by the Chief Enabled Operations, there were nine of us, and we were given a year to study the national security environment in the year 2010. Okay, so, that was 20 years ago. We spent a year traveling the world, talking to every smart person inside the United States and outside, both in a national



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security environment, a business and commercial side, to talk to them about what they thought the world would like in the future. And, by the way, many of you may remember that Japan was supposed to take over the world 20 years ago. Japan was going to be everything. Japan is what we're talking about with China today.

Now, there are fundamental and structural differences between Japan and China, but, I want to remind you of that. No matter where we went, every expert was out there saying Japan is going to just rule the world.

Did we get everything right? A lot of people ask that question. I think, more importantly, it's not whether you got it right, it's whether you got many of the trends and the fundamentals correct, and we did, but, did we see terrorism for example? Not really, we didn't discuss it. We talked about ethnic conflicts but we didn't talk about terrorism and the way we see it today.

So, I'm just telling you right now, despite me telling you what I think the world will look like, it's my opinion, you need to understand that no one is perfect in this game.

The United States currently excels in what I call "industrial warfare." It's called moving a major American city somewhere overseas. In this case, into the Middle East, into Iraq, Saudi Arabia, Afghanistan, we do this exceptionally well. For example, that move from Iraq into Afghanistan, the United States moved over one million pieces of hardware. We're very good at this. We're excellent at it.

Do I think we're going to continue to do this every time in the future that we need to respond to a crisis? I am not sure we will. As opposed to a cold war rivalry, we're going to be operating against a stateless enemy, in many cases, non-traditional and asymmetric. You've heard those words before. There's no doubt in my mind about that and I truly do believe that, that we're going to be operating against stateless enemies.

Now, the Defense Department, to respond to these, made as a goal back in 2002 to create a man-hunting capability inside the Department of Defense and that capacity has been building for almost nine years now. What does that mean? It requires a large increase in Special Force numbers, Special Forces, but also Special Forces capabilities if an inexorable increase in capability in this area. Not only does it require a large increase in these capabilities but it also requires us to have an all-out support to fight and win the wars of today. And, what does that mean? Intelligence, Surveillance and Reconnaissance is the name of the game in this area.

You've heard mention, repeatedly, of ISR today. But, in my view, since I used to own all of these assets as a combatant commander and supply them to central command in all of the four deployed regional commanders, they were called high demand, low density, because we simply didn't have enough of them. And, we have been buying huge numbers of these ISR assets. For example, unmanned aerial vehicles, aircraft. And, in my view, we will continue to go after ISR and away because of this insatiable appetite overseas to be able to do the types of operations we need to do in counter insurgency, in counter terrorism.

This massive intel support is similar to what we needed to do during the cold war as a submariner, during the cold war, we used to detect, classify and approach. Those were the terms we used at that time. Today's ISR is required to allow us to do what's called, "Find, fix and finish." That's a term we coined back in the early 2000's after we had been in this game of man-hunting for a period of time. It requires a very, very high degree of full motion video, in other words, you have to have a capability to use full motion video. It's a very full motion video intensive environment.

And, you're going to hear more about that from Dave Martinez. It's similar to what we had to do to use SOSUS and ASW aircraft to find submarines. It's a very intensive business and in order to pursue the types of stateless enemies, counter insurgency and terrorism, full motion video from a variety of platforms, UAV's twin engine aircraft, whatever the case may be, is very, very necessary.

In addition, what does this mean? We cannot buy enough bandwidth for all of the reach back of all of these vehicles. It's just not possible. So; therefore, what happens is we can't just apply data back the year up for the United States for processing. It



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takes too long, it's not timely enough, plus, there are not sufficient analysts out there to do all of this work. So, what are the implications here? What it means is we've got to put this out where the operator is. Combatant commanders will continue to demand ISR and it will be insatiable.

As I said, we've been investing heavily over nine years in these systems. We are drowning in data right now. So, how do we get it to the operators, as I mentioned, when distribution and use to serve today's wars are immediate? Not sufficient data analysts is a very important part of this.

Finally, let's go to the high end. You also have to be prepared to deal with peer competitors. You all know who they are, but, you've got to be able to deal with them. That requires a different set of systems, it requires a higher end capability with large platforms and power projection capabilities, it requires a lot of intelligence, it requires maritime ASW, missile defense, particularly naval, and it requires a less ground-centric focus which is just the opposite of what you've been seeing here on the other end. In addition, a demand for wide area surveillance.

So, I've given you a pretty good description, I think, of what I see in the future here.

Now, let's move to program implications for Mercury. The number of programs starts will go down just like in the 1990's. It will go down. We've had many more new program starts in the first decade of the 21st Century. The number in the first decade of this next decade will go down. We'll have a new strategic submarine, for example. We've got a Littoral Combatant Ship that was started, frankly, under the last administration. Platforms will stay around longer. Platforms will stay around longer.

So, what does that imply, what does that mean? System upgrades; therefore, are essential to existing platforms and capabilities and the need for these modifications will actually increase. Sensors, processors, weapons, and networks must be forward with operators and will be using more and more local area wireless. So, what you see here is pushing these capabilities out with the operating forces.

What will these demand? They will demand high technology readiness and high manufacturing readiness levels to be able to produce this ever increasing number of spirals in upgrades. Very important.

Once again, as I mentioned, and I actually haven't changed my brief since the 3rd of November mandate, open architecture becomes more and more important. It's important, even though it's mandated right now, it will become more and more important today.

I think you need to understand why open architecture started in the 90's and why you have to do it now and why you're going to have to do much more of it. Open architecture is all about improving cost affordability and speed of delivery of capability. It's about reducing risk. One can't predict when the systems developed will be pressed in action or combat; however, we do know that the speed and cost of improvements will determine the measure of the capability available when the gun goes off, when they're needed.

The underlying technical and business case for open architecture, in my view, are very sound, and that's, again, based on my significant experience with a very successful Acoustic Rapid COTS Insertion Program, which turned out to be one of the single largest small business initiatives applied in the federal government.

