

PRAXAIR INC
Form 424B3
March 23, 2009

Table of Contents

The information in this preliminary prospectus supplement is not complete and may be changed without notice. Neither this preliminary prospectus supplement nor the accompanying prospectus is an offer to sell securities nor a solicitation of an offer to buy these securities in any jurisdiction where the offering is not permitted.

**As filed pursuant to Rule 424(b)(3)
Registration No. 333-139328**

**SUBJECT TO COMPLETION
PRELIMINARY PROSPECTUS SUPPLEMENT DATED MARCH 23, 2009**

**Prospectus Supplement
March , 2009
(To Prospectus Dated December 14, 2006)**

\$

% Notes due

Praxair, Inc. will pay interest on the notes on and of each year, beginning , 2009. The notes will mature on . We may redeem the notes at our option, at any time in whole or from time to time in part, by paying the greater of (i) 100% of the principal amount of and accrued interest on the notes or (ii) a Make-Whole Amount. There is no sinking fund for the notes.

Investing in the notes involves risk. See Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

	Per Note	Total
Public offering price(1)	%	\$
Underwriting discount	%	\$
Proceeds, before expenses, to Praxair(1)	%	\$

(1) Plus accrued interest, if any, from , 2009 if settlement occurs after that date.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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The notes will be ready for delivery in book-entry form only through The Depository Trust Company on or about , 2009.

Joint Book-Running Managers

Banc of America Securities LLC

Citi

TABLE OF CONTENTS

Prospectus Supplement

	Page
<u>Where You Can Find More Information</u>	S-2
<u>Note Regarding Forward-Looking Statements</u>	S-2
<u>The Company</u>	S-3
<u>Use of Proceeds</u>	S-3
<u>Ratio of Earnings To Fixed Charges and Earnings To Fixed Charges and Preferred Stock Dividends</u>	S-4
<u>Description of the Notes</u>	S-5
<u>Underwriting</u>	S-7
<u>Experts</u>	S-8

Prospectus

	Page
<u>About This Prospectus</u>	1
<u>Note Regarding Forward-Looking Statements</u>	1
<u>The Company</u>	2
<u>Use of Proceeds</u>	2
<u>Ratio of Earnings To Fixed Charges and Earnings To Combined Fixed Charges and Preferred Stock Dividends</u>	3
<u>Description of Capital Stock</u>	4
<u>Description of Debt Securities</u>	8
<u>Plan of Distribution</u>	19
<u>Legal Matters</u>	20
<u>Experts</u>	20
<u>Where You Can Find More Information</u>	20
<u>Incorporation of Certain Documents by Reference</u>	20

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus is accurate as of the date on the front of this prospectus supplement only. Our business, financial condition, results of operations and prospects may have changed since that date.

References to we , us, our, the Company, and Praxair are to Praxair, Inc. and its subsidiaries unless the context otherwise requires.

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC and our common stock is listed on the New York Stock Exchange under the symbol PX. Our SEC filings are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. You may also read and copy any document we file at the SEC's public reference room at 100 F Street, NE, Washington, D.C. 20549. You can call the SEC at 1-800-732-0330 for further information about the public reference rooms.

The SEC allows us to incorporate by reference the information we file with them, which means we are assumed to have disclosed important information to you when we refer you to documents that are on file with the SEC. The information we have incorporated by reference is an important part of this prospectus supplement and the accompanying prospectus, and information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future documents we file with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until we sell all of the securities covered by this prospectus supplement and the accompanying prospectus, provided that information furnished and not filed by us under any item of any Current Report on Form 8-K including the related exhibits is not incorporated by reference.

Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

The information responsive to Part III of Form 10-K for the fiscal year ended December 31, 2008 provided in our Proxy Statement on Schedule 14A filed on March 17, 2009.

Our Registration Statement on Form 8A dated June 27, 2002.

You may request a copy of these documents at no cost by writing to us at the following address:

Praxair, Inc.
39 Old Ridgebury Road
Danbury, Connecticut 06810-5113
Attn: Assistant Corporate Secretary
Telephone: (203) 837-2000.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement and the accompanying prospectus contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's reasonable expectations and assumptions as of the date the statements are made but involve risks and uncertainties. These risks and uncertainties include, without limitation: the performance of stock markets generally; developments in worldwide and national economies and other international events and circumstances; changes in foreign currencies and in interest rates; the cost and availability of electric power, natural gas and other raw materials; the ability to achieve price increases to offset cost increases; catastrophic events including natural disasters, epidemics and acts of war and terrorism; the ability to attract, hire and retain qualified personnel; the impact of changes in financial accounting standards; the impact of tax, environmental, home healthcare and other legislation and government regulation in jurisdictions in which the Company operates; the cost and outcomes of investigations, litigation and regulatory proceedings; continued timely development and market acceptance of new products and applications; the impact of competitive products and pricing; future financial and operating performance of major customers and industries

served; and the effectiveness and speed of integrating new acquisitions into the business. These risks and uncertainties may cause actual future results or circumstances to differ materially from the projections or estimates contained in the forward-looking statements. The Company assumes no obligation to update or provide revisions to any forward-looking statement in response to changing circumstances. The above listed risks and uncertainties are further described in Item 1A (Risk Factors) in the Company's latest Annual Report on Form 10-K filed with the SEC which should be reviewed carefully. Please consider the Company's forward-looking statements in light of those risks.

S-2

Table of Contents

THE COMPANY

Praxair was founded in 1907 and became an independent publicly traded company in 1992. Praxair was the first company in the United States to produce oxygen from air using a cryogenic process and continues to be a major technological innovator in the industrial gases industry.

Praxair is the largest industrial gas supplier in North and South America, is rapidly growing in Asia, and has strong, well-established businesses in Europe. Praxair's primary products for its industrial gases business are atmospheric gases (oxygen, nitrogen, argon, rare gases) and process gases (carbon dioxide, helium, hydrogen, electronic gases, specialty gases, acetylene). The Company also designs, engineers and builds equipment that produces industrial gases for internal use and external sale. The Company's surface technologies segment, operated through Praxair Surface Technologies, Inc., supplies wear-resistant and high-temperature corrosion-resistant metallic and ceramic coatings and powders. Sales for Praxair were \$10,796 million, \$9,402 million and \$8,324 million for 2008, 2007 and 2006, respectively.

Praxair serves approximately 25 industries as diverse as healthcare and petroleum refining; computer-chip manufacturing and beverage carbonation; fiber-optics and steel making; and aerospace, chemicals and water treatment. In 2008, 95% of sales were generated in four geographic segments (North America, Europe, South America and Asia) primarily from the sale of industrial gases with the balance generated from the surface technologies segment. Praxair provides a competitive advantage to its customers by continuously developing new products and applications, which allow them to improve their productivity, energy efficiency and environmental performance.

The Company's principal offices are located at 39 Old Ridgebury Road in Danbury, Connecticut 06810-5113 and its telephone number is (203) 837-2000.

USE OF PROCEEDS

We will use the net proceeds from this offering (i) to repay short-term debt that we incurred in part to repay our 2.75% notes due 2008 and (ii) for general corporate purposes. Prior to their application, the net proceeds may be invested in short-term investments.

Table of Contents

**RATIO OF EARNINGS TO FIXED CHARGES
AND
RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS**

The following table sets forth our ratio of earnings to fixed charges and ratio of earnings to fixed charges and preferred stock dividends for the periods indicated:

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Ratio of Earnings to Fixed Charges(a)	7.0	7.6	7.6	6.6	6.1
Ratio of Earnings to Fixed Charges and Preferred Stock Dividends(b)	7.0	7.6	7.6	6.6	6.0

- (a) For the purpose of computing the ratio of earnings to fixed charges, earnings are comprised of income from continuing operations of consolidated subsidiaries before provision for income taxes and adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, less capitalized interest, plus depreciation of capitalized interest, dividends from companies accounted for using the equity method, and fixed charges. Fixed charges are comprised of interest on long-term and short-term debt plus capitalized interest and rental expense representative of an interest factor.
- (b) For the purpose of computing the ratio of earnings to fixed charges and preferred stock dividends, earnings are comprised of income from continuing operations of consolidated subsidiaries before provision for income taxes and adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, less capitalized interest, plus depreciation of capitalized interest, dividends from companies accounted for using the equity method, and fixed charges as defined in (a). Fixed charges and preferred stock dividends are comprised of fixed charges as defined in (a) plus preferred stock dividend requirements of consolidated subsidiaries.

Table of Contents

DESCRIPTION OF THE NOTES

In this section entitled Description of the Notes, references to the Company, Praxair, we, our, or us refers to Praxair, Inc., as issuer of the notes and not to any of the subsidiaries of Praxair, Inc.

The following description of the particular terms of the notes supplements, and to the extent inconsistent therewith supersedes, the description of the general terms and provisions of the senior debt securities included in the accompanying prospectus, to which description reference is hereby made.

The notes will be our unsecured general obligations, will be issued under an indenture dated as of July 15, 1992 between Praxair, Inc. and U.S. Bank National Association, as the ultimate successor trustee to Bank of America, Illinois, will be issued only in book-entry form and will mature on _____, _____.

The notes will bear interest from _____, 2009 or from the most recent date to which interest has been paid or provided for, at the rate of _____ % per year, payable semi-annually in arrears on _____ and _____, commencing on _____, 2009 to the persons in whose names the notes are registered at the close of business on the preceding _____ and _____, respectively. The notes will accrue interest on the basis of a 360-day year consisting of twelve months of 30 days each.

We will issue the notes in registered form without coupons in denominations of \$2,000 and whole multiples of \$1,000 in excess thereof. The notes are subject to defeasance under the conditions described in the accompanying prospectus, including the condition that an opinion of counsel be delivered with respect to the absence of any tax effect of any such defeasance to holders of the notes.

Upon issuance, the notes will be represented by one or more global securities that will be deposited with, or on behalf of, DTC and will be registered in the name of DTC or a nominee of DTC. See Description of Debt Securities Global Debt Securities in the accompanying prospectus.

We may from time to time without the consent of the holders of the notes create and issue further notes having the same terms and conditions as these notes so that the further issue would be consolidated and form a single series with these notes.

At December 31, 2008, approximately \$2.5 billion aggregate principal amount of senior debt securities were outstanding under the indenture.

Optional Redemption

We may redeem the notes at our option, at any time in whole or from time to time in part, at a redemption price equal to the greater of (1) the principal amount of the notes being redeemed plus accrued and unpaid interest to the redemption date or (2) the Make-Whole Amount for the notes being redeemed.

Make-Whole Amount means, as determined by a Quotation Agent, the sum of the present values of the principal amount of the notes to be redeemed, together with the scheduled payments of interest (exclusive of interest to the redemption date) from the redemption date to the maturity date of the notes being redeemed, in each case discounted to the redemption date on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Adjusted Treasury Rate, plus accrued and unpaid interest on the principal amount of the notes being redeemed to the redemption date.

Adjusted Treasury Rate means, with respect to any redemption date, the sum of (x) either (1) the yield, under the heading that represents the average for the immediately preceding week, appearing in the most recent published statistical release designated H.15 (519) or any successor publication that is published weekly by the Board of Governors of the Federal Reserve System and that establishes yields on actively traded United States Treasury securities adjusted to the Comparable Treasury Issue (if no maturity is within three months before or after the remaining term of the notes being redeemed, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue shall be determined and the Adjusted Treasury Rate shall be interpolated or extrapolated from such yields on a straight-line basis, rounded to the nearest month) or (2) if such release (or any successor release) is not published during the week preceding the calculation date or does not contain such yields, the rate per year equal to the semi-annual equivalent yield to

S-5

Table of Contents

maturity of the Comparable Treasury Price for such redemption date, in each case calculated on the third business day preceding the redemption date, and (y) %.

Comparable Treasury Issue means the United States Treasury security selected by the Quotation Agent as having a maturity comparable to the remaining term from the redemption date to the maturity date of the notes being redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of notes.

Comparable Treasury Price means, with respect to any redemption date, if clause (2) of the Adjusted Treasury Rate is applicable, the average of three, or such lesser number as is obtained by the indenture trustee, Reference Treasury Dealer Quotations for such redemption date.

Quotation Agent means the Reference Treasury Dealer selected by the indenture trustee after consultation with us.

Reference Treasury Dealer means Banc of America Securities LLC and Citigroup Global Markets Inc., and their respective successors and assigns, and one other nationally recognized investment banking firm selected by us that is a primary U.S. Government securities dealer.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the indenture trustee, of the bid and asked prices for the Comparable Treasury Issue, expressed in each case as a percentage of its principal amount, quoted in writing to the indenture trustee by such Reference Treasury Dealer at 5:00 p.m., New York City time, on the third business day preceding such redemption date.

Defaults and Remedies

Clause 1 of the definition of event of default under the caption Description of the Debt Securities Defaults and Remedies in the accompanying prospectus is revised and applicable to this series of notes as follows:

the Company defaults in any payment of interest on any of the notes when the same becomes due and payable and the default continues for a period of 30 days .

Book-Entry System

We will initially issue the notes in the form of one or more global notes (the Global Notes). The Global Notes will be deposited with, or on behalf of, the Depository Trust Company (DTC) and registered in the name of DTC or its nominee. Except as set forth below, the Global Notes may be transferred, in whole and not in part, only to DTC or another nominee of DTC. A holder may hold beneficial interests in the Global Notes directly through DTC if such holder has an account with DTC or indirectly through organizations which have accounts with DTC, including Euroclear and Clearstream.

Investors may hold interests in the notes outside the United States through Euroclear or Clearstream if they are participants in those systems, or indirectly through organizations which are participants in those systems. Euroclear and Clearstream will hold interests on behalf of their participants through customers securities accounts in Euroclear s and Clearstream s names on the books of their respective depositaries which in turn will hold such positions in customers securities accounts in the names of the nominees of the depositaries on the books of DTC. All securities in Euroclear or Clearstream are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts.

Table of Contents**UNDERWRITING**

Under the terms and subject to the conditions set forth in an underwriting agreement dated the date hereof, the underwriters named below have severally agreed to purchase, and we have agreed to sell to them, severally, the respective principal amounts of notes set forth opposite their names below:

Underwriters	Principal Amount of Notes
Banc of America Securities LLC	\$
Citigroup Global Markets Inc.	
Total	\$

The underwriting agreement provides that the obligation of the several underwriters to pay for and accept delivery of the notes is subject to the approval of certain legal matters by their counsel and to certain other conditions. The underwriters are committed to purchase all of the notes if any are purchased.

The underwriters propose to offer the notes initially to the public at the public offering price shown on the cover page hereof and to selling group members at that price less a selling concession of % of the principal amount of the notes. The underwriters and selling group members may reallow a discount of % of the principal amount of the notes on sales to other dealers. After the initial offering of the notes, the underwriters may change the offering price and other selling terms.

We estimate that our expenses for this offering will be approximately \$250,000.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, and to contribute to payments the underwriters may be required to make in respect of any of these liabilities.

The notes are a new issue of securities with no established trading market. We do not intend to apply for listing of the notes on a national securities exchange, but have been advised by the underwriters that they currently intend to make a secondary market in the notes, as permitted by applicable laws and regulations. The underwriters are not obligated, however, to make a market in the notes and any such secondary market making may be discontinued at any time without notice at the sole discretion of the underwriters. Accordingly, no assurance can be given as to the liquidity of, or trading market for, the notes.

In connection with the offering of the notes, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the notes. Specifically, the underwriters may overallocate in connection with the offering of the notes, creating a syndicate short position. In addition, the underwriters may bid for, and purchase notes in the open market to cover syndicate short positions or to stabilize the price of the notes. Finally, the underwriting syndicate may reclaim selling concessions allowed for distributing the notes in the offering of the notes, if the syndicate repurchases previously distributed notes in syndicate covering transactions, stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of the notes above independent market levels. The underwriters are not required to engage in any of these activities, and may end any of them at any time without notice.

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In the ordinary course of their respective businesses, the underwriters and their affiliates have engaged, are engaging and may in the future engage, in commercial banking and/or investment banking transactions with us and our affiliates for which they have received, are receiving and will receive customary compensation, including as arrangers and/or lenders under credit facilities for us and our subsidiaries.

Affiliates of the underwriters own certain of our short-term debt and may receive more than 10% of the net proceeds of this offering used to repay the short-term debt that we incurred in part to pay down our 2.75% notes due 2008. Accordingly, this offering is being conducted in accordance with Rule 5110(h) of the Financial Industry Regulatory Authority.

S-7

Table of Contents

EXPERTS

The financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) incorporated in this prospectus supplement by reference to the Annual Report on Form 10-K for the year ended December 31, 2008 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

S-8

Table of Contents

Prospectus

PRAXAIR, INC.

**Common Stock
Preferred Stock
and
Debt Securities**

We may offer, from time to time, in one or more series:

- shares of our common stock;
- shares of our preferred stock;
- unsecured senior debt securities; and
- unsecured subordinated debt securities.

The securities:

- will be offered at prices and on terms to be set forth in one or more prospectus supplements;
- may be denominated in U.S. dollars or in other currencies or currency units;
- may be offered separately or together with other securities as units, or in separate series;
- may be issued upon conversion of, or in exchange for, other securities; and
- may be listed on a national securities exchange, if specified in the applicable prospectus supplement.

Our common stock is listed on the New York Stock Exchange under the symbol PX .

Our principal offices are located at 39 Old Ridgebury Road in Danbury, Connecticut 06810-5113 and our telephone number is (203) 837-2000.

Investing in these securities involves risk. See Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The securities may be sold from time to time directly, through agents or through underwriters and/or dealers. If any agent of the issuer or any underwriter is involved in the sale of the securities, the name of such agent or underwriter and any applicable commission or discount will be set forth in the accompanying prospectus supplement.

This prospectus may not be used unless accompanied by a prospectus supplement.

The date of this prospectus is December 14, 2006.

TABLE OF CONTENTS

Prospectus

	Page
<u>About This Prospectus</u>	1
<u>Note Regarding Forward-Looking Statements</u>	1
<u>The Company</u>	2
<u>Use of Proceeds</u>	2
<u>Ratio of Earnings To Fixed Charges and Ratio of Earnings To Fixed Charges and Preferred Stock Dividends</u>	3
<u>Description of Capital Stock</u>	4
<u>Description of Debt Securities</u>	8
<u>Plan of Distribution</u>	19
<u>Legal Matters</u>	20
<u>Experts</u>	20
<u>Where You Can Find More Information</u>	20
<u>Incorporation of Certain Information by Reference</u>	20

Table of Contents

ABOUT THIS PROSPECTUS

This prospectus is part of a shelf registration statement filed with the United States Securities and Exchange Commission by us. By using a shelf registration statement, we may sell an unlimited aggregate principal amount of any combination of the securities described in this prospectus from time to time and in one or more offerings. This prospectus only provides you with a general description of the securities that we may offer. Each time we sell securities, we will provide a supplement to this prospectus that contains specific information about the terms of the securities. The prospectus supplement may also add, update or change information contained in this prospectus. Before purchasing any securities, you should carefully read both this prospectus and any prospectus supplement, together with the additional information described under the headings **Where You Can Find More Information** and **Incorporation of Certain Information by Reference**.

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement. We have not authorized anyone else to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer of the securities in any jurisdiction where the offer is not permitted. You should not assume that the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents.

References to **we**, **us**, **our**, **the Company**, and **Praxair** are to Praxair, Inc. and its subsidiaries unless the context requires otherwise.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus (including the documents incorporated herein by reference) contains and any prospectus supplement (including the documents incorporated therein by reference) will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's reasonable expectations and assumptions as of the date the statements are made but involve risks and uncertainties. These risks and uncertainties include, without limitation: the performance of stock markets generally; developments in worldwide and national economies and other international events and circumstances; changes in foreign currencies and in interest rates; the cost and availability of electric power, natural gas and other raw materials; the ability to achieve price increases to offset cost increases; catastrophic events; the ability to attract, hire and retain qualified personnel; the impact of changes in financial accounting standards; the impact of tax and other legislation and government regulation in jurisdictions in which we operate; the cost and outcomes of litigation and regulatory agency actions; continued timely development and market acceptance of new products and applications; the impact of competitive products and pricing; future financial and operating performance of major customers and industries served; and the effectiveness and speed of integrating new acquisitions into our business. These risks and uncertainties may cause actual future results or circumstances to differ materially from the projections or estimates contained in the forward-looking statements. We assume no obligation to update or provide revisions to any forward-looking statement in response to changing circumstances. The above listed risks and uncertainties are further described in Item 1a, **Risk Factors**, in our Annual Report on Form 10-K for the year ended December 31, 2005 and will be described in the applicable prospectus supplement (including information incorporated by reference) and our filings with the SEC. Please consider our forward-looking statements in light of those risks. We are under no duty and do not intend to update any of the forward-looking statements after the date of this prospectus or to conform our prior statements to actual results.

Table of Contents

THE COMPANY

Praxair was founded in 1907 and became an independent publicly traded company in 1992. Praxair was the first company in the United States to produce oxygen from air using a cryogenic process and continues to be a major technological innovator in the industrial gases industry.

Praxair is the largest industrial gases supplier in North and South America, is rapidly growing in Asia, and has strong, well-established businesses in Europe. Praxair's primary products for its industrial gases business are atmospheric gases (oxygen, nitrogen, argon, rare gases) and process gases (carbon dioxide, helium, hydrogen, electronic gases, specialty gases, acetylene). The Company also designs, engineers and builds equipment that produces industrial gases for internal use and external sale. The Company's surface technology segment, operated through Praxair Surface Technologies, Inc., supplies wear-resistant and high-temperature corrosion-resistant metallic and ceramic coatings and powders. Sales for Praxair were \$7,656 million, \$6,594 million and \$5,613 million for 2005, 2004 and 2003, respectively. For the nine-month periods ended September 30, 2006 and 2005, sales for the Company were \$6,201 million and \$5,636 million, respectively.

Praxair serves approximately 25 industries as diverse as healthcare and petroleum refining; computer-chip manufacturing and beverage carbonation; fiber-optics and steel making; and aerospace, chemicals and water treatment. In 2005, 94% of sales were generated in four regional segments (North America, Europe, South America and Asia) primarily from the sale of industrial gases with the balance generated from the surface technologies segment. Praxair provides a competitive advantage to its customer base by continually developing new products and applications, which allow them to improve their productivity, energy efficiency and environmental performance.

The Company's principal offices are located at 39 Old Ridgebury Road in Danbury, Connecticut 06810-5113 and our telephone number is (203) 837-2000.

USE OF PROCEEDS

Except as otherwise described in the applicable prospectus supplement, we will use the net proceeds from the sale or sales of our securities for general corporate purposes, which may include, without limitation, the repayment of outstanding indebtedness, working capital increases and capital expenditures, and acquisitions of companies in a similar line of business. Prior to their application, the proceeds may be invested in short-term investments. Reference is made to our financial statements incorporated by reference herein for a description of the terms of our outstanding indebtedness.

Table of Contents

**RATIO OF EARNINGS TO FIXED CHARGES
AND
RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS**

The following table sets forth our ratio of earnings to fixed charges and ratio of earnings to fixed charges and preferred stock dividends for the periods indicated:

	Year Ended December 31,					Nine Months Ended September 30, 2006
	2005	2004	2003	2002	2001	
Ratio of Earnings to Fixed Charges(a)	6.6	6.1	5.2	3.9	3.1	7.4
Ratio of Earnings to Fixed Charges and Preferred Stock Dividends(b)	6.6	6.0	5.2	3.9	3.1	7.4

- (a) For the purpose of computing the ratio of earnings to fixed charges, earnings are comprised of income from continuing operations of consolidated subsidiaries before provision for income taxes and adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, less capitalized interest, plus depreciation of capitalized interest, dividends from companies accounted for using the equity method, and fixed charges. Fixed charges are comprised of interest on long-term and short-term debt plus capitalized interest and rental expense representative of an interest factor.
- (b) For the purpose of computing the ratio of earnings to fixed charges and preferred stock dividends, earnings are comprised of income from continuing operations of consolidated subsidiaries before provision for income taxes and adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, less capitalized interest, plus depreciation of capitalized interest, dividends from companies accounted for using the equity method, and fixed charges as defined in (a). Fixed charges and preferred stock dividends are comprised of fixed charges as defined in (a) plus preferred stock dividend requirements of consolidated subsidiaries.

Table of Contents

DESCRIPTION OF CAPITAL STOCK

Authorized Capital Stock

Under the Restated Certificate of Incorporation of the Company the total number of shares of all classes of stock that the Company has authority to issue is 825,000,000, of which 25,000,000 may be shares of preferred stock, par value \$.01 per share, and 800,000,000 may be shares of common stock, par value \$.01 per share. As of November 30, 2006, 367,543,065 shares of our common stock were issued (of which 322,113,873 shares were outstanding and 45,429,192 shares were held in treasury) and 57,394,845 shares reserved for issuance pursuant to benefit plans.

Common Stock

Holders of the Company's common stock are entitled to receive ratably dividends, if any, subject to the prior rights of holders of outstanding shares of preferred stock, as are declared by the board of directors of the Company out of the funds legally available for the payment of dividends. Except as otherwise provided by law, each holder of common stock is entitled to one vote per share of common stock on each matter submitted to a vote of a meeting of stockholders. The common stock does not have cumulative voting rights in the election of directors.

In the event of any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, after all liabilities and liquidation preference, if any, of preferred stock have been paid in full, the holders of the Company's common stock are entitled to receive any remaining assets of the Company.

The Company's common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to our common stock. Each outstanding share of the Company's common stock is accompanied by a right to purchase one one-hundredth of a share of participating preferred stock at a price of \$150 subject to certain anti-dilution adjustments. This right is described in more detail below under the heading "Rights Agreement".

The Company is authorized to issue additional shares of common stock without further stockholder approval (except as may be required by applicable law or stock exchange regulations). With respect to the issuance of common shares of any additional series, the board of directors of the Company is authorized to determine, without any further action by the holders of the Company's common stock, the dividend rights, dividend rate, conversion rights, voting rights and rights and terms of redemption, as well as the number of shares constituting such series and the designation thereof. Should the board of directors of the Company elect to exercise its authority, the rights and privileges of holders of the Company's common stock could be made subject to rights and privileges of any such other series of common stock. The Company has no present plans to issue any common stock of a series other than the Company's common stock currently issued and outstanding.

The transfer agent and registrar for the shares of our common stock is Registrar and Transfer Company, 10 Commerce Drive, Cranford, New Jersey 07016-3572.

Preferred Stock

The Company's board of directors may issue up to 25,000,000 shares of preferred stock in one or more series and, subject to the Delaware corporation law, may:

fix the rights, preferences, privileges and restrictions of the preferred stock;

fix the number of shares and designation of any series of preferred stock; and

increase or decrease the number of shares of any series of preferred stock but not below the number of outstanding shares.

The Company's board of directors has the power to issue our preferred stock with voting and conversion rights that could negatively affect the voting power or other rights of our common stockholders, and the board

Table of Contents

of directors could take that action without stockholder approval. The issuance of our preferred stock could delay or prevent a change in control of the Company.

At September 30, 2006, no shares of our preferred stock, series A, and no shares of our preferred stock, series B, were outstanding.

If the Company offers any series of preferred stock, whether separately, or together with, or upon the conversion of, or in exchange for, other securities, certain terms of that series of preferred stock will be described in the applicable prospectus supplement, including, without limitation, the following:

the designation;

the number of authorized shares of the series in question;

voting rights, if any;

the dividend rate, period and/or payment dates or method of calculation;

the relative ranking and preferences of the preferred stock as to dividend rights and rights upon the liquidation, dissolution or winding up of the Company's affairs;

any limitations on the issuance of any class or series of preferred stock ranking senior to or on parity with the class or series of preferred stock as to dividend rights and rights upon liquidation, dissolution or winding up of the affairs of the Company;

the terms and conditions, if any, upon which the preferred stock will be convertible into or exchangeable for other securities;

any redemption provisions;

any sinking fund provisions; and

any other specific terms, preferences, rights, limitations or restrictions of the preferred stock.

No Preemptive Rights

No holder of any stock of any class of the Company has any preemptive right to subscribe for any securities of any kind or class.

Rights Agreement

Pursuant to a stockholder protection rights agreement, dated as of May 3, 2004, holders of the Company's common stock as of April 30, 2004 received on May 3, 2004 one stockholder protection right for every share of common stock that they held on April 30, 2004. Each share of common stock of the Company issued after the close of business on April 30, 2004 also will be issued one corresponding right. The rights are evidenced by the Company's common stock certificates. After the separation time, which is described below, each right will entitle the holder to purchase from the Company one one-hundredth of a share of participating preferred stock, no par value, at a purchase price of \$150 per interest, subject to adjustment. The rights also entitle holders to acquire common stock of an acquiror in the circumstances described below.

The rights serve as an anti-takeover device and encourage third parties who may be interested in acquiring the Company to negotiate directly with our board of directors. The rights will not prevent a takeover of the Company. However, as described below, the rights may cause substantial dilution to a person or group that acquires 20% or more of the Company's common stock unless the rights are first redeemed by our board of directors.

Nevertheless, the rights should not interfere with a transaction that is in the best interests of the Company and its stockholders because the rights may be redeemed on or prior to the close of business on the flip-in date that is described below, before the consummation of such a transaction.

Table of Contents

The terms of the rights are included in the rights agreement, which has been filed as an exhibit to the registration statement of which this prospectus forms a part. The description below is a summary of certain of the provisions of the rights agreement, and is qualified in its entirety by reference to the rights agreement.

Events causing the exercisability of the rights

The rights will become exercisable upon the occurrence of the separation time, which is defined in the rights agreement as the earlier to occur of:

the tenth business day (or a later date as determined by the board of directors of the Company) after the date on which any person commences a tender or exchange offer which, if consummated, would result in that person's becoming an acquiring person under the rights agreement, which generally means a person or group that has become the beneficial owner of 20% or more of the Company's outstanding common stock, and

the flip-in date, which is the tenth business day after the first date (or a later date as determined by the board of directors of the Company) of

a public announcement by the Company that any person has become an acquiring person or

the date and time on which any acquiring person becomes the beneficial owner of more than 20% of the outstanding shares of the Company's common stock.

Until the separation time, the rights may be transferred only with the Company's common stock.

The Company's board of directors may redeem or exchange the rights

The Company's board of directors may redeem the rights at a price of \$.001 per right at any time prior to the close of business on a flip-in date.

In the event that a flip-in date occurs prior to the expiration of the rights, each right (other than rights owned by an acquiring person, its affiliates or transferees, which will become void) will thereafter constitute the right to receive, upon exercise for the exercise price of \$150, subject to adjustment, that number of shares of the Company's common stock (or, in certain circumstances, cash, property or other securities of the Company) having a value equal to two times the exercise price. However, the Company's board of directors may exchange the rights (other than rights owned by the acquiror, which will become void) at any time after a flip-in date, in whole or in part, at an exchange ratio per right equal to one times the exercise price.

