

CUBIC CORP /DE/  
Form 10-K  
December 04, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**  
**EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended September 30, 2008**

**Commission File Number 1-8931**

**CUBIC CORPORATION**

Exact Name of Registrant as Specified in its Charter

**Delaware**  
State of Incorporation

**95-1678055**  
IRS Employer Identification No.

**9333 Balboa Avenue**  
**San Diego, California 92123**  
**Telephone (858) 277-6780**

Securities registered pursuant to Section 12(b) of the Act:

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**Common Stock**  
Title of each class

**New York Stock Exchange, Inc.**  
Name of exchange on which registered

Securities registered pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes  No

The aggregate market value of 15,549,143 shares of voting stock held by non-affiliates of the registrant was: \$442,062,135 as of March 31, 2008, based on the closing stock price on that date.

Number of shares of common stock outstanding as of November 12, 2008 including shares held by affiliates is: 26,727,487 (after deducting 8,945,120 shares held as treasury stock).

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Registrant's Proxy Statement for its 2009 Annual Meeting of Shareholders to be held on February 24, 2009, are incorporated by reference into Part III of this Annual Report on Form 10-K.



**PART I**

**Item 1. BUSINESS.**

**GENERAL**

CUBIC CORPORATION (Cubic or the Company), was incorporated in the State of California in 1949 and began operations in 1951. In 1984, the Company moved its corporate domicile to the State of Delaware.

We design, develop, manufacture and install products which are mainly electronic in nature, such as:

Equipment for use in customized military range instrumentation, training and applications systems, simulators, communications and surveillance systems, surveillance receivers, power amplifiers, and avionics systems.

Automated revenue collection systems, including contactless smart cards, passenger gates, central computer systems and ticket vending machines for mass transit networks, including rail systems, buses, and parking applications.

We also perform a variety of services, such as computer simulation training, distributed interactive simulation and development of military training doctrine, as well as field operations and maintenance. We also manufacture replacement parts for the products we produce.

During fiscal year 2008, approximately 54% of our total business was conducted, either directly or indirectly, with various agencies of the United States government. Most of the remainder of our revenue was from local, regional and foreign governments or agencies.

Cubic's internet address is [www.Cubic.com](http://www.Cubic.com). The content on our website is available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Form 10-K. We make available free of charge on or through our Internet website under the heading Investor Information, our reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission.

## **BUSINESS SEGMENTS**

Information regarding the amounts of revenue, operating profit and loss and identifiable assets attributable to each of our business segments, is set forth in Note 11 to the Consolidated Financial Statements for the year ended September 30, 2008. Additional information regarding the amounts of revenue and operating profit and loss attributable to major classes of products and services is set forth in Management's Discussion and Analysis which follows at Item 7.

### **DEFENSE**

Cubic's defense business segment consists of three market-focused businesses: Mission Support Services, Training Systems and Communications. Our products include customized military range instrumentation systems, electro-optical systems, firearm simulation systems, communications and surveillance systems, surveillance receivers, power amplifiers, and avionics systems. Our services include training mission support, computer simulation training, distributed interactive simulation, development of military training doctrine, and field operations and maintenance. We market our capabilities directly to various U.S. government departments and agencies and foreign governments. In addition, we frequently contract or team with other leading defense suppliers.

#### **Mission Support Services**

Cubic Mission Support Services (MSS) is a leading provider of training, operations, maintenance, technical, and other support services to the U.S. Government and allied nations, with an emphasis on military training. MSS comprises approximately 5,000 Cubic employees working at more than 130 locations throughout the world. Our people serve with clients in actual training and operational environments to help prepare and support forces through provision of comprehensive training, exercises, education, operational, and logistical assistance to meet the full scope of their assigned missions. The scope of mission support that Cubic provides includes training and rehearsal for both small and large scale combat operations; combat and material development; logistics and maintenance support for fielded and deployed systems; special operations; peacekeeping; consequence management; and humanitarian assistance operations worldwide. We plan, prepare, execute and document realistic and focused mission rehearsal exercises (using both live and computer-based exercises) as final preparation of forces prior to deployment. In addition, we provide high level consultation and advisory services to the governments and militaries of allied nations.

In July 2008, we acquired all outstanding capital stock of the privately-held Omega Training Group, Inc. (Omega). Omega provides training, testing, analysis, logistics and staffing services to U.S. Army locations at the U.S. Army Infantry School at Fort Benning, Fort Bliss, Fort Jackson and Fort Hood. Founded in 1990, Omega now has 790 employees. We believe this acquisition will enhance our position in the defense services market place and add revenues of approximately \$60 -70 million in 2009.