Reuse of system, of software, cross-system, and platform is significant under open architecture. This is a big deal, it's a foot stomper, is reuse of software. It saves time and money.

Increased networking on forces and capabilities are the way of the future. Modular architectures, in addition, also allow for these rapid upgrades. Solutions for how to use the data and get it immediately to the warrior is a Mercury sweet-spot, in my view.



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Simply stated, prime contractors need this to be successful in this emerging market.

Finally, in summary, this, I think, is an actual time for adaptive and nimble companies that will have core capabilities they can take advantage of today and tomorrow's environment. Mercury is not only one of these companies, it's a leader, in my view. It's a company well positioned to take advantage of the budget and the acquisition trends that exist out there, once again, flat and/or declining budgets require innovation and a turnaround of rapid cycles. Primes need companies like Mercury to take advantage of the trends and demands to reduce the acquisition cycle and what is an acquisition cycle? Cost, risk and time.

Virginia class attack submarine, for example, Super Hornet, Acoustic Rapid COTS Insertion, were born in times of flat budgets. Affordability was a key in putting those programs together. I think you're going to find that open architecture will help bring a lot of this to the fore in this next decade.

My experience with Mercury tells me they are well positioned for the future, making a difference through lower risk.

Thank you very much. Mark, I don't know if we have time for questions or if you want to move right on.

Okay, thank you all.

Dave Martinez - Mercury Federal Systems - President

Good morning, my name is Dave Martinez, I am the President of Mercury Federal Systems. I am very pleased to present to you the strategic direction of Mercury Federal, as well as the status in the future plans.

Before I do that, I want to take a little bit of time to give you a little bit of my background and, more importantly, why I joined Mercury Computers.

I spent 22 years at MIT Lincoln Laboratory. My last six years at Lincoln Lab was as Head of the ISR Assistance and Technology Division. In this capacity, we developed prototypes of hardware and software systems for the ISR Mission Area and at the time of my departure, I was responsible for an operating budget of \$160 million, as well as a total personnel of 300 people.

So, why did I join Mercury Computers? I joined Mercury because I believe in the journey that we're on and I also wanted to be part of the transformation of the company from being a premier and better computer systems company to be a premier national asset in the ISR's system and technology marketplace.

So, what I wanted to do is focus our attention on the journey that we're on and, as Mark pointed out earlier, we're basically focusing on five key tenants, or five key areas. Didier Thibaud, following me, is going to focus on three of these, as shown on the right hand side of this chart. I'm going to, principally, focus on Mercury Federal Systems. Mark already covered the acquisition side.

So, in terms of our objectives within MFS and the strategic direction, we want to focus our attention on the growth in electro optics, EO, IR infrared, both for Quick Reaction Capabilities i.e., QRC type of programs as well as production.

We also want to focus our attention on the signal intelligence as a growth opportunity, and I'm going to elaborate later on why those two are so important.

Very important to a strategic direction and a strategic roadmap is the ability to move from government labs, the IP's that have already been developed, and bring it into our product in order to more effectively transition quick capabilities into the marketplace. And, we do this by being the best-of-breed provider and more and more of the ISR applications are classified. So, MFS, as Mark pointed out, is focusing on the ability to bring classified applications in order to be effective at providing capability.

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So, our growth for MFS is, basically, focus both organically as well as through acquisitions.

So, what I want to do next is walk you through and bring your attention to what is the trend, what is the actual roadmap that the country sees in the area of C4ISR before, we then see how that matches into MFS.

You look back and you step back a bit from what, for example, Frost & Sullivan has put forward, with additions from us and where we see the trends in the roadmap, in the area of command and control, communications and computers, i.e., the C4, as well as the ISR, Intelligence, Surveillance and Reconnaissance.

And, then, I would like to walk you through it. On the left hand side, you see the different areas that are the key elements of C4ISR, Intelligence, Surveillance and Reconnaissance and electronic warfare, and it's divided as a function of time every five years. I don't have the time to focus on every single one of those five years, I, principally, want to focus on the next five years; the 2010-2015 timeframe.

In dark blue are the areas that were internally brought in already, providing products and services. In the grey area, I think, is the area that we believe are opportunities in the marketplace.

So, for example, let's take the case of intelligence. We heard earlier, both from Admiral Giambastiani as well as Mark, that it's critically important to bring capabilities to the war fighter and today, the kind of conflicts that we have is in the area of COMINT, communications intelligence, moving target indicators, i.e., MTI, as well as full motion video.

We have to be able to see what is actually happening in a very rapid cycle. And, this interoperability and putting capabilities from a product as well as services that is the key opportunity in the marketplace.

We move down, now, to Surveillance and Reconnaissance. It's all about providing timely information to the war fighter. You hear often the term PED, which stands for Processing, Exploitation and Dissemination. It's not enough to collect the data, we've got to get it to the war fighter in a timely manner. And, that's an area that is critically important because full motion video is a huge amount of information that the war fighters are presented with. And, we're providing capability in order to be able fuse that information in this multi-int. When I refer to multi-int, I think of it as multi means, just simply, electro optics, infrared, COMINT, and other modalities.

Electronic warfare. We're at the center of that, and you're going to hear later on from Didier, in terms of providing capabilities to our ground forces for being able to deal with some of the threat.

So, now, if we look at the C4 part of it, the computers, command and control, as well as the tactical communications. So, what is happening in the marketplace and the roadmap and the trend? What is happening in the marketplace is trying to bring the capabilities to bring more compact processing in terms of addressing the size, weight and power and how would you do that? The way you do it is, effectively, working through heterogeneous environment from general purpose processors, field programmable gate arrays, graph processing units and more effectively bringing them in a way that were meeting the demands of unmet platforms of very compact ground vehicles, of surface ships and so forth, and we're at the center of it.

That allows you to have the processing capabilities. Now, you need to be able to resource manage the available sensing. Why is that important? The reason why it's important is exactly what Admiral Giambastiani mentioned before and that is that we have a very high demand in terms of the available resources that we need to bring to the fight but they're very much in low density, very few of them. So, we're providing products and services to address these opportunities to resource manage the sensing, the collection, the processing, the exploitation and dissemination.