Until a right is exercised or exchanged, the holder of the right, by virtue of being a right holder, will have no rights as a stockholder of the Company, including, for example, the right to vote or to receive dividends.

Exercise of rights for shares of an acquiring company

If before the expiration of the rights the Company enters into, consummates or permits to occur a transaction or series of transactions on or after a flip-in date in which, directly or indirectly:

the Company will consolidate, merge or participate in a share exchange with any other person if, at the time of that transaction, an acquiring person is the beneficial owner of 90% or more of the outstanding shares of the Company's common stock or controls the board of directors of the Company and either

any term of or arrangement concerning the treatment of shares of capital stock in that transaction relating to the acquiring person is not identical to the terms and arrangements relating to other holders of the Company's common stock, or

the person with whom such transaction occurs is the acquiring person (or one of its affiliates or associates), or

the Company or a subsidiary sells or otherwise transfers more than 50% of its assets or assets that generate more than 50% of the operating income or cash flow of the Company and its subsidiaries to any other person or group and, at the time the Company enters into an agreement with respect to such

Table of Contents

a transaction, the acquiring person or its affiliates or associates controls the board of directors of the Company, then the Company must take all required actions so that upon consummation or occurrence of the transaction:

each right will thereafter constitute the right to purchase from the acquiring entity that number of shares of common stock of the acquiring entity having an aggregate market price on the date of the transaction equal to twice the exercise price of the right, for an amount in cash equal to the then current exercise price of the right, and

the acquiring person will thereafter be liable for, and assume, all the obligations and duties of the Company pursuant to the rights agreement.

Adjustments to exercise price

The exercise price for each right and the number of shares of participating preferred stock (or other securities or property) issuable upon exercise of the rights are subject to adjustment from time to time to prevent dilution.

Amendments to terms of the rights

Any of the provisions of the rights agreement may be amended by the Company's board of directors prior to the close of business on the flip-in date. After the rights are no longer redeemable, the provisions of the rights agreement may be amended by the Company's board of directors in order to cure any ambiguity, defect or inconsistency, or to make changes that do not materially adversely affect the interests of holders of rights.

Redemption

The board of directors of the Company may, at its option, at any time prior to the close of business on the flip-in date, redeem all (but not less than all) of the then outstanding rights at a price of \$.001 per right. The rights will then terminate immediately and each right, whether or not previously exercised, will thereafter represent only the right to receive the redemption price in cash or securities, as determined by the board of directors.

Term

The rights will expire at the close of business on May 2, 2009, unless earlier redeemed, exercised or exchanged by the Company as described above.

Table of Contents

DESCRIPTION OF DEBT SECURITIES

Senior Debt Securities may be issued either separately, or together with, or upon the conversion of, or in exchange for, other securities, from time to time in one or more series, under an Indenture dated July 15, 1992 (the Senior Indenture) between the Company and U.S. Bank National Association, as the ultimate successor trustee to Bank of America Illinois (formerly Continental Bank, National Association), as trustee (the Senior Trustee), which is an exhibit to the Registration Statement of which this prospectus is a part.

Subordinated Debt Securities may be issued either separately, or together with, or upon the conversion of, or in exchange for, other securities, from time to time in series under an indenture (the Subordinated Indenture) between the Company and a trustee to be identified in the related prospectus supplement (the Subordinated Trustee). The Subordinated Indenture is an exhibit to the Registration Statement of which this prospectus is a part. The Senior Indenture and the Subordinated Indenture are sometimes referred to collectively as the Indentures, and the Senior Trustee and the Subordinated Trustee are sometimes referred to collectively as the Debt Trustees. The following statements under this caption are summaries of certain provisions contained or, in the case of the Subordinated Indenture, to be contained in the Indentures, do not purport to be complete and are qualified in their entirety by reference to the Indentures, including the definitions therein of certain terms. Capitalized terms used herein and not defined shall have the meanings assigned to them in the related Indenture. The particular terms of the Debt Securities and any variations from such general provisions applicable to any series of Debt Securities will be set forth in the prospectus supplement applicable to such series.

At November 30, 2006, approximately \$2,300 million principal amount of Senior Debt Securities were outstanding under the Senior Indenture and there were no Subordinated Debt Securities outstanding under the Subordinated Indenture.

General

Each Indenture provides or, in the case of the Subordinated Indenture, will provide for the issuance of Debt Securities in one or more series with the same or various maturities. Neither Indenture limits the amount of Debt Securities that can be issued thereunder and each provides that the Debt Securities may be issued in series up to the aggregate principal amount which may be authorized from time to time by the Company. The Debt Securities will be unsecured.

Reference is made to the prospectus supplement for the following terms, if applicable, of the Debt Securities offered thereby:

- (1) the designation, aggregate principal amount, currency or composite currency and denominations;
- (2) the price at which such Debt Securities will be issued and, if an index formula or other method is used, the method for determining amounts of principal or interest;
- (3) the maturity date and other dates, if any, on which principal will be payable;
- (4) the interest rate (which may be fixed or variable), if any;
- (5) the date or dates from which interest will accrue and on which interest will be payable, and the record dates for the payment of interest;

- (6) the manner of paying principal or interest;
- (7) the place or places where principal and interest will be payable;
- (8) the terms of any mandatory or optional redemption by the Company;
- (9) the terms, if any, upon which the debt securities may be convertible into or exchangeable for other securities;
- (10) the terms of any redemption at the option of holders;

Table of Contents

(11) whether such Debt Securities are to be issuable as registered Debt Securities, bearer Debt Securities, or both, and whether and upon what terms any registered Debt Securities may be exchanged for bearer Debt Securities and vice versa;

(12) whether such Debt Securities are to be represented in whole or in part by a Debt Security in global form and, if so, the identity of the depository for any global Debt Security;

(13) any tax indemnity provisions;

(14) if the Debt Securities provide that payments of principal or interest may be made in a currency other than that in which Debt Securities are denominated, the manner for determining such payments;

(15) the portion of principal payable upon acceleration of a Discounted Debt Security (as defined below);

(16) whether and upon what terms Debt Securities may be defeased;

(17) any events of default or restrictive covenants in addition to or in lieu of those set forth in the Indentures;

(18) provisions for electronic issuance of Debt Securities or for Debt Securities in uncertificated form; and

(19) any additional provisions or other special terms not inconsistent with the provisions of the Indentures, including any terms that may be required or advisable under United States or other applicable laws or regulations, or advisable in connection with the marketing of the Debt Securities.

If the principal of, premium, if any, or interest on Debt Securities of any series are payable in a foreign or composite currency, any material risks relating to an investment in such Debt Securities will be described in the prospectus supplement relating to that series.

Debt Securities of any series may be issued as registered Debt Securities, bearer Debt Securities or uncertificated Debt securities, as specified in the terms of the series. Unless otherwise indicated in the applicable prospectus supplement, registered Debt Securities will be issued in denominations of \$1,000 and whole multiples thereof and bearer Debt Securities will be issued in denominations of \$5,000 and whole multiples thereof. The Debt Securities of a series may be issued in whole or in part in the form of one or more global Debt Securities that will be deposited with, or on behalf of, a depository identified in the prospectus supplement relating to the series. Unless otherwise indicated in the prospectus supplement relating to a series, the terms of the depository arrangement with respect to any Debt Securities of a series specified in the prospectus supplement as being represented by global Debt Securities will be as set forth below under Global Debt Securities.

In connection with its original issuance, no bearer Debt Security will be offered, sold, resold, or mailed or otherwise delivered to any location in the United States and a bearer Debt Security in definitive form may be delivered in connection with its original issuance only if the person entitled to receive the bearer Debt Security furnishes certification as described in United States Treasury regulation section 1.163-5(c)(2)(i)(D)(iii). If there is a change in the relevant provisions or interpretation of United States laws, the foregoing restrictions will not apply to a series if the Company determines that such provisions no longer apply to the series or that failure to so comply would not have an adverse tax effect on the Company or on holders or cause the series to be treated as registration-required obligations under United States law.

For purposes of this prospectus, unless otherwise indicated, United States means the United States of America (including the States and the District of Columbia), its territories and possessions and all other areas subject to its jurisdiction. United States person means a citizen or resident of the United States, any corporation, partnership or other entity created or organized in or under the laws of the United States or a political subdivision thereof or any estate or trust the income of which is subject to United States federal income taxation regardless of its source. Any special United States federal income tax considerations applicable to bearer Debt Securities will be described in the prospectus supplement relating thereto.

Table of Contents

To the extent set forth in the applicable prospectus supplement, except in special circumstances set forth in the applicable Indenture, principal and interest on bearer Debt Securities will be payable only upon surrender of bearer Debt Securities and coupons at a paying agency of the Company located outside of the United States. During any period thereafter for which it is necessary in order to conform to United States tax law or regulations, the Company will maintain a paying agent outside the United States to which the bearer Debt Securities and coupons may be presented for payment and will provide the necessary funds therefor to the paying agent upon reasonable notice.

Registration of transfer of registered Debt Securities may be requested upon surrender thereof at any agency of the Company maintained for that purpose and upon fulfillment of all other requirements of the agent. Bearer Debt Securities and the coupons related thereto will be transferable by delivery.

Debt Securities may be issued under the Indentures as Discounted Debt Securities to be offered and sold at a discount from the principal amount thereof. Special United States federal income tax and other considerations applicable thereto will be described in the applicable prospectus supplement relating to such Discounted Debt Securities.

Discounted Debt Security means a Debt Security where the amount of principal due upon acceleration is less than the stated principal amount.

Ranking of Debt Securities

The Senior Debt Securities will be unsecured and will rank on a parity with other unsecured and unsubordinated debt of the Company.

At September 30, 2006, the Company had outstanding approximately \$2,824 million in long-term debt (net of current maturities) consisting of Senior Indebtedness (as defined below).

The obligations of the Company pursuant to any Subordinated Debt Securities will be subordinate in right of payment to all Senior Indebtedness of the Company. Senior Indebtedness of the Company is defined to mean the principal of (and premium, if any) and interest on (a) any and all indebtedness and obligations of the Company (including indebtedness of others guaranteed by the Company) other than the Subordinated Debt Securities, whether or not contingent and whether outstanding on the date of the Subordinated Indenture or thereafter created, incurred or assumed, which (i) are for money borrowed; (ii) are evidenced by any bond, note, debenture or similar instrument; (iii) represent the unpaid balance on the purchase price of any property, business, or asset of any kind; (iv) are obligations of the Company as lessee under any and all leases of property, equipment or other assets required to be capitalized on the balance sheet of the lessee under generally accepted accounting principles; (v) are reimbursement obligations of the Company with respect to letters of credit; and (b) any deferrals, amendments, renewals, extensions, modifications and refundings of any indebtedness or obligations of the types referred to above; provided that Senior Indebtedness shall not include (i) the Subordinated Debt Securities; (ii) any indebtedness or obligation of the Company which, by its express terms or the express terms of the instrument creating or evidencing it, is not superior in right of payment to the Subordinated Debt Securities; or (iii) any indebtedness or obligation incurred by the Company in connection with the purchase of assets, materials or services in the ordinary course of business and which constitutes a trade payable.

The Subordinated Indenture will not contain any limitation on the amount of Senior Indebtedness which may be hereafter incurred by the Company.

The Subordinated Indenture will provide that where notice of certain defaults in respect of Senior Indebtedness has been given to the Company, no payment with respect to the principal of or interest on the Subordinated Debt Securities will be made by the Company unless and until such default has been cured or waived. Upon any payment or

distribution of the Company's assets to creditors of the Company in a liquidation or dissolution of the Company, or in a reorganization, bankruptcy, insolvency, receivership or similar proceeding relating to the Company or its property, whether voluntary or involuntary, the holders of Senior Indebtedness will first be entitled to receive payment in full of all amounts due thereon before the holders of the Subordinated Debt Securities will be entitled to receive any payment upon the principal of or premium, if any, or interest on the Subordinated Debt Securities. By reason of such subordination, in the event

Table of Contents

of insolvency of the Company, holders of Senior Indebtedness of the Company may receive more, ratably, and holders of the Subordinated Debt Securities may receive less, ratably, than the other creditors of the Company. Such subordination will not prevent the occurrence of any event of default in respect of the Subordinated Debt Securities.

Certain Covenants

The Senior Indenture contains, among others, the covenants summarized below, which will be applicable (unless waived or amended) so long as any of the Senior Debt Securities are outstanding, unless otherwise stated in the applicable prospectus supplement.

The Debt Securities will not be secured by any properties or assets and will represent unsecured debt of the Company. Because secured debt ranks ahead of unsecured debt with respect to the assets securing such secured debt, the limitation on liens and the limitation on sale-leaseback transactions place some restrictions on the Company's ability to incur additional secured debt or its equivalent when the asset securing the debt is a material manufacturing facility in the United States. The limitations are subject to a number of qualifications and exceptions described below. There can be no assurance that a facility subject to the limitations at any time will continue to be subject to those limitations at a later time.

Unless otherwise indicated in a prospectus supplement, the covenants contained in the Senior Indenture and the Senior Debt Securities do not afford holders of the Senior Debt Securities protection in the event of a highly leveraged or other transaction involving the Company that may adversely affect holders of the Senior Debt Securities.

Definitions

Attributable Debt for a lease means, as of the date of determination, the present value of net rent for the remaining term of the lease. Rent shall be discounted to present value at a discount rate that is compounded semi-annually. The discount rate shall be 10% per annum or, if the Company elects, the discount rate shall be equal to the weighted average Yield to Maturity of the Senior Debt Securities under the Senior Indenture. Such average shall be weighted by the principal amount of the Senior Debt Securities of each series or, in the case of Discounted Senior Debt Securities, the amount of principal that would be due as of the date of determination if payment of the Senior Debt Securities were accelerated on that date.

Rent is the lesser of (a) rent for the remaining term of the lease assuming it is not terminated or (b) rent from the date of determination until the first possible termination date plus the termination payment then due, if any. The remaining term of a lease includes any period for which the lease has been extended. Rent does not include (1) amounts due for maintenance, repairs, utilities, insurance, taxes, assessments and similar charges or (2) contingent rent, such as that based on sales. Rent may be reduced by the discounted present value of the rent that any sublessee must pay from the date of determination for all or part of the same property. If the net rent on a lease is not definitely determinable, the Company may estimate it in any reasonable manner.

Consolidated Net Tangible Assets means total assets less (a) total current liabilities (excluding short-term Debt and payments due within one year on long-term Debt) and (b) goodwill, as reflected in the Company's most recent consolidated balance sheet preceding the date of a determination under clause (9) of the **Limitation on Liens** covenant of the Senior Indenture.

Debt means any debt for borrowed money or any guarantee of such a debt.

Lien means any mortgage, pledge, security interest or lien.

Long-Term Debt means Debt that by its terms matures on a date more than 12 months after the date it was created or Debt that the obligor may extend or renew without the obligee's consent to a date more than 12 months after the date the Debt was created.

Principal Property means (i) any manufacturing facility, whether now or hereafter owned, located in the United States (excluding territories and possessions), except any such facility that in the opinion of the board

Table of Contents

of directors of the Company or any authorized committee of the board is not of material importance to the total business conducted by the Company and its consolidated Subsidiaries, and (ii) any shares of stock of a Restricted Subsidiary. At December 31, 2005, our Principal Properties were our production facilities in Northern Indiana (air separation/hydrogen/carbon dioxide), Houston, Texas (air separation) and Detroit, Michigan (air separation/hydrogen), and, to the extent owned by us, Gulf Coast (hydrogen/carbon monoxide) and Louisiana (hydrogen/carbon monoxide).

Restricted Subsidiary means a Wholly-Owned Subsidiary that has substantially all of its assets located in the United States (excluding territories or possessions) or Puerto Rico and owns a Principal Property.

Sale-Leaseback Transaction means an arrangement pursuant to which the Company or a Restricted Subsidiary now owns or hereafter acquires a Principal Property, transfers it to a person, and leases it back from the person.

Subsidiary means a corporation a majority of whose Voting Stock is owned by the Company or a Subsidiary.

Voting Stock means capital stock having voting power under ordinary circumstances to elect directors.

Wholly-Owned Subsidiary means a corporation all of whose Voting Stock is owned by the Company or a Wholly-Owned Subsidiary, the accounts of which are consolidated with those of the Company in its consolidated financial statements.

Yield to Maturity means the yield to maturity on a Security at the time of its issuance or at the most recent determination of interest on the Security.

Limitation on Liens

The Company will not, and will not permit any Restricted Subsidiary to, incur a Lien on Principal Property to secure a Debt unless:

1. the Lien equally and ratably secures the Senior Debt Securities and the Debt. The Lien may equally and ratably secure the Senior Debt Securities and any other obligation of the Company or a Subsidiary. The Lien may not secure an obligation of the Company that is subordinated to the Senior Debt Securities;
2. the Lien secures Debt incurred to finance all or some of the purchase price or the cost of construction or improvement of property of the Company or a Restricted Subsidiary. The Lien may not extend to any other Principal Property owned by the Company or a Restricted Subsidiary at the time the Lien is incurred. However, in the case of any construction or improvement, the Lien may extend to unimproved real property used for the construction or improvement. The Debt secured by the Lien may not be incurred more than one year after the later of the (a) acquisition, (b) completion of construction or improvement or (c) commencement of full operation, of the property subject to the Lien;
3. the Lien is on property of a corporation at the time the corporation merges into or consolidates with the Company or a Restricted Subsidiary;
4. the Lien is on property at the time the Company or a Restricted Subsidiary acquires the property;
5. the Lien is on property of a corporation at the time the corporation becomes a Restricted Subsidiary;
6. the Lien secures Debt of a Restricted Subsidiary owing to the Company or another Restricted Subsidiary;

7. the Lien is in favor of a government or governmental entity and secures (a) payments pursuant to a contract or statute or (b) Debt incurred to finance all or some of the purchase price or cost of construction or improvement of the property subject to the Lien;

Table of Contents

8. the Lien extends, renews or replaces in whole or in part a Lien (existing Lien) permitted by any of clauses (1) through (7). The Lien may not extend beyond (a) the property subject to the existing Lien and (b) improvements and construction on such property. However, the Lien may extend to property that at the time is not a Principal Property. The Debt secured by the Lien may not exceed the Debt secured at the time by the existing Lien unless the existing Lien or a predecessor Lien was incurred under clause (1) or (6); or

9. the Debt plus all other Debt secured by Liens on Principal Property at the time does not exceed 10% of Consolidated Net Tangible Assets. However, the following Debt shall be excluded from all other Debt in the determination: (a) Debt secured by a Lien permitted by any of clauses (1) through (8) and (b) Debt secured by a Lien incurred prior to the date of the Senior Indenture that would have been permitted by any of those clauses if the Senior Indenture had been in effect at the time the Lien was incurred. Attributable Debt for any lease permitted by clause (4) of the Limitation on Sale and Leaseback covenant of the Senior Indenture must be included in the determination and treated as Debt secured by a Lien on Principal Property not otherwise permitted by any of clauses (1) through (8).

In general, clause (9) above, sometimes called a basket clause, permits Liens to be incurred that are not permitted by any of the exceptions enumerated in clauses (1) through (8) above if the Debt secured by all such additional Liens does not exceed 10% of Consolidated Net Tangible Assets at the time. At September 30, 2006, Consolidated Net Tangible Assets were approximately \$7,784 million. At that date, additional Liens securing Debt equal to 10% of that amount could have been incurred under clause (9).

Limitation on Sale and Leaseback

The Company will not, and will not permit any Restricted Subsidiary to, enter into a Sale-Leaseback Transaction unless:

1. the lease has a term of three years or less;
2. the lease is between the Company and a Restricted Subsidiary or between Restricted Subsidiaries;
3. the Company or a Restricted Subsidiary under clauses (2) through (8) of the Limitation on Liens covenant could create a Lien on the property to secure Debt at least equal in amount to the Attributable Debt for the lease;
4. the Company or a Restricted Subsidiary under clause (9) of the Limitation on Liens covenant could create a Lien on the property to secure Debt at least equal in amount to the Attributable Debt for the lease; or
5. the Company or a Restricted Subsidiary within 180 days of the effective date of the lease retires Long-Term Debt of the Company or a Restricted Subsidiary at least equal in amount to the Attributable Debt for the lease. A Debt is retired when it is paid or cancelled. However, the Company or a Restricted Subsidiary may not receive credit for retirement of: Debt of the Company that is subordinated to the Senior Debt Securities; or Debt, if paid in cash, that is owned by the Company or a Restricted Subsidiary.

In clauses (3) and (4) above, Sale-Leaseback Transactions and Liens are treated as equivalents. Thus, if the Company or a Restricted Subsidiary could create a Lien on a property, it may enter into a Sale-Leaseback Transaction to the same extent.

Limitation on Debt of Restricted Subsidiaries

The Company will not permit any Restricted Subsidiary to incur any Debt unless:

1. such Restricted Subsidiary could create Debt secured by Liens in accordance with the Limitation on Liens covenant in an amount equal to such Debt, without equally and ratably securing the Senior Debt Securities;

2. the Debt is owed to the Company or another Restricted Subsidiary;

Table of Contents

3. the Debt is Debt of a corporation at the time the corporation becomes a Restricted Subsidiary;
4. the Debt is Debt of a corporation at the time the corporation merges into or consolidates with a Restricted Subsidiary or at the time of a sale, lease or other disposition of its properties as an entirety or substantially as an entirety to a Restricted Subsidiary;
5. the Debt is incurred to finance all or some of the purchase price or the cost of construction or improvement of property of the Restricted Subsidiary. The Debt may not be incurred more than one year after the later of the (a) acquisition, (b) completion of construction or improvement or (c) commencement of full operation, of the property;
6. the Debt is incurred for the purpose of extending, renewing or replacing in whole or in part Debt permitted by any of clauses (1) through (5); or
7. the Debt plus all other Debt of Restricted Subsidiaries at the time does not exceed 10% of Consolidated Net Tangible Assets. However, the following Debt shall be excluded from all other Debt in the determination: (a) Debt permitted by any of clauses (1) through (6) and (b) Debt incurred prior to the date of the Senior Indenture that would have been permitted by any of those clauses if the Senior Indenture had been in effect at the time the Debt was incurred.

Successor Obligor

The Indentures provide or, in the case of the Subordinated Indenture, will provide that the Company will not consolidate with or merge into, or transfer all or substantially all of its assets to, any person, unless (1) the person is organized under the laws of the United States or a State thereof; (2) the person assumes by supplemental indenture all the obligations of the Company under the applicable Indenture, the Debt Securities issued under such Indenture and any coupons pertaining thereto; (3) immediately after the transaction no default exists; and (4) if, as a result of the transaction, a Principal Property would become subject to a Lien not permitted by the Limitation on Liens covenant of the Senior Indenture, the Company or such person secures the Senior Debt Securities equally and ratably with or prior to all obligations secured by the Lien.

The successor will be substituted for the Company, and thereafter all obligations of the Company under the applicable Indenture, the Debt Securities issued under such Indenture and any coupons shall terminate.

Exchange of Securities

Registered Debt Securities may be exchanged for an equal aggregate principal amount of registered Debt Securities of the same series and date of maturity in such authorized denominations as may be requested upon surrender of the registered Debt Securities at an agency of the Company maintained for such purpose and upon fulfillment of all other requirements of the agent.

To the extent permitted by the terms of a series of Debt Securities authorized to be issued in registered form and bearer form, bearer Debt Securities may be exchanged for an equal aggregate principal amount of registered or bearer Debt Securities of the same series and date of maturity in such authorized denominations as may be requested upon surrender of the bearer Debt Securities with all unpaid coupons relating thereto (except as may otherwise be provided in the Debt Securities) at an agency of the Company maintained for such purpose and upon fulfillment of all other requirements of the agent. As of the date of this prospectus, it is expected that the terms of a series of Debt Securities will not permit registered Debt Securities to be exchanged for bearer Debt Securities.

Defaults and Remedies

An event of default with respect to any series of Debt Securities will occur if:

1. the Company defaults in any payment of interest on any Debt Securities of the series when the same becomes due and payable and the default continues for a period of 10 days;

Table of Contents

2. the Company defaults in the payment of the principal of any Debt Securities of the series when the same becomes due and payable at maturity or upon redemption, acceleration or otherwise;
3. the Company defaults in the performance of any of its other agreements applicable to the series and the default continues for 90 days after the notice specified below;
4. the Company pursuant to or within the meaning of any Bankruptcy Law:
 - commences a voluntary case,
 - consents to the entry of an order for relief against it in an involuntary case,
 - consents to the appointment of a custodian for it or for all or substantially all of its property, or
 - makes a general assignment for the benefit of its creditors;
5. a court of competent jurisdiction enters an order or decree under any Bankruptcy Law that:
 - is for relief against the Company in an involuntary case,
 - appoints a custodian for the Company or for all or substantially all of its property, or
 - orders the liquidation of the Company;and the order or decree remains unstayed and in effect for 60 days; or
6. any other event of default provided for in the series.

The term **Bankruptcy Law** means Title 11, U.S. Code or any similar Federal or State law for the relief of debtors. The term **custodian** means any receiver, trustee, assignee, liquidator or a similar official under any Bankruptcy Law.

A default under clause (3) is not an event of default until the applicable Debt Trustee or the holders of at least 25% in principal amount of the series notify the Company of the default and the Company does not cure the default within the time specified after receipt of the notice. The applicable Debt Trustee may require indemnity satisfactory to it before it enforces the applicable Indenture or the Debt Securities of the series. Subject to certain limitations, holders of a majority in principal amount of the Debt Securities of the series may direct the applicable Debt Trustee in its exercise of any trust or power. A Debt Trustee may withhold from holders of the series notice of any continuing default (except a default in payment of principal or interest) if it determines that withholding notice is in their interest.

The Indentures do not have or, in the case of the Subordinated Indenture, will not have cross-default provisions. Thus, a default by the Company or a Subsidiary on any other debt would not constitute an event of default.

Amendments and Waivers

Unless the resolution establishing the terms of a series otherwise provides, the applicable Indenture and the Debt Securities or any coupons of the series may be amended, and any default may be waived as follows: The Debt Securities and the applicable Indenture may be amended with the consent of the holders of a majority in principal amount of the Debt Securities of all series affected voting as one class. A default on a series may be waived with the

consent of the holders of a majority in principal amount of the Debt Securities of the series. However, without the consent of each holder affected, no amendment or waiver may (1) reduce the amount of Debt Securities whose holders must consent to an amendment or waiver, (2) reduce the interest on or change the time for payment of interest on any Debt Security, (3) change the fixed maturity of any Debt Security, (4) reduce the principal of any non-Discounted Debt Security or reduce the amount of principal of any Discounted Debt Security that would be due on acceleration thereof, (5) change the currency in which principal or interest on a Debt Security is payable, (6) waive any default in payment of interest on or principal of a Debt Security or (7) change certain provisions of the applicable Indenture regarding waiver of past defaults and amendments with the consent of holders other than to increase the principal amount of Debt Securities required to consent. Without the consent of any holder, the applicable Indenture, the Debt Securities

Table of Contents

or any coupons may be amended to cure any ambiguity, omission, defect or inconsistency; to provide for assumption of Company obligations to holders in the event of a merger or consolidation requiring such assumption; to provide that specific provisions of the applicable Indenture not apply to a series of Debt Securities not previously issued; to create a series and establish its terms; to provide for a separate Debt Trustee for one or more series; or to make any change that does not materially adversely affect the rights of any holder.

Legal Defeasance and Covenant Defeasance

Debt Securities of a series may be defeased in accordance with their terms and, unless the resolution establishing the terms of the series otherwise provides, as set forth below. The Company at any time may terminate as to a series all of its obligations (except for certain obligations with respect to the defeasance trust and obligations to register the transfer or exchange of a Debt Security, to replace destroyed, lost or stolen Debt Securities and coupons and to maintain agencies in respect of the Debt Securities) with respect to the Debt Securities of the series and any related coupons and the applicable Indenture (legal defeasance). The Company at any time may terminate as to a series its obligations with respect to the Debt Securities and coupons of the series under the covenants described under Certain Covenants (covenant defeasance).

The Company may exercise its legal defeasance option notwithstanding its prior exercise of its covenant defeasance option. If the Company exercises its legal defeasance option, a series may not be accelerated because of an event of default. If the Company exercises its covenant defeasance option, a series may not be accelerated by reference to the covenants described under Certain Covenants.

To exercise either option as to a series, the Company must deposit in trust (the defeasance trust) with the applicable Debt Trustee money or U.S. Government Obligations for the payment of principal, premium, if any, and interest on the Debt Securities of the series to redemption or maturity and must comply with certain other conditions. In particular, the Company must obtain an opinion of tax counsel that the defeasance will not result in recognition for Federal income tax purposes of any gain or loss to holders of the series. U.S. Government Obligations are direct obligations of the United States of America which have the full faith and credit of the United States of America pledged for payment and which are not callable at the issuer's option, or certificates representing an ownership interest in such obligations.

Global Debt Securities

Global Debt Securities may be issued in registered, bearer or uncertificated form and in either temporary or permanent form. If Debt Securities of a series are to be issued as global Debt Securities, one or more global Debt Securities will be issued in a denomination or aggregate denominations equal to the aggregate principal amount of outstanding Debt Securities of the series to be represented by such global Debt Security or Securities.

Ownership of beneficial interests in global Debt Securities will be limited to participants and to persons that have accounts with the depository (participants) or persons that may hold interests through participants. Ownership interests in global Debt Securities will be shown on, and the transfer of that ownership interest will be effected only through, records maintained by the depository or its nominee for such global Debt Securities (with respect to a participant's interest) and records maintained by participants (with respect to interests of persons other than participants).

Unless otherwise indicated in a prospectus supplement, payment of principal of and any premium and interest on the book-entry Debt Securities represented by a global Debt Security will be made to the depository or its nominee, as the case may be, as the sole registered owner and the sole holder of the book-entry Debt Securities represented thereby for all purposes under the applicable Indenture. Neither the Company or the applicable Debt Trustee, nor any agent of the Company or the applicable Debt Trustee, will have any responsibility or liability for any acts or omissions of the

depository for any records of the depository relating to beneficial ownership interests in any global Debt Security for any transactions between a depository and beneficial owners.

Table of Contents

Upon receipt of any payment of principal of or any premium or interest on a global Debt Security, the depository will immediately credit, on its book-entry registration and transfer system, the accounts of participants with payments in amounts proportionate to their respective beneficial interests in the principal amount of such global Debt Security as shown on the records of the depository. Payments by participants to owners of beneficial interests in global Debt Securities held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for customer accounts registered in street name, and will be the sole responsibility of such participants.

