Otto Analytics

FRONTIER GROWTH · CONVICTION RESEARCH

MRCY *Mercury Systems, Inc.*

● **Accumulate / Watch: right business, wrong price**

INVESTMENT MEMORANDUM | JUNE 28, 2026

CONVICTION	CURRENT PRICE	PRICE TARGET	HORIZON
6/10	$109.38 *as of June 26, 2026 close*	Bear $68 · Base $95 · Bull $130	2–3 years

Conviction scores reflect our analytical assessment and are not recommendations to buy, sell, or hold any security. These ratings do not take into account any individual subscriber's financial situation, investment objectives, or risk tolerance.

PRICE TARGET RANGE

✦ *AI-assisted. Human editorial review is required before publication. See disclaimer below.*

Thesis

Mercury Systems is a structurally advantaged, hard-to-replicate supplier of secure, trusted mission-processing electronics into a multi-year defense modernization supercycle, a real infrastructure position with a $1.6B record backlog and ITAR and trusted-foundry barriers competitors cannot cheaply cross. The Ballhaus turnaround is genuine and the macro tailwind is durable. But the stock has roughly doubled in a year, trades above consensus on margins still about half of management's own goal, and is pricing a fully recovered Mercury that does not yet exist.

The Debate

▲ BULL CASE

Visionary and Macro Man define a strong thesis spine. Mercury sits at the intersection of US defense modernization, NATO rearmament to 3%+ GDP, electronic-warfare, radar and missile-defense demand, and the mandated domestic trusted-microelectronics ecosystem, a structural regulatory moat. Operator confirms the moat is real: 10 to 30 year program design-in lock-in, cleared and TS/SCI manufacturing, $1.6B record backlog, 1.48x book-to-bill. The turnaround shows in the numbers, adj. EBITDA margin 15.3% versus 11.7% a year ago, free cash flow positive after years of pain. Electronic warfare is a large, fast-growing market, and Mercury is a picks-and-shovels supplier to that spend.

▼ BEAR CASE

Skeptic and Quant carry the warning. The recovery is incomplete and priced as if complete: a 15.3% adj. EBITDA margin is still about half the mid-20s target; TTM free cash flow has already re-decelerated to $73.5M from $119.0M; Q3 free cash flow was actually negative at roughly $1.8M. Valuation is extreme, around 78x EV/EBITDA, roughly 73x forward earnings, about 6.8x sales on a still-GAAP-loss business, above consensus, with Goldman Sachs at a Sell, $68. Thesis killer: an estimate-at-completion charge in the tens of millions on a ramping fixed-price program would crack both the margin narrative and the multiple at once.

CIO JUDGMENT

The bull case wins on the business and loses on the entry. The moat and backlog are real, the turnaround is structurally sound, and the macro tailwind is bipartisan and multi-year. What does not hold up is the valuation math. At roughly 78x EV/EBITDA on margins still half of target, above consensus, with Goldman at a Sell ($68) and zero insider buying into a stock that has doubled, the price embeds flawless execution, which is the one thing a half-finished turnaround cannot promise. The intent is to own Mercury, just not at $109. That is why this is Accumulate / Watch, not Buy.

Key Metrics

METRIC	VALUE	NOTE
Price	$109.38	June 26, 2026 close; above ~$101.50 consensus high
Revenue (TTM)	~$967M	+8.6% YoY; +11.5% organic Q3

METRIC	VALUE	NOTE
Backlog	~$1.6B record	Book-to-bill 1.48x; $891M within 12 months
Adj. EBITDA margin	15.3% (Q3)	vs 11.7% yr-ago; target mid-20s
Gross Margin	28.7% TTM	29.3% Q3; vs FY21 peak ~41.7%
GAAP EPS (TTM)	-$0.24	Still loss-making
FCF (TTM)	$73.5M	down from $119.0M FY25; Q3 -$1.8M
EV/EBITDA	~78x	as of June 26; vs A&D peers ~15–28x
Fwd P/E	~73x	as of June 26; prices full recovery
P/S (TTM)	~6.8x	on a still-GAAP-loss business
Rule of 40	Fail	margin still well below target
Net Debt	~$260M spot	~$110M pro-forma after $150M revolver repaid Apr 30
Short Interest	~7.7%	of float; June 15 settlement

Valuation multiples (EV/EBITDA, forward P/E, P/S, short interest) as of the June 26, 2026 close. Filing-based figures per the 10-Q (quarter ended March 27, 2026), 10-K (FY ended June 27, 2025), and Q3-FY26 press release.