And, finally, it's all about bringing that data, that processing information, that actionable intelligence to the war fighter at the tactical edge. That's referring to tactical communication.



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What we're doing is providing capabilities in a way of doing what is called software-defined radio to be able to program different types of systems in order to be able to more effectively bring that data down to the ground.

So, if you take that as where the overall roadmap and the trend is going and then ask ourselves the question, well, how does that map to Mercury Federal Systems? Mercury Federal Systems is focused on being the ISR system and technologies services arm of Mercury Computers by providing affordable, innovative best-of-breed open solutions.

How are we going to do that? The way we're going to do it is we're going to be acquiring companies that are the core of a strong growth and a strong ISR capability; we want to team with other organizations to core multiply the abilities of Mercury Computers. We want to transition government IT from Federally Funded Research and Development Centers, also known as FFRDC's, University-affiliated Research Centers, or UR's, as well as academia. We want to emphasize the best-of-breed capabilities, as well as bringing application-ready subsystems that we effectively can address the needs of the primes and the government. And, finally, do it in a way that is rapid in modular implementations.

So, one of the key elements of this is to recognize in order to be able to address today's needs and today's opportunities is to look at what's the overall construct of an ISR system that our forces, our branches of the military, are addressing, either being in the Navy, the Marines, the Army or the Air Force, as well as the intelligence community.

And, it's all about effective ISR all the way from a wide area surveillance, also referred as synoptic view, that provides a broad view of what's going on in theatre, what's going on in the battlefield, but you don't get that kind of high resolution that you need in order to be able to track, ID and neutralize the threat. You do that by, effectively, getting down to what is called a localized information of ISR. You got to work all the way from the synoptic view all the way down to video information, infrared or human information in a local domain.

So, our emphasis from MFS working together with ACS, the Advanced Computing Solutions Division, is to effectively provide product and service to address the full spectrum of the ISR architecture. Very important to do it in a way that we're addressing what area, multi-int and persistent ISR, the challenge today is all about, as Admiral Giambastiani mentioned before, to find, to fix and to finish.

The finding of insurgence, the finding of a terrorist, they hide in plain sight. It is very difficult to find them. So; therefore, our capabilities in the form of application-ready subsystems, building blocks, computing systems, services, products, is to be able to address the key element of finding the enemy threat and being able to neutralize it and predict ahead in terms of their activity.

We're fighting today in very mountainous terrain. As we see what might be happening in the future, the environment will change either through the need to be responsive to potential peer threat or other scenarios that are not represented to what we're fighting today. And, it's all about this whole cross-platform queuing from machine to machine.

Graphic capabilities is important. We don't need to have the 100% solution, 80% solution is perfectly fine.

So, what's our mantra? Our mantra is best-of-breed provider of commercially developed open-application ready subsystems for the multi-int market that allows us to provide these capabilities to the war fighter.

So, in terms of our business model between the advanced computing solution and Mercury Federal Systems, the process going forward is to leverage the building blocks, the foundation that ACS developed to what we called the white box. What is a white box? As mentioned before by Mark, those are the building blocks in terms of hardware, in terms of software, in terms interoperability, in terms both in modular architecture. And, then, from MFS, it would be the ability to bring the application on top of it and then provide the best rapid solution in a modular way to both the prime as well as the government.



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We want to do this, also focus on onboard exploitation. There is more and more of a need to be able to put timely information to our war fighter, again, doing it in an affordable, in an open architecture, to enable these rapid developments.

The future will continue to migrate to bring in more multi-int. Right now, we're focusing in electro optics, we're focused on IR, infrared, as well as COMINT, Communications Intelligence, will continue to bring other types of sensing modalities, radars and others, to bring it all in the context of multi-int to provide net-centric systems, software and services. And, it is this business model that would be effective by leveraging the vertical integration into the ISR market.

So, let me elaborate a little bit more about the multi-int exploitation. Multi-int exploitation onboard of the platform is so critically important because if you anecdotally take, for example, what our analysts out of the Air Force, 480 ISR's wing are doing today, they're literally looking at about 800 hours of full motion video, every day. Basically looking at a huge amount of information coming to them in order to be able to address over a thousand targets that they're tracking on a daily basis.

Here's an opportunity, a key opportunity and a strong need to be able to address what is causing a significant problem in terms of the ability to do the exploitation of the data when we are limited by the communication bottleneck. So, our objective here is to bring in more of the heavy lifting on board of the platforms and then allow to address this issue of the communication bottleneck and then focus our few analysts in the whole area of transforming knowledge into action.

So, now let me give you a specific example. Specific example is the largest program within MFS which is a persistent ISR airborne surveillance. This is a quick reaction capability where we are the payload providers. We're working closely with another set of a very agile company, specifically Sierra Nevada, who provides the whole integration of the system. BAE provides the electro optics, ITT provides the infrared, L-3 Communications provides the communication and AdamWorks provides the overall pod.

Together, as the best-of-breed, we bring in, in a rapid modular way a solution to the war fighter in a quick reaction capability mode. We have two significant capabilities, one of them is to do the real-time onboard exploitation for the reasons that I mentioned earlier, as well as to do what is referred as Tivo i.e., after the collection, being able to do the forensic analysis. And, this is a very important area for us and it a very, very excellent example of the ACS, MFS, white box and black box.

Now, think of these as providing the eyes to be able to effectively see what's going on the battlefield.

The next element of these, and these two play closely with, is the ability to hear. Those two are very important because one provides the ability to see what's happening in the battlefield, the COM in the communications intelligence allows you say, let me now fix them, let me now locate them. Think of find, fix and finish. I've got to find them through the electro optics, through the IR at night, then I got to be able to fix them through the ability to be able to hear them, i.e., COMINT, Communications Intelligence.

So, we're in the middle of developing, again, products and services in the COMINT area and both planning and collection as well as to be able to be scalable all the way from manned platforms, like shown on the right hand side with the Rivet Joint from the Air Force, as well as unmanned platforms such as shown here like a Predator or the Shadow 200, as well as ground systems and being able to have that full interplay among these different platforms.