Unless otherwise stated in a prospectus supplement, global Debt Securities will not be transferred except as a whole by the depository to a nominee of the depository. Global Debt Securities will be exchangeable only if (i) the depository notifies the Company that it is unwilling or unable to continue as depository for such global Debt Securities or if at any time the depository ceases to be a clearing agency registered under the Exchange Act, (ii) the Company in its sole discretion determines that such global Debt Securities shall be exchangeable for definitive Debt Securities in registered form, or (iii) an event of default with respect to the series of Debt Securities represented by such global Debt Securities has occurred and is continuing. Any global Debt Security that is exchangeable pursuant to the preceding sentence shall be exchangeable for Registered Debt Securities issuable in denominations of \$1,000 and integral multiples thereof and registered in such names as the depository holding such global Debt Security shall direct. Subject to the foregoing, the global Debt Security is not exchangeable, except for a global Debt Security of like denomination to be registered in the name of the depository or its nominee.

So long as the depository for global Debt Securities of a series, or its nominee, is the registered owner of such global Debt Securities, such depository or such nominee, as the case may be, will be considered the sole holder of Debt Securities represented by such global Debt Securities for the purposes of receiving payment on such global Debt Securities, receiving notices and for all other purposes under the applicable Indenture and such global Debt Securities. Except as provided above, owners of beneficial interests in global Debt Securities of a series will not be entitled to receive physical delivery of Debt Securities of such series in definitive form and will not be considered the holders thereof for any purpose under the applicable Indenture. Accordingly, each person owning a beneficial interest in a global Debt Security must rely on the procedures of the depository and, if such person is not a participant, on the procedures of the participant through which such person owns its interest, to exercise any rights of a holder under the applicable Indenture. The depository may grant proxies and otherwise authorize participants to give or take any request, demand, authorization, direction, notice, consent, waiver or other action which a holder is entitled to give or take under the applicable Indenture. The Company understands that under existing industry practices, in the event that the Company requests any action of holders or that an owner of a beneficial interest in such a global Debt Security desires to give or take any action which a holder is entitled to give or take under the applicable Indenture, the depository would authorize the participants holding the relevant beneficial interests to give or take such action, and such participants would authorize beneficial owners owning through such participants to give or take such action or would otherwise act upon the instructions of beneficial owners owning through them.

Unless otherwise specified in a prospectus supplement relating to Debt Securities of a series to be issued as global Debt Securities, The Depository Trust Company will be the depository. DTC has advised the Company that it is a limited-purpose trust company organized under the law of the State of New York, a member of the Federal Reserve System, a clearing corporation within the meaning of the New York Uniform Commercial Code, and a clearing agency registered under the Exchange Act. DTC was created to hold the securities of its participants and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book-entry changes in accounts of the participants, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers (which may include the underwriters, dealers or agents with respect to the Debt Securities), banks, trust companies, clearing corporations, and certain other organizations some of whom (and/or their representatives) own DTC. Access to DTC's book-entry system is also

available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant either directly or indirectly.

Table of Contents

Conversion and Exchange

The terms, if any, on which debt securities of any series are convertible into or exchangeable for our common stock, preferred stock, or other debt securities will be set forth in the applicable prospectus supplement and a supplemental indenture. Those terms may include provisions for conversion or exchange, whether mandatory, at the option of the holders or at our option.

Trustee

U.S. Bank National Association, as the ultimate successor trustee to Bank of America Illinois (formerly Continental Bank, National Association), is Senior Trustee for Debt Securities issued under the Senior Indenture. The Subordinated Trustee for Debt Securities issued under the Subordinated Indenture will be identified in the related prospectus supplement. The Senior Trustee is one of several banks which provide credit and banking services to the Company.

Table of Contents

PLAN OF DISTRIBUTION

The Company may sell the securities described in this prospectus in any of the following ways:

- (1) through underwriters or dealers;
- (2) directly to one or more purchasers;
- (3) through agents; or
- (4) through a combination of any such methods of sale.

Any of these underwriters, dealers or agents may be deemed to be an underwriter within the meaning of the Securities Act of 1933. The prospectus supplement with respect to the securities being offered thereby will set forth the terms of the offering of such securities, including the name or names of any underwriters or agents, the purchase price of such securities and the proceeds to the Company from such sale, any underwriting discounts, commissions and other items constituting underwriters' compensation under the Securities Act of 1933, any initial public offering price and any discounts or concessions allowed or reallocated or paid to dealers and any securities exchanges on which such securities may be listed.

If underwriters are used in the sale of securities, such securities will be acquired by the underwriters for their own account and may be resold from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The securities may be offered to the public either through underwriting syndicates (which may be represented by managing underwriters designated by the Company), or directly by one or more underwriters acting alone. Unless otherwise set forth in the prospectus supplement, the obligations of the underwriters to purchase the securities offered thereby will be subject to certain customary conditions precedent, and the underwriters will be obligated to purchase all such securities if any are purchased. Any initial public offering price and any discounts or concessions allowed or reallocated or paid to dealers may be changed from time to time.

The securities may be sold directly by the Company or through agents designated by the Company from time to time. The prospectus supplement with respect to any securities sold in this manner will set forth the name of any agent involved in the offer or sale of the securities as well as any commissions payable by the Company to such agent. Unless otherwise indicated in the prospectus supplement, any such agent is acting on a best efforts basis for the period of its appointment.

If dealers are utilized in the sale of any securities, the Company will sell the securities to the dealers, as principals. Any dealer may then resell the securities to the public at varying prices to be determined by the dealer at the time of resale. The name of any dealer and the terms of the transaction will be set forth in the prospectus supplement with respect to the securities being offered thereby.

If so indicated in the prospectus supplement, the Company will authorize agents, underwriters or dealers to solicit offers by certain specified institutions to purchase securities from the Company at the public offering price set forth in the prospectus supplement pursuant to delayed delivery contracts providing for payment and delivery on a specified date in the future. Such contracts will be subject only to those conditions set forth in the prospectus supplement and the prospectus supplement will set forth the commission payable for the solicitation of such contracts.

In connection with the offering of the securities, underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the securities. Specifically, the underwriters may over allot in connection with the offerings of the securities, creating a syndicate short position. In addition, underwriters may bid for, and purchase, securities in the open market to cover syndicate shorts or to stabilize the price of the securities. Finally, the underwriting syndicate may reclaim selling concessions allowed for distributing the securities in the offering of the securities, if the syndicate repurchases previously distributed securities in syndicate covering transactions, syndicate transactions or otherwise. Any of these activities may stabilize or maintain the market prices of the securities above independent market levels. The underwriters are not required to engage in any of these activities, and may end any of them at any time.

Table of Contents

It has not been determined whether any securities will be listed on a securities exchange. Underwriters will not be obligated to make a market in any securities. The Company cannot predict the activity of trading in, or liquidity of, any securities.

Agents, underwriters and dealers may be entitled, under agreements entered into with the Company, to indemnification by the Company against certain civil liabilities, including liabilities under the Securities Act or to contribution with respect to payments which the agents, underwriters or dealers may be required to make in respect thereof. Agents, underwriters and dealers may be customers of, engage in transactions with, or perform services for the Company in the ordinary course of business.

LEGAL MATTERS

Certain legal matters in connection with the securities will be passed upon for the Company by Cahill Gordon & Reindel llp, New York, New York, and for the agents, underwriters and dealers by Davis Polk & Wardwell of New York, New York.

EXPERTS

The financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) incorporated in this Prospectus by reference to the Annual Report on Form 10-K for the year ended December 31, 2005 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC and our common stock is listed on the New York Stock Exchange under the symbol PX. Our SEC filings are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. You may also read and copy any document we file at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can call the SEC at 1-800-732-0330 for further information about the public reference rooms.

We have filed with the SEC a registration statement on Form S-3 under the Securities Act of 1933, as amended, with respect to the securities that may be offered. This prospectus, which forms a part of the registration statement, does not contain all of the information set forth in the registration statement and the exhibits and schedules thereto, parts of which are omitted in accordance with the rules and regulations of the SEC. For more information about us and the securities, you should see the registration statement and its exhibits and schedules. Any statement made in this prospectus concerning the provisions of documents is a summary and you should refer to the copy of that document filed as an exhibit to the registration statement with the SEC.

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to incorporate by reference the information we file with them, which means we are assumed to have disclosed important information to you when we refer you to documents that are on file with the SEC. The information we have incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future documents we file with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until the termination of the offering of the securities to which this prospectus relates.

Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Proxy Statement on Form 14A dated March 21, 2006.

Table of Contents

Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006.

Current Reports on Form 8-K filed on March 2, 2006, March 29, 2006, April 5, 2006, June 30, 2006, July 14, 2006, September 11, 2006, October 6, 2006 and November 3, 2006.

Our Registration Statement on Form 8-A dated June 27, 2002.

You may request a copy of any or all of the documents that we have incorporated by reference at no cost by writing to us at the following address:

Praxair, Inc.
39 Old Ridgebury Road
Danbury, Connecticut 06810-5113
Attn: Assistant Corporate Secretary
Telephone: (203) 837-2000.

Table of Contents

, our results of operations may be adversely affected.

Our future success will depend in part on our ability to enhance current products and to develop new products on a timely and cost-effective basis in order to respond to technological developments and changing customer needs. Defense customers, in particular, demand frequent technological improvements as a means of gaining military advantage. Military planners have historically funded significantly more design projects than actual deployments of new equipment, and those systems that are deployed tend to contain the components of the subcontractors selected to participate in the design process. In order to participate in the design of new defense electronics systems, we must demonstrate the ability to deliver superior technological performance on a timely and cost-effective basis. There can be no assurance that we will secure an adequate number of defense design wins in the future, that the equipment in which our products are intended to function will eventually be deployed in the field, or that our products will be included in such equipment if it eventually is deployed.

Customers in our commercial markets also seek technological improvements through product enhancements and new generations of products. OEMs historically have selected certain suppliers whose products have been included in the OEMs' machines for a significant portion of the products' life cycles. We may not be selected to participate in the future design of any commercial equipment, or if selected, we may not generate any revenues for such design work. The design-in process is typically lengthy and expensive, and there can be no assurance that we will be able to continue to meet the product specifications of customers in a timely and adequate manner. In addition, any failure to anticipate or respond adequately to changes in technology, customer preferences and future order demands, or any significant delay in product developments, product introductions or order volume, could negatively impact our financial condition and results of operations, including the risk of inventory obsolescence. Because of the complexity of our products, we have experienced delays from time to time in completing products on a timely basis. If we are unable to design, develop or introduce competitive new products on a timely basis, our future operating results may be adversely affected.

Table of Contents

Our products are complex, and undetected defects may increase our costs, harm our reputation with customers or lead to costly litigation.

Our products are extremely complex and must operate successfully with complex products of our customers and their other vendors. Our products may contain undetected errors when first introduced or as we introduce product upgrades. The pressures we face to be the first to market new products or functionality and the lapsed time before our products are integrated into our customer's systems increases the possibility that we will offer products in which we or our customers later discover problems. We have experienced new product and product upgrade errors in the past and expect similar problems in the future. These problems may cause us to incur significant warranty costs and costs to support our service contracts and divert the attention of personnel from our product development efforts. Undetected errors may adversely affect our product's ease of use and may create customer satisfaction issues. If we are unable to repair these problems in a timely manner, we may experience a loss of or delay in revenue and significant damage to our reputation and business prospects. Many of our customers rely upon our products for mission-critical applications. Because of this reliance, errors, defects, or other performance problems in our products could result in significant financial and other damage to our customers. Our customers could attempt to recover those losses by pursuing products liability claims against us which, even if unsuccessful, would likely be time-consuming and costly to defend and could adversely affect our reputation.

We may be unsuccessful in protecting our intellectual property rights which could result in the loss of a competitive advantage.

Our ability to compete effectively against other companies in our industry depends, in part, on our ability to protect our current and future proprietary technology under patent, copyright, trademark, trade secret and unfair competition laws. We cannot assure that our means of protecting our proprietary rights in the United States or abroad will be adequate, or that others will not develop technologies similar or superior to our technology or design around our proprietary rights. In addition, we may incur substantial costs in attempting to protect our proprietary rights.

Also, despite the steps taken by us to protect our proprietary rights, it may be possible for unauthorized third parties to copy or reverse-engineer aspects of our products, develop similar technology independently or otherwise obtain and use information from our supply chain that we regard as proprietary and we may be unable to successfully identify or prosecute unauthorized uses of our technology. Furthermore, with respect to our issued patents and patent applications, we cannot assure you that any patents from any pending patent applications (or from any future patent applications) will be issued, that the scope of any patent protection will exclude competitors or provide competitive advantages to us, that any of our patents will be held valid if subsequently challenged or that others will not claim rights in or ownership of the patents (and patent applications) and other proprietary rights held by us.

If we become subject to intellectual property infringement claims, we could incur significant expenses and could be prevented from selling specific products.

We may become subject to claims that we infringe the intellectual property rights of others in the future. We cannot assure that, if made, these claims will not be successful. Any claim of infringement could cause us to incur substantial costs defending against the claim even if the claim is invalid, and could distract management from other business. Any judgment against us could require substantial payment in damages and could also include an injunction or other court order that could prevent us from offering certain products.

Our need for continued or increased investment in research and development may increase expenses and reduce our profitability.

Our industry is characterized by the need for continued investment in research and development. If we fail to invest sufficiently in research and development, our products could become less attractive to potential customers and our business and financial condition could be materially and adversely affected. As a result of the need to maintain or increase spending levels in this area and the difficulty in reducing costs associated with research and development, our operating results could be materially harmed if our research and development efforts fail to result in new products or if revenues fall below expectations. As a result of our commitment to invest in research and development, spending levels of research and development expenses as a percentage of revenues may fluctuate in the future. In addition, defense prime contractors could increase their requirement for sub-contractors, such as Mercury, to increase their share in the research and development costs for new programs and design wins.

Table of Contents

Our results of operations are subject to fluctuation from period to period and may not be an accurate indication of future performance.

We have experienced fluctuations in operating results in large part due to the sale of products and services in relatively large dollar amounts to a relatively small number of customers. Customers specify delivery date requirements that coincide with their need for our products and services. Because these customers may use our products and services in connection with a variety of defense programs or other projects with different sizes and durations, a customer's orders for one quarter generally do not indicate a trend for future orders by that customer. As such, we have not been able in the past to consistently predict when our customers will place orders and request shipments so that we cannot always accurately plan our manufacturing, inventory, and working capital requirements. As a result, if orders and shipments differ from what we predict, we may incur additional expenses and build excess inventory, which may require additional reserves and allowances and reduce our working capital and operational flexibility. Any significant change in our customers' purchasing patterns could have a material adverse effect on our operating results and reported earnings per share for a particular quarter. Thus, results of operations in any period should not be considered indicative of the results to be expected for any future period.

High quarterly book-ship ratios may pressure inventory and cash flow management, necessitating increased inventory balances to ensure quarterly revenue attainment. Increased inventory balances tie up additional capital, limiting our operational flexibility. Some of our customers may have become conditioned to wait until the end of a quarter to place orders in the expectation of receiving a discount. Customers conditioned to seek quarter-end discounts increase risk and uncertainty in our financial forecasting and decrease our margins and profitability.

Our quarterly results may be subject to fluctuations resulting from a number of other factors, including:

- delays in completion of internal product development projects;
- delays in shipping hardware and software;
- delays in acceptance testing by customers;
- a change in the mix of products sold to our served markets;
- changes in customer order patterns;
- production delays due to quality problems with outsourced components;
- inability to scale quick reaction capability products due to low product volume;
- shortages and costs of components;
- delays due to the implementation of new tariffs or other trade barriers;
- the timing of product line transitions;
- declines in quarterly revenues from previous generations of products following announcement of replacement products containing more advanced technology;
- inability to realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits;
- potential asset impairment, including goodwill and intangibles, or restructuring charges; and
- changes in estimates of completion on fixed price service engagements.

In addition, from time to time, we have entered into contracts, referred to as development contracts, to engineer a specific solution based on modifications to standard products. Gross margins from development contract revenues are typically lower than gross margins from standard product revenues. We intend to continue to enter into development contracts and anticipate that the gross margins associated with development contract revenues will continue to be lower than gross margins from standard product sales.

Another factor contributing to fluctuations in our quarterly results is the fixed nature of expenditures on personnel, facilities and marketing programs. Expense levels for these programs are based, in significant part, on expectations of future revenues. If actual quarterly revenues are below management's expectations, our results of operations will likely be adversely affected.

Further, the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and changes in estimates in subsequent periods could cause our results of operations to fluctuate.

Table of Contents

Changes in regulations could materially adversely affect us.

Our business, results of operations, or financial condition could be materially adversely affected if laws, regulations, or standards relating to us or our products are newly implemented or changed. In addition, our compliance with existing regulations may have a material adverse impact on us. Under applicable federal securities laws, we are required to evaluate and determine the effectiveness of our internal control structure and procedures for financial reporting. Should we or our independent registered public accounting firm determine that we have material weaknesses in our internal controls, our results of operations or financial condition may be materially adversely affected or our stock price may decline.

We rely on the significant experience and specialized expertise of our senior management, engineering and operational staff and must retain and attract qualified and highly skilled personnel in order to grow our business successfully.

Our performance is substantially dependent on the continued services and performance of our senior management and our highly qualified team of engineers, many of whom have numerous years of experience, specialized expertise in our business, and security clearances required for certain defense projects. If we are not successful in hiring and retaining highly qualified engineers, we may not be able to extend or maintain our engineering expertise, and our future product development efforts could be adversely affected. Competition for hiring these employees is intense, especially with regard to engineers with specialized skills and security clearances required for our business, and we may be unable to hire and retain enough engineers to implement our growth strategy. Like our defense prime contractor customers, we face the potential for knowledge drain due to the impending retirement of the older members of our engineering workforce in the coming years.

We may be unable to deliver subsystem level products and related services on time and on budget with our limited engineering resources. Without sufficient resources in hardware, software, and mechanical engineering and quality assurance we may be unable to adequately scale our business and deliver the subsystem solutions that our customers expect. We must also develop new engineering talent in our engineering base to contain high engineering costs to alleviate pressures on our margins and price points.

Increased workloads and responsibilities due to cost containment measures in recent years has led to a leaner employee base, increasing our risk of employee and organizational fatigue. Resulting lower morale and organizational disruption could lead to execution issues, missed commitments, and general employee attrition.

Our future success also depends on our ability to timely identify, attract, hire, train, retain and motivate highly skilled managerial and operational personnel as we continue our pace of growth. In addition, our ability to maintain growth as a portion of our workforce nears retirement is dependent upon our ability to adapt to the pending changes in our workforce demographics. If we fail to attract, integrate and retain the necessary personnel, our ability to maintain and grow our business could suffer significantly. Further, stock price volatility and improvements in the economy could impact our ability to attract and retain key personnel.

If we experience a disaster or other business continuity problem, we may not be able to recover successfully, which could cause material financial loss, loss of human capital, regulatory actions, reputational harm, or legal liability.

If we experience a local or regional disaster or other business continuity problem, such as an earthquake, terrorist attack, pandemic or other natural or man-made disaster, our continued success will depend, in part, on the availability of our personnel, our office facilities, and the proper functioning of our computer, telecommunication and other related systems and operations. As we attempt to grow our operations, the potential for particular types of natural or man-made disasters, political, economic or infrastructure instabilities, or other country- or region-specific business continuity risks increases.

If we are unable to continue to obtain U.S. federal government authorization regarding the export of our products, or if current or future export laws limit or otherwise restrict our business, we could be prohibited from shipping our products to certain countries, which would harm our ability to generate revenue.

We must comply with U.S. laws regulating the export of our products and technology. In addition, we are required to obtain a license from the U.S. federal government to export certain of our products and technical data as well as to provide technical services to foreign persons related to such products and technical data. We cannot be sure of our ability to obtain any licenses required to export our products or to receive authorization from the U.S. federal

government for international sales or domestic sales to foreign persons including transfers of technical data or the provision of technical services. Likewise, our international operations are subject to the export laws of the countries in which they conduct business. Moreover, the export regimes and the governing policies applicable to our business are subject to change. We cannot assure you of the extent that such export authorizations will be available to us, if at all, in the future. If we cannot obtain required government approvals under applicable regulations in a timely manner or at all, we could be delayed or prevented from selling our products in certain jurisdictions, which could adversely affect our business and financial results.

25

Table of Contents

If we are unable to obtain or maintain appropriate government security clearances for our facilities or personnel, we may be precluded from bidding on certain opportunities.

We must comply with security requirements pursuant to the National Industrial Security Program Operating Manual, or NISPOM, and other U.S. government security protocols when accessing sensitive information. Several of our facilities maintain a facility security clearance and many of our employees maintain a personal security clearance in order to access sensitive information necessary to the performance of our work on certain government contracts and subcontracts. Failure to comply with the NISPOM or other security requirements may subject us to civil or criminal penalties, loss of access to sensitive information, loss of a U.S. government contract or subcontract, or potentially debarment as a government contractor.

If we suffer any data breaches involving the designs, schematics, or source code for our products or other sensitive information, our business and financial results could be adversely affected.

As a leading commercial provider to critical defense programs, our business may be subject to heightened risks of cyber intrusion as nation-state hackers seek access to technology used in U.S. defense programs. Like all DOD contractors that process, store or transmit controlled unclassified information, we must meet DFARS minimum security standards or risk losing our DOD contracts. We securely store our designs, schematics, and source code for our products as they are created. A breach, whether physical, electronic or otherwise, of the systems on which this sensitive data is stored could lead to damage or piracy of our products. If we are subject to data security breaches from external sources or from an insider threat, we may have a loss in sales or increased costs arising from the restoration or implementation of additional security measures, either of which could adversely affect our business and financial results. Other potential costs could include loss of brand value, incident response costs, loss of stock market value, regulatory inquiries, litigation, and management distraction. In addition, a security breach that involved classified information could subject us to civil or criminal penalties, loss of a government contract, loss of access to classified information, or debarment as a government contractor. Similarly, a breach that involved loss of customer-provided data could subject us to loss of a customer, loss of a contract, litigation costs and legal damages, and reputational harm.

The highly-publicized cyber-attack on Sony Pictures Entertainment demonstrates the vulnerability of companies to cyber-attacks and the severe impact these attacks can have. In addition to the potential costs discussed above, the Sony cyber-attack illustrates that such attacks can also damage physical infrastructure (e.g. corrupted servers) and destroy all copies of company intellectual property on a company's network.

We may need to invest in new information technology systems and infrastructure to scale our operations.

We may need to adopt new information technology systems and infrastructure to scale our business and obtain the synergies from prior and future business acquisitions. Our older information technology systems and infrastructure could create product development or production work stoppages, unnecessarily increase our inventory, negatively impact product delivery times and quality, and increase our compliance costs. Failure to invest in newer information technology systems and infrastructure may lead to operational inefficiencies and increased compliance costs and risks. In addition, an inability to maximize the utility and benefit of our current information technology tools could impact our ability to meet cost reduction and planned efficiency and operational improvement goals.

Our income tax provision and other tax liabilities may be insufficient if taxing authorities are successful in asserting tax positions that are contrary to our position. Increases in tax rates could impact our financial performance.

From time to time, we are audited by various federal, state and local authorities regarding income tax matters.

Significant judgment is required to determine our provision for income taxes and our liabilities for federal, state, local and other taxes. Although we believe our approach to determining the appropriate tax treatment is supportable and in accordance with relevant authoritative guidance it is possible that the final tax authority will take a tax position that is materially different than that which is reflected in our income tax provision. Such differences could have an adverse effect on our income tax provision or benefit, in the reporting period in which such determination is made and, consequently, on our results of operations, financial position and/or cash flows for such period. Further, future increases in tax rates may adversely affect our financial results.

Provisions in our organizational documents and Massachusetts law and other actions we have taken could make it more difficult for a third party to acquire us.

Provisions of our charter and by-laws could have the effect of discouraging a third party from making a proposal to acquire our company and could prevent certain changes in control, even if some shareholders might consider the proposal to be in their best interest. These provisions include a classified board of directors, advance notice to our board of directors of shareholder proposals and director nominations, and limitations on the ability of shareholders to remove directors and to call shareholder meetings. In addition, we may issue shares of any class or series of preferred stock in the future without shareholder approval upon such terms as our board of directors may determine. The rights of holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any such class or series of preferred stock that may be issued.

Table of Contents

We also are subject to the Massachusetts General Laws which, subject to certain exceptions, prohibit a Massachusetts corporation from engaging in a broad range of business combinations with any “interested shareholder” for a period of three years following the date that such shareholder becomes an interested shareholder. These provisions could discourage a third party from pursuing an acquisition of our company at a price considered attractive by many shareholders.

The Massachusetts Business Corporation Act permits directors to look beyond the interests of shareholders and consider other constituencies in discharging their duties. In determining what the director of a Massachusetts corporation reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, the region and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation. This provision of Massachusetts law could reduce the likelihood that we may be acquired in a transaction that our shareholders consider to be attractive.

Our profits may decrease and/or we may incur significant unanticipated costs if we do not accurately estimate the costs of fixed-price engagements.

A significant number of our system integration projects are based on fixed-price contracts, rather than contracts in which payment to us is determined on a time and materials or other basis. Our failure to estimate accurately the resources and schedule required for a project, or our failure to complete our contractual obligations in a manner consistent with the project plan upon which our fixed-price contract was based, could adversely affect our overall profitability and could have a material adverse effect on our business, financial condition and results of operations. We are consistently entering into contracts for large projects that magnify this risk. We have been required to commit unanticipated additional resources to complete projects in the past, which has occasionally resulted in losses on those contracts. We will likely experience similar situations in the future. In addition, we may fix the price for some projects at an early stage of the project engagement, which could result in a fixed price that is too low. Therefore, any changes from our original estimates could adversely affect our business, financial condition and results of operations.

The trading price of our common stock may continue to be volatile, which may adversely affect our business, and investors in our common stock may experience substantial losses.

Our stock price, like that of other technology companies, has been volatile. The stock market in general and technology companies in particular may continue to experience volatility. The stock prices for companies in the defense technology industry may continue to remain volatile given the uncertainty and timing of funding for defense programs. This volatility may or may not be related to our operating performance. Our operating results, from time to time, may be below the expectations of public market analysts and investors, which could have a material adverse effect on the market price of our common stock. Our low stock trading volume and small cap status could hamper existing and new shareholders from gaining a meaningful position in our stock. In addition, the continued threat of terrorism in the United States and abroad and the resulting military action and heightened security measures undertaken in response to threats may cause continued volatility in securities markets. Market rumors or the dissemination of false or misleading information may impact our stock price. When the market price of a stock has been volatile, holders of that stock will sometimes issue securities class action litigation against the company that issued the stock. If any shareholders were to issue a lawsuit, we could incur substantial costs defending the lawsuit. Also, the lawsuit could divert the time and attention of management.

We have never paid dividends on our capital stock and we do not anticipate paying any dividends in the foreseeable future. Consequently, any gains from an investment in our common stock will likely depend on whether the price of our common stock increases.

We have not declared or paid cash dividends on any of our classes of capital stock to date and we currently intend to retain our future earnings, if any, to fund the development and growth of our business. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future. Furthermore, we may in the future become subject to contractual restrictions on, or prohibitions against, the payment of dividends. Consequently, in the foreseeable future, you will likely only experience a gain from your investment in our common stock if the price of our common stock increases. There is no guarantee that our common stock will appreciate in

value or even maintain the price at which you purchased your shares, and you may not realize a return on your investment in our common stock.

If our internal controls over financial reporting are not considered effective, our business and stock price could be adversely affected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each fiscal year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report on Form 10-K for that fiscal year. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal controls over financial reporting.

Table of Contents

Our management, including our chief executive officer and chief financial officer, does not expect that our internal controls over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud involving a company have been, or will be, detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become ineffective because of changes in conditions or deterioration in the degree of compliance with policies or procedures. In addition, as part of our growth strategy, we may continue to explore acquisitions or strategic alliances that could adversely affect internal control over financial reporting during the integration period until the acquired business has been fully incorporated into our internal control environment. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to consider our internal controls as ineffective. If our internal controls over financial reporting are not considered effective, we may experience a loss of public confidence, which could have an adverse effect on our business and on the market price of our common stock.

If equity research analysts do not publish research or reports about our business or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.

The trading market for our common stock relies in part on the research and reports that equity research analysts publish about us and our business. We do not control these analysts. The price of our common stock could decline if one or more equity analysts downgrade our common stock or if analysts issue other unfavorable commentary or cease publishing reports about us or our business.

We may need additional capital and may not be able to raise funds on acceptable terms, if at all. In addition, any funding through the sale of additional common stock or other equity securities could result in additional dilution to our stockholders and any funding through indebtedness could restrict our operations.

We may require additional cash resources to finance our continued growth or other future developments, including any investments or acquisitions we may decide to pursue. The amount and timing of such additional financing needs will vary principally depending on the timing of new product and service launches, investments and/or acquisitions, and the amount of cash flow from our operations. If our resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a larger credit facility. The sale of additional equity securities or securities convertible into our ordinary shares could result in additional dilution to our stockholders. The incurrence of additional indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations.

Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

- investors' perception of, and demand for, securities of defense technology companies;
- conditions of the United States and other capital markets in which we may seek to raise funds;
- our future results of operations, financial condition and cash flows; and
- prevailing interest rates.

We cannot assure that financing will be available in amounts or on terms acceptable to us, if at all. If we fail to raise additional funds, we may need to sell debt or additional equity securities or to reduce our growth to a level that can be supported by our cash flow. Without additional capital, we may not be able to:

- further develop or enhance our customer base;
- acquire necessary technologies, products or businesses;
- expand operations in the United States and elsewhere;
- hire, train and retain employees;
- market our software solutions, services and products; or

respond to competitive pressures or unanticipated capital requirements.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

28

Table of Contents

ITEM 2. PROPERTIES

The following table sets forth our significant properties as of June 30, 2018:

Location	Size in Sq. Feet	Commitment
Andover, MA	145,262	Leased, expiring 2029
Hudson, NH	100,111	Leased, expiring 2024
Phoenix, AZ	73,729	Leased, expiring 2020
Oxnard, CA	72,673	Leased, expiring 2025
Fremont, CA	53,713	Leased, expiring 2023
Cypress, CA	42,770	Leased, expiring 2021
Geneva, CH	27,287	Leased, expiring 2027
Camarillo, CA	25,017	Leased, expiring 2020

The Company actively manages its facilities and is in pursuit of lease extensions or alternative locations for facilities with expiration dates in 2020. In addition, we lease a number of smaller offices around the world primarily for sales. For financial information regarding obligations under our leases, see Note K to the consolidated financial statements.

ITEM 3. LEGAL PROCEEDINGS

We are subject to litigation, claims, investigations, and audits arising from time to time in the ordinary course of our business. Although legal proceedings are inherently unpredictable, we believe that we have valid defenses with respect to those matters currently pending against us and intend to defend our self vigorously. The outcome of these matters, individually and in the aggregate, is not expected to have a material impact on our cash flows, results of operations, or financial position.