Position Sizing

> Position sizes are illustrative only and are for general guidance purposes, not investment advice. Please determine appropriate position sizes based on your own financial circumstances, risk tolerance and investment objectives.

2%	3.5%	$45–68
RECOMMENDED	HARD CAP	WORST-CASE ZONE

Staged, dollar-cost entry over 8 to 12 weeks rather than a lump-sum purchase here. The name overlaps existing defense and aerospace exposure, so size down if the theme is already held. Worst case is a margin relapse paired with a fresh estimate-at-completion charge, which would retest the $45 to $68 zone, a drawdown on the order of 50 to 55% (the historical max drawdown ran near 72% from the 2020 peak to the 2024 trough). The cleanest expression is a small starter only on a pullback into the $90 to $100 structural support zone, then building on thesis confirmation: margins marching toward 20%, clean free cash flow, and book-to-bill holding above 1.

Tracked Prediction & Watch Items

KILL TRIGGERS

- ✕ An estimate-at-completion charge of $20M or more on a ramping fixed-price program, which would crack both the margin narrative and the multiple.
- ✕ Adjusted EBITDA margin stalls or reverses below 15% over the next two quarters.

CONFIRMATIONS

- ✓ Adjusted EBITDA margin marches toward 20% with clean, positive free cash flow.
- ✓ Book-to-bill holds above 1.0x and total backlog continues to build.

ENTRY SIGNALS

- Pullback into the $90 to $100 structural support zone.

Analyst Scorecard

2 Bull · 5 Neutral · **1 Bear**

Visionary	BULLISH	Infrastructure pick on battlefield digitization; durable EW and missile-defense supercycle.
Operator	NEUTRAL	Real ITAR and design-in moat and record backlog, but margins below the wide-moat bar.
Skeptic	BEARISH	Recovery real but incomplete and priced to perfection; FCF re-decelerating; Goldman Sell $68.
Quant	NEUTRAL	Genuine turnaround, but the multiple sits above every target and Rule of 40 fails; base near $95.
Macro Man	BULLISH	Structural tailwind: defense modernization, NATO rearmament, trusted microelectronics.
Insider	NEUTRAL	No insider buying into the run; quality buyer adding.
Risk Manager	NEUTRAL	Legit turnaround but easy money made; 2% staged, hard stops.

Technician	NEUTRAL	Markup, strong relative strength, but extended; wait for $90–100.

IMPORTANT DISCLAIMER: PLEASE READ

This report is produced and published by Otto Analytics, LLC ("the Company") and is provided for informational and educational purposes only. It is general in nature, does not constitute investment, financial, legal, or tax advice, and does not take into account the individual circumstances, objectives, financial situation, or risk tolerance of any reader.

No advisory relationship. Nothing here creates an investment-advisory, fiduciary, or other client relationship between you and the Company. The Company is not a registered investment adviser or broker-dealer. The Company does not provide advice attuned to any specific portfolio or to any subscriber's particular needs. All content is impersonal commentary offered uniformly to all subscribers.

Conviction scores. Conviction scores reflect our analytical assessment and are not recommendations to buy, sell, or hold any security. These ratings do not take into account any individual subscriber's financial situation, investment objectives, or risk tolerance.

Position sizing. Position sizes are illustrative only and are for general guidance purposes, not investment advice. Please determine appropriate position sizes based on your own financial circumstances, risk tolerance and investment objectives.

Not an offer or solicitation. Nothing here is an offer to sell, or a solicitation of an offer to buy, any security.

AI-assisted content. AI tools may be used in preparing this analysis. Human editorial review is required before publication. AI assistance and human review do not eliminate the possibility of errors, omissions, or inaccuracies. Data may be drawn from third-party sources believed to be reliable but not guaranteed to be accurate or current.

Risk of loss. All investing involves risk, including the possible loss of principal. Past performance is not indicative of future results. Forward-looking statements are inherently uncertain and should not be relied upon as predictions of actual future events.

Personal positions. The Company or its personnel may hold positions in securities discussed. Our commentary reflects disinterested analysis, and any personal holdings may be disclosed on our website.

Independent decisions. You are solely responsible for your own investment decisions and for executing your own trades. You should consult a licensed financial professional, attorney, and/or tax advisor before making any investment decision.

By accessing this report, you acknowledge and agree to the foregoing. This disclaimer is governed by the laws of the State of Oregon.

otto@ottoanalytics.ai