Now, as Mercury Computer, one of the things that attract me to Mercury is that when you think of our ability as a nimble and agile company, we can migrate very effectively all the way from prototyping to low rate initial production to full production and bringing in these capabilities more and more but doing it rapidly, modular and an 80% solution is perfectly fine. The acquisition for MFS, the platform for MFS is focusing on the commentary.

In terms of our revenues, we had a significant growth in the last year from fiscal year '09 to fiscal year '10, a 95% increase. Backlog was \$2.9 million. Again, we're focusing on these growth opportunities in the key areas that are needed by the ISR market. Best-of-breed solution providers for the ISR, we are, from MFS, we are the architect, we're also the designers and we're also the



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payload integrators. And, that's the skill set that we're bringing in terms of vertically integrating the company, moving Mercury from being a premier embedded system to be a premier and a national asset in the ISR marketplace.

Leveraging ACS application-ready subsystems to provide a solution and doing it again, the emphasis is more and more in terms of being sensor agnostic, open platform independent architectures.

So, in summary, the growth opportunities for MFS are in the multi-int onboard processing, the initial focus is, again, on electro optic IR infrared in COMINT, Communications Intelligence, leveraging the ACS investment in order to more rapidly bring capabilities to the marketplace, transition the government IP. Leverage what has already been invested on and be able to effectively bring into the market by way of providing product and services, deliver that whole interchange between the black-box with the application with a white box, which provides us that infrastructure.

And then, finally, be the center of excellence for rapid and modular development with innovative solutions at an affordable price.

Thank you and now I would like to introduce Didier Thibaud, the Senior VP of Advanced Computing Solutions.

Didier Thibaud - Mercury Computer Systems - SVP, General Manager, Advanced Computing Solutions

Thank you, Dave. Good morning, everybody. How are we doing so far? I am glad you didn't say behind, on time.

Anyway, my goal is to give you a different angle, at least if I don't do it, you will get a different accent for sure.

My name is Didier Thibaud and I am the Senior Vice-President and General Manager of Advanced Computing Solutions that you have -- I'm sure you know now, we call it ACS.

I will talk first about ACS business, per se, high level general of what we are doing. Second, I will move quickly into the commercial world, where we'll talk about the dynamic we are seeing in this area.

But, I will spend most of my time in the defense side of the business where we'll talk about the growth drivers that we are seeing in ACS.

First, I will say it's a very exciting time. We are back to growth, always exciting to be back to growth. The growth is 11% CAGR in the last four years, where defense grew by 36%.

What do we do in ACS? In ACS, obviously, we are focusing on C4ISR, as we mentioned before, but, more importantly, we are architecting, designing and developing the building blocks to provide the application-ready subsystem. But, we don't do this as a me-to type of building block.

We are really a technology leader. We have been for years, recognizing the innovations in the industry where we can bar none provide the best-of-breed of those application-ready, subsystem products C4ISR business.

Why is this important? Well, if you are the best-of-breed, you basically will provide superior capability to the prime of customers. By doing so, they want you to be part of their team, to really increase their field win. This is what we're all about. How do we provide those technology advantages? First, we leverage those technologies across the commercial market and defense.

A good example of that is what we did in the open VPX where we really bring the architecture developed are very well known in the telecom industry to the embedded defense market. At the same time, and I will talk a little bit more about that, we are



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really focusing in optimizing the performance with the constraint of size, weight and power because, obviously, defense, it's all about bringing the maximum capabilities in the small compact or minimizing the power.

Also, to align all that to the requirements of the defense market or the field requirements as Admiral Giambastiani mentioned, we have to provide quick response capability. How can we help the customer to provide those capabilities faster to the battlefield?

Let's talk now a little bit about numbers. The ACS business is 80% defense, 20% commercial. Inside defense, radar is 50% and our radar business has been growing very fast, 30% CAGR. Followed, and it's very interesting, by EO, 29% CAGR. EO is interesting because it's really a market that we grew the last couple of years, actually, being in radar mainly in EW before. And, in short, you can see also commercial is stabilized.

In summary, our commercial business is stabilized and we are driving double-digit growth in defense and we think we'll sustain that.

Let's talk first about our commercial segment and the dynamics there. The semiconductor capital equipment market where we play is 60% of the commercial business. Here, we did benefit from the economy rebound, clearly, which helped us to stabilize our commercial business.

But, also, ASML which was one of our major design win in the last few years, has started to be in production and, in fact, they're all coming from ASML has been growing in the last four quarters. We are part of the next generation of system the NXP-scanner.

At the same time, we are at the end of a cycle with KLA Tencor where we think that at the end of this year, the system we were in will be ending.

The second market we are playing and it's in communication. But we're playing in a very different area in communication, not the classical base station type. And, in this market, it's really more the defense side it's what we called program based, that means it's more -- the money is running by the program.

We are in 4G test equipment market and it's a very interesting, obviously, market because everybody wants to test the equipment for the next 4G network, as well as the new satellite communications systems.

The last business we are involved with is homeland security and we've got a couple of design wins there, but it takes a long time to develop those designs because you have the certification. That means we are still in development of the certification phase, hopefully those will come in production at some point.

In short, our commercial business now is satellite.

Let's now move into our different business and let's talk about the three main drivers in this area. First is defense is a design win-led business and what we have done in the last couple of years is really going through a full product refresh and technology refresh where we can bring our technology leadership in order to provide the best-of-breed type of product in order to provide those application-ready subsystems.

But, not only do we develop a refresh of product line, but we also use technology refresh to expand into new customers and new segment at the same time. And, a good example is what I was saying before. We are getting now 29% CAGR in the EO/IR domain.

The second driver is, obviously, we create the services and system integration capabilities and growth in ACS. Here, we want to be fully aligned with the procurements reform which is really pushing the prime to do more with less and faster and we want to be their outsourcing partner.



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Not only do we want to be their trusted partner, but also this allows us to benefit and get faster time-to-money because when you provide services, you are, basically, getting money along the development phase where in the past where giving a develop system, you didn't see nothing for a while and then you only get the production system. Now, we can participate with them along the way.