On July 10, 2018, a securities class action complaint was filed against us, Mark Aslett, and Gerald M. Haines II in the U.S. District Court for the District of Massachusetts. The complaint asserts Section 10(b) and 20(a) securities fraud claims on behalf of a purported class of purchasers and sellers of our stock from October 24, 2017 to April 24, 2018. The complaint alleges that our public disclosures in SEC filings and on earnings calls were false and/or misleading. We believe the claims in the complaint are without merit and intend to defend our self vigorously.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 4.1. EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers are appointed to office by the Board of Directors at the first board meeting following the Annual Meeting of Shareholders or at other board meetings as appropriate, and hold office until the first board meeting following the next Annual Meeting of Shareholders and until a successor is chosen, subject to prior death, resignation or removal. Information regarding our executive officers as of the date of filing of this Annual Report on Form 10-K is presented below.

Mark Aslett, age 50, joined Mercury in 2007 and has served as the President and Chief Executive Officer and as a member of the Board since 2007. Prior to joining Mercury, he was Chief Operating Officer and Chief Executive Officer of Enterasys Networks from 2003 to 2006, and held various positions with Marconi plc and its affiliated companies, including Executive Vice President of Marketing, Vice President of Portfolio Management, and President of Marconi Communications- North America, from 1998 to 2002. Mr. Aslett has also held positions at GEC Plessey Telecommunications, as well as other telecommunications-related technology firms.

Christopher C. Cambria, age 60, joined Mercury in 2016 as Senior Vice President, General Counsel, and Secretary and was appointed Executive Vice President, General Counsel, and Secretary in 2017. Prior to joining Mercury, he was Vice President, General Counsel, and Secretary of Aerojet Rocketdyne Holdings, Inc. from 2012 to 2016 and Vice President, General Counsel from 2011 to 2012. He was with L-3 Communications Holdings, Inc. from 1997 through 2009 serving as Senior Vice President and Senior Counsel, Mergers and Acquisitions from 2006 to 2009, Senior Vice President, Secretary and General Counsel from 2001 to 2006, and Vice President, General Counsel and Secretary from 1997 to 2001. Prior to L-3, Mr. Cambria was an Associate with Fried, Frank, Harris, Shriver & Jacobson and Cravath, Swaine & Moore.

Michael D. Ruppert, age 44, joined Mercury in 2014 as Senior Vice President, Strategy and Corporate Development and in 2017 was named Executive Vice President, Strategy and Corporate Development. In 2018 Mr. Ruppert was appointed the Company's Executive Vice President, Chief Financial Officer and Treasurer. Prior to joining Mercury, from 2013 to 2014, Mr. Ruppert was Co-Founder and Managing Partner of RS Partners, LLC, a boutique advisory firm focused on the aerospace & defense

29

Table of Contents

industries. Prior to that, he was a Managing Director at UBS Investment Bank where he led the defense investment banking practice from 2011 to 2013. Mr. Ruppert also held positions in the investment banking divisions at Lazard Freres & Co from 2008 to 2011 and at Lehman Brothers from 2000 to 2008.

Didier M.C. Thibaud, age 57, joined Mercury in 1995, and has served as our Executive Vice President, Chief Operating Officer since 2016. He served as the President of our Mercury Commercial Electronics business unit from 2012 to 2016 and the President of our Advanced Computing Solutions business unit from 2007 to 2012. Prior to that, he was Senior Vice President, Defense & Commercial Businesses from 2005 to 2007 and Vice President and General Manager, Imaging and Visualization Solutions Group, from 2000 to 2005 and served in various capacities in sales and marketing from 1995 to 2000.

Table of Contents

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the Nasdaq Global Select Market under the symbol MRCY. The following table sets forth, for the fiscal periods indicated, the high and low sale prices per share for our common stock during such periods. Such market quotations reflect inter-dealer prices without retail markup, markdown or commission.

	High	Low
2018 Fourth quarter	\$49.35	\$30.11
Third quarter	\$52.59	\$41.64
Second quarter	\$55.00	\$47.69
First quarter	\$52.00	\$39.96
2017 Fourth quarter	\$43.15	\$36.09
Third quarter	\$40.86	\$29.31
Second quarter	\$32.75	\$22.31
First quarter	\$26.37	\$21.52

As of July 31, 2018, we had 312 record shareholders and 20,920 nominee holders.

Dividend Policy

We have never declared or paid cash dividends on shares of our common stock. We currently intend to retain any earnings for future growth. Accordingly, we do not anticipate that any cash dividends will be declared or paid on our common stock in the foreseeable future.

Net Share Settlement Plans

The following table includes information with respect to net share settlements we made of our common stock during the fiscal year ended June 30, 2018:

Period of Net Share Settlement	Total Number of Shares Net Settled (1)	Average Price Per Share
July 1, 2017 - September 30, 2017	295	\$ 46.96
October 1, 2017 - December 31, 2017	19	\$ 51.24
January 1, 2018 - March 31, 2018	4	\$ 48.16
April 1, 2018 - June 30, 2018	11	\$ 34.93
Total	329	

(1) Represents shares we net settled in connection with the surrender of shares to cover the minimum taxes on vesting of restricted stock.

Share Repurchase Plans

During fiscal 2018, we had no active share repurchase programs.

Equity Compensation Plans

The information required by this item is incorporated by reference to our Proxy Statement for the Shareholders Meeting.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following table summarizes certain historical consolidated financial data, restated for discontinued operations, which should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report (in thousands, except per share data):

	For the Years Ended June 30,				
	2018	2017	2016	2015	2014
Statement of Operations Data:					
Net revenues	\$493,184	\$408,588	\$270,154	\$234,847	\$208,729
Income (loss) from operations	\$46,985	\$37,403	\$23,973	\$18,355	\$(7,405)
Income (loss) from continuing operations	\$40,883	\$24,875	\$19,742	\$14,429	\$(4,072)
Adjusted EBITDA(1)	\$115,362	\$93,921	\$57,274	\$44,414	\$23,522
Net earnings (loss) per share from continuing operations:					
Basic	\$0.88	\$0.59	\$0.58	\$0.45	\$(0.13)
Diluted	\$0.86	\$0.58	\$0.56	\$0.44	\$(0.13)
	As of June 30,				
	2018	2017	2016	2015	2014
Balance Sheet Data:					
Working capital	\$260,063	\$173,351	\$177,748	\$142,472	\$127,375
Total assets	\$1,064,480	\$815,745	\$736,496	\$386,880	\$373,712
Long-term obligations	\$220,909	\$17,483	\$195,808	\$3,457	\$13,635
Total shareholders' equity	\$771,891	\$725,417	\$473,044	\$350,138	\$327,147

In our periodic communications, we discuss a key measure that is not calculated according to U.S. generally accepted accounting principles ("GAAP"), adjusted EBITDA. Adjusted EBITDA is defined as income from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based and other non-cash compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating (1) budgets, supplementing the financial results and forecasts reported to our board of directors, determining components of bonus and equity compensation for executive officers based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe the adjusted EBITDA financial measure assists in providing a more complete understanding of our underlying operational measures to manage our business, to evaluate our performance compared to prior periods and the marketplace, and to establish operational goals. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

Adjusted EBITDA is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted EBITDA financial adjustments described above, and investors should not infer from our presentation of this non-GAAP financial measure that these costs are unusual, infrequent or non-recurring. See the Non-GAAP Financial Measures section of this annual report for a reconciliation of our adjusted EBITDA to income from continuing operations.

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

FORWARD-LOOKING STATEMENTS

From time to time, information provided, statements made by our employees or information included in our filings with the Securities and Exchange Commission ("SEC") may contain statements that are not historical facts but that are "forward-looking statements," which involve risks and uncertainties. You can identify these statements by the use of the

words “may,” “will,” “could,” “should,” “would,” “plans,” “expects,” “anticipates,” “continue,” “estimate,” “project,” “intend,” “probable,”

32

Table of Contents

“potential,” and similar expressions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, continued funding of defense programs, the timing and amounts of such funding, general economic and business conditions, including unforeseen weakness in the Company’s markets, effects of any U.S. Federal government shutdown or extended continuing resolution, effects of continued geopolitical unrest and regional conflicts, competition, changes in technology and methods of marketing, delays in completing engineering and manufacturing programs, changes in customer order patterns, changes in product mix, continued success in technological advances and delivering technological innovations, changes in, or in the U.S. Government’s interpretation of, federal export control or procurement rules and regulations, market acceptance of the Company’s products, shortages in components, production delays or unanticipated expenses due to performance quality issues with outsourced components, inability to fully realize the expected benefits from acquisitions and restructurings, or delays in realizing such benefits, challenges in integrating acquired businesses and achieving anticipated synergies, increases in interest rates, changes to cyber-security regulations and requirements, changes in tax rates or tax regulations, changes to generally accepted accounting principles, difficulties in retaining key employees and customers, unanticipated costs under fixed-price service and system integration engagements, and various other factors beyond our control. These risks and uncertainties also include such additional risk factors as set forth under Part I-Item 1A (Risk Factors) in this Annual Report on Form 10-K. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

OVERVIEW

Mercury Systems, Inc. is a leading commercial provider of secure sensor and safety critical mission processing subsystems. Optimized for customer and mission success, our solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, Massachusetts, we are pioneering a next-generation defense electronics business model designed to meet the industry’s current and emerging business needs. We deliver affordable innovative solutions, rapid time-to-value and service and support to our defense prime contractor customers. Our products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program (“SEWIP”), Gorgon Stare, Predator, F-35, Reaper, F-16 SABR, E2D Hawkeye, Paveway, Filthy Buzzard, Precision Guidance Kit (“PGK”), ProVision, P1, and AIDEWS. Our organizational structure allows us to deliver capabilities that combine technology building blocks and deep domain expertise in the defense sector.

Our technologies and capabilities include secure embedded processing modules and subsystems, mission computers, safety-critical avionics, radio frequency (“RF”) components, multi-function assemblies and subsystems. We utilize leading edge, high performance computing technologies architected by leveraging open standards and open architectures to address highly data-intensive applications that include data signal, sensor and image processing while addressing the packaging challenges, often referred to as “SWaP” (size, weight, and power), that are common in military applications. We have design, development, and manufacturing capabilities in mission computing, safety-critical avionics and platform management. In addition, we design and manufacture RF, microwave and millimeter wave components and subsystems to meet the needs of the radar, electronic warfare (“EW”), signals intelligence (“SIGINT”) and other high bandwidth communications requirements and applications.

We also provide significant capabilities relating to pre-integrated EW, electronic attack (“EA”) and electronic counter measure (“ECM”) subsystems, SIGINT and electro-optical/infrared (“EO/IR”) processing technologies, and radar environment test and simulation systems. We deploy these solutions on behalf of defense prime contractors and the Department of Defense (“DoD”), leveraging commercially available technologies and solutions (or “building blocks”) from our business and other commercial suppliers. We leverage this technology to design and build integrated sensor processing subsystems, often including classified application-specific software and intellectual property (“IP”) for the C4ISR (command, control, communications, computers, intelligence, surveillance and reconnaissance), EW, and ECM markets. We bring significant domain expertise to customers, drawing on over 25 years of experience in EW, SIGINT, and radar environment test and simulation.

Since we conduct much of our business with our defense customers via commercial items, requests by customers are a primary driver of revenue fluctuations from quarter to quarter. Customers specify delivery date requirements that coincide with their need for our products. Because these customers may use our products in connection with a variety of defense programs or other projects of different sizes and durations, a customer's orders for one quarter generally do not indicate a trend for future orders by that customer. Additionally, order patterns do not necessarily correlate amongst customers and, therefore, we generally cannot identify sequential quarterly trends.

As of June 30, 2018, we had 1,320 employees. During 2018, the growth in our headcount resulted in us exceeding the threshold for qualifying as a "small business" for government contract purposes. The revenues received as a result of small business set aside funding are not considered material.

Our consolidated revenues, net income, earnings per share ("EPS"), adjusted EPS and adjusted EBITDA for fiscal 2018 were \$493.2 million, \$40.9 million, \$0.86, \$1.42 and \$115.4 million, respectively. See the Non-GAAP Financial Measures section for a reconciliation to our most directly comparable GAAP financial measures.

Table of Contents

BUSINESS DEVELOPMENTS:

FISCAL 2018

On February 1, 2018, we acquired Themis Computer ("Themis"). Themis is a leading designer, manufacturer and integrator of commercial, SWaP-optimized rugged servers, computers and storage systems for U.S. and international markets. The acquisition and transaction related expenses were funded with borrowings obtained under our existing revolving credit facility ("the Revolver").

On July 3, 2017, we acquired Richland Technologies, LLC ("RTL"). RTL specializes in safety-critical and high integrity systems, software and hardware development as well as safety-certification services for mission-critical applications, and is a leader in safety-certifiable embedded graphics software for commercial and military aerospace applications. The acquisition and transaction related expenses were funded with cash on hand. The acquisition had an immaterial impact to the Company's results of operations.

FISCAL 2017

On June 27, 2017, we amended our revolving credit facility ("Revolving Credit Facility"), increasing and extending the facility into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining principal on our term loan using cash on hand. The Revolving Credit Facility remained undrawn at June 30, 2017, other than for outstanding letters of credit.

On April 3, 2017, we acquired Delta Microwave, LLC ("Delta"). Delta is a leading designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace and space markets. The acquisition and transaction related expenses were funded with cash on hand.

On January 26, 2017, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On February 1, 2017, we closed the offering, including the full over-allotment allocation, selling an aggregate of 6.9 million shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215.7 million.

On November 4, 2016, we acquired CES Creative Electronic Systems, S.A. ("CES"). Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission-critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as several types of unmanned platforms.

FISCAL 2016

On May 2, 2016, we acquired the custom microelectronics, RF and microwave solutions, and embedded security operations of Microsemi Corporation (the "Carve-Out Business"), resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the "Acquisition").

The Carve-Out Business is a leader in the design, development, and production of sophisticated electronic subsystems and components for use in high-technology products for defense and aerospace markets. The Carve-Out Business' defense electronics solutions include high-density memory modules, secure solid-state drives, secure GPS receiver modules, high-power RF amplifiers, millimeter-wave modules and subsystems, and specialized software and firmware for anti-tamper applications. The Carve-Out Business' customers, which include many significant defense prime contractors, outsource many of their electronic design and manufacturing requirements to the Carve-Out Business as a result of its specialized capabilities in packaging electronics for SWaP-constrained environments, its focus on security and the unique requirements of defense applications, and its expertise in RF and microwave technologies. The Carve-Out Business' products and technologies are used in a variety of defense applications, including missiles and precision munitions, fighter and surveillance aircraft, airport security portals, and advanced electronic systems for radar and EW.

On December 16, 2015, we acquired Lewis Innovative Technologies, Inc. ("LIT"). Embedded systems security has become a requirement for new and emerging military programs, and LIT's security solutions significantly extend our capabilities and leadership in secure embedded computing, a critical differentiator from our traditional competition.

LIT's solutions, combined with our next-generation secure Intel server-class product line, together with increasingly frequent mandates from the government to secure electronic systems for domestic and foreign military sales, position us well to capitalize on DoD program protection security requirements.

Table of ContentsRESULTS OF OPERATIONS:
FISCAL 2018 VS. FISCAL 2017

Results of operations for the twelve month period ended June 30, 2017 includes only results from the acquisition dates for CES and Delta. Results of operations for the twelve month period ended June 30, 2018 includes only results from the acquisition dates for RTL and Themis, which were acquired subsequent to June 30, 2017. Accordingly, the periods presented below are not directly comparable.

The following tables set forth, for the periods indicated, financial data from the consolidated statements of operations:

(In thousands)	Fiscal 2018	As a % of		As a % of	
		Total Net Revenue	Fiscal 2017	Total Net Revenue	
Net revenues	\$ 493,184	100.0 %	\$ 408,588	100.0 %	
Cost of revenues	267,326	54.2	217,045	53.1	
Gross margin	225,858	45.8	191,543	46.9	
Operating expenses:					
Selling, general and administrative	88,365	17.9	76,491	18.7	
Research and development	58,807	11.9	54,086	13.2	
Amortization of intangible assets	26,004	5.3	19,680	4.8	
Restructuring and other charges	3,159	0.7	1,952	0.5	
Acquisition costs and other related expenses	2,538	0.5	1,931	0.5	
Total operating expenses	178,873	36.3	154,140	37.7	
Income from operations	46,985	9.5	37,403	9.2	
Interest income	32	—	462	0.1	
Interest expense	(2,850)	(0.6)	(7,568)	(1.9)	
Other (expense) income, net	(1,594)	(0.3)	771	0.2	
Income before income taxes	42,573	8.6	31,068	7.6	
Tax provision	1,690	0.3	6,193	1.5	
Net income	\$ 40,883	8.3 %	\$ 24,875	6.1 %	

REVENUES

(In thousands)	Fiscal 2018	As a % of		As a % of		\$ Change	% Change
		Total Net Revenue	Fiscal 2017	Total Net Revenue			
Organic revenue	\$ 433,438	88 %	\$ 404,632	99 %	\$ 28,806	7 %	
Acquired revenue	59,746	12 %	3,956	1 %	55,790	1,410 %	
Total revenues	\$ 493,184	100 %	\$ 408,588	100 %	\$ 84,596	21 %	

Total revenues increased \$84.6 million, or 21%, to \$493.2 million during fiscal 2018 compared to \$408.6 million during fiscal 2017 including "Acquired revenue" which represents net revenue from acquired businesses that have been part of Mercury for completion of four full quarters or less (and excludes any intercompany transactions). After the completion of four fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenues is primarily attributed to higher revenues associated with the F-35, Aegis, MoDREx, PGK, and E2D Hawkeye programs and the increase of \$55.8 million of Acquired revenue. These increases were partially offset by lower revenues from a large ground based radar program.

International revenues, which consist of foreign military sales through the U.S. government, sales to prime defense contractor customers where the end user is known to be outside of the U.S., and direct sales to non-U.S. based customers, increased \$16.2 million to \$83.1 million during fiscal 2018 compared to \$66.9 million during fiscal 2017. International revenues represented 17% and 16% of total revenues during fiscal 2018 and 2017, respectively. Revenues from Command, Control, Communications, Computers, and Intelligence ("C4I"), Other Sensor and Effector, Radar and Electronic Warfare ("EW") increased by \$55.7 million, \$20.4 million, \$9.3 million and \$8.4 million, respectively, during fiscal 2018 as compared to fiscal 2017. The C4I increase was driven primarily by the F-35 program as well as Acquired revenue from

Table of Contents

the Themis acquisition, partially offset by lower revenue from the ProVision program. The Other Sensor and Effector increase was driven primarily by the Digital Electronic Warfare System ("DEWS") and Advanced Medium Range Air to Air Missile ("AMRAAM") programs. The Radar increase was primarily driven by the Aegis and E2D Hawkeye programs, partially offset by lower revenues from a large ground based radar program. The EW increase was primarily driven by the MoDREx and Surface Electronic Warfare Improvement Program ("SEWIP") programs, partially offset by lower revenues from the Miniature Air Launched Decoy ("MALD") program. These end application increases were partially offset by a decrease of \$9.2 million related to component and other sales where the end use is not specified during fiscal 2018 as compared to fiscal 2017.

Revenues from components, modules and sub-assemblies, and integrated subsystems increased by \$37.3 million, \$32.8 million, and \$14.5 million, respectively, during fiscal 2018 as compared to fiscal 2017. The components increase was driven primarily by the PGK and F-35 programs. The increase in modules and sub-assemblies was driven by the SEWIP and MoDREx programs, partially offset by lower revenues from the DEWS program. The increase in integrated subsystems was primarily due to higher revenues from the Aegis and E2D Hawkeye programs, as well as Acquired revenue from the Themis acquisition, partially offset by lower revenues from a large ground based radar program.

GROSS MARGIN

Gross margin was 45.8% for fiscal 2018, a decrease of 110 basis points from the 46.9% gross margin achieved in fiscal 2017. The lower gross margin in fiscal 2018 was primarily due to lower margin product mix, which was partially offset by lower inventory step-up amortization of \$1.7 million related to our acquired businesses compared to fiscal 2017.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$11.9 million, or 16%, to \$88.4 million during fiscal 2018 as compared to \$76.5 million during fiscal 2017. The increase was primarily due to added headcount from our recent acquisitions of Delta, RTL and Themis and higher compensation related costs. Selling, general and administrative expenses decreased as a percentage of revenue to 17.9% during fiscal 2018 from 18.7% during fiscal 2017 due to higher revenues and improved operating leverage in fiscal 2018 compared to fiscal 2017.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$4.7 million, or 9%, to \$58.8 million during fiscal 2018 compared to \$54.1 million for fiscal 2017. The increase was primarily due to added headcount from our recent acquisitions of Delta, RTL and Themis and higher compensation related costs. These increases were partially offset by increased customer funded development. Research and development expenses accounted for 11.9% and 13.2% of our revenues during fiscal 2018 and fiscal 2017, respectively. The decrease was primarily driven due to higher revenues in fiscal 2018 compared to fiscal 2017.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased \$6.3 million to \$26.0 million during fiscal 2018 compared to \$19.7 million for fiscal 2017, primarily due to the full year impact of amortization from the acquisitions of CES and Delta, as well as the amortization from the RTL and Themis acquisitions.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges increased \$1.2 million, or 62%, to \$3.2 million during fiscal 2018 compared to \$2.0 million in fiscal 2017. The increase was primarily driven by higher severance costs related to the separation of 38 employees primarily in R&D and operations functions. Fiscal 2017 included severance related activities associated with the closure of our former Manteca, California location and facility related charges from our former Chelmsford, Massachusetts headquarters facility, which was relocated to Andover, Massachusetts during fiscal 2017. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$2.5 million of acquisition costs and other related expenses during fiscal 2018, compared to \$1.9 million during fiscal 2017. The acquisition costs and other related expenses incurred during fiscal 2018 primarily related to the acquisitions of Themis and RTL during fiscal 2018, as well as expenses associated with the acquisition of

Germane Systems ("Germane") in early fiscal 2019. The acquisition costs and other related expenses incurred during fiscal 2017 primarily related to the acquisitions of both CES and Delta. We expect to incur acquisition costs and other related expenses periodically in the future as we continue to seek acquisition opportunities to expand our capabilities within the entire sensor processing chain.

INTEREST INCOME

Interest income decreased to less than \$0.1 million in fiscal 2018, compared to \$0.5 million in fiscal 2017 due to lower average balances of cash on hand throughout the year.

Table of Contents**INTEREST EXPENSE**

Interest expense for fiscal 2018 decreased \$4.7 million to \$2.9 million compared to fiscal 2017 interest expense of \$7.6 million. Fiscal 2017 included a \$5.8 million cash interest expense and \$1.8 million of amortization of debt issuance costs related to the full year impact of our former term loan, which was repaid in the fourth quarter. During fiscal 2018, we incurred \$2.9 million in cash interest expense on the Revolver in order to facilitate the acquisition of Themis.

OTHER (EXPENSE) INCOME, NET

Other (expense) income, net decreased \$2.4 million to \$(1.6) million during fiscal 2018 compared to \$0.8 million in fiscal 2017. The increase in other expense, net was primarily due to \$2.4 million in financing and registration fees incurred during fiscal 2018 compared to \$0.6 million in fiscal 2017. Other income, net in fiscal 2017 includes \$0.9 million related to the amortization of the gain on the sale leaseback of our former corporate headquarters. The decrease in other (expense) income, net was offset by \$0.6 million foreign exchange gain compared to a \$0.3 million gain during the same period in fiscal 2017.

INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted by the U.S. government. The Tax Act has impacted the U.S. corporate tax rate that we will use going forward, which has been reduced to 21% from 35%. As we have a June 30 fiscal year-end, the lower U.S. corporate tax rate will be phased in, resulting in a U.S. corporate tax rate of approximately 28% for our fiscal year ending June 30, 2018, and 21% for subsequent fiscal years. In addition to the reduced U.S. corporate tax rate we also expect to benefit from the immediate deduction for certain new investments. The Tax Act also includes items that we expect will increase our tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on deductions for executive compensation. To transition to the reduced U.S. corporate tax rate, adjustments were required to be made to our U.S. deferred tax assets and liabilities, as well as discrete tax items recorded prior to the Tax Act. For the year ended June 30, 2018, these adjustments resulted in a tax benefit of \$0.9 million. The Tax Act also provided for a one-time deemed mandatory repatriation of post-1986 undistributed foreign subsidiary earnings and profits ("E&P") through December 31, 2017. We had an estimated \$5.6 million of undistributed foreign E&P subject to the deemed mandatory repatriation and recognized a provisional \$0.8 million of income tax expense for the year ended June 30, 2018. The actual effective tax rate may be materially different than the U.S. corporate tax rate (including being higher) based on the availability and impact of various other adjustments including but not limited to state taxes, Federal research and development credits, discrete tax benefits related to stock compensation, and the inclusion or exclusion of various items in taxable income which may differ from GAAP income.

The effective tax rate for fiscal 2018 differed from the federal statutory rate primarily due to benefits related to research and development tax credits, domestic manufacturing deductions, excess tax benefits for equity compensation, and acquired tax attributes. These benefits are partially offset by additional tax expense for state and local income taxes, non-deductible officer compensation and non-deductible equity compensation. During fiscal 2018 and 2017, we recognized a discrete tax benefit of \$7.9 million and \$4.1 million, respectively, related to excess tax benefits on stock-based compensation. The discrete tax benefit for fiscal 2018 included the enactment of the Tax Act. The benefit is the result of the increase in value from the stock award between the grant date and the vest date. Fiscal 2018 also included discrete tax benefits of \$3.7 million derived from new information obtained about net operating loss carry-forwards of the Carve-Out Business acquired from Microsemi Corporation in May 2016. The discrete items disclosed above for fiscal 2018 included the effect of the Tax Act.

Within the calculation of our annual effective tax rate we have used assumptions and estimates that may change as a result of future guidance and interpretation from the Internal Revenue Service, the SEC, and the FASB. The Tax Act contains many significant changes to the U.S. tax laws, the consequences of which have not yet been fully determined, primarily related to the changes in the taxation of foreign earnings and the deductibility of expenses. These changes contained in the Tax Act could have a material impact on our future U.S. tax expense.

FISCAL 2017 VS. FISCAL 2016

Results of operations for the twelve month period ended June 30, 2016 does not include results for CES and Delta since both businesses were acquired subsequent to June 30, 2016 and includes only two months results for the

Carve-Out Business. Accordingly, the periods presented below are not directly comparable.

37

Table of Contents

The following tables set forth, for the periods indicated, financial data from the consolidated statement of operations:

(In thousands)	Fiscal 2017	As a % of		As a % of	
		Total Net Revenue	Fiscal 2016	Total Net Revenue	Fiscal 2016
Net revenues	\$ 408,588	100.0 %	\$ 270,154	100.0 %	
Cost of revenues	217,045	53.1	142,535	52.8	
Gross margin	191,543	46.9	127,619	47.2	
Operating expenses:					
Selling, general and administrative	76,491	18.7	52,952	19.6	
Research and development	54,086	13.2	36,388	13.4	
Amortization of intangible assets	19,680	4.8	8,842	3.2	
Restructuring and other charges	1,952	0.5	1,240	0.5	
Impairment of long-lived assets	—	—	231	0.1	
Acquisition costs and other related expenses	1,931	0.5	3,993	1.5	
Total operating expenses	154,140	37.7	103,646	38.3	
Income from operations	37,403	9.2	23,973	8.9	
Interest income	462	0.1	131	—	
Interest expense	(7,568)	(1.9)	(1,172)	(0.4)	
Other income, net	771	0.2	2,354	0.9	
Income before income taxes	31,068	7.6	25,286	9.4	
Tax provision	6,193	1.5	5,544	2.1	
Net income	\$ 24,875	6.1 %	\$ 19,742	7.3 %	

REVENUES

(In thousands)	Fiscal 2017	As a % of		As a % of		\$ Change	% Change
		Total Net Revenue	Fiscal 2016	Total Net Revenue	Fiscal 2016		
Organic revenue	\$ 277,699	68 %	\$ 253,516	94 %	\$ 24,183	10 %	
Acquired revenue	130,889	32 %	16,638	6 %	114,251	687 %	
Total revenues	\$ 408,588	100 %	\$ 270,154	100 %	\$ 138,434	51 %	

Total revenues increased \$138.4 million, or 51%, to \$408.6 million during fiscal 2017 compared to \$270.2 million during fiscal 2016 including "Acquired revenue" which represents net revenue from acquired businesses that have been part of Mercury for completion of four full quarters or less (which excludes any intercompany transactions). After the completion of four fiscal quarters, acquired businesses will be treated as organic for current and comparable historical periods. The increase in total revenues is primarily attributed to higher revenues associated with a large ground based radar program and ProVision program and the increase of \$114.3 million of Acquired revenue. International revenues, which consist of foreign military sales through prime defense contractor customers and direct sales to non-U.S. based customers, increased by \$17.0 million to \$66.9 million during fiscal 2017 compared to \$49.9 million during fiscal 2016. International revenues represented 16% and 19% of total revenues during fiscal 2017 and 2016, respectively.

GROSS MARGIN

Gross margin was 46.9% for fiscal 2017, a decrease of 30 basis points from the 47.2% gross margin achieved in fiscal 2016. The lower gross margin in fiscal 2017 was primarily due to inventory step-up amortization related to the Carve-Out Business, CES and Delta of \$2.8 million, \$0.7 million, and \$0.2 million, respectively, partially offset by production cost efficiencies and acquisition integration synergies, as well as the continuing ramp up of our insourced U.S. manufacturing operations. The remaining \$0.6 million of inventory step-up was amortized into cost of goods sold over the first four months of fiscal 2018.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased \$23.5 million, or 44%, to \$76.5 million during fiscal 2017 as compared to \$53.0 million during fiscal 2016. The increase was primarily due to increased headcount driven by the

full year impact of the Carve-Out Business, as well as the acquisitions of CES and Delta in the second and fourth quarters of fiscal 2017, respectively,

38

Table of Contents

and higher compensation related costs. Selling, general and administrative expenses decreased as a percentage of revenue to 18.7% during fiscal 2017 from 19.6% during fiscal 2016 due to higher revenues in fiscal 2017.

RESEARCH AND DEVELOPMENT

Research and development expenses increased \$17.7 million, or 49%, to \$54.1 million during fiscal 2017 compared to \$36.4 million for fiscal 2016. The increase was primarily due to increased headcount from the full year impact of the Carve-Out Business, as well as the acquisitions of CES and Delta in the second and fourth quarters of fiscal 2017, respectively. The increase was also due to higher compensation related costs, partially offset by increased customer funded development. Research and development expenses accounted for 13.2% and 13.4% of our revenues during fiscal 2017 and fiscal 2016, respectively.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased \$10.9 million to \$19.7 million during fiscal 2017 compared to \$8.8 million for fiscal 2016, primarily due to the full year impact of amortization from the acquisition of the Carve-Out Business, as well as the amortization from CES and Delta acquisitions.

