Otto Analytics

FRONTIER GROWTH · CONVICTION RESEARCH

MRCY *Mercury Systems, Inc.*

ACCUMULATE / WATCH — RIGHT BUSINESS, WRONG PRICE

INVESTMENT MEMORANDUM | JUNE 20, 2026

CONVICTION	CURRENT PRICE	PRICE TARGET	HORIZON
6/10	$113.91	Bear $68 · Base $95 · Bull $130	2–3 years

PRICE TARGET RANGE

✦ *Generated in part by an automated AI system. 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/trusted-foundry barriers competitors can't cheaply cross. The Ballhaus turnaround is genuine and the macro tailwind is durable. But the stock has already run +121% in a year, trades above every analyst target on margins still half of management's own goal, and is pricing a fully-recovered Mercury that doesn't yet exist.

The Debate

▲ BULL CASE

Visionary (Bullish) and Macro Man (Bullish) define a strong thesis spine. Mercury sits at the intersection of US defense modernization, NATO rearmament to 3%+ GDP, EW/radar/missile-defense ("Golden Dome") demand, and the mandated domestic trusted-microelectronics ecosystem — a structural regulatory moat. Operator confirms the moat is real: 10–30yr program design-in lock-in, cleared/TS-SCI manufacturing, $1.6B record backlog, 1.48x book-to-bill. The turnaround is showing in the numbers — adj. EBITDA margin 15.3% vs ~11% a year ago, FCF positive after years of pain. Electronic Warfare TAM alone is projected to roughly double to ~$64.66B by 2031 (14.9% CAGR), and Mercury is a picks-and-shovels supplier to that spend.

▼ BEAR CASE

Skeptic (Bearish, Moderate) and Quant (Neutral) carry the warning. The recovery is incomplete and priced as if complete: 15.3% adj. EBITDA margin is still ~half the mid-20s target; TTM FCF already re-decelerated to $73.5M from $119M; Q3 FCF was actually -$2M with ~$25M pulled forward from Q4. Valuation is extreme — ~80x EV/EBITDA (GAAP), ~107x forward non-GAAP P/E, ~7x P/S on a still-GAAP-loss business, 12% above consensus target, with Goldman at a Sell, $68. Thesis killer: a $20M+ EAC charge resurrection on a ramping fixed-price program would crack both the margin narrative and the multiple.

The Verdict

CIO JUDGMENT

The bull case wins on the business and loses on the entry. I can refute the Skeptic on durability — the moat and backlog are real, the turnaround is structurally sound, and the macro tailwind is bipartisan and multi-year; this is exactly the infrastructure-layer defense name our framework favors. What I cannot refute is the valuation math. At ~80x EV/EBITDA on margins still half of target, 12% above consensus, with Goldman at a Sell ($68) and zero insider buying into a 121% rally, the price embeds flawless execution. Per our discipline, an unrefuted valuation bear case caps conviction. I want to own Mercury — not at $114. That's why it's Accumulate/Watch, not Buy.

Key Metrics

METRIC	VALUE	NOTE
Price	$113.91	+121% 1yr; above $101.50 consensus
Revenue (TTM)	~$967M	+8.95% YoY; +11.5% organic Q3
Backlog	~$1.6B record	Book-to-bill 1.48x
Adj. EBITDA margin	15.3% (Q3)	vs ~11% yr-ago; target mid-20s
Gross Margin	28.7% TTM / 29.3% Q3	vs FY21 peak 41.7%; peers 35–38%
GAAP EPS (TTM)	-$0.23	Still loss-making
FCF (TTM)	$73.5M	down from $119M FY25; Q3 -$2M
EV/EBITDA	~80x GAAP / ~50x adj	vs A&D peers ~15–28x
Fwd P/E (non-GAAP)	~107x	Prices full recovery
P/S	~7x	vs CW ~4x, HEI ~6x
Rule of 40	~17	Fail
Net Debt	~$322M	Total debt ~$654M; ~2.2x adj. EBITDA
Short Interest	~8%	Rising

Position Sizing

2%	3.5%	50–55%
RECOMMENDED	HARD CAP	WORST-CASE ZONE

Per Risk Manager: 2% recommended, 3.5% hard cap, staged/DCA entry (8–12 weeks) — not lump-sum here. Overlaps existing defense/A&D (ITA-correlated); size down if you already hold the theme. Worst case: margin relapse + EAC charge re-tests $45–68, a ~50–55% drawdown (historical max drawdown ~72%, 2020 peak → 2024 trough). Cleanest expression: small starter only on a pullback into the $90–100 structural support zone, build on thesis confirmation (margin march toward 20%, clean FCF, book-to-bill >1).

Analyst Scorecard

2 Bull | 5 Neutral | 1 Bear

ANALYST	RATING	TAKE
Visionary	BULLISH	Infrastructure pick on battlefield digitization; durable EW/missile-defense supercycle, strong trend conviction.
Operator	NEUTRAL	Real ITAR/design-in moat (narrow, widening) and record backlog, but margins below wide-moat bar.
Skeptic	BEARISH	Recovery real but incomplete and priced to perfection; FCF re-decelerating; GS Sell $68.
Quant	NEUTRAL	Genuine turnaround, but ~80x EBITDA / ~107x fwd P/E above all targets; Rule of 40 fails; base ~$95.
Macro Man	BULLISH	Structural tailwind — defense modernization, NATO rearmament, trusted microelectronics.
Insider	NEUTRAL	No insider buying into the rally; Jana profit-taking but keeps board seat; quality buyer Segall Bryant adding.
Risk Manager	NEUTRAL	Legit turnaround but easy money made; 2% staged, hard stops.
Technician	NEUTRAL	Markup, strong RS (+121% 1yr vs SPY +25%), but extended; entry Unfavorable, wait $90–100.

The Otto Analytics Lens

Otto Analytics is a long-duration growth mandate. We seek to identify secular supercycles early — platform shifts at the frontier of AI infrastructure, advanced compute, connectivity, and next-generation energy — and build concentrated, conviction-weighted positions in the businesses best positioned to dominate them over a 3–5 year horizon. We are allocators, not traders: we buy to hold for years, minimize turnover and tax drag, and sell only on a broken thesis, never a price drop. A recommendation is therefore a judgment of fit against *this* mandate, not a verdict on a company's quality. A fundamentally excellent business may rate "Watch" because its valuation, catalyst timing, or strategic fit does not serve this specific strategy at this specific price.