The last driver is, obviously, we are involved in major programs. Those major programs are fully in line with the defense budget and with the strategic direction of the defense and of the defense administration like missile defense, UAV for ISR, as well as fighter radar or airborne EW systems.

As you can see, with those main drivers, we are very well positioned to sustain our double digit growth in defense.

Let's talk about, and it may be the most technical slide you will see from my presentation, about what we do. First of all, we are providing building blocks across the full chain of what we call sensor processing.

From the radio, that means close to the sensor, up to the dissemination of the information, the visualization of the information. Here, we are align with the government direction in pushing for open architecture. In fact, we are leading the open architecture mantra. We have been the one leading the new open architecture open VPX for the embedded world.

But, we don't stop at the hardware level. We, as Mark mentioned, we really provide a lot of value in the software area. And, what we do here, we provide open software architecture, but underneath, under the core, we really provide a lot of technology and product innovation to provide the best of breed capabilities in this open architecture.

Just to give you a few examples, Mark talked about two. But, I'd like to give you -- I am a visual person, I don't know if you are, but I am a visual person and when Mark said it, we did the best processing Intel board in the market today. I just want to give you a visual of that.

This is what you see if you want to buy. It's roughly the size of this speaker. This is what you can buy in the market. Okay, kind of a tower, pretty big. What we did, we did make this to about the size of the book you have in front of you, of our presentation. This is what we do. In bringing these capabilities, this level of performance has never been achieved yet, in the size, weight and power that can be used in an airborne system compartment. The defense system, it's roughly two times the size of this projector, that's 90 terabytes of (inaudible) system that we are providing.

Another example is we are very well known as providing the basing noise-to-noise ratio in the acquisition of the signal. Okay, it's very important. Why is it important? Because, if you can do that, you provide better probability of detection to a prime that the all-prime, can bring an application to provide better detection capability. What does that mean for the battlefield for the war fighter on the field? Better probability of intercept of the enemy.

This is how through our technology leadership we align this to the battlefield requirement to provide superior capability to our customer. This is how we can increase our key win, and be their trusted provider.

We talked about the first driver linked to design wins. First of all, I think our numbers speak for themselves. 15% CAGR in the last three years and defense 38% CAGR, but the most important is, maybe, also what we talked to you about in Q1. We moved from 6 design wins, in defense, to 13, which kind of doubled, but the value has been increasing by 300%. That means in effect for two times the number of design wins and defense in Q1. We are getting three times the value. It's part of bringing more of the system to our customers.

Let me talk about a few of them because I think they are critical and demonstrate very well what Admiral Giambastiani was talking about. ASIP, which is Airborne Signal Intelligence Payload, where we have been involved in providing -- we are providing the new technology refresh for the -- for their platform and here what is interesting, as Mark mentioned, is they started to



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develop the application on the application on the tower, like this, where they could simulate the full application when we did provide to them our embedded processing, they port the application in two days. In two days, they were ready to go.

This is how you improve the cycle of the prime for the government. This is how you can do more with less and minimize the risk.

Another example, and I will talk more about it, is, obviously, SEWIP, which is Surface Electronic Warfare Improvement Program Block Two. It's all about, again, technology refresh to the platform that exists. But, they need to improve the capability because the world is changing. The type of signal, the type of strategy is changing. That means the government, the administration, has to adapt to those threats.

The last one, it's one of the most interesting as, obviously, JCREW but it's, again, the same thing. It's bringing the next generation of counter IED capabilities to platforms which exist and which are existing, but, really move to the next step of capabilities there. But, I will talk more about this later.

The last one is in commercial, obviously, is with ASML. We've got several design wins, some are in production and some will be in production soon. That means, as you can see, those design wins are really the first growth driver moving forward.

As I mentioned, one of them is a 100% performance from Mercury. It's SEWIP Block Two Program. What is interesting is the story there. There is always a story behind those design wins. The story is Lockheed Martin was not yet the incumbent. But, it was a must-win program. It's important because when you are not the incumbent but you really want this program usually you have to provide better capabilities than your competition. But, you also have to prove you can bring those capabilities.

They came to us because in the radio side, we really have the best tuner in the industry for those type of capabilities. They came to us with this. Quickly, we worked with them as part of their team to provide the best-of-breed application-ready subsystem for electronic warfare.

What did this partnership mean? First, they won, which is good, we won as well. But, not only this, now we are the trusted partner. We are the partner, we are teaming with them and, in effect, they are giving us more content now. That means this partnership is driving content expansion that could double our program value moving forward. This is how we will grow. This is a good example of this partnership.

The second driver is our services and system integration. First, again, as I said, the numbers speak for themselves. We have been able to grow this business by 120% CAGR over the last three years.

Clearly, major revenue growth in a short period of time but what is important is also we're expanding our market, our addressable market. As you know, if we were staying in the embedded board business, it will be a \$900 million cap in our market side. By doing the services and system integration, we are really moving to a \$3.5 billion market.

Not only that, as I mentioned, it's also we are building partnerships and teaming with our customers. That means you are not a vendor, you are a partner, you are part of their team. This is also how you increase your value and your growth moving forward. We are the outsourcing partner. The good news is that it's fully aligned with the procurement reform, with what the government is pushing the prime to do. They need more flexible warfare because they have to minimize their overhead. When the budget is flat or it's going down, you have to really manage your expense.

We want to be their partner and in order to do that, we have to provide technology leadership, product leadership, innovation, this how we do it, through our best-of-breed, application-ready subsystem solutions. Being involved with them at this system level also is bringing us the revenue when they are all reaching their production. This is how we will drive growth moving forward.



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Good example is JCREW3.3 that means I'm very glad to present to you this slide. This banner came from ITT to basically celebrate with their team the award that they got to move to the EDM phase. Just to give you a little bit of background based on some of the questions I got during the break.

There was a first phase which was a demonstration phase of capabilities that ended by the end of September and, then, the goal is to move to the EDM, that is finishing the system, then you move to LRIP and then you move to production.