RESTRUCTURING AND OTHER CHARGES

Restructuring and other charges increased \$0.7 million, or 58%, to \$1.9 million during fiscal 2017 compared to \$1.2 million in fiscal 2016. The increase was driven by the severance related activities associated with the closure of our Manteca, California facility in fiscal 2018. We also incurred facility related charges through April 2017, as we were unable to sublease the unoccupied portion of our former Chelmsford, Massachusetts headquarters facility. We relocated our headquarters to Andover, Massachusetts in March 2017. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

IMPAIRMENT OF LONG-LIVED ASSETS

We had no impairment charges during fiscal 2017, compared to an impairment charge of \$0.2 million related to a pre-existing LIT relationship during fiscal 2016.

ACQUISITION COSTS AND OTHER RELATED EXPENSES

We incurred \$1.9 million of acquisition costs and other related expenses during fiscal 2017, compared to \$4.0 million during fiscal 2016. The acquisition costs and other related expenses incurred during fiscal 2017 relate to the acquisitions of both CES and Delta. \$2.0 million of the fiscal 2016 costs related to the acquisition of the Carve-Out Business.

INTEREST INCOME

Interest income increased to \$0.5 million in fiscal 2017, compared to \$0.1 million in fiscal 2016 due to higher average balances of cash on hand throughout the year.

INTEREST EXPENSE

Interest expense for fiscal 2017 increased \$6.4 million to \$7.6 million compared to \$1.2 million in fiscal 2016. The increase was driven by \$5.8 million cash interest expense and \$1.8 million of amortization of debt issuance costs related to our term loan, which was entered into during the fourth quarter of fiscal 2016, and repaid during June 2017 as noted above.

OTHER INCOME, NET

Other income, net decreased \$1.6 million to \$0.8 million during fiscal 2017 compared to \$2.4 million in fiscal 2016. During fiscal 2016 we realized \$1.9 million gain on the settlement of escrow litigation, which was associated with our fiscal 2012 acquisition of KOR Electronics. Other income includes \$0.9 million and \$1.2 million related to the amortization of the gain on the sale leaseback of our former corporate headquarters during fiscal 2017 and fiscal 2016, respectively. In fiscal 2017, we realized \$0.3 million foreign exchange gain compared to \$0.2 million loss during the same period in fiscal 2016. We incurred bank operating fees of \$0.6 million and \$0.4 million during fiscal 2017 and 2016, respectively.

INCOME TAXES

We recorded an income tax provision of \$6.2 million in fiscal 2017 compared to \$5.5 million in fiscal 2016. The effective tax rates for fiscal 2017 and fiscal 2016 were 19.9% and 21.9%, respectively.

Our effective tax rate for fiscal 2017 differed from the federal statutory rate primarily due to benefits related to research and development tax credits, domestic manufacturing deductions, excess tax benefits for equity compensation and releases for reserves for tax contingencies, partially offset by non-deductible equity compensation.

39

Table of Contents

The difference in the effective tax rates between fiscal 2017 and fiscal 2016 is mainly driven by additional excess tax benefits for equity compensation, and a portion of the legal settlement of the escrow litigation associated with our acquisition of KOR Electronics that was classified as a reduction of cost basis in an investment for income tax purposes which occurred in fiscal 2016.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity come from existing cash and cash generated from operations, our revolving credit facility and our ability to raise capital under our universal shelf registration statement. Our near-term fixed commitments for cash expenditures consist primarily of payments under operating leases and inventory purchase commitments. We do not currently have any material commitments for capital expenditures. We plan to invest in improvements to our new facilities during fiscal 2019.

Based on our current plans and business conditions, we believe that existing cash and cash equivalents, our available revolving credit facility, cash generated from operations, and our financing capabilities will be sufficient to satisfy our anticipated cash requirements for at least the next twelve months.

Shelf Registration Statement

On August 28, 2017, we filed a shelf registration statement on Form S-3ASR with the SEC. The shelf registration statement, which was effective upon filing with the SEC, registered each of the following securities: debt securities, preferred stock, common stock, warrants and units. We intend to use the proceeds from financings using the shelf registration statement for general corporate purposes, which may include the following:

- the acquisition of other companies or businesses;

- the repayment and refinancing of debt;

- capital expenditures;

- working capital; and

- other purposes as described in the prospectus supplement.

We have an unlimited amount available under the shelf registration statement. Additionally, as part of the shelf registration statement, we have entered into an equity distribution agreement which allows us to sell an aggregate of up to \$200.0 million of our common stock from time to time through our agents. The actual dollar amount and number of shares of common stock we sell pursuant to the equity distribution agreement will be dependent on, among other things, market conditions and our fund raising requirements. The agents may sell the common stock by any method deemed to be an “at the market offering” as defined in Rule 415 of the Securities Act of 1933, as amended, including without limitation sales made directly on NASDAQ, on any other existing trading market for the common stock or to or through a market maker. In addition, our common stock may be offered and sold by such other methods, including privately negotiated transactions, as we and the agents may agree.

Follow-on Equity Offerings

On January 26, 2017, we announced the commencement of an underwritten public offering of our common stock, par value \$0.01 per share. On February 1, 2017, we closed the offering, including the full over-allotment allocation, selling an aggregate of 6.9 million shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215.7 million.

Revolving Credit Facilities

In June 2017, we amended the Revolver, increasing and extending it into a \$400.0 million, 5-year revolving credit line expiring in June 2022. In connection with the amendment, we repaid the remaining outstanding principal and interest on our term loan using cash on hand. To facilitate the acquisition of Themis, we drew \$195.0 million from the Revolver, with the higher amount reflecting an estimated adjustment for working capital. See Note L in the accompanying consolidated financial statements for further discussion of the Revolver.

Accounts Receivable Factoring

On December 21, 2017, we executed a Master Receivables Purchase Agreement (the “Purchase Agreement”) with Bank of America, N.A. (the “Bank”) for the sale of certain eligible accounts receivable balances of the Company, up to a maximum of \$30.0 million. Factoring under the Purchase Agreement is treated as a true sale of accounts receivable by us. We have continued involvement in servicing accounts receivable under the Purchase Agreement, but have no significant retained interests related to the factored accounts receivable.

Proceeds from amounts factored are recorded as an increase to cash and a reduction to accounts receivable outstanding in the consolidated balance sheets. Cash flows attributable to factoring are reflected as cash flows from operating activities in our consolidated statements of cash flows. Factoring fees are included as selling, general, and administrative expenses in the Company's consolidated statements of operations and comprehensive income.

Table of Contents

We factored accounts receivable and incurred factoring fees of \$18.8 million and \$0.1 million, respectively, during the second quarter of fiscal 2018. We did not factor any accounts receivable or incur any factoring fees during the second half of fiscal 2018.

CASH FLOWS

(In thousands)	For the Years Ended June 30,		
	June 30, 2018	June 30, 2017	June 30, 2016
Net cash provided by operating activities	\$43,321	\$59,146	\$36,940
Net cash used in investing activities	\$(200,877)	\$(111,087)	\$(318,208)
Net cash provided by financing activities	\$182,937	\$11,338	\$284,894
Net increase (decrease) in cash and cash equivalents	\$24,884	\$(40,054)	\$4,105
Cash and cash equivalents at end of year	\$66,521	\$41,637	\$81,691

Our cash and cash equivalents increased by \$24.9 million during fiscal 2018 primarily as the result of \$43.3 million provided by operating activities and net borrowings under the credit facility of \$195.0 million. These increases were offset by \$185.4 million used in acquisition activities, \$15.5 million used in the retirement of common stock used to settle individual employees' tax liabilities associated with vesting of restricted stock awards and \$15.1 million invested in purchases of property and equipment.

Operating Activities

During fiscal 2018, we generated \$43.3 million in cash from operating activities compared to \$59.1 million in cash generated from operating activities in fiscal 2017. The decrease was primarily a result of higher cash uses for income tax payables, accounts payables, accounts receivables and inventory. The decrease was partially offset by higher comparable net income, additional depreciation and amortization expense and deferred revenues and customer advances.

During fiscal 2017, we generated \$59.1 million in cash from operating activities compared to \$36.9 million in cash generated from operating activities in fiscal 2016. The increase was primarily a result of less cash used for income taxes payable as well as increased collections from accounts receivable. This increase was partially offset by higher cash uses for inventory purchases and a lower source of cash for accounts payable and accrued expenses.

Investing Activities

During fiscal 2018, we used cash of \$200.9 million in investing activities compared to \$111.1 million used during fiscal 2017. The increase was primarily driven by \$185.4 million used in the acquisitions of Themis and RTL, during fiscal 2018 compared to \$77.8 million primarily used in the acquisitions of CES and Delta during fiscal 2017. The increase in cash used for investing activities was partially offset by decreased purchases of property and equipment of \$17.7 million.

During fiscal 2017, we used cash of \$111.1 million in investing activities compared to \$318.2 million used during fiscal 2016. The decrease is primarily due to the acquisition of the Carve-Out Business for \$300.0 million during fiscal 2016 compared to \$77.8 million primarily used in the acquisitions of CES and Delta during fiscal 2017. The decrease in cash used for investing activities was partially offset by increased purchases of property and equipment of \$25.0 million.

Financing Activities

During fiscal 2018, we had \$195.0 million of net borrowings that were drawn against the Revolver. These net borrowings were offset by \$15.5 million in payments related to the retirement of common stock used to settle employees' tax liabilities associated with vesting of restricted stock awards. As a result of these activities, we generated net cash of \$182.9 million from financing activities during fiscal 2018.

During fiscal 2017, we closed a follow on offering which generated \$215.7 million of cash. We utilized a portion of these proceeds to pay down the remaining principal balance of the term loan. As a result of these activities, we generated net cash of \$11.3 million from financing activities during fiscal 2017.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following is a schedule of our commitments and contractual obligations outstanding at June 30, 2018:

(In thousands) Total

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		Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating leases	\$62,612	\$ 8,790	\$16,762	\$14,196	\$ 22,864
Purchase obligations	50,285	50,285	—	—	—
	\$112,897	\$ 59,075	\$16,762	\$14,196	\$ 22,864

41

Table of Contents

Purchase obligations represent open non-cancelable purchase commitments for certain inventory components and services used in normal operations. The purchase commitments covered by these agreements are for less than one year and aggregated \$50.3 million at June 30, 2018.

We have a liability at June 30, 2018 of \$1.0 million for uncertain tax positions that have been taken or are expected to be taken in various income tax returns. We do not know the ultimate resolution of these uncertain tax positions and as such, do not know the ultimate timing of payments related to this liability. Accordingly, these amounts are not included in the above table.

Our standard product sales and license agreements entered into in the ordinary course of business typically contain an indemnification provision pursuant to which we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with certain intellectual property infringement claims by any third party with respect to our products. Such provisions generally survive termination or expiration of the agreements. The potential amount of future payments we could be required to make under these indemnification provisions is, in some instances, unlimited.

As part of our strategy for growth, we continue to explore acquisitions or strategic alliances. The associated acquisition costs incurred in the form of professional fees and services may be material to the future periods in which they occur, regardless of whether the acquisition is ultimately completed.

We may elect from time to time to purchase and subsequently retire shares of common stock in order to settle individual employees' tax liability associated with vesting of restricted stock awards. These transactions would be treated as a use of cash in financing activities in our statement of cash flows.

OFF-BALANCE SHEET ARRANGEMENTS

Other than our lease commitments incurred in the normal course of business and certain indemnification provisions, we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not consolidated in the financial statements. Additionally, we do not have an interest in, or relationships with, any special purpose entities.

RELATED PARTY TRANSACTIONS

During fiscal 2018 and 2017, we did not engage in any related party transactions.

NON-GAAP FINANCIAL MEASURES

In our periodic communications, we discuss certain important measures that are not calculated according to U.S. generally accepted accounting principles ("GAAP"), including adjusted EBITDA, adjusted income from continuing operations, adjusted earnings per share ("adjusted EPS") and free cash flow.

Adjusted EBITDA is defined as income from continuing operations before interest income and expense, income taxes, depreciation, amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based and other non-cash compensation expense. We use adjusted EBITDA as an important indicator of the operating performance of our business. We use adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining a component of bonus and equity compensation for executive officers based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe the adjusted EBITDA financial measure assists in providing a more complete understanding of our underlying operational measures to manage our business, to evaluate our performance compared to prior periods and the marketplace, and to establish operational goals. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

Adjusted EBITDA is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted EBITDA financial adjustments described above, and investors should not infer from our presentation of this non-GAAP financial measure that these costs are unusual, infrequent or non-recurring.

Table of Contents

The following table reconciles our income from continuing operations, the most directly comparable GAAP financial measure, to our adjusted EBITDA:

(In thousands)	Year Ended June 30,		
	2018	2017	2016
Income from continuing operations	\$40,883	\$24,875	\$19,742
Interest expense, net	2,818	7,106	1,041
Tax provision	1,690	6,193	5,544
Depreciation	16,273	12,589	6,900
Amortization of intangible assets	26,004	19,680	8,842
Restructuring and other charges (1)	3,159	1,952	1,240
Impairment of long-lived assets	—	—	231
Acquisition and financing costs	4,928	2,389	4,701
Fair value adjustments from purchase accounting (2)	1,992	3,679	1,384
Litigation and settlement expense (income), net	—	117	(1,925)
Stock-based and other non-cash compensation expense	17,615	15,341	9,574
Adjusted EBITDA	\$115,362	\$93,921	\$57,274

(1) Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities. We believe these items are non-routine and may not be indicative of ongoing operating results.

(2) Fair value adjustments from purchase accounting for fiscal year 2018 relate to Themis, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2017 relate to the Carve-Out Business, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2016 relate to the Carve-Out Business inventory step-up amortization.

Adjusted income from continuing operations and adjusted EPS exclude the impact of certain items and, therefore, have not been calculated in accordance with GAAP. We believe that exclusion of these items assists in providing a more complete understanding of our underlying results and trends and allows for comparability with our peer company index and industry. We use these measures along with the corresponding GAAP financial measures to manage our business and to evaluate our performance compared to prior periods and the marketplace. We define adjusted income from continuing operations as income before amortization of intangible assets, restructuring and other charges, impairment of long-lived assets, acquisition and financing costs, fair value adjustments from purchase accounting, litigation and settlement income and expense, and stock-based compensation and other non-cash compensation expense. The impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision. Adjusted EPS expresses adjusted income on a per share basis using weighted average diluted shares outstanding.

Adjusted income from continuing operations and adjusted EPS are non-GAAP financial measures and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. These non-GAAP financial measures may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the adjusted income from continuing operations and adjusted EPS financial adjustments described above, and investors should not infer from our presentation of these non-GAAP financial measures that these costs are unusual, infrequent or non-recurring.

Table of Contents

The following table reconciles income from continuing operations and diluted earnings per share, the most directly comparable GAAP measures, to adjusted income from continuing operations and adjusted EPS:

(In thousands, except per share data)	Year Ended June 30,					
	2018		2017		2016	
Income from continuing operations and diluted earnings per share	\$40,883	\$ 0.86	\$24,875	\$ 0.58	\$19,742	\$ 0.56
Amortization of intangible assets	26,004		19,680		8,842	
Restructuring and other charges (1)	3,159		1,952		1,240	
Impairment of long-lived assets	—		—		231	
Acquisition and financing costs	4,928		2,389		4,701	
Fair value adjustments from purchase accounting (2)	1,992		3,679		1,384	
Litigation and settlement expense (income), net	—		117		(1,925)	
Stock-based and other non-cash compensation expense	17,615		15,341		9,574	
Impact to income taxes (3)	(27,269)		(18,602)		(9,975)	
Adjusted income from continuing operations and adjusted earnings per share	\$67,312	\$ 1.42	\$49,431	\$ 1.15	\$33,814	\$ 0.96
Diluted weighted-average shares outstanding		47,471		43,018		35,097

(1) Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities. We believe these items are non-routine and may not be indicative of ongoing operating results.

(2) Fair value adjustments from purchase accounting for fiscal year 2018 relate to Themis, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2017 relate to the Carve-Out Business, CES and Delta inventory step-up amortization. Fair value adjustments from purchase accounting for fiscal year 2016 relate to the Carve-Out Business inventory step-up amortization.

(3) Impact to income taxes is calculated by recasting income before income taxes to include the add-backs involved in determining adjusted income and recalculating the income tax provision using this adjusted income from continuing operations before income taxes. The impact to income taxes includes the impact to the effective tax rate, current tax provision and deferred tax provision.

Free cash flow, a non-GAAP measure for reporting cash flow, is defined as cash provided by operating activities less capital expenditures for property and equipment, which includes capitalized software development costs. We believe free cash flow provides investors with an important perspective on cash available for investments and acquisitions after making capital investments required to support ongoing business operations and long-term value creation. We believe that trends in our free cash flow can be valuable indicators of our operating performance and liquidity. Free cash flow is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenditures similar to the free cash flow adjustment described above, and investors should not infer from our presentation of this non-GAAP financial measure that these expenditures reflect all of our obligations which require cash.

The following table reconciles cash provided by operating activities, the most directly comparable GAAP financial measure, to free cash flow:

(In thousands)	Year Ended June 30,		
	2018	2017	2016
Cash provided by operating activities	\$43,321	\$59,146	\$36,940
Capital expenditures	(15,106)	(32,844)	(7,885)
Free cash flow	\$28,215	\$26,302	\$29,055

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

We have identified the policies discussed below as critical to understanding our business and our results of operations. The impact and any associated risks related to these policies on our business operations are discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. We believe the following critical accounting policies to be those most important to the portrayal of our financial position and results of operations and those that require the most subjective judgment.

44

Table of Contents

REVENUE RECOGNITION

We recognize revenue using three different types of accounting methods: ship and bill, multiple-deliverable arrangements and contract accounting which encompass the percentage of completion, completed contract and time and materials methods. Ship and bill revenues, multiple-deliverable arrangements and contract accounting revenues totaled 44%, 35%, and 21% of total Company revenues in fiscal 2018, respectively.

Revenue from system sales is recognized upon shipment utilizing the ship and bill method provided that title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, have been successfully demonstrated.

For multiple-deliverable revenue arrangements that may include a combination of hardware components, related integration or other services, we allocate revenue to each deliverable based on its relative fair value. We generally determine relative selling price using best estimate of the selling price (“BESP”). We determine BESP for each deliverable using a bottoms-up cost plus expected margin approach. Each deliverable within our multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting if the delivered item or items have value to the customer on a standalone basis. We consider a deliverable to have standalone value if the item is sold separately by us or another vendor or if the item could be resold by the customer.

We also have long term production type contracts that are primarily fixed-price for which we apply the percentage-of-completion method for revenue recognition. These long-term contracts involve the design, development, manufacture, or modification of complex electronic equipment and related services. Under this method, revenue is recognized based on the extent of progress towards completion of the long-term contract.

Application of the percentage-of-completion method requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, labor productivity, anticipated increases in wages and prices for subcontractor services and materials, the availability of our subcontractor’s services and materials, the availability and timing of funding from our customer, and overhead rates, among other variables. We primarily use the cost-to-cost measure of progress for our long-term contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the contracts. Our estimates are based upon the professional knowledge and experience of our engineers, program managers and finance professionals, who review each long-term contract monthly to assess the contract's schedule, performance, technical matters and estimated cost at completion.

A cancellation, schedule delay, or modification of a fixed-price contract which is accounted for using the percentage-of-completion method may adversely affect our gross margins for the period in which the contract is modified or canceled. Changes in estimates are applied retrospectively and when adjustments in estimated contract costs are identified in the ordinary course of business, such revisions may result in current period adjustments to earnings applicable to performance in prior periods. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. The completed contract method is utilized when reasonable and reliable cost estimates for a project cannot be made.

Our analysis of these contracts also contemplates whether contracts should be combined or segmented in accordance with the applicable criteria under GAAP. We combine closely related contracts when all the applicable criteria under GAAP are met. The combination of two or more contracts requires judgment in determining whether the intent of entering into the contracts was effectively to enter into a single project, which should be combined to reflect an overall profit rate. Similarly, we may segment a project, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria under GAAP are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement was negotiated and the performance criteria. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period. For all types of contracts, we recognize anticipated contract losses as soon as they become known and estimable. These losses are recognized in advance of contract performance and as of June 30, 2018, approximately \$0.4 million of these costs were in accrued expenses on

our balance sheet.

We do not provide our customers with rights of product return, other than those related to warranty provisions that permit repair or replacement of defective goods. We accrue for anticipated warranty costs upon product shipment. Our payment terms generally range from 30 to 90 days from invoice date based on the nature of the contracts, customers' geographic locations and customer type.

We define service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold by us. Examples of our service revenues include: analyst services and systems engineering support, consulting, maintenance and other support, testing and installation. We combine our product and service revenues into a single class as services revenues are less than 10 percent of total revenues.

45

Table of Contents

INVENTORY VALUATION

We value our inventory at the lower of cost (first-in, first-out) or its net realizable value. We write down inventory for excess and obsolescence based upon assumptions about future demand, product mix and possible alternative uses. Actual demand, product mix and alternative usage may be lower than those that we project and this difference could have a material adverse effect on our gross margin if inventory write-downs beyond those initially recorded become necessary. Alternatively, if actual demand, product mix and alternative usage are more favorable than those we estimated at the time of such a write-down, our gross margin could be favorably impacted in future periods.

GOODWILL, INTANGIBLE ASSETS AND LONG-LIVED ASSETS

We evaluate our goodwill for impairment annually in the fourth quarter and in any interim period in which events or circumstances arise that indicate our goodwill may be impaired. Indicators of impairment include, but are not limited to, a significant deterioration in overall economic conditions, a decline in our market capitalization, the loss of significant business, significant decreases in funding for our contracts, or other significant adverse changes in industry or market conditions.

We test goodwill for impairment at the reporting unit level. Goodwill impairment guidance provides entities an option to perform a qualitative assessment (commonly known as “step zero”) to determine whether further impairment testing is necessary before performing the two-step test. The qualitative assessment requires significant judgments by management about macro-economic conditions including the entity's operating environment, its industry and other market considerations, entity-specific events related to financial performance or loss of key personnel, and other events that could impact the reporting unit. If we conclude that further testing is required, the impairment test involves a two-step process. Step one compares the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount exceeds the fair value of the reporting unit, step two is required to determine if there is an impairment of the goodwill. Step two compares the implied fair value of the reporting unit's goodwill to the carrying amount of the goodwill. The Company estimates the fair value of its reporting units using the income approach based upon a discounted cash flow model. The income approach requires the use of many assumptions and estimates including future revenues, expenses, capital expenditures, and working capital, as well as discount factors and income tax rates. In addition, the Company uses the market approach, which compares the reporting unit to publicly-traded companies and transactions involving similar businesses, to support the conclusions of the income approach. As part of our annual goodwill impairment testing, we utilized a discount rate for each of our reporting units, as defined by ASC 350, Intangibles-Goodwill and Other, that we believe represents the risks that our businesses face, considering their sizes, the current economic environment, and other industry data we believe is appropriate. The discount rates for Sensor and Mission Processing (“SMP”), Advanced Microelectronic Solutions (“AMS”) and Mercury Defense Systems (“MDS”) were 10.0%, 8.0%, and 8.0%. The annual testing indicated that the fair values of our SMP, AMS, and MDS reporting units significantly exceeded their carrying values, and thus no further testing was required. We also review finite-lived intangible assets and long-lived assets when indications of potential impairment exist, such as a significant reduction in undiscounted cash flows associated with the assets. Should the fair value of our long-lived assets decline because of reduced operating performance, market declines, or other indicators of impairment, a charge to operations for impairment may be necessary.

INCOME TAXES

The determination of income tax expense requires us to make certain estimates and judgments concerning the calculation of deferred tax assets and liabilities, as well as the deductions and credits that are available to reduce taxable income. We recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been included in our consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates for the year in which the differences are expected to reverse.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results, our forecast of future earnings, future taxable income, and tax planning strategies. The assumptions utilized in determining future taxable income require significant judgment. We record a valuation allowance against deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. If it becomes more likely than not that a tax asset will be used for which

a reserve has been provided, we reverse the related valuation allowance. If our actual future taxable income by tax jurisdiction differs from estimates, additional allowances or reversals of reserves may be necessary.

We use a two-step approach to recognize and measure uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon

Table of Contents

ultimate settlement. We reevaluate our uncertain tax positions on a quarterly basis and any changes to these positions as a result of tax audits, tax laws or other facts and circumstances could result in additional charges to operations.

BUSINESS COMBINATIONS

We utilize the acquisition method of accounting for business combinations and allocate the purchase price of an acquisition to the various tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. We primarily establish fair value using the income approach based upon a discounted cash flow model. The income approach requires the use of many assumptions and estimates including future revenues and expenses, as well as discount factors and income tax rates. Other estimates include:

- estimated step-ups for the fixed assets and inventory;
- estimated fair values of intangible assets; and
- estimated income tax assets and liabilities assumed from the acquiree.

While we use our best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business acquisition date, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business acquisition date, we record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. For changes in the valuation of intangible assets between preliminary and final purchase price allocation, the related amortization is adjusted in the period it occurs. Subsequent to the purchase price allocation period any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning on or after December 15, 2017. In accordance with this standard, we will adopt the new standard effective July 1, 2018.

The new standard permits adoption by using either (i) a retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. We will adopt the standard using the retrospective approach. We have developed an implementation plan in adopting this standard and completed the assessment phase. Further, we have evaluated our policies in relation to our internal controls framework. This assessment included identification, consideration, and quantification of the impact of the new standard on our financial statements, accounting policies, processes, control environment and systems. The outcome of this assessment included implementation of supporting processes and systems that enable timely and accurate reporting under the new standard. We do not expect a significant change in our control environment due to the adoption of the new standard. The adoption of the new standard will also result in additional disclosures around the nature and timing of our performance obligations, deferred revenue contract liabilities, deferred contract cost assets, as well as significant judgments and practical expedients used by us.

We believe that, based on our assessment, upon adoption, the new standard will not have a material impact to the amount or timing of revenue recognition related to our legacy accounting methods including ship and bill arrangements, multiple-deliverable arrangements and contract accounting arrangements, which encompassed the legacy percentage of completion, completed contract and time and materials methods. As a result of adoption, we do not expect a material impact to the financial statements presented.

In connection with the adoption of the new standard, there is a requirement to capitalize certain incremental costs of obtaining a contract, which for us primarily comprises commission expenses for internal and external sales representatives. Any such costs required to be capitalized would be amortized over the period of performance for the underlying contracts. We expect to elect the practical expedient under the new standard whereby costs associated with contracts that have a duration less than one year would be expensed as incurred. We have completed the evaluation of

capitalizing costs to obtain a contract, noting that the impact related to these costs would be limited to commissions on contracts with a duration exceeding one year. The impact is not expected to be material.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for us on July 1, 2019. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. We are continuing to evaluate our population of leases to determine the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

Table of Contents

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. We do not expect this guidance to have a material impact to our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory). Under current U.S. GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or annual). We do not expect this guidance to have a material impact to our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement to measure the implied fair value of goodwill by assigning the fair value of a reporting unit to all assets and liabilities within that unit ("the Step 2 test") from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized in an amount equal to that excess, limited by the amount of goodwill in that reporting unit. For public business entities, the new standard is effective for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The ASU requires prospective adoption and permits early adoption for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We do not expect this guidance to have a material impact to our consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. We do not expect this guidance to have a material impact to our consolidated financial statements.

In March 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects for Accumulated Other Comprehensive Income, an amendment of the FASB Accounting Standards Codification. This ASU permits a company to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act of 2017 on items within accumulated other comprehensive income ("AOCI") to

retained earnings. The amounts applicable for reclassification should include the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of the enactment of the Tax Cuts and Jobs Act of 2017 related to the items remaining in AOCI. The effect of the change in the U.S. federal corporate income tax rate on gross valuation allowances that were originally charged to income from continuing operations shall not be included. For all entities, the new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that annual period, and early adoption is permitted. We are evaluating the effect that ASU 2018-02 will have on our consolidated financial statements and related disclosures.

Table of Contents

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2017, we adopted FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, an amendment of the FASB Accounting Standards Codification. This ASU changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out or retail inventory method. The ASU also eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximately normal profit margin when measuring inventory. Such adoption has not and will not have any impact to our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk is related primarily to our investment portfolio and the Revolver.

Our investment portfolio includes money market funds from high quality U.S. government issuers. A change in prevailing interest rates may cause the fair value of our investments to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing rate rises, the fair value of the principal amount of our investment will probably decline. To minimize this risk, investments are generally available for sale and we generally limit the amount of credit exposure to any one issuer.

We also are exposed to the impact of interest rate changes primarily through our borrowing activities. For our variable rate borrowings, we may use fixed interest rate swaps, effectively converting variable rate borrowings to fixed rate borrowings in order to mitigate the impact of interest rate changes on earnings. These swaps will be designated as cash flow hedges. There were no swaps outstanding at June 30, 2018. As of June 30, 2018, there were outstanding borrowings of \$195 million against the Revolver.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. We place our cash and cash equivalents with financial institutions with high credit quality. At June 30, 2018 and 2017, we had \$66.5 million and \$41.6 million, respectively, of cash and cash equivalents on deposit or invested with our financial and lending institutions.

We provide credit to customers in the normal course of business. We perform ongoing credit evaluations of our customers' financial condition and limit the amount of credit extended when deemed necessary. At June 30, 2018, five customers accounted for 54% of our receivables, unbilled receivables and costs in excess of billings. At June 30, 2017, five customers accounted for 53% of our receivables, unbilled receivables and costs in excess of billings.

FOREIGN CURRENCY RISK

We operate primarily in the United States; however, we conduct business outside the United States through our foreign subsidiaries in Switzerland, the United Kingdom, France, Japan, Spain and Canada where business is largely transacted in non-U.S. dollar currencies. Accordingly, we are subject to exposure from adverse movements in the exchange rates of local currencies. Local currencies are used as the functional currency for our non-U.S. subsidiaries. Consequently, changes in the exchange rates of the currencies may impact the translation of the foreign subsidiaries' statements of operations into U.S. dollars, which may in turn affect our consolidated statement of operations.

We have not entered into any financial derivative instruments that expose us to material market risk, including any instruments designed to hedge the impact of foreign currency exposures. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors

Mercury Systems, Inc.:

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting

We have audited the accompanying consolidated balance sheets of Mercury Systems, Inc. and subsidiaries (the Company) as of June 30, 2018 and 2017, the related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2018, and the related notes and financial statement schedule II (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Company acquired Themis Computer (Themis) during fiscal year 2018, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of June 30, 2018, Themis' internal control over financial reporting associated with 20 percent of total consolidated assets (of which 17 percent represented goodwill and intangible assets included within the scope of the assessment) and 6 percent of total consolidated revenues included in the consolidated financial statements of the Company as of and for the year ended June 30, 2018. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Themis.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Table of Contents

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

We have served as the Company's auditor since 2006.

Boston, Massachusetts

August 16, 2018

51

ITEM 8. FINANCIAL STATEMENTS AND
SUPPLEMENTARY DATA

MERCURY SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	June 30, 2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$66,521	\$41,637
Accounts receivable, net of allowance for doubtful accounts of \$359 and \$83 at June 30, 2018 and 2017, respectively	104,040	76,341
Unbilled receivables and costs in excess of billings	39,774	37,332
Inventory	108,585	81,071
Prepaid income taxes	3,761	1,434
Prepaid expenses and other current assets	9,062	8,381
Total current assets	331,743	246,196
Property and equipment, net	50,980	51,643
Goodwill	497,442	380,846
Intangible assets, net	177,904	129,037
Other non-current assets	6,411	8,023
Total assets	\$1,064,480	\$815,745
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$21,323	\$27,485
Accrued expenses	16,386	20,594
Accrued compensation	21,375	18,406
Deferred revenues and customer advances	12,596	6,360
Total current liabilities	71,680	72,845
Deferred income taxes	13,635	4,856
Income taxes payable	998	855
Long-term debt	195,000	—
Other non-current liabilities	11,276	11,772
Total liabilities	292,589	90,328
Commitments and contingencies (Note K)		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.01 par value; 85,000,000 shares authorized; 46,924,238 and 46,303,075 shares issued and outstanding at June 30, 2018 and 2017, respectively	469	463
Additional paid-in capital	590,163	584,795
Retained earnings	179,968	139,085
Accumulated other comprehensive income	1,291	1,074
Total shareholders' equity	771,891	725,417
Total liabilities and shareholders' equity	\$1,064,480	\$815,745

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

MERCURY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In thousands, except per share data)

	For the Years Ended June 30,		
	2018	2017	2016
Net revenues	\$493,184	\$408,588	\$270,154
Cost of revenues	267,326	217,045	142,535
Gross margin	225,858	191,543	127,619
Operating expenses:			
Selling, general and administrative	88,365	76,491	52,952
Research and development	58,807	54,086	36,388
Amortization of intangible assets	26,004	19,680	8,842
Restructuring and other charges	3,159	1,952	1,240
Impairment of long-lived assets	—	—	231
Acquisition costs and other related expenses	2,538	1,931	3,993
Total operating expenses	178,873	154,140	103,646
Income from operations	46,985	37,403	23,973
Interest income	32	462	131
Interest expense	(2,850)	(7,568)	(1,172)
Other (expense) income, net	(1,594)	771	2,354
Income before income taxes	42,573	31,068	25,286
Tax provision	1,690	6,193	5,544
Net income	\$40,883	\$24,875	\$19,742
Basic net earnings per share	\$0.88	\$0.59	\$0.58
Diluted net earnings per share	\$0.86	\$0.58	\$0.56
Weighted-average shares outstanding:			
Basic	46,719	41,986	34,241
Diluted	47,471	43,018	35,097

Comprehensive income:

Net income	\$40,883	\$24,875	\$19,742
Foreign currency translation adjustments	(137)	(93)	171
Pension benefit plan, net of tax	354	220	—
Total other comprehensive income, net of tax	217	127	171
Total comprehensive income	\$41,100	\$25,002	\$19,913

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

MERCURY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Years Ended June 30, 2018, 2017 and 2016
(In thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
Balance at June 30, 2015	32,571	\$ 326	\$254,568	\$94,468	\$ 776	\$ 350,138
Issuance of common stock under employee stock incentive plans	1,267	12	6,867	—	—	6,879
Issuance of common stock under employee stock purchase plan	88	1	1,217	—	—	1,218
Retirement of common stock	(426)	(4)	(7,951)	—	—	(7,955)
Follow-on public stock offering	5,175	52	92,726	—	—	92,778
Stock-based compensation	—	—	9,666	—	—	9,666
Net income	—	—	—	19,742	—	19,742
Share-based business combination consideration	—	—	407	—	—	407
Foreign currency translation adjustments	—	—	—	—	171	171
Balance at June 30, 2016	38,675	387	357,500	114,210	947	473,044
Issuance of common stock under employee stock incentive plans	976	9	2,747	—	—	2,756
Issuance of common stock under employee stock purchase plan	96	1	2,213	—	—	2,214
Retirement of common stock	(344)	(3)	(8,763)	—	—	(8,766)
Follow-on public stock offering	6,900	69	215,656	—	—	215,725
Stock-based compensation	—	—	15,442	—	—	15,442
Net income	—	—	—	24,875	—	24,875
Foreign currency translation adjustments	—	—	—	—	(93)	(93)
Pension benefit plan, net of tax	—	—	—	—	220	220
Balance at June 30, 2017	46,303	463	584,795	139,085	1,074	725,417
Issuance of common stock under employee stock incentive plans	868	8	655	—	—	663
Issuance of common stock under employee stock purchase plan	82	1	2,781	—	—	2,782
Retirement of common stock	(329)	(3)	(15,505)	—	—	(15,508)
Stock-based compensation	—	—	17,437	—	—	17,437
Net income	—	—	—	40,883	—	40,883
Foreign currency translation adjustments	—	—	—	—	(137)	(137)
Pension benefit plan, net of tax	—	—	—	—	354	354
Balance at June 30, 2018	46,924	\$ 469	\$590,163	\$179,968	\$ 1,291	\$ 771,891

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

MERCURY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Years Ended June 30,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	\$40,883	\$24,875	\$19,742
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	42,277	32,269	15,742
Stock-based compensation expense	17,314	15,341	9,574
Benefit for deferred income taxes	(5,464)	(7,841)	(3,061)
Impairment of goodwill and long-lived assets	—	—	231
Non-cash interest expense	—	1,810	301
Other non-cash items	2,103	(626)	(722)
Changes in operating assets and liabilities, net of effects of businesses acquired:			
Accounts receivable, unbilled receivables, and costs in excess of billings	(22,751)	(14,054)	(25,396)
Inventory	(16,230)	(9,318)	(865)
Prepaid income taxes	(2,327)	1,978	346
Prepaid expenses and other current assets	(361)	(1,270)	2,964
Other non-current assets	296	372	(778)
Accounts payable, accrued expenses and accrued compensation	(5,267)	3,520	18,871
Deferred revenues and customer advances	6,035	(1,621)	(194)
Income taxes payable	(11,187)	9,622	253
Other non-current liabilities	(2,000)	4,089	(68)
Net cash provided by operating activities	43,321	59,146	36,940
Cash flows from investing activities:			
Acquisition of businesses, net of cash acquired	(185,396)	(77,757)	(309,756)
Purchases of property and equipment	(15,106)	(32,844)	(7,885)
Other investing activities	(375)	(486)	(567)
Net cash used in investing activities	(200,877)	(111,087)	(318,208)
Cash flows from financing activities:			
Proceeds from equity offering, net	—	215,725	92,778
Proceeds from employee stock plans	3,445	4,970	8,097
Payments for retirement of common stock	(15,508)	(8,766)	(7,955)
Payments under credit facilities	(15,000)	(200,000)	—
Borrowings under credit facilities	210,000	—	194,900
Payments of debt issuance costs	—	(591)	(2,926)
Net cash provided by financing activities	182,937	11,338	284,894
Effect of exchange rate changes on cash and cash equivalents	(497)	549	479
Net increase (decrease) in cash and cash equivalents	24,884	(40,054)	4,105
Cash and cash equivalents at beginning of year	41,637	81,691	77,586
Cash and cash equivalents at end of year	\$66,521	\$41,637	\$81,691
Cash paid during the period for:			
Interest	\$1,607	\$5,758	\$1,041
Income taxes	\$17,004	\$2,834	\$7,975
Supplemental disclosures—non-cash activities:			
Share-based business combination consideration	\$—	\$—	\$407

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

Table of Contents

MERCURY SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

A. Description of Business

Mercury Systems, Inc. (the “Company” or “Mercury”) is a leading commercial provider of secure sensor and safety critical mission processing subsystems. Optimized for customer and mission success, its solutions power a wide variety of critical defense and intelligence programs. Headquartered in Andover, Massachusetts, it is pioneering a next-generation defense electronics business model specifically designed to meet the industry's current and emerging technology and business needs. The Company delivers affordable innovative solutions, rapid time-to-value and service and support primarily to defense prime contractor customers. The Company's products and solutions have been deployed in more than 300 programs with over 25 different defense prime contractors. Key programs include Aegis, Patriot, Surface Electronic Warfare Improvement Program (“SEWIP”), Gorgon Stare, Predator, F-35, Reaper, F-16 SABR, E2D Hawkeye, Paveway, Filthy Buzzard, PGK, ProVision, P1, and AIDEWS. The Company's organizational structure allows it to deliver capabilities that combine technology building blocks and deep domain expertise in the aerospace and defense sector.

On February 1, 2018, the Company acquired Themis Computer (“Themis”) on a cash-free, debt-free basis for a total purchase price of approximately \$180,000, prior to net working capital and net debt adjustments. Based in Fremont, California, Themis is a leading designer, manufacturer and integrator of commercial, SWaP-optimized rugged servers, computers and storage systems for U.S. and international defense programs. The acquisition of Themis is consistent with the Company's strategy and will expand its position in the Command, Control, Communications, Computers, and Intelligence (“C4I”) market. See Note C to consolidated financial statements.

On July 3, 2017, the Company acquired Richland Technologies, LLC (“RTL”) on a cash-free, debt-free basis for a total purchase price of \$5,798. Based in Duluth, Georgia, RTL specializes in safety-critical and high integrity systems, software, and hardware development as well as safety-certification services for mission-critical applications. In addition, RTL is a leader in safety-certifiable embedded graphics software for commercial and military aerospace applications. See Note C to consolidated financial statements.

On April 3, 2017, the Company acquired Delta Microwave, LLC (“Delta”) on a cash-free, debt-free basis for a total purchase price of \$40,500. Based in Oxnard, California, Delta is a leading designer and manufacturer of high-value radio frequency (“RF”), microwave and millimeter wave sub-assemblies and components for the military, aerospace, and space markets. See Note C to consolidated financial statements.

On November 4, 2016, the Company acquired CES Creative Electronic Systems, S.A. (“CES”) for a total purchase price of approximately \$39,123, prior to net working capital and net debt adjustments. Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and input-output (“IO”). CES has decades of experience designing subsystems deployed in applications certified up to the highest levels of design assurance. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as several types of unmanned platforms. See Note C to consolidated financial statements.

On May 2, 2016, the Company acquired the custom microelectronics, RF and microwave solutions, and embedded security operations of Microsemi Corporation (the “Carve-Out Business”), resulting in the entities comprising the Carve-Out Business becoming 100% owned direct or indirect subsidiaries of Mercury (the “Carve-Out Acquisition”). Under the terms of the Purchase Agreement, the Company paid \$300,000 in cash on a cash-free, debt-free basis, prior to working capital and other post-closing adjustments.

B. Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

The preparation of financial statements in conformity with Generally Accepted Accounting Principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Table of Contents**BUSINESS COMBINATIONS**

The Company utilizes the acquisition method of accounting under ASC 805, Business Combinations, (“ASC 805”), for all transactions and events which it obtains control over one or more other businesses, to recognize the fair value of all assets and liabilities acquired, even if less than one hundred percent ownership is acquired, and in establishing the acquisition date fair value as of the measurement date for all assets and liabilities assumed. The Company also utilizes ASC 805 for the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in business combinations. Other estimates include:

- estimated step-ups for the fixed assets and inventory;
- estimated fair values of intangible assets; and
- estimated income tax assets and liabilities assumed from the acquiree.

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business acquisition date, the estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. For changes in the valuation of intangible assets between the preliminary and final purchase price allocation, the related amortization is adjusted in the period it occurs. Subsequent to the purchase price allocation period, any adjustment to assets acquired or liabilities assumed is included in operating results in the period in which the adjustment is determined.

REVENUE RECOGNITION

The Company recognizes revenue using three different types of accounting methods: ship and bill, multiple-deliverable arrangements and contract accounting which encompass the percentage of completion, completed contract and time and materials methods. The Company relies upon ASC 605, Revenue Recognition, to account for its revenue transactions. Revenue is recognized upon shipment provided that title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable, collection of the related receivable is reasonably assured, and customer acceptance criteria, if any, have been successfully demonstrated. Out-of-pocket expenses that are reimbursable by the customer are included in revenue and cost of revenue.

Certain contracts with customers require the Company to perform tests of its products prior to shipment to ensure their performance complies with the Company’s published product specifications and, on occasion, with additional customer-requested specifications. In these cases, the Company conducts such tests and, if they are completed successfully, includes a written confirmation with each order shipped. As a result, at the time of each product shipment, the Company believes that no further customer testing requirements exist and that there is no uncertainty of acceptance by its customer. Total revenue recognized under ship and bill revenue arrangements was 44%, 44% and 35% of total revenue in the years ended June 30, 2018, 2017 and 2016, respectively.

The Company uses FASB Accounting Standards Update (“ASU”) No. 2009-13 (“ASU 2009-13”), Multiple-Deliverable Revenue Arrangements. ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence (“VSOE”) if available; (2) third-party evidence (“TPE”) if VSOE is not available; and (3) best estimated selling price (“BESP”), if neither VSOE nor TPE is available. Additionally, ASU 2009-13 expands the disclosure requirements related to a vendor’s multiple-deliverable revenue arrangements.

The Company enters into multiple-deliverable arrangements that may include a combination of hardware components, related integration or other services. These arrangements generally do not include any performance-, cancellation-, termination- or refund-type provisions. Total revenue recognized under multiple-deliverable revenue arrangements was 35%, 33% and 37% of total revenue in the years ended June 30, 2018, 2017 and 2016, respectively.

In accordance with the provisions of ASU 2009-13, the Company allocates arrangement consideration to each deliverable in an arrangement based on its relative selling price. The Company generally expects that it will not be able to establish VSOE or TPE due to limited single element transactions and the nature of the markets in which the Company competes, and, as such, the Company typically determines its relative selling price using BESP. The objective of BESP is to determine the price at which the Company would transact if the product or service were sold

by the Company on a standalone basis.

The Company's determination of BESP involves the consideration of several factors based on the specific facts and circumstances of each arrangement. Specifically, the Company considers the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, the Company's ongoing pricing strategy and policies (as evident from the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable and the characteristics of the varying markets in which the deliverable is sold.

57

Table of Contents

The Company analyzes the selling prices used in its allocation of arrangement consideration at a minimum on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in the Company's business necessitates a more timely analysis or if the Company experiences significant variances in its selling prices. Each deliverable within the Company's multiple-deliverable revenue arrangements is accounted for as a separate unit of accounting under the guidance of ASU 2009-13 if both of the following criteria are met: the delivered item or items have value to the customer on a standalone basis; and for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. The Company's revenue arrangements generally do not include a general right of return relative to delivered products. The Company considers a deliverable to have standalone value if the item is sold separately by the Company or another vendor or if the item could be resold by the customer. Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting.

The Company also engages in long-term contracts for development, production and services activities which it accounts for consistent with ASC 605-35, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, and other relevant revenue recognition accounting literature. The Company considers the nature of these contracts and the types of products and services provided when determining the proper accounting for a particular contract. Generally for fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method or, for certain short-term contracts, by the completed contract method. Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate input or output methods to measure service provided, and contract costs are expensed as incurred. The Company establishes billing terms at the time project deliverables and milestones are agreed. Revenues recognized in excess of the amounts invoiced to clients are classified as unbilled receivables. The Company expects to bill substantially all of the unbilled receivables within the next 12 months. The risk to the Company on a fixed-price contract is that if estimates to complete the contract change from one period to the next, profit levels will vary from period to period. For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. For all types of contracts, the Company recognizes anticipated contract losses as soon as they become known and estimable.

The Company also considers whether contracts should be combined or segmented in accordance with the applicable criteria under GAAP, and combines closely related contracts when all the applicable criteria under GAAP are met. The combination of two or more contracts requires judgment in determining whether the intent of entering into the contracts was effectively to enter into a single project, which should be combined to reflect an overall profit rate. Similarly, the Company may separate a project, which may consist of a single contract or group of contracts, with varying rates of profitability, only if the applicable criteria under GAAP are met. Judgment also is involved in determining whether a single contract or group of contracts may be segmented based on how the arrangement was negotiated and the performance criteria. The decision to combine a group of contracts or segment a contract could change the amount of revenue and gross profit recorded in a given period.

The use of contract accounting requires significant judgment relative to estimating total contract revenues and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, anticipated increases in wages and prices for subcontractor services and materials, and the availability of subcontractor services and materials. The Company's estimates are based upon the professional knowledge and experience of its engineers, program managers and other personnel, who review each long-term contract monthly to assess the contract's schedule, performance, technical matters and estimated cost at completion. Changes in estimates are applied retrospectively and when adjustments in estimated contract costs are identified in the ordinary course of business, such revisions may result in current period adjustments to earnings applicable to performance in prior periods.

Contract costs also may include estimated contract recoveries for matters such as contract changes and claims for unanticipated contract costs. The Company records revenue associated with these matters only when the amount of

recovery can be estimated reliably and realization is probable. Assumed recoveries for claims included in contracts in process were not material at June 30, 2018 or 2017. Total revenue recognized under contract accounting revenue arrangements was 21%, 23% and 28% of total revenue in the years ended June 30, 2018, 2017 and 2016, respectively. The Company defines service revenues as revenue from activities that are not associated with the design, development, production, or delivery of tangible assets, software or specific capabilities sold. Examples of the Company's service revenues include: analyst services and systems engineering support, consulting, maintenance and other support, testing and installation. The Company combines its product and service revenues into a single class as service revenues are less than 10 percent of total revenues.

The Company does not provide its customers with rights of product return, other than those related to warranty provisions that permit repair or replacement of defective goods. The Company accrues for anticipated warranty costs upon product shipment.

Table of Contents

Revenues from product royalties are recognized upon invoice by the Company. Additionally, all revenues are reported net of government assessed taxes (e.g. sales taxes or value-added taxes).

CASH AND CASH EQUIVALENTS

Cash equivalents, consisting of highly liquid money market funds and U.S. government and U.S. government agency issues with original maturities of 90 days or less at the date of purchase, are carried at fair market value which approximates cost.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company measures at fair value certain financial assets and liabilities, including cash equivalents, restricted cash and contingent consideration. ASC 820, Fair Value Measurement and Disclosures, specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1—Quoted prices for identical instruments in active markets;

Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company places its cash and cash equivalents with financial institutions of high credit quality. At June 30, 2018 and 2017, the Company had \$66,521 and \$41,637, respectively, of cash and cash equivalents on deposit or invested with its financial and lending institutions.

The Company provides credit to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. At June 30, 2018, five customers accounted for 54% of the Company's accounts receivable, unbilled receivables and costs in excess of billings. At June 30, 2017, five customers accounted for 53% of the Company's accounts receivable, unbilled receivables and costs in excess of billings.

INVENTORY

Inventory is stated at the lower of cost (first-in, first-out) or net realizable value, and consists of materials, labor and overhead. On a quarterly basis, the Company evaluates inventory for net realizable value. Once an item is written down, the value becomes the new inventory cost basis. The Company reduces the value of inventory for excess and obsolete inventory, consisting of on-hand and non-cancelable on-order inventory in excess of estimated usage. The excess and obsolete inventory evaluation is based upon assumptions about future demand, product mix and possible alternative uses.

SEGMENT INFORMATION

The Company uses the management approach for segment disclosure, which designates the internal organization that is used by management for making operating decisions and assessing performance as the source of its reportable segments. The Company manages its business on the basis of one reportable segment, as a commercial provider of secure sensor and safety critical mission processing subsystems for critical defense and intelligence programs.

GOODWILL AND INTANGIBLE ASSETS

Goodwill is the amount by which the cost of the net assets obtained in a business acquisition exceeded the fair values of the net identifiable assets on the date of purchase (see Note G). Goodwill is not amortized in accordance with the requirements of ASC 350, Intangibles-Goodwill and Other ("ASC 350"). Goodwill is assessed for impairment at least annually, on a reporting unit basis, or when events and circumstances occur indicating that the recorded goodwill may be impaired. If the book value of a reporting unit exceeds its fair value, the implied fair value of goodwill is compared with the carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recorded in an amount equal to that excess.

Intangible assets result from the Company's various business acquisitions (see Note H) and certain licensed technologies, and consist of identifiable intangible assets, including completed technology, licensing agreements, patents, customer relationships, trademarks, backlog, and non-compete agreements. Intangible assets are reported at cost, net of accumulated amortization and are either amortized on a straight-line basis over their estimated useful lives of up to 12.5 years or over the period the economic benefits of the intangible asset are consumed.

Table of Contents

LONG-LIVED ASSETS

Long-lived assets primarily include property and equipment and acquired intangible assets. The Company regularly evaluates its long-lived assets for events and circumstances that indicate a potential impairment in accordance with ASC 360, Property, Plant, and Equipment (“ASC 360”). The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the estimated undiscounted cash flows of the asset as compared to the recorded value of the asset. If impairment is indicated, the asset is written down to its estimated fair value.

Property and equipment are the long-lived, physical assets of the Company acquired for use in the Company’s normal business operations and are not intended for resale by the Company. These assets are recorded at cost. Renewals and betterments that increase the useful lives of the assets are capitalized. Repair and maintenance expenditures that increase the efficiency of the assets are expensed as incurred. Equipment under capital lease is recorded at the present value of the minimum lease payments required during the lease period. Depreciation is based on the estimated useful lives of the assets using the straight-line method (see Note F).

As assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations.

Expenditures for major software purchases and software developed for internal use are capitalized and depreciated using the straight-line method over the estimated useful lives of the related assets, which are generally three years. For software developed for internal use, all external direct costs for material and services and certain payroll and related fringe benefit costs are capitalized in accordance with ASC 350. During fiscal 2018, 2017 and 2016, the Company capitalized \$733, \$508 and \$0 of software development costs.

DEFERRED REVENUES AND CUSTOMER ADVANCES

Deferred revenues consist of deferred product revenue, billings in excess of revenues, deferred service revenue, and customer advances. Deferred product revenue represents amounts that have been invoiced to customers, but are not yet recognizable as revenue because one or more of the conditions for revenue recognition have not been met. Billings in excess of revenues represents milestone billing arrangements on percentage of completion projects where the billings of the contract exceed recognized revenues. Deferred service revenue primarily represents amounts invoiced to customers for annual maintenance contracts or extended warranty concessions, which are recognized ratably over the term of the arrangements. Customer advances represent deposits received from customers on an order.

INCOME TAXES

The Company accounts for income taxes under ASC 740, Income Taxes (“ASC 740”). The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the Company’s consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates for the year in which the differences are expected to reverse. The Company records a valuation allowance against net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

ASC 740 requires a two-step approach to recognizing and measuring uncertain tax positions. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

PRODUCT WARRANTY ACCRUAL

The Company’s product sales generally include a 12 month standard hardware warranty. At time of product shipment, the Company accrues for the estimated cost to repair or replace potentially defective products. Estimated warranty costs are based upon prior actual warranty costs for substantially similar transactions and any specifically identified warranty requirements. Product warranty accrual is included as part of accrued expenses in the accompanying consolidated balance sheets. The following table presents the changes in the Company’s product warranty accrual.

Table of Contents

	Fiscal 2018	Fiscal 2017	Fiscal 2016
Beginning balance at July 1,	\$1,691	\$1,523	\$1,974
Warranty assumed from Themis	117	—	—
Warranty assumed from CES	—	176	—
Warranty assumed from Delta	—	30	—
Warranty assumed from Carve-Out Business	—	—	114
Accruals for warranties issued during the period	1,318	1,328	1,976
Settlements made during the period	(1,790)	(1,366)	(2,541)
Ending balance at June 30,	\$1,336	\$1,691	\$1,523

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are expensed as incurred. Research and development costs are primarily made up of labor charges and prototype material and development expenses.

STOCK-BASED COMPENSATION

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of the awards that will be forfeited. Stock-based compensation expense for the Company's performance-based restricted stock awards are amortized over the requisite service period using graded vesting. The Company's other restricted stock awards recognize expense over the requisite service period on a straight-line basis. The Company uses the Black-Scholes valuation model for estimating the fair value on the date of grant of stock options.

RETIREMENT OF COMMON STOCK

Stock that is repurchased or received in connection with the exercise of stock options or in order to cover tax payment obligations triggered by exercise of stock options or the vesting of restricted stock is retired immediately upon the Company's repurchase. The Company accounts for this under the cost method and upon retirement the excess amount over par value is charged against additional paid-in capital.

NET EARNINGS PER SHARE

Basic net earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net earnings per share computation includes the effect of shares which would be issuable upon the exercise of outstanding stock options and the vesting of restricted stock, reduced by the number of shares which are assumed to be purchased by the Company under the treasury stock method. For all periods presented, income from continuing operations is the control number for determining whether securities are dilutive or not.

Basic and diluted weighted average shares outstanding were as follows:

	Years Ended June 30,		
	2018	2017	2016
Basic weighted-average shares outstanding	46,719	41,986	34,241
Effect of dilutive equity instruments	752	1,032	856
Diluted weighted-average shares outstanding	47,471	43,018	35,097

Equity instruments to purchase 329, 16 and 7 shares of common stock were not included in the calculation of diluted net earnings per share for the fiscal years ended June 30, 2018, 2017 and 2016, respectively, because the equity instruments were anti-dilutive.

ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income ("AOCI") includes foreign currency translation adjustments and pension benefit plan adjustments. The components of accumulated other comprehensive (loss) income included \$(137), \$(93), and \$171 of foreign currency translation adjustments for the years ended June 30, 2018, 2017 and 2016, respectively. In addition, pension benefit plan adjustments totaled \$354, \$220 and \$0 for the years ended June 30, 2018, 2017 and 2016 respectively. There were no material net unrealized gains on investments for the years ended June 30, 2018, 2017 and 2016.

Table of Contents**ACCOUNTS RECEIVABLE FACTORING**

On December 21, 2017, the Company executed a Master Receivables Purchase Agreement (the “Purchase Agreement”) with Bank of America, N.A. (the “Bank”) for the sale of certain eligible accounts receivable balances of the Company, up to a maximum of \$30,000. Factoring under the Purchase Agreement is treated as a true sale of accounts receivable by the Company. The Company has a continued involvement in servicing accounts receivable under the Purchase Agreement, but has no retained interests related to the factored accounts receivable.

Proceeds from amounts factored by the Company are recorded as an increase to cash and a reduction to accounts receivable outstanding in the consolidated balance sheets. Cash flows attributable to factoring are reflected as cash flows from operating activities in the Company’s Consolidated Statements of Cash Flows. Factoring fees are included as selling, general, and administrative expenses in the Company’s Consolidated Statements of Operations and Comprehensive Income.

The Company factored accounts receivable and incurred factoring fees of \$18,821 and \$69, respectively, during the second quarter of fiscal 2018. The Company did not factor any accounts receivable or incur any factoring fees during the second half of fiscal 2018.

FOREIGN CURRENCY

Local currencies are the functional currency for the Company’s subsidiaries in Switzerland, the United Kingdom, France, Japan, Spain and Canada. The accounts of foreign subsidiaries are translated using exchange rates in effect at period-end for assets and liabilities and at average exchange rates during the period for results of operations. The related translation adjustments are reported in accumulated other comprehensive income in shareholders’ equity. Gains (losses) resulting from non-U.S. currency transactions are included in other income (expense), net in the Consolidated Statements of Operations and Comprehensive Income and were immaterial for all periods presented.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning on or after December 15, 2017. In accordance with this standard, the Company will adopt the new standard effective July 1, 2018.

The new standard permits adoption by using either (i) a retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. The Company will adopt the standard using the retrospective approach. The Company has developed an implementation plan in adopting this standard and completed the assessment phase. Further, the Company has evaluated its policies in relation to its internal controls framework. This assessment included identification, consideration, and quantification of the impact of the new standard on the Company’s financial statements, accounting policies, processes, control environment and systems. The outcome of this assessment included implementation of supporting processes and systems that enable timely and accurate reporting under the new standard. The Company does not expect a significant change in its control environment due to the adoption of the new standard. The adoption of the new standard will also result in additional disclosures around the nature and timing of the Company’s performance obligations, deferred revenue contract liabilities, deferred contract cost assets, as well as significant judgments and practical expedients used by the Company.

The Company believes that, based on its assessment, upon adoption, the new standard will not have a material impact to the amount or timing of revenue recognition related to its legacy accounting methods including ship and bill arrangements, multiple-deliverable arrangements and contract accounting arrangements, which encompassed the legacy percentage of completion, completed contract and time and materials methods. As a result of adoption, the Company does not expect a material impact to the financial statements presented.

In connection with the adoption of the new standard, there is a requirement to capitalize certain incremental costs of obtaining a contract, which for the Company, primarily comprises commission expenses for internal and external sales

representatives. Any such costs required to be capitalized would be amortized over the period of performance for the underlying contracts. The Company expects to elect the practical expedient under the new standard whereby costs associated with contracts that have a duration less than one year would be expensed as incurred. The Company has completed the evaluation of capitalizing costs to obtain a contract, noting that the impact related to these costs would be limited to commissions on contracts with a duration exceeding one year. The impact is not expected to be material. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for the Company on July 1, 2019. The standard mandates a modified retrospective transition method for all

Table of Contents

entities and early adoption is permitted. The Company is continuing to evaluate its population of leases to determine the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company does not expect this guidance to have a material impact its consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory). Under current GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or annual). The Company does not expect this guidance to have a material impact its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, an amendment of the FASB Accounting Standards Codification. This ASU eliminates the requirement to measure the implied fair value of goodwill by assigning the fair value of a reporting unit to all assets and liabilities within that unit (“the Step 2 test”) from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized in an amount equal to that excess, limited by the amount of goodwill in that reporting unit. For public business entities, the new standard is effective for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The ASU requires prospective adoption and permits early adoption for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect this guidance to have a material impact to its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The Company does not expect this guidance to have a material impact its consolidated financial statements.

In March 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects for Accumulated Other Comprehensive Income, an amendment of the FASB Accounting Standards Codification. This ASU permits a company to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act of 2017 on items within AOCI to retained earnings. The amounts applicable for reclassification should include the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of the enactment of the Tax Cuts and Jobs Act of 2017 related to the items remaining in AOCI. The effect of the change in the U.S. federal corporate income tax rate on gross valuation allowances that were originally charged to income from continuing operations shall not be included. For all entities, the new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that annual period, and early adoption is permitted. The Company is evaluating the effect that ASU 2018-02 will have on its consolidated financial statements and related disclosures.

Table of Contents

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2017, the Company adopted FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, an amendment of the FASB Accounting Standards Codification. This ASU changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out or retail inventory method. The ASU also eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximately normal profit margin when measuring inventory. Such adoption did not have any impact to the Company's consolidated financial statements.