The award was a down-select from 221 to move from the demonstration phase to the EDM phase. This is what is happening. That mean in effect, the company who have been down-selected in effect won JCREW3.3. We are very proud of that and I think this is also showing that the government is looking for best-of-breed.

I would like to talk more about this. It's obviously the next generation of counter-IED, but, there's a lot behind this, those words.

First is, it's the first system which is fully online with spiral software development. That means this system is capable to get upgrading along the way to adapt to the potential mission as well as new threats. This is very important.

This is also an open architecture and, just to give you an idea, when ITT came to us is, and engage us, it was challenging. They wanted to use our capabilities because we did provide to the Army, to the lab of the Army, a demonstration system for the Army to check what new capability they could develop. But, we had to shrink it in a way to meet the size, weight and power requirement but we had to do it in 12 months. 12 months because we had to demonstrate the capabilities.

Well, I can tell you, it was really challenging. Even people didn't think we could do it. We did it, as a team, with ITT and all the members, and they have been successful day one based on that. This is how we make our customers successful and with real partnership with them that we'll drive a long term relationship with customers like ITT.

What does it mean for Mercury? Clearly, again, from a volume standpoint, if you use the example of JCREW 2.1 which was deployed in 25,000 systems or even JCREW 3.2 which was been awarded to ITT recently in September, 5,000 systems, it's clearly a type of volume we have never seen in Mercury's history.

Regarding the number in 3.3 we don't know, the only thing we know which is public is what has been published in the General Journal of Electronic Defense is by the program manager of the Navy saying that production will be starting in fiscal year '13.

Clearly, this program has a major potential to drive growth for Mercury moving forward.

Let's talk about the program we are involved in, and I will try to give a different angle than Mark talked about. Clearly, we are first aligned, totally, with where the budget is going.

If you talk about ballistic missile defense or on AEGIS Patriot missile, if you talk about electronic warfare based on the potential new threat with SEWIP, ASIP, where if you talk about the ISR requirement to find the enemy with the UAV, we are there. We are there, we are involved, we provide, usually, the most electronic piece of the system from an ISR standpoint.

But, not only that we are in those programs, but, those programs are key for our customers. They are their must win, they are their money maker, they are what makes them a big company. Meaning when you help them to be successful with those programs, when you help them to continue to be involved with their program, when you help them because you have the highest quality, you are there with them for a long, long time.

And this is how we will grow in Mercury moving forward. And, we work with most of the big prime, the "who's who" as Mark said. That means this is what we drive, the foundation of our growth.



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A very good example is the relationship we have developed with Lockheed Martin on all AEGIS for the ballistic missile defense where we provide the radar processing system for the SPY-1 radar.

I can say I am pretty sure that this is the most powerful processing system ever deployed in defense. If you see the processing capabilities of this system, it's unbelievable.

We're in production now. We've got \$35 million bookings in fiscal year '10 and a couple of ship have been installed with those new capabilities and I'm sure you've read the press recently, the Navy did an exercise in Japan where they used for the first time all new capabilities. It is the new radar with a new processor and they have been very successful. Obviously for us it's a major achievement, major milestone for us.

That means now we are moving into production where we expect to have an order for more than 30 ships over the next five years but what is key, I mentioned earlier, is this relationship we have developed with Lockheed Martin.

First of all, we have been involved in improving the capability by providing a very specific data recorder for them and we got an award in fiscal year '10, as well as, you have maybe seen, that Lockheed Martin got the award of the Ashore system. That means the equivalent of being on the ship to deploy on Ashore. That means they just got these developments awards and, obviously, we are a part of it.

That means that should drive more business for us moving forward. That means all in all, we expect to have more than \$100 million business in the five years coming from this design win and program.

Another very good example of a partnership is with Raytheon. In the Patriot Missile Defense where we provide the next-generation ground radar. Here, again, I can claim, I am pretty sure that we did provide the most powerful radar processing open VPX space. And, we did it again in record time. The award was for \$18 million, which covered the development phase as well as the UAE program and we are at the end of the development phase, entering production, and very successfully.

The customer has been amazed at the speed, at where they could put their software and track missiles. And, this is very good for us because this is showing Mercury's capabilities not only to deliver high capabilities but, more importantly, for the customer to go fast to market, fast to deployment, fully align with what the procurement reform is striving for.

We got the second award for the Taiwan country and, as you know, Raytheon is talking about getting award from Saudi Arabia as well as Turkey in the next 12 months. And, several countries should follow behind. That means it's a very good business for Mercury.

At the same time, and it's even more exciting for us, is the US Army, now that they see that they have, potentially, the country has better capabilities, they want those capabilities as well. That means if it's happening, it's a major potential for us, that means the US Army upgrading all their Patriot radar system.

All in all, we think that we could expect \$50 to \$80 million additional businesses in the next five years.

In summary, I hope you are convinced. I am convinced that we are very well positioned for growth. First of all, we are focused on the right market, the ISR market, which is the fastest growing market in defense, we are fully positioned to align to the procurement reform and the defense budget, but, at the same time, we are providing technology leadership, product leadership, to provide better capability to our prime which will push them to be their partner, outsourcing partner moving forward by providing to them best-of-breed application ISR subsystems.

In summary, our commercial business is stabilized and we strongly believe we are positioned to sustain double digit growth in defense.



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I would like to thank you and now I introduce our Chief Financial Officer, Bob Hult, who I'm sure will talk numbers now.

Bob Hult - Mercury Computer Systems - CFO

Thank you, Didier. Good morning, everyone. My name is Bob Hult, I'm Mercury's Chief Financial Officer. My mission this morning is to share with you a prospective with regard to our turnaround and perhaps, more importantly, look forward to our investment story as we enter the growth phase of the turnaround.

I want to start with a recap, if you will, of the journey we've been on these past three years. For those of you who have been following the company, you've heard me say in the past that FY '07, it was an easy lay up to declare that as the low watermark in terms of Mercury's financial performance. Again, easily recognized by the \$41 million operating loss and an operating cash burn of \$10 million.

Mark Aslett joined the company as our CEO in the second quarter of FY '08. It did not take the team long to point directly at the ACS Defense Business as the economic core of the company, that part of the company that would carry us forward and provide the growth for the future.

Our turnaround plan was centered on three major pillars, if you will. The first was we needed to exit five small businesses, hopefully through a sale mechanism. We also identified the need to take costs out, seeing that we needed to take costs out not just from the businesses that we hoped we would exit, but also from the core itself.

The third element of the turnaround, which I found, actually, quite fascinating, was we got about the business of recognizing where we needed to invest quickly. We saw we needed to get new products to market faster and it would require investment, changing our engineering methodologies. We also recognized that we needed to invest in our supply chain infrastructure capabilities if we were going to have scalable platform that could support growth in the future.

And, lastly, a clear recognition that investing in our go to market resources, our sales force and our marketing capabilities would serve us well in redefining new relationships we our key customers.

The turnaround took just under two years. It was done as we exited FY '09. We sold the five businesses, we took costs out through several restructuring actions and we could see the early returns with regard to those investments, most notably, we were bringing new products to market at a faster clip and, in fact, if I could be so bold, we were bringing new products to market which was not the case in previous years.

So, we turned into FY '10, entering the growth phase. Mark pointed at it earlier, we did get some modest growth up on the top line, 6%. Yes, it's modest. I think what excited us the most was it was the first time since FY '05 that the top line of the company moved positively. You can chart our course here. You can see tremendous amount of costs coming out on the operating expense line, \$165 million in FY '07. Yes, we sold businesses and we took costs out, \$95 million in FY '10.

The bottom line improved steadily and we kept a laser focus on generating cash throughout the turnaround. We took that cash burn and in the very next year, generated \$14 million positive cash flow from operations and, frankly, we haven't looked back since.

The other thing -- I don't think this group would overlook it, but, we've had the good fortune of very robust gross margins throughout the turnaround and we've been able to maintain them this past fiscal year.

So, with the turnaround behind us, our focus has shifted to strengthening and growing the defense business. I won't take long on this slide but a couple callouts. The pie charts on the left, what I want to point out there is MFS in FY '09 was 3% of the company's revenues. Dave had a chart up there. They pretty much doubled their revenue in FY '10, now 5% of the company.



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On the far right, the important point for me is, and I'm not going to say this again after this chart, is commercial is stabilized, \$42 million in revenue in FY '10 versus \$44 million in FY '09.

On our year-end FY '10 call and again on our Earnings Call just two weeks ago, as we reported, our first quarter results for FY '11, we reaffirm that we felt that our commercial revenues would be flat to FY '10. No change there. And that's what we mean by stabilization. We've got enough strength in our design wins, most notably with ASML to feel very comfortable with that, even as KLA Tencor rolls off as this year unfolds.

Under the covers, our defense business total company has delivered a 12% revenue CAGR in the '07 to FY '10 timeframe.

A few leading indicators. So, in addition to that defense revenue CAGR in the '07 to '10 timeframe of 12%, our defense business has delivered in the same timeframe a 10% CAGR on bookings, a 10% CAGR on backlog, and an 18% CAGR in terms of 12-month backlog.

The 12-month backlog, again, I think is a great leading indicator. It's certainly something that we've been quite proud of and have taken full advantage of. It helps us a lot with our forecasting and predictability for the business in terms of the immediate next couple of quarters.

So, my conclusion here is it is all about growth going forward, driven by our defense business and the leading indicators have been lining up in a very solid way the past couple of years.

On the turnaround journey, we did restore the company to profitability. It did take the two years in the turnaround. We almost got it back to breakeven in FY '08. We did get it back to profitability in FY '09 and now on the strength of the top line starting to move, we've further extended the profitability performance in FY '10.

A quick call out on FY '10. Taxes take some understanding here. We did reverse a sizable valuable allowance against certain deferred tax assets and we had an effective tax rate benefit of 5% for the full year. I'm not going to dissect that further for you other than to say for FY '11, we expect a more normalized tax rate in the range of approximately 36%.

I don't think there's a CFO still standing and going to work everyday that hasn't become super sensitized to cash, particularly these past few years. I'm certainly not an exception to that. I do think I've had a great advantage the past few years.

The entire Mercury team has not just supported the cash initiatives of the company but they've gotten involved. And, let me describe that a little bit to you. So, you can see our inventory. We've improved the turns and we actually pulled over \$10 million out of our inventories while we were turning the company around.

But, what was really exciting was the transformation that we put our supply chain through. Starting with our engineering team, they completely changed the methodology, how we engineer design products, to a much more modularized approach which allows for reuse across many verticals and product offerings. We really went after the design to manufacturability issues hoping there to get our products into market in a quicker manner and also have them perform better in the field.

Relentlessly pursuing operational efficiencies and going after cost of quality has all delivered those gross margins I spoke to earlier. This is all part of what has happened under the covers to keep those gross margins performing at the level that they perform at.

On the accounts receivable side measured by day sales outstanding, we've got great advantages here, too. All of our customers are primes, they are all blue chip customers in their own right or they behave in a similar fashion. So, we've taken full advantages of that, we have not tied up a lot of cash in accounts receivable, we pretty much averaged around 60 days. You'll note that we've got a target model of 50 days, where's that coming from? We still have a little work to do here. In my opinion, I think all of our



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opinions, we're still pushing too much product out in month three. What technology company doesn't do that, but we're determined to smooth that shipment pattern out into a more linear fashion, perhaps something like a 30-30-40 split.

Assuming we're successful at doing that over the next year or two, we should be able to get these DSO's down and likewise if I pop back up to inventory, we've got some headroom on the inventory turn side, too.

So, at this juncture, we have put in place an efficient working capital platform that will support the company's growth going forward, we even have a little headroom left where we can improve that.

This is all translated into a much improved cash conversion cycle. I don't know if I was terrorized a bit but -- probably only because we didn't put the slide together right away. At the beginning of the turnaround, it was taking us over 140 days to convert cash through the supply chain back to cash.

We've driven that down to approximately 100 days and as I said, I believe we can further improve this. So, another view, if you will, of what does an efficient working capital platform look like.