C. Acquisitions

THEMIS COMPUTER ACQUISITION

On December 21, 2017, the Company and Thunderbird Merger Sub, Inc., a newly formed, wholly-owned subsidiary of the Company (the "Merger Sub"), entered into a Merger Agreement (the "Merger Agreement") with Ceres Systems ("Ceres"), the holding company that owned Themis Computer ("Themis", and together with Ceres, collectively the "Acquired Company"). On February 1, 2018, the Company closed the transaction and the Merger Sub merged with and into Ceres with Ceres continuing as the surviving company and a wholly-owned subsidiary of Mercury (the "Merger"). By operation of the Merger, the Company acquired both Ceres and its wholly-owned subsidiary, Themis.

Based in Fremont, California, Themis is a leading designer, manufacturer and integrator of commercial, SWaP-optimized rugged servers, computers and storage systems for U.S. and international markets. Under the terms of the Merger Agreement, the merger consideration (including payments with respect to outstanding stock options) consisted of an all cash purchase price of approximately \$180,000. The merger consideration is subject to post-closing adjustments based on a determination of closing net working capital, transaction expenses and net debt (all as defined in the Merger Agreement). The Company funded the acquisition with borrowings obtained under its existing revolving credit facility ("the Revolver").

On July 13, 2018, the Company and former owners of Ceres agreed to post-closing adjustments totaling \$700, which will decrease the Company's net purchase price in the first quarter of fiscal 2019.

Table of Contents

The following table presents the net purchase price and the preliminary fair values of the assets and liabilities of the Acquired Company on a preliminary basis:

	Amounts
Consideration transferred	
Cash paid at closing	\$ 187,089
Working capital and net debt adjustment	(574)
Less cash acquired	(6,810)
Net purchase price	\$ 179,705
Estimated fair value of tangible assets acquired and liabilities assumed	
Cash	\$6,810
Accounts receivable	7,713
Inventory	7,333
Fixed assets	479
Other current and non-current assets	2,896
Accounts payable	(3,287)
Accrued expenses	(4,672)
Other current and non-current liabilities	(1,210)
Deferred tax liability	(14,115)
Estimated fair value of net tangible assets acquired	1,947
Estimated fair value of identifiable intangible assets	71,720
Estimated goodwill	112,848
Estimated fair value of net assets acquired	186,515
Less cash acquired	(6,810)
Net purchase price	\$ 179,705

The amounts above represent the preliminary fair value estimates as of June 30, 2018 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. The preliminary identifiable intangible asset estimates include customer relationships of \$52,600 with a useful life of 12.5 years, completed technology of \$17,150 with a useful life of 9.5 years and backlog of \$1,970 with a useful life of 1 year. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill.

The goodwill of \$112,848 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The goodwill from this acquisition is reported under the Mercury Defense Systems ("MDS") reporting unit and is not tax deductible.

The revenues and income before income taxes from Themis included in the Company's consolidated results for the fiscal year ended June 30, 2018 were \$27,190 and \$1,325, respectively.

Table of Contents

Pro Forma Financial Information

The following table summarizes the supplemental statements of operations information on an unaudited pro forma basis, excluding the pro forma impact of the RTL, Delta and CES acquisitions, as if the Merger had occurred on July 1, 2016. The Company has not furnished pro forma financial information relating to RTL, Delta and CES because such information is not material to the Company's financial results.

	Year Ended June	
	30,	
	2018	2017
Pro forma net revenues	\$530,340	\$455,002
Pro forma net income	\$38,584	\$12,248
Basic pro forma net earnings per share	\$0.83	\$0.29
Diluted pro forma net earnings per share	\$0.81	\$0.28

RICHLAND TECHNOLOGIES ACQUISITION

On July 3, 2017, the Company entered into a membership interest purchase agreement with RTL, pursuant to which, the Company acquired RTL on a cash-free, debt-free basis for a total purchase price of \$5,798. RTL specializes in safety-critical and high integrity systems, software and hardware development as well as safety-certification services for mission-critical applications. The Company recognized primarily intangible assets including customer relationships, completed technology and goodwill based on its purchase price allocation. The Company has not furnished pro forma financial information relating to RTL because such information is not material to the Company's financial results.

DELTA ACQUISITION

On April 3, 2017, the Company entered into a membership interest purchase agreement with Delta, pursuant to which, the Company acquired Delta on a cash-free, debt-free basis for a total purchase price of \$40,500, subject to net working capital and net debt adjustments. Delta is a designer and manufacturer of high-value RF, microwave and millimeter wave sub-assemblies and components for the military, aerospace and space markets. The acquisition and transaction related expenses were funded with cash on hand.

The following table presents the net purchase price and the fair values of the assets and liabilities of Delta:

	Amounts
Consideration transferred	
Cash paid at closing	\$40,500
Net purchase price	\$40,500
Fair value of tangible assets acquired and liabilities assumed	
Accounts receivable and cost in excess of billings	\$957
Inventory	4,452
Fixed assets	1,918
Other current and non-current assets	77
Current liabilities	(2,055)
Fair value of net tangible assets acquired	5,349
Fair value of identifiable intangible assets	17,000
Goodwill	18,151
Fair value of net assets acquired	40,500
Net purchase price	\$40,500

On April 2, 2018, the measurement period for Delta expired. The identifiable intangible assets include customer relationships of \$8,000 with a useful life of 9 years, completed technology of \$5,900 with a useful life of 7 years and backlog of \$3,100 with a useful life of 2 years.

The goodwill of \$18,151 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. The Delta acquisition expands the scale and

Table of Contents

breadth of the Company's RF, microwave and millimeter wave capabilities, provides highly complementary program portfolio in missiles and munitions, deepens market penetration in core radar, electronic warfare ("EW"), and precision-guided munitions markets, and opens new growth opportunities in space launch, GPS, satellite communications and datalinks. The goodwill from this acquisition is reported under the Advanced Microelectronic Solutions ("AMS") reporting unit.

The Company and the shareholders of Delta agreed to treat the acquisition of Delta as an asset purchase for tax purposes by filing the required election forms under IRC Section 338(h)(10). The Company has estimated the tax value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. As of June 30, 2018, the Company had \$16,991 of goodwill deductible for tax purposes. The Company has not furnished pro forma financial information relating to Delta because such information is not material to the Company's financial results.

CES ACQUISITION

On November 4, 2016, the Company and the shareholders of CES entered into a Stock Purchase Agreement, pursuant to which, Mercury acquired CES for a total purchase price of \$39,123, subject to net working capital and net debt adjustments. The acquisition and associated transaction expenses were funded with cash on hand. Based in Geneva, Switzerland, CES is a leading provider of embedded solutions for military and aerospace mission-critical computing applications. CES specializes in the design, development and manufacture of safety-certifiable product and subsystems solutions including: primary flight control units, flight test computers, mission computers, command and control processors, graphics and video processing and avionics-certified Ethernet and IO. CES products and solutions are used on platforms such as aerial refueling tankers and multi-mission aircraft, as well as the several types of unmanned platforms.

The following table presents the net purchase price and the fair values of the assets and liabilities of CES:

	Amounts
Consideration transferred	
Cash paid at closing	\$ 39,123
Working capital adjustment	(330)
Net purchase price	\$ 38,793
Fair value of tangible assets acquired and liabilities assumed	
Accounts receivable and cost in excess of billings	\$ 2,698
Inventory	8,950
Fixed assets	1,480
Other current and non-current assets	748
Current liabilities	(3,154)
Non-current liabilities	(6,140)
Deferred tax liabilities	(1,148)
Fair value of net tangible assets acquired	3,434
Fair value of identifiable intangible assets	14,722
Goodwill	20,637
Fair value of net assets acquired	38,793
Net purchase price	\$ 38,793

On November 4, 2017, the measurement period for CES expired. The identifiable intangible assets include customer relationships of \$9,060 with a useful life of 9 years and completed technology of \$5,662 with a useful life of 7 years. The goodwill of \$20,637 largely reflects the potential synergies and expansion of the Company's offerings across product lines and markets complementary to the Company's existing products and markets. CES provides the Company with capabilities in mission computing, safety-critical avionics and platform management that are in demand from its customers. These new capabilities will also substantially expand Mercury's addressable market into commercial aerospace, defense platform management, C4I and mission computing markets that are aligned to Mercury's existing market focus. The acquisition is directly aligned with the Company's strategy of expanding its

capabilities, services and offerings along the sensor processing chain. The goodwill from this acquisition is reported under the Sensor and Mission Processing (“SMP”) reporting unit. The Company has not furnished pro forma financial information relating to CES because such information is not material to the Company's financial results.

Table of Contents

D. Fair Value of Financial Instruments

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at June 30, 2018:

	Fair Value Measurements			
	June 30, 2018	Level 1	Level 2	Level 3
Assets:				
Certificates of deposit	\$ 1,056	\$ —	\$ 1,056	\$ —
Total	\$ 1,056	\$ —	\$ 1,056	\$ —

The following table summarizes the Company's financial assets measured at fair value on a recurring basis at June 30, 2017:

	Fair Value Measurements			
	June 30, 2017	Level 1	Level 2	Level 3
Assets:				
Certificates of deposit	\$ 1,043	\$ —	\$ 1,043	\$ —
Total	\$ 1,043	\$ —	\$ 1,043	\$ —

The carrying values of cash and cash equivalents, including money market funds, restricted cash, accounts receivable and payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The fair value of the Company's certificates of deposit are determined through quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable.

E. Inventory

Inventory was comprised of the following:

	June 30,	
	2018	2017
Raw materials	\$61,748	\$48,645
Work in process	30,841	22,567
Finished goods	15,996	9,859
Total	\$108,585	\$81,071

The \$27,514 increase in inventory was primarily due to an increase in overall demand, especially for larger, more complex sub-assemblies and integrated sub-systems, an investment in component and safety stock inventory for the transition to insourced manufacturing, and the acquisition of Themis. There are no amounts in inventory relating to contracts having production cycles longer than one year.

F. Property and Equipment

Property and equipment consisted of the following:

	Estimated Useful Lives (Years)	June 30,	
		2018	2017
Computer equipment and software	3-4	\$71,799	\$64,374
Furniture and fixtures	5	4,927	4,810
Leasehold improvements	lesser of estimated useful life or lease term	21,552	19,092
Machinery and equipment	5-10	47,419	42,193
		145,697	130,469
Less: accumulated depreciation		(94,717)	(78,826)
		\$50,980	\$51,643

The \$663 decrease in property and equipment was primarily due to the full year impact of accumulated depreciation associated with the build-out of the Company's new corporate headquarters, integration activities associated with recently acquired businesses, partially offset by current year additions, including the property and equipment associated with the acquisition of Themis. During

Table of Contents

fiscal 2018 and 2017, the Company retired \$611 and \$14,310, respectively, of computer equipment and software, furniture, and fixtures, leasehold improvements, and machinery and equipment that were no longer in use by the Company.

Depreciation expense related to property and equipment for the fiscal years ended June 30, 2018, 2017 and 2016 was \$16,273, \$12,589 and \$6,900, respectively.

G. Goodwill

The following table sets forth the changes in the carrying amount of goodwill by reporting unit for the year ended June 30, 2018:

	SMP	AMS	MDS	Total
Balance at June 30, 2017	\$ 116,003	\$ 217,956	\$ 46,887	\$ 380,846
Goodwill adjustment for the CES acquisition	291	—	—	291
Goodwill adjustment for the Delta acquisition	—	191	—	191
Goodwill arising from the RTL acquisition	3,266	—	—	3,266
Goodwill arising from the Themis acquisition	—	—	112,848	112,848
Balance at June 30, 2018	\$ 119,560	\$ 218,147	\$ 159,735	\$ 497,442

As defined by ASC 350, goodwill is tested for impairment on an interim basis at the occurrence of certain triggering events or at a minimum on an annual basis. In fiscal 2018, there were no triggering events which required an interim goodwill impairment test. The Company performed its annual goodwill impairment test in the fourth quarter of fiscal 2018 with no impairment noted.

H. Intangible Assets

Intangible assets consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
June 30, 2018				
Customer relationships	\$ 171,940	\$ (46,505)	\$ 125,435	10.7 years
Licensing agreements and patents	1,506	(640)	866	3.5 years
Completed technologies	62,392	(13,101)	49,291	8.1 years
Backlog	7,650	(5,338)	2,312	1.6 years
	\$ 243,488	\$ (65,584)	\$ 177,904	
June 30, 2017				
Customer relationships	\$ 117,630	\$ (31,533)	\$ 86,097	10.0 years
Licensing agreements and patents	1,131	(277)	854	3.7 years
Completed technologies	44,503	(6,079)	38,424	7.9 years
Backlog	5,430	(1,768)	3,662	2.0 years
	\$ 168,694	\$ (39,657)	\$ 129,037	

Estimated future amortization expense for intangible assets remaining at June 30, 2018 is as follows:

	Year Ending
	June 30,
2019	\$ 25,372
2020	21,524
2021	20,867
2022	20,771
2023	18,789
Thereafter	70,581
Total future amortization expense	\$ 177,904

Table of Contents

The following table summarizes the preliminary estimated fair value of acquired intangible assets arising as a result of the Themis acquisition. These assets are included in the Company's gross and net carrying amounts as of June 30, 2018.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life
Customer relationships	\$52,600	\$ (1,753)	\$50,847	12.5 years
Completed technologies	17,150	(752)	16,398	9.5 years
Backlog	1,970	(821)	1,149	1.0 year
	\$71,720	\$ (3,326)	\$68,394	

I. Restructuring

During fiscal 2018, the Company incurred \$3,159 of restructuring and other charges primarily related to the elimination of 38 positions predominantly in R&D and operations functions as well as executive severance. Restructuring and other charges are typically related to acquisitions and organizational redesign programs initiated as part of discrete post-acquisition integration activities.

During the fourth quarter of fiscal 2017, the Company initiated a plan to close its Manteca, California facility as a result of the acquisition of Delta. The Company incurred \$910 of severance and related expenses in conjunction with the elimination of 33 positions primarily in operations functions related to the planned closure of the facility. Additionally, the Company incurred \$1,042 in restructuring expenses related to other various restructuring events during fiscal 2017.

During fiscal 2016, the Company incurred restructuring and other charges of \$1,240, primarily related to executive severance and facility consolidation.

All of the restructuring and other charges are classified as operating expenses in the consolidated statements of operations and any remaining severance obligations are expected to be paid within the next twelve months. The remaining restructuring liability is classified as accrued expenses in the consolidated balance sheets.

The following table presents the detail of expenses for the Company's restructuring plans:

	Severance Facilities & Related & Other		Total
Restructuring liability at June 30, 2016	\$ 190	\$ 736	\$926
Restructuring charges	1,706	253	1,959
Cash paid	(524)	(989)	(1,513)
Reversals (*)	(7)	—	(7)
Restructuring liability at June 30, 2017	1,365	—	1,365
Restructuring charges	3,181	230	3,411
Cash paid	(2,546)	(177)	(2,723)
Reversals (*)	(199)	(53)	(252)
Restructuring liability at June 30, 2018	\$ 1,801	\$ —	\$ 1,801

(*) Reversals result from the unused outplacement services and operating costs.

J. Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted by the U.S. government. The Tax Act has impacted the U.S. corporate tax rate that the Company will use going forward, which has been reduced to 21% from 35%. As the Company has a June 30 fiscal year-end, the lower U.S. corporate tax rate will be phased in, resulting in a U.S. corporate tax rate of approximately 28% for the Company's fiscal year ended June 30, 2018, and 21% for subsequent fiscal years.

The Tax Act also includes items that the Company expects will increase its tax expense including, but not limited to, the elimination of the domestic manufacturing deduction and increased limitations on deductions for executive compensation. In addition, the actual effective tax rate may be materially different than the statutory Federal tax rate (including being higher) based on the availability and impact of various other adjustments including, but not limited to, state taxes, Federal research and development credits, discrete tax benefits related to stock compensation, and the

inclusion or exclusion of various items in taxable income which may differ from GAAP income.

To transition to the reduced U.S. corporate tax rate, adjustments were required to be made to the Company's U.S. deferred tax assets and liabilities, as well as discrete tax items recorded prior to the Tax Act. For the year ended June 30, 2018, these

70

Table of Contents

adjustments resulted in a tax benefit of \$861. The Tax Act also provided for a one-time deemed mandatory repatriation of post-1986 undistributed foreign subsidiary earnings and profits (“E&P”) through December 31, 2017. The Company had an estimated \$5,627 of undistributed foreign E&P subject to the deemed mandatory repatriation and recognized a provisional \$801 of income tax expense for the year ended June 30, 2018. After the utilization of existing tax credits, the Company expects to pay additional U.S. federal cash taxes of approximately \$386 on the deemed mandatory repatriation, payable over eight years. No additional provision for U.S. federal or foreign taxes has been made on unrepatriated foreign earnings as it is not practicable to determine the amount of other taxes that would be payable if these amounts were repatriated to the U.S.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”) to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The Company has recognized the provisional tax impacts related to deemed repatriated earnings and the revaluation of deferred tax assets and liabilities and included these amounts in its consolidated financial statements for the year ended June 30, 2018. The ultimate impact may differ from these provisional amounts due to additional regulatory guidance that may be issued and changes in interpretations and assumptions the Company has made. The Company does not expect the final amounts to be materially different than those recorded.

The components of income before income taxes and income tax expense were as follows:

	Year Ended June 30,		
	2018	2017	2016
Income before income taxes:			
United States	\$43,368	\$30,499	\$25,194
Foreign	(795)	569	92
	\$42,573	\$31,068	\$25,286
Tax provision (benefit):			
Federal:			
Current	\$4,470	\$11,476	\$6,707
Deferred	(4,527)	(7,645)	(2,627)
	\$(57)	\$3,831	\$4,080
State:			
Current	\$2,370	\$3,650	\$1,839
Deferred	(537)	(1,684)	(424)
	\$1,833	\$1,966	\$1,415
Foreign:			
Current	\$186	\$240	\$59
Deferred	(272)	156	(10)
	(86)	396	49
	\$1,690	\$6,193	\$5,544

Table of Contents

The following is the reconciliation between the statutory federal income tax rate and the Company's effective income tax rate:

	Year Ended June 30,		
	2018	2017	2016
Tax provision at federal statutory rates	28.0 %	35.0 %	35.0 %
State income tax, net of federal tax benefit	5.6	4.9	5.0
Research and development credits	(5.1)	(6.1)	(8.4)
Excess tax benefits on stock compensation	(18.5)	(13.1)	(4.4)
Domestic manufacturing deduction	(2.0)	(3.9)	(3.5)
Income from legal settlement excluded from taxable income	—	—	(2.8)
Deemed repatriation of foreign earnings	1.9	(0.1)	(0.2)
Foreign income tax rate differential	0.3	0.2	—
Officer and equity compensation	1.7	1.8	2.6
Acquisition costs	1.4	0.9	—
Reserves for tax contingencies	0.3	(0.6)	(3.2)
Benefit from tax rate changes	(2.3)	—	—
Impacts related to acquired tax attributes	(8.7)	—	—
Other	1.4	0.9	1.8
	4.0 %	19.9 %	21.9 %

The effective tax rate for fiscal 2018 differed from the federal statutory rate primarily due to benefits related to research and development tax credits, domestic manufacturing deductions, excess tax benefits for equity compensation, and acquired tax attributes. These benefits are partially offset by additional tax expense for state and local income taxes, non-deductible officer compensation and non-deductible equity compensation. During fiscal 2018 and 2017, the Company recognized a discrete tax benefit of \$7,897 and \$4,066, respectively, related to excess tax benefits on stock-based compensation. The discrete tax benefit for fiscal 2018 included the enactment of the Tax Act. The benefit is the result of the increase in value from the stock award between the grant date and the vest date. Fiscal 2018 also included discrete tax benefits of \$3,716 derived from new information obtained about net operating loss carry-forwards of the Carve-Out Business acquired from Microsemi Corporation in May 2016. The discrete items disclosed above for fiscal 2018 included the effect of the Tax Act.

Table of Contents

The components of the Company's net deferred tax liabilities were as follows:

	June 30,	
	2018	2017
Deferred tax assets:		
Inventory valuation and receivable allowances	\$8,476	\$13,845
Accrued compensation	3,803	4,555
Equity compensation	3,944	4,858
Federal and state research and development tax credit carryforwards	18,784	13,415
Other accruals	1,085	2,125
Deferred compensation	1,561	1,606
Acquired net operating loss carryforward	1,634	—
Capital loss carryforwards	2,413	3,562
Other temporary differences	1,565	1,500
	43,265	45,466
Valuation allowance	(16,992)	(16,570)
Total deferred tax assets	26,273	28,896
Deferred tax liabilities:		
Prepaid expenses	(696)	(481)
Property and equipment	(4,436)	(3,749)
Intangible assets	(34,546)	(28,163)
Tax method of accounting change	—	(285)
Other temporary differences	(230)	(441)
Total deferred tax liabilities	(39,908)	(33,119)
Net deferred tax (liabilities) assets	\$(13,635)	\$(4,223)
As reported:		
Deferred tax assets	\$—	\$633
Deferred tax liabilities	(13,635)	(4,856)
	\$(13,635)	\$(4,223)

At June 30, 2018, the Company evaluated the need for a valuation allowance on deferred tax assets. In assessing whether the deferred tax assets are realizable, management considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the Company's past operating results, its forecast of future earnings, future taxable income, and tax planning strategies. The Company continues to conclude that it is more likely than not that most domestic deferred tax assets would be realizable based on recent financial performance, projected future taxable income and the reversal of existing deferred tax liabilities.

The Company continues to record a full valuation allowance on capital loss carryforwards and certain state research and development credits as of June 30, 2018 as management continues to believe that it is not more likely than not that these deferred tax assets would be realized. Any future reversals of the valuation allowance will impact income tax expense.

The Company had federal research and development credit carryforwards of \$1,227, which will begin to expire in 2029. The Company had state research and development credit carryforwards of \$17,557, which will expire from 2018 through 2033.

The Company files income tax returns in all jurisdictions in which it operates. The Company has established reserves to provide for additional income taxes that management believes will more likely than not be due in future years as these previously filed tax returns are audited. These reserves have been established based upon management's assessment as to the potential exposures. All tax reserves are analyzed quarterly and adjustments are made as events occur and warrant modification.

Table of Contents

The changes in the Company's reserves for unrecognized income tax benefits are summarized as follows:

	Year Ended June 30,	
	2018	2017
Unrecognized tax benefits, beginning of period	\$ 804	\$ 1,566
Increases for previously recognized positions	—	46
Settlements of previously recognized positions	—	(793)
Reductions as a result of a lapse of the applicable statute of limitations	(81)	(273)
Increases for currently recognized positions	315	384
Reductions for previously recognized positions	(40)	(126)
Unrecognized tax benefits, end of period	\$ 998	\$ 804

The \$998 of unrecognized tax benefits as of June 30, 2018, if released, would reduce income tax expense.

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of June 30, 2018 and 2017, the total amount of gross interest and penalties accrued were \$84 and \$54, respectively. In connection with tax matters, the Company recognized interest and penalty expense in fiscal 2018, 2017 and 2016 of \$42, \$30 and \$204, respectively.

The Company's major tax jurisdiction is the U.S. and the open tax years are fiscal 2015 through 2018.

K. Commitments and Contingencies

LEGAL CLAIMS

The Company is subject to litigation, claims, investigations and audits arising from time to time in the ordinary course of business. Although legal proceedings are inherently unpredictable, the Company believes that it has valid defenses with respect to any matters currently pending against the Company and intends to defend itself vigorously. The outcome of these matters, individually and in the aggregate, is not expected to have a material impact on the Company's cash flows, results of operations, or financial position.

INDEMNIFICATION OBLIGATIONS

The Company's standard product sales and license agreements entered into in the ordinary course of business typically contain an indemnification provision pursuant to which the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with any patent, copyright or other intellectual property infringement claim by any third party with respect to the Company's products. Such provisions generally survive termination or expiration of the agreements. The potential amount of future payments the Company could be required to make under these indemnification provisions is, in some instances, unlimited.

PURCHASE COMMITMENTS

As of June 30, 2018, the Company has entered into non-cancelable purchase commitments for certain inventory components and services used in its normal operations. The purchase commitments covered by these agreements are for less than one year and aggregate to \$50,285.

Table of Contents

LEASE COMMITMENTS

The Company leases certain facilities, machinery and equipment under various cancelable and non-cancelable operating leases that expire at various dates through fiscal 2029. The leases contain various renewal options. Rental charges are subject to escalation for increases in certain operating costs of the lessor. For tenant improvement allowances and rent holidays, the Company records a deferred rent liability on the consolidated balance sheets and amortizes the deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of operations. Rental expense during the fiscal years ended June 30, 2018, 2017, and 2016 was \$6,534, \$7,774 and \$4,015, respectively. Minimum lease payments under the Company's non-cancelable operating leases are as follows:

	Year Ending June 30,
2019	\$ 8,790
2020	9,017
2021	7,745
2022	7,424
2023	6,772
Thereafter	22,864
Total minimum lease payments	\$ 62,612

OTHER

As part of the Company's strategy for growth, the Company continues to explore acquisitions or strategic alliances. The associated acquisition costs incurred in the form of professional fees and services may be material to the future periods in which they occur, regardless of whether the acquisition is ultimately completed.

The Company may elect from time to time to purchase and subsequently retire shares of common stock in order to settle an individual employees' tax liability associated with vesting of a restricted stock award or exercise of stock options. These transactions would be treated as a use of cash in financing activities in the Company's statement of cash flows.

L. Debt

Revolving Credit Facilities

On May 2, 2016, the Company and certain of its subsidiaries, as guarantors, entered into a Credit Agreement (the "Credit Agreement") with a syndicate of commercial banks and Bank of America, N.A acting as the administrative agent. The Credit Agreement provided for a \$200,000 term loan facility ("the Term Loan") and a \$100,000 revolving credit facility ("Revolver").

On June 27, 2017, the Company amended the Credit Agreement to increase and extend the borrowing capacity of the Revolver to \$400,000 expiring in June 2022 ("the Amended Credit Agreement"). In connection with the amendment, the Company also repaid the remaining principal and accrued and unpaid interest outstanding on the Term Loan using cash on hand. The Company evaluated the amended Credit Agreement under ASC 470, Debt, and determined that the amendment represented a modification of the Credit Agreement. Accordingly, \$6,522 in unamortized debt issuance costs at June 27, 2017, in addition to \$591 in new fees paid to the syndicate of lenders in connection with the amendment are being amortized to other income (expense), net on a straight line basis over the new term of the Revolver. As of June 30, 2018, the Company's outstanding balance of unamortized deferred financing costs was \$5,326. As of June 30, 2018, there were outstanding borrowings of \$195,000 against the Revolver, resulting in interest expense of \$2,850 for the year ended June 30, 2018. There were also outstanding letters of credit of \$2,771 as of June 30, 2018.

Maturity

The Revolver has a five year maturity.

Interest Rates and Fees

Borrowings under the Revolver bear interest, at the Company's option, at floating rates tied to LIBOR or the prime rate plus an applicable percentage. The applicable percentage is set at LIBOR plus 1.5% and is established pursuant to a pricing grid based on the Company's total net leverage ratio. As of June 30, 2018, the stated interest rate on the Revolver was 3.86% per annum.

In addition to interest on the aggregate outstanding principal amounts of any borrowings, the Company will also pay a quarterly commitment fee on the unutilized commitments under the Revolver. The applicable percentage is pursuant to a pricing grid based on the Company's total net leverage ratio. As of June 30, 2018, the stated interest rate for unutilized commitments was 0.25% per annum. The Company will also pay customary letter of credit and agency fees.

75

Table of Contents

Covenants and Events of Default

The Amended Credit Agreement provides for customary negative covenants. The Amended Credit Agreement also requires the Company to comply with certain financial covenants, including a quarterly minimum consolidated cash interest charge ratio test and a quarterly maximum consolidated total net leverage ratio test.

The Amended Credit Agreement also provides for customary representations and warranties, affirmative covenants and events of default. If an event of default occurs, the lenders under the Amended Credit Agreement will be entitled to take various actions, including the termination of unutilized commitments, the acceleration of amounts outstanding under the Amended Credit Agreement and all actions permitted to be taken by a secured creditor. As of June 30, 2018, the Company was in compliance with all covenants and conditions under the Amended Credit Agreement.

Guarantees and Security

The Company's obligations under the Amended Credit Agreement are guaranteed by certain of its material domestic wholly-owned restricted subsidiaries (the "Guarantors"). The obligations of both the Company and the Guarantors are secured by a perfected security interest in substantially all of the assets of the Company and the Guarantors, in each case, now owned or later acquired, including a pledge of all of the capital stock of substantially all of its domestic wholly-owned restricted subsidiaries and 65% of the capital stock of certain of its foreign restricted subsidiaries, subject in each case to the exclusion of certain assets and additional exceptions.

M.Employee Benefit Plans

Pension Plan

With the acquisition of CES on November 4, 2016, the Company assumed a pension plan (the "Plan") for its Swiss employees, which is administered by an independent pension fund. The Plan is mandated by Swiss law and meets the criteria for a defined benefit plan under ASC 715, Compensation—Retirement Benefits ("ASC 715"), since participants of the Plan are entitled to a defined rate of return on contributions made. The independent pension fund is a multi-employer plan with unrestricted joint liability for all participating companies for which the Plan's overfunding or underfunding is allocated to each participating company based on an allocation key determined by the Plan.

The Company recognizes a net asset or liability for the Plan equal to the difference between the projected benefit obligation of the Plan and the fair value of the Plan's assets as required by ASC 715. The funded status may vary from year to year due to changes in the fair value of the Plan's assets and variations on the underlying assumptions of the projected benefit obligation of the Plan.

On January 1, 2017, the Company changed pension providers. The Company's results contain the effects of the change in pension provider as prior service costs. These prior service costs will be amortized from AOCI to net periodic benefit costs over approximately 10 years.

On January 1, 2019, the independent pension fund will change the conversion rate for accumulated retirement savings. The Company's results contain the effects of this change in conversion rates by the independent pension fund as prior service costs. These prior service costs will be amortized from AOCI to net periodic benefit costs over approximately 10 years.

At June 30, 2018, the accumulated benefit obligation of the Plan equals the fair value of the Plan's assets. The Plan's funded status at June 30, 2018 and 2017 was a net liability of \$6,098 and \$6,601, respectively, which is recorded in other non-current liabilities on the consolidated balance sheets. The Company recorded net gains of \$354 and \$220 in AOCI during the year ended June 30, 2018 and 2017, respectively. Total employer contributions to the Plan were \$596 during the year ended June 30, 2018, and the Company's total expected employer contributions to the Plan during fiscal 2019 are \$642.

The following table reflects the total pension benefits expected to be paid from the Plan, which is funded from contributions by participants and the Company.

	Year Ended June 30,
2019	\$ 603
2020	892
2021	573
2022	720

2023	1,012
Thereafter (next 5 years)	3,944
Total	\$ 7,744

The following table outlines the components of net periodic benefit cost of the Plan for the year ended June 30, 2018 and 2017:

	Year Ended	
	June 30,	
	2018	2017
Service cost	\$835	\$557
Interest cost	121	73
Expected return on assets	(162)	(105)
Amortization of prior service cost	39	20
Net periodic benefit cost	\$833	\$545

The following table reflects the related actuarial assumptions used to determine net periodic benefit cost of the Plan for the year ended June 30, 2018 and 2017:

	Year Ended	
	June 30,	
	2018	2017
Discount rate	0.85 %	0.70 %
Expected rate of return on Plan assets	1.50 %	1.50 %
Expected inflation	1.00 %	1.00 %
Rate of compensation increases	1.20 %	1.00 %

The calculation of the projected benefit obligation ("PBO") utilized BVG 2015 Generational data for assumptions related to the mortality rates, disability rates, turnover rates, and early retirement ages.

The PBO represents the present value of Plan benefits earned through the end of the year, with an allowance for future salary and pension increases as well as turnover rates. The following table presents the change in projected benefit obligation for the periods presented:

	Year Ended June	
	30,	
	2018	2017
Projected benefit obligation, beginning	\$17,526	\$16,800
Service cost	835	557
Interest cost	121	73
Employee contributions	1,931	581
Actuarial gain	466	(598)
Benefits paid	(1,215)	(563)
Plan amendment	(941)	390
Foreign exchange (gain) loss	(596)	286
Projected benefit obligation at end of year	\$18,127	\$17,526

The following table presents the change in Plan assets for the periods presented:

	Year Ended June	
	30,	
	2018	2017
Fair value of Plan assets, beginning	\$10,925	\$10,276
Actual return on Plan assets	167	100
Company contributions	608	348
Employee contributions	1,931	581
Benefits paid	(1,215)	(563)
Foreign exchange (loss) gain	(387)	183
Fair value of Plan assets at end of year	\$12,029	\$10,925

The following table presents the Company's reconciliation of funded status for the period presented:

	June 30, 2018	June 30, 2017
Projected benefit obligation at end of year	\$18,127	\$17,526
Fair value of plan assets at end of year	12,029	10,925
Funded status	\$(6,098)	\$(6,601)

The Company did not recognize any (gain) loss from other comprehensive income ("OCI") in its consolidated results of operations during the years ended June 30, 2018 and 2017. The Company does not expect to recognize any (gain) loss from OCI for the year ended June 30, 2019.

The fair value of Plan assets were \$12,029 at June 30, 2018. The Plan is denominated in a foreign currency, the Swiss Franc, which can have an impact on the fair value of Plan assets. The Plan was not subject to material fluctuations during years ended June 30, 2018 or 2017. The Plan's assets are administered by an independent pension fund foundation (the "foundation"). As of June 30, 2018, the foundation has invested the assets of the Plan in various investments vehicles, including cash, real estate, equity securities, and bonds. The investments are measured at fair value using a mix of Level 1, Level 2 and Level 3 inputs.

401(k) Plan

The Company maintains a qualified 401(k) plan (the "401(k) Plan") for its U.S. employees. During fiscal 2018, 2017 and 2016, the Company matched employee contributions up to 3% of eligible compensation. The Company may also make optional contributions to the plan for any plan year at its discretion. Expense recognized by the Company for matching contributions related to the 401(k) plan was \$3,684, \$3,206 and \$1,874 during the fiscal years ended June 30, 2018, 2017, and 2016, respectively.

N. Shareholders' Equity

PREFERRED STOCK

The Company is authorized to issue 1,000 shares of preferred stock with a par value of \$0.01 per share.

SHELF REGISTRATION STATEMENT

On August 28, 2017, the Company filed a shelf registration statement on Form S-3ASR with the SEC. The shelf registration statement, which was effective upon filing with the SEC, registered each of the following securities: debt securities, preferred stock, common stock, warrants and units. The Company has an unlimited amount available under the shelf registration statement. Additionally, as part of the shelf registration statement, the Company has entered into an equity distribution agreement which allows the Company to sell an aggregate of up to \$200,000 of its common stock from time to time through its agents.

FOLLOW-ON EQUITY OFFERINGS

On January 26, 2017, the Company announced the commencement of an underwritten public offering of its common stock, par value \$0.01 per share. On February 1, 2017, the Company closed the offering, including the full over-allotment allocation, selling an aggregate of 6,900 shares of common stock at a price to the public of \$33.00 for total net proceeds of \$215,725.

O. Stock-Based Compensation

STOCK OPTION PLANS

The number of shares authorized for issuance under the Company's 2005 Stock Incentive Plan, as amended and restated (the "2005 Plan"), is 15,252 shares at June 30, 2018. The 2005 Plan provides for the grant of non-qualified and incentive stock options, restricted stock, stock appreciation rights and deferred stock awards to employees and non-employees. All stock options are granted with an exercise price of not less than 100% of the fair value of the Company's common stock at the date of grant and the options generally have a term of seven years. There were 1,614 shares available for future grant under the 2005 Plan at June 30, 2018.

As part of the Company's ongoing annual equity grant program for employees, the Company grants performance-based restricted stock awards to certain executives pursuant to the 2005 Plan. Performance awards vest based on the requisite service period subject to the achievement of specific financial performance targets. Based on the performance targets, some of these awards require graded vesting which results in more rapid expense recognition compared to traditional time-based vesting over the same vesting period. The Company monitors the probability of

achieving the performance targets on a quarterly basis and may adjust periodic stock compensation expense accordingly. The performance targets include: (i) the achievement of internal performance targets only, and (ii) the achievement of internal performance targets in relation to a peer group of companies.

Table of Contents**EMPLOYEE STOCK PURCHASE PLAN**

The number of shares authorized for issuance under the Company's 1997 Employee Stock Purchase Plan, as amended and restated ("ESPP"), is 1,800 shares. Under the ESPP, rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at either the beginning or the end of each six-month offering period. The ESPP permits employees to purchase common stock through payroll deductions, which may not exceed 10% of an employee's compensation as defined in the ESPP. The number of shares issued under the ESPP during fiscal years 2018, 2017, and 2016 was 82, 96 and 88, respectively. Shares available for future purchase under the ESPP totaled 220 at June 30, 2018.

STOCK OPTION AND AWARD ACTIVITY

The following table summarizes activity of the Company's stock option plans since June 30, 2016:

	Options Outstanding		Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of 6/30/2018
	Number of Shares	Weighted Average Exercise Price		
Outstanding at June 30, 2016	258	\$ 13.34	1.06	
Granted	—	—		
Exercised	(207)	13.29		
Cancelled	—	—		
Outstanding at June 30, 2017	51	\$ 13.53	0.60	
Granted	—	—		
Exercised	(47)	14.12		
Cancelled	—	—		
Outstanding at June 30, 2018	4	\$ 5.52	3.13	\$ 114
Vested and expected to vest at June 30, 2018	4	\$ 5.52	3.13	\$ 114
Exercisable at June 30, 2018	4	\$ 5.52	3.13	\$ 114

The intrinsic value of the options exercised during fiscal years 2018, 2017, and 2016 was \$1,780, \$3,762 and \$1,976, respectively. Non-vested stock options are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2018 and 2017, there was \$0 of total unrecognized compensation cost related to non-vested options granted under the Company's stock plans. There were no stock options granted during fiscal years 2018, 2017 or 2016. The following table summarizes the status of the Company's non-vested restricted stock awards since June 30, 2016:

	Non-Vested Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2016	1,666	\$ 13.09
Granted	718	24.72
Vested	(769)	11.94
Forfeited	(51)	15.02
Outstanding at June 30, 2017	1,564	\$ 18.93
Granted	521	47.28
Vested	(821)	46.71
Forfeited	(129)	31.41
Outstanding at June 30, 2018	1,135	\$ 27.26

The total fair value of restricted stock awards vested during fiscal years 2018, 2017, and 2016 was \$38,344, \$19,402 and \$12,185, respectively.

Non-vested restricted stock awards are subject to the risk of forfeiture until the fulfillment of specified conditions. As of June 30, 2018, there was \$24,740 of total unrecognized compensation cost related to non-vested restricted stock awards granted under the Company's stock plans that is expected to be recognized over a weighted-average period of

2.3 years from June 30, 2018. As of June 30, 2017, there was \$12,160 of total unrecognized compensation cost related to non-vested restricted stock awards granted under the Company's stock plans that is expected to be recognized over a weighted-average period of 1.5 years from June 30, 2017.

Table of Contents**STOCK-BASED COMPENSATION EXPENSE**

The Company recognizes expense for its share-based payment plans in the consolidated statements of operations for the fiscal years 2018, 2017, and 2016 in accordance with ASC 718. The Company had \$317, \$194 and \$93 of capitalized stock-based compensation expense on the consolidated balance sheet as of June 30, 2018, 2017, and 2016, respectively. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period. The following table presents share-based compensation expenses from continuing operations included in the Company's consolidated statement of operations:

	Year Ended June 30,		
	2018	2017	2016
Cost of revenues	\$502	\$531	\$441
Selling, general and administrative	14,828	13,212	7,864
Research and development	1,984	1,598	1,269
Stock-based compensation expense before tax	17,314	15,341	9,574
Income taxes	(5,713)	(5,874)	(3,727)
Stock-based compensation expense, net of income taxes	\$11,601	\$9,467	\$5,847

P. Operating Segment, Geographic Information and Significant Customers

Operating segments are defined as components of an enterprise evaluated regularly by the Company's chief operating decision maker ("CODM") in deciding how to allocate resources and assess performance. The Company is comprised of one operating and reportable segment. The Company utilized the management approach for determining its operating segment in accordance with ASC 280, Segment Reporting.

The geographic distribution of the Company's revenues as determined by order origination based on the country in which the Company's legal subsidiary is domiciled is summarized as follows:

	U.S.	Europe	Asia Pacific	Eliminations	Total
YEAR ENDED JUNE 30, 2018					
Net revenues to unaffiliated customers	\$450,218	\$35,000	\$ 7,966	\$ —	\$493,184
Inter-geographic revenues	10,650	925	—	(11,575)	—
Net revenues	\$460,868	\$35,925	\$ 7,966	\$ (11,575)	\$493,184
Identifiable long-lived assets (1)	\$47,997	\$2,974	\$ 9	\$ —	\$50,980
YEAR ENDED JUNE 30, 2017					
Net revenues to unaffiliated customers	\$380,538	\$22,242	\$ 5,808	\$ —	\$408,588
Inter-geographic revenues	7,637	44	—	(7,681)	—
Net revenues	\$388,175	\$22,286	\$ 5,808	\$ (7,681)	\$408,588
Identifiable long-lived assets (1)	\$50,340	\$1,288	\$ 15	\$ —	\$51,643
YEAR ENDED JUNE 30, 2016					
Net revenues to unaffiliated customers	\$259,781	\$5,464	\$ 4,909	\$ —	\$270,154
Inter-geographic revenues	7,911	447	—	(8,358)	—
Net revenues	\$267,692	\$5,911	\$ 4,909	\$ (8,358)	\$270,154
Identifiable long-lived assets (1)	\$28,187	\$127	\$ 23	\$ —	\$28,337

(1) Identifiable long-lived assets exclude goodwill and intangible assets.

Table of Contents

In recent years, the Company completed a series of acquisitions that changed its technological capabilities, applications and end markets. As these acquisitions and changes occurred, the Company increased the proportion of its revenue derived from the sale of components in different technological areas, and also increased the amount of revenue associated with combining technologies into more complex and diverse products including modules, sub-assemblies and integrated subsystems. The following tables present revenue consistent with the Company's strategy of expanding its technological capabilities and program content. As additional information related to the Company's products by end user, application and/or product grouping is attained, the categorization of these products can vary over time. When this occurs, the Company reclassifies revenue by end user, application and/or product grouping for prior periods. Such reclassifications typically do not materially change the sizing of, or the underlying trends of results within, each revenue category.

The following table presents the Company's net revenue by end market for the periods presented:

	Year Ended June 30,		
	2018	2017	2016
Domestic (1)	\$410,050	\$341,699	\$220,253
International/Foreign Military Sales (2)	83,134	66,889	49,901
Total Net Revenue	\$493,184	\$408,588	\$270,154

(1) Domestic revenues consist of sales where the end user is within the U.S., as well as sales to prime defense contractor customers where the ultimate end user location is not defined.

(2) International/Foreign Military Sales consist of sales to U.S. prime defense contractor customers where the end user is outside the U.S., foreign military sales through the U.S. government, and direct sales to non-U.S. based customers intended for end use outside of the U.S.

The following table presents the Company's net revenue by end application for the periods presented:

	Year Ended June 30,		
	2018	2017	2016
Radar (1)	\$159,737	\$150,441	\$140,289
Electronic Warfare (2)	114,801	106,446	72,118
Other Sensor and Effector (3)	48,088	27,719	12,494
Total Sensor and Effector	322,626	284,606	224,901
C4I (4)	87,414	31,679	3,472
Other (5)	83,144	92,303	41,781
Total Net Revenue	\$493,184	\$408,588	\$270,154

(1) Radar includes end-use applications where radio frequency signals are utilized to detect, track, and identify objects.

(2) Electronic Warfare includes end-use applications comprising the offensive and defensive use of the electromagnetic spectrum.

(3) Other Sensor and Effector products include all Sensor and Effector end markets other than Radar and Electronic Warfare.

(4) C4I includes rugged secure rackmount servers that are designed to drive the most powerful military processing applications.

(5) Other products include all component and other sales where the end use is not specified.

Table of Contents

The following table presents the Company's net revenue by product grouping for the periods presented:

	Year Ended June 30,		
	2018	2017	2016
Components (1)	\$142,982	\$105,669	\$31,252
Modules and Sub-assemblies (2)	194,377	161,973	126,777
Integrated Subsystems (3)	155,825	140,946	112,125
Total Net Revenue	\$493,184	\$408,588	\$270,154

(1) Components include technology elements typically performing a single, discrete technological function, which when physically combined with other components may be used to create a module or sub-assembly. Examples include but are not limited to power amplifiers and limiters, switches, oscillators, filters, equalizers, digital and analog converters, chips, MMICs (monolithic microwave integrated circuits), and memory and storage devices.

(2) Modules and Sub-assemblies include combinations of multiple functional technology elements and/or components that work together to perform multiple functions but are typically resident on or within a single board or housing. Modules and sub-assemblies may in turn be combined to form an integrated subsystem. Examples of modules and sub-assemblies include but are not limited to embedded processing modules, embedded processing boards, switch fabric boards, high speed input/output boards, digital receiver boards, graphics and video processing and Ethernet and IO (input-output) boards, multi-chip modules, integrated radio frequency and microwave multi-function assemblies, tuners, and transceivers.

(3) Integrated Subsystems include multiple modules and/or sub-assemblies combined with a backplane or similar functional element and software to enable a solution. These are typically but not always integrated within a chassis and with cooling, power and other elements to address various requirements and are also often combined with additional technologies for interaction with other parts of a complete system or platform. Integrated subsystems also include spare and replacement modules and sub-assemblies sold as part of the same program for use in or with integrated subsystems sold by the Company.

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

	Year Ended June 30,		
	2018	2017	2016
Lockheed Martin Corporation	19%	20%	23%
Raytheon Company	19%	16%	20%
	38%	36%	43%

While the Company typically has customers from which it derives 10% or more of its revenue, the sales to each of these customers are spread across multiple programs and platforms. Programs comprising 10% or more of the Company's revenues for the periods shown below are as follows:

	Year Ended June 30,		
	2018	2017	2016
SEWIP*	*	*	12%
Aegis	*	*	10%
	—%	—%	22%

*Indicates that the amount is less than 10% of the Company's revenues for the respective period. No programs were in excess of 10% of the Company's revenues for fiscal 2018 and 2017.

Q. Subsequent Events

On July 10, 2018, a securities class action complaint was filed against the Company, Mark Aslett, and Gerald M. Haines II in the U.S. District Court for the District of Massachusetts. The complaint asserts Section 10(b) and 20(a) securities fraud claims on behalf of a purported class of purchasers and sellers of the Company's stock from October 24, 2017 to April 24, 2018. The complaint alleges that the Company's public disclosures in SEC filings and on earnings calls were false and/or misleading. The Company believes the claims in the complaint are without merit and the Company intends to defend itself vigorously.

On July 31, 2018, the Company acquired Germane Systems, LC ("Germane"). Based in Chantilly, VA, Germane is an industry leader in the design, development and manufacturing of rugged servers, computers and storage systems for C2I applications. Germane's quality solutions are used in harsh environments serving critical U.S. and international defense programs. The Company acquired Germane for an all cash purchase price of \$45,000, subject to net working capital and net debt adjustments. The acquisition and associated transaction expenses were funded through the Revolver.

The Company has evaluated subsequent events from the date of the consolidated balance sheet through the date the consolidated financial statements were issued.

Table of Contents

SUPPLEMENTARY INFORMATION (UNAUDITED)

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

2018 (In thousands, except per share data)	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Net revenues	\$ 106,069	\$ 117,912	\$ 116,336	\$ 152,867
Gross margin	\$ 50,674	\$ 54,160	\$ 52,766	\$ 68,258
Income from operations	\$ 10,371	\$ 10,888	\$ 6,838	\$ 18,888
Income before income taxes	\$ 9,572	\$ 10,468	\$ 5,905	\$ 16,628
Income tax (benefit) provision	\$ (8,381)	\$ 1,335	\$ 2,209	\$ 6,527
Net income	\$ 17,953	\$ 9,133	\$ 3,696	\$ 10,101
Net income per share:				
Basic net income per share	\$ 0.39	\$ 0.20	\$ 0.08	\$ 0.22
Diluted net income per share	\$ 0.38	\$ 0.19	\$ 0.08	\$ 0.21
2017 (In thousands, except per share data)	1ST QUARTER	2ND QUARTER	3RD QUARTER	4TH QUARTER
Net revenues	\$ 87,649	\$ 98,014	\$ 107,317	\$ 115,608
Gross margin	\$ 39,444	\$ 47,389	\$ 50,783	\$ 53,927
Income from operations	\$ 3,742	\$ 8,958	\$ 11,695	\$ 13,008
Income before income taxes	\$ 2,560	\$ 6,983	\$ 10,218	\$ 11,307
Income tax (benefit) provision	\$ (1,259)	\$ 1,779	\$ 3,170	\$ 2,503
Net income	\$ 3,819	\$ 5,204	\$ 7,048	\$ 8,804
Net income per share:				
Basic net income per share	\$ 0.10	\$ 0.13	\$ 0.16	\$ 0.19
Diluted net income per share	\$ 0.10	\$ 0.13	\$ 0.16	\$ 0.19

Due to the effects of rounding, the sum of the four quarters does not equal the annual total.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) EFFECTIVENESS OF DISCLOSURE CONTROLS AND
PROCEDURES

We conducted an evaluation as of June 30, 2018 under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), and concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, the "Exchange Act") were effective as of June 30, 2018 and designed to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that it is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Table of Contents

(c)MANAGEMENT’S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of the Chief Executive Officer and Chief Financial Officer, management conducted an assessment of the effectiveness of our internal control over financial reporting as of June 30, 2018 based on the framework in Internal Control - Integrated Framework (2013) published by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of this assessment, management concluded that our internal control over financial reporting was effective as of June 30, 2018. The effectiveness of our internal control over financial reporting as of June 30, 2018 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report.

The audited consolidated financial statements of the Company include the results of the acquired RTL and Themis businesses on and after July 3, 2017 and February 1, 2018, respectively, as described in Note C to the Consolidated Financial Statements. Upon consideration of the date of the fiscal 2018 Themis acquisition and the time constraints under which our management’s assessment would have to be made, management determined that it would not be possible to conduct a sufficiently comprehensive assessment of the Themis internal control over financial reporting environment as allowable under section 404 of the Sarbanes-Oxley Act of 2002. Accordingly, this operation has been excluded from the scope of management’s assessment of internal controls for fiscal year 2018. However, management is in the process of integrating Themis into the overall internal control over financial reporting environment for fiscal year 2019. Meanwhile, RTL was considered fully integrated during fiscal 2018. The Company’s consolidated financial statements reflect revenues and total assets from the acquired Themis business of approximately 6 percent and 20 percent (of which 17 percent represented goodwill and intangible assets included within the scope of the Company’s assessment), respectively, as of and for the year ended June 30, 2018.

(d)CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of fiscal 2018 identified in connection with our Chief Executive Officer’s and Chief Financial Officer’s evaluation that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Although management has completed the integration of the CES and Delta businesses, it is in the process of integrating the RTL and Themis businesses into our overall internal control over financial reporting environment.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated herein by reference to our Proxy Statement for our 2018 Annual Meeting of Shareholders (the “Shareholders Meeting”), except that information required by this item concerning our executive officers appears in Part I, Item 4.1. of this Annual Report on Form 10-K.

**ITEM 11. EXECUTIVE
COMPENSATION**

The information required by this item is incorporated by reference to our Proxy Statement for the Shareholders Meeting.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND
RELATED STOCKHOLDER MATTERS**

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference to our Proxy Statement for the Shareholders Meeting.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) FINANCIAL STATEMENTS, SCHEDULES AND EXHIBITS

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

1. Financial statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of June 30, 2018 and 2017

Consolidated Statements of Operations and Comprehensive Income for the fiscal years ended June 30, 2018, 2017, and 2016

Consolidated Statements of Shareholders' Equity for the fiscal years ended June 30, 2018, 2017, and 2016

Consolidated Statements of Cash Flows for the years ended June 30, 2018, 2017, and 2016

Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

II. Valuation and Qualifying Accounts

85

Table of Contents

MERCURY SYSTEMS, INC.
 SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
 FOR FISCAL YEARS ENDED JUNE 30, 2018, 2017 AND 2016

(In thousands)

Allowance for Doubtful Accounts

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS	REVERSALS	WRITE- OFFS	BALANCE AT END OF PERIOD
2018	\$ 83	\$ 359	\$ 31	\$ 52	\$ 359
2017	\$ 92	\$ 22	\$ —	\$ 31	\$ 83
2016	\$ 56	\$ 425	\$ —	\$ 389	\$ 92

Deferred Tax Asset Valuation Allowance

	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS & EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS	BALANCE AT END OF PERIOD
2018	\$ 16,570	\$ 422	\$ —	—	\$ 16,992
2017	\$ 18,472	\$ (1,902)	\$ —	—	\$ 16,570
2016	\$ 18,864	\$ (392)	\$ —	—	\$ 18,472

3.Exhibits:

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index on page 88, which is incorporated herein by reference.

Table of Contents

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Andover, Massachusetts, on August 16, 2018.

MERCURY SYSTEMS, INC.

By/s/ MICHAEL D. RUPPERT

Michael D. Ruppert

EXECUTIVE VICE PRESIDENT, CHIEF FINANCIAL OFFICER, AND TREASURER

[PRINCIPAL FINANCIAL OFFICER]

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

Signature	Title(s)	Date
/s/ MARK ASLETT Mark Aslett	President, Chief Executive Officer and Director (principal executive officer)	August 16, 2018
/S/ MICHAEL D. RUPPERT Michael D. Ruppert	Executive Vice President, Chief Financial Officer, and Treasurer (principal financial officer)	August 16, 2018
/S/ MICHELLE M. MCCARTHY Michelle M. McCarthy	Vice President, Controller, and Chief Accounting Officer (principal accounting officer)	August 16, 2018
/S/ VINCENT VITTO Vincent Vitto	Chairman of the Board of Directors	August 16, 2018
/S/ JAMES K. BASS James K. Bass	Director	August 16, 2018
/S/ MICHAEL A. DANIELS Michael A. Daniels	Director	August 16, 2018
/S/ LISA S. DISBROW Lisa S. Disbrow	Director	August 16, 2018
/S/ MARY LOUISE KRAKAUER Mary Louise Krakauer	Director	August 16, 2018
/S/ GEORGE K. MUELLNER George K. Muellner	Director	August 16, 2018
/S/ MARK S. NEWMAN Mark S. Newman	Director	August 16, 2018
/S/ WILLIAM K. O'BRIEN William K. O'Brien	Director	August 16, 2018

Table of Contents

EXHIBIT INDEX

ITEM NO. DESCRIPTION OF EXHIBIT

- 1.1 Underwriting Agreement, dated April 7, 2016, among Mercury Systems, Inc. as issuer and Citigroup Global Markets Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated as representatives of the several underwriters named therein (incorporated herein by reference to Exhibit 1.1 of the Company's current report on Form 8-K filed on April 8, 2016)
- 1.2 Underwriting Agreement, dated January 26, 2017, among the Company as issuer and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC as representatives of the several underwriters named therein (incorporated herein by reference to Exhibit 1.1 of the Company's current report on Form 8-K filed on January 27, 2017)
- 3.1.1 Articles of Organization (incorporated herein by reference to Exhibit 3.1.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009)
- 3.1.2 Articles of Amendment (incorporated herein by reference to Exhibit 3.1.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2010)
- 3.1.3 Articles of Amendment (incorporated herein by reference to Exhibit 1 of the Company's registration statement on Form 8-A filed on December 15, 2005)
- 3.1.4 Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on November 13, 2012)
- 3.1.5 Articles of Amendment (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on June 30, 2015)
- 3.2 Bylaws, amended and restated effective as of January 17, 2017 (incorporated herein by reference to Exhibit 3.1 of the Company's current report on Form 8-K filed on January 20, 2017)
- 4.1 Form of Stock Certificate (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-1/A filed on January 7, 1998)
- 10.1* 1997 Employee Stock Purchase Plan, as amended and restated (incorporated herein by reference to Appendix B to the Company's definitive proxy statement filed on October 29, 2015)
- 10.2* Form of Indemnification Agreement between the Company and each of its current directors (incorporated herein by reference to Exhibit 10.4 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2009)
- 10.3* Annual Executive Bonus Plan - Corporate Financial Performance (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on August 30, 2013)
- 10.4* 2005 Stock Incentive Plan, as amended and restated (incorporated herein by reference to Appendix A to the Company's definitive proxy statement filed on September 20, 2016)
- 10.5.1* Form of Stock Option Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
- 10.5.2* Form of Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
- 10.5.3* Form of Deferred Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8.3 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)
- 10.5.4* Form of Stock Option Agreement for performance stock options under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on September 28, 2007)
- 10.5.5* Form of Amended and Restated Performance-Based Restricted Stock Award Agreement under the 2005 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2014)
- 10.6.1*

Form of Change in Control Severance Agreement between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.9.1 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)

10.6.2*

Form of Change in Control Severance Agreement between the Company and Non-CEO Executives (incorporated herein by reference to Exhibit 10.9.2 of the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011)

10.7†

Compensation Policy for Non-Employee Directors

Table of Contents

ITEM NO. DESCRIPTION OF EXHIBIT

10.8.1* Employment Agreement, dated as of November 19, 2007, by and between the Company and Mark Aslett (incorporated herein by reference to Exhibit 10.1 of the Company’s current report on Form 8-K filed on November 20, 2007)

10.8.2* First Amendment to Employment Agreement, dated as of December 20, 2008, by and between the Company and Mark Aslett (incorporated by reference to Exhibit 10.2 of the Company’s quarterly report on Form 10-Q for the quarter ended December 31, 2008)

10.8.3* Second Amendment to Employment Agreement, dated as of September 30, 2009, by and between the Company and Mark Aslett (incorporated by reference to Exhibit 10.1 of the Company’s quarterly report on Form 10-Q for the quarter ended September 30, 2009)

10.9† Agreement, dated July 12, 2016, by and between the Company and Christopher C. Cambria

10.10 Micronetics, Inc. 2006 Equity Incentive Plan (incorporated herein by reference to Exhibit 99.1 to the Company’s registration statement on Form S-8 filed on August 10, 2012)

10.11 Stock Purchase Agreement by and between Mercury Systems, Inc. and Microsemi Corporation, dated as of March 23, 2016 (incorporated by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on April 4, 2016)

10.12.1 Credit Agreement, dated May 2, 2016, among Mercury Systems, Inc., the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent and Collateral Agent (incorporated by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on May 2, 2016)

10.12.2 Amendment No. 1 to Credit Agreement, dated June 27, 2017, among Mercury Systems, Inc., the Guarantors party thereto, the Lenders party thereto and Bank of America, N.A., as Administrative Agent and Collateral Agent (incorporated by reference to Exhibit 10.1 of the Company's current report on Form 8-K filed on June 27, 2017)

10.13 Agreement and Plan of Merger by and among Mercury Systems, Inc., Thunderbird Merger Sub, Inc., Ceres Systems and the Shareholder Representatives Named Herein Dated as of December 21, 2017 (incorporated herein by reference to Exhibit 10.1 of the Company’s current report on Form 8-K filed on February 1, 2018)

10.14* Letter Agreement, dated August 7, 2014, as amended to date, between Michael D. Ruppert and the Company (incorporated herein by reference to Exhibit 10.1 of the Company’s current report on Form 8-K filed on February 6, 2018)

12.1† Computation of Ratio of Earnings to Fixed Charges

21.1† Subsidiaries of the Company

23.1† Consent of KPMG LLP

23.3 Consent of SingerLewak LLP, independent accountants for Ceres Systems ("Ceres"), the holding company that owns Themis Computer ("Themis", and together with Ceres, collectively the "Acquired Company") (incorporated by reference to Exhibit 23.1 of the Company’s Current Report on Form 8-K/A filed with the Securities Exchange Commission on March 2, 2018)

31.1† Certification of the Company’s Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2† Certification of the Company’s Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1+ Certification of the Company’s Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

99.1 Unaudited consolidated financial statements of the Acquired Company as of September 30, 2017 and for the nine months ended September 30, 2017 and 2016 and accompanying notes thereto (incorporated by reference to Exhibit 99.1 of the Company’s Current Report on Form 8-K/A filed with the Securities Exchange Commission on March 2, 2018)

99.2

Audited consolidated financial statements of the Acquired Company as of and for the year ended December 31, 2016 and accompanying notes thereto (incorporated by reference to Exhibit 99.2 of the Company's Current Report on Form 8-K/A filed with the Securities Exchange Commission on March 2, 2018)

99.3 Unaudited pro forma condensed combined financial information as of December 31, 2017 and for the six months and year ended December 31, 2017 and June 30, 2017, respectively, and accompanying notes thereto (incorporated by reference to Exhibit 99.3 of the Company's Current Report on Form 8-K/A filed with the Securities Exchange Commission on March 2, 2018)

Table of Contents

ITEM NO. DESCRIPTION OF EXHIBIT

101† Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Statement of Operations, (ii) Consolidated Balance Sheet, (iii) Consolidated Statement of Shareholders' Equity, (iv) Consolidated Statement of Cash Flows, and (v) Notes to Consolidated financial Statements

* Identifies a management contract or compensatory plan or arrangement in which an executive officer or director of the Company participates.

† Filed with this Form 10-K.

Furnished herewith. This certification shall not be deemed "filed" for purposes of Section 18 of the Securities +Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.