Balance sheet. A few moments on the balance sheet. Two weeks ago, we reported our Q1 FY '11 results. We came in with a cash and marketable securities balance of \$82 million. We have no debt on the balance sheet, whether short term or long term, and we're generating positive free cash flow from operations. In fact, we've generated \$8 million of positive free cash flow from operations in the September quarter.

In addition, we have other financing sources that should serve us well in terms of supporting our acquisition-based growth agenda. We have an operating line of credit in the amount of \$15 million, an acquisition line of credit in the amount of \$20 million, both with Silicon Valley Bank and, at least at this juncture, I'm happy to report there's no outstanding withdrawals against these. We also have a \$100 million universal shelf registration that remains in effect.

Approximately two years ago, we introduced our target business model. It's actually two models, one for Mercury Federal and one for the ACS business. And, on the far right is the blended total target business model, a pro forma for all of Mercury.

Do a couple of callouts here with regards to the characteristics of Mercury's target business model. It's comprehended while built only around organic growth. So, no acquisitions are in here. We look for a revenue split, 90-10, so 90% of the revenue is coming from ACS, 10% from Mercury Fed, and a quick reminder there, Mercury Fed finished FY '10 at 5% of the revenue. So, we know that business is going to grow rapidly and the headroom is built into the model here.

You will note that Mercury Federal, their business model, being mostly in engineering services and solutions provider, you're going to recognize it. Look at the gross margin line, 20%. I do get a bit more excited when I look at the 8% income from operation. So, good result on the bottom line but, clearly, evidencing characteristics of a service business.

ACS, perhaps a bit more traditional, hardware, software, services and systems integration, runs with a very robust gross margin, 55% and pushes through 13 points to the bottom line.

R&D, our model looks forward to running to the low to mid 20's. Everybody's first reaction is almost an, "Oh my god." I like to look at it as the proxy or the value that we'll bring to our customers in terms of what we bring to the table to participate in their solutions. So, we're actually feeling pretty good about that.

Our business, no matter how you look at it, is characterized by high mix, low volume. You can look at our products, you can look at our programs, our customers, and, of course, you hear us talking about it every quarter. It is a characteristic of the business, although I sit here a little bit smiling out the corner of my mouth, looking over at Didier saying I'm not sure what I'm going to do with this comment when JCREW kicks in. Clearly a different animal. So, we're excited to be looking at that on a forward basis.



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All morning we've been talking about our services and systems integration businesses, how important they are. From a model standpoint, it's these businesses that are going to lead to the design wins that will deliver the product based annuity streams and that, of course, is built into the model. So, hard, lower right side, we're pursuing with a fair degree of focus and excitement, a target business model that delivers an adjusted EBITDA in the 17% to 18% range.

So, you're asking how we're doing against it. Results are approaching the model. I think we're closing in rapid fashion here. You can see that we've had an advantage throughout the turnaround. Our gross margins have been running a couple hundred basis points above the model. As Mercury Federal grows, as those systems integration, engineering services offerings grow, that will bring us down towards the 54%, so, we're standing firm on that but we've had a great advantage here in the past couple of years.

Operating income, 9% for all of FY '10, chasing that 12% to 13% in adjusted EBITDA, 15% against the 17% to 18%.

We got off to a good start for FY '11. We reported earnings two weeks ago. It might even be better than a good start, it's certainly solid. What I've done here is contrast Q1 FY '11 performance against Q1 FY '10. You can see a 10% growth on the top line, a further improvement on the gross margin line, 120 basis points year over year and, of course, substantially above that target model of 54+%.

Operating expenses at \$25 million are actually flat, sequentially, to the fourth quarter of FY '10. Operating income came in at 10%, 10.1%, adjusted EBITDA 9%. I think Mark noted it, that adjusted EBITDA is actually 17% of revenue, which puts us at the low end of our target model range of adjusted EBITDA. Operating cash flow, \$9 million, on a net basis \$8 million.

Backlog, again, leading indicators, if you will, 5% growth year over year. And, again, the part that, perhaps, gives us the most confidence in terms of forecasting the business in the next quarter or two, the 12-month backlog having grown 45% year over year.

So, here we are. We're not in a quiet period. We did deliver guidance on our call two weeks ago for the second quarter, the December quarter. No change. Revenue is at \$54 million to \$55 million. GAAP EPS 10 pennies to 12 pennies and adjusted EBITDA \$7.1 million to \$7.7 million. So, no change there. I did want to reaffirm that. However, I'm going to contrast that guidance with Q2 FY '10. That revenue guidance range of \$54 million to \$55 million is going to line up against \$45 million one year ago and, equally, whether we look at our bottom line profitability on an EPS basis or an adjusted EBITDA basis, we're showing improvements there also year over year.

I think everybody pretty much knows we're in the one quarter at a time guidance business. We're staying with that, sticking with that. I think it has served the company and the various stakeholders very well. We've laid down now a 13-quarter track record of meeting or slightly exceeding our guidance ranges on both the top and bottom lines.

So, in summary, we've restored the company to profitability. The top line is growing. We've built an efficient working capital to support future growth. We're generating healthy cash flows from operations. The balance sheet is strong with no debt and we do have sufficient capital sources available to support our acquisition agenda and, again, we're closing nicely on our target business model.

So, with that, I'd like to invite Mark back up here for a few closing remarks and then we're going to run a Q&A session.

Mark Aslett - Mercury Computer Systems - President and Chief Executive Officer

So, I know we've gone through a lot of charts but, hopefully, you get a sense of how it is that we're positioned. We feel that we've done a pretty good job turning the company around and positioning it well within the company well within the defense marketplace.



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We certainly have a business model, it's absolutely aligned with the needs of the primes going forward and we see more opportunity for our business today than what we have seen in the past couple of years since I joined Mercury.

We're growing our defense business pretty well right now with double digit rates and we see the opportunity of actually supplementing that growth with acquisitions going forward.

So, thanks very much for all your support, thanks for coming today and that will close down the formal part of the presentation and would like to open it up to your questions.

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