U.S. government service contracts are typically awarded on a competitive basis with options for multiple years. In this competitive market, Cubic is viewed as a premier service provider and formidable competitor. We typically compete as prime contractors to the government, but also team with other companies, depending on the skills required. Much of our early work centered on battle command training and simulation, in which military commanders are taught to make correct decisions in battle situations. More recently, our business base has broadened to include integrated live, virtual, and constructive training support; advanced distance learning and other professional military education; comprehensive logistics and maintenance support; weapons effects and analytical modeling; intelligence analysis; homeland security training and exercises; and military force modernization. Additionally, we support the deployment and re-deployment of both active and reserve component forces at U.S. Army Mobilization Centers at Fort Bliss, TX and several other U.S. locations; and we provide in-country logistics, maintenance, operational, and training support to U.S. Forces deployed in Kuwait, Iraq, and Afghanistan.



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Cubic's contracts include providing mission support services to three of the Army's major Combat Training Centers (CTCs): the Joint Readiness Training Center (JRTC) as prime contractor; and to the National Training Center (NTC) and Battle Command Training Program (BCTP) as a principal subcontractor. These services include planning, executing, and documenting large scale exercises aimed at stressing both active and reserve U.S. forces in situations as close to actual combat as possible.

At U.S. Joint Forces Command (USJFCOM), Cubic is a principal member of the contractor team that supports and helps manage all aspects of the operations of the Joint Warfighting Center (JWFC), including support to worldwide exercises and the development and fielding of the Joint National Training Capability (JNTC). We provide similar technical and management support services to the U.S. Army's National Simulation Center (NSC) at Fort Leavenworth, Kansas. Under the Marine Air Ground Task Force (MAGTF) Training Systems Support (MTSS) contract, Cubic provides comprehensive training and exercise support to U.S. Marine Corps forces worldwide, including real-world mission rehearsals. We have planned and executed virtually all Marine Corps simulation-based exercises worldwide since 1998, directly preparing Marines for combat operations. Cubic provides training and professional military education support to the U.S. Army's Quartermaster Center and School and to the Transportation School. We also provide contractor maintenance and instructional support necessary to operate and maintain a wide variety of flight simulation systems, Unmanned Aerial Vehicles (UAV), and other facilities worldwide for U.S. and allied forces under multiple long-term contracts. In addition, we provide a broad range of operational support to the U.S. Navy's Anti-Submarine Warfare (ASW) Command.

Cubic initiated and has continued to operate the Korea Battle Simulation Center (KBSC) since its inception in 1991. KBSC prepares U.S. and allied forces in Korea to deal with mission situations that may develop in their areas of responsibility. Our KBSC contract includes support to the world's largest and most complex simulation-based training events.

At the U.S. Army I Corps Battle Simulation Center, Cubic provides the technical and operational expertise necessary to support worldwide training, exercises, evaluations, and mission rehearsals for I Corps active and reserve component units, the new Stryker brigades, other services, and joint commands.

Cubic supports the Defense Threat Reduction Agency (DTRA) with technology-based engineering and other services necessary to accomplish DTRA's mission of predicting and defeating the effects of chemical, biological, radiological, nuclear and high explosive (CBRNE) weapons. Cubic supports DTRA with modeling and simulations to analyze, assess and predict the effects of such weapons in combat and other environments. Additionally, Cubic provides comprehensive support to help plan, manage, and execute DTRA's worldwide CBRNE exercise program, which trains senior U.S. and allied civilian and military personnel, first responders, and other users of DTRA products.

Cubic has multiple contracts with the U.S. Army and other government agencies to improve the quality and reach of training and education initiatives for individuals up through large organizations. Cubic's products and capabilities include development and deployment of curriculum and related courseware, computer-based training, knowledge management and distribution, advanced distance learning, serious games for training, and other advanced education programs for U.S. and allied forces.

An important part of Cubic's services business is to provide specialized teams of military experts to advise the governments and militaries of the nations of the former Warsaw Pact and Soviet Union, and other former communist countries in the transformation of their militaries to a NATO environment. These very broad defense modernization contracts entail sweeping vision and minute detail, involving both the nations' strategic foundation and the detailed planning of all aspects of reform. Cubic also operates battle simulation centers for select countries in Central and Eastern Europe.

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We believe the combination and scope of Cubic's growing mission support services and training systems business is unique in the industry, permitting us to offer customers a complete training and combat readiness capability from one source.

## **Training Systems**

Our Training Systems business is a pioneer and market leader in the design and production of instrumented training systems for military customers. These systems generally permit live training in air and ground combat environments, with weapons and other effects simulated by electronic and/or laser technology. The systems also enable the collection (based on Global Positioning System technology) and analysis of behavior and event data for determination of combat effectiveness and lessons learned. As such, the systems generally have a high degree of communications and software sophistication.

Our training business is organized into Air Combat Training, Ground Combat Training, Electro-optics, and Simulation Systems. In Air Combat Training, Cubic was the initial developer and supplier of Air Combat Maneuvering Instrumentation (ACMI) capability during the Vietnam War and continues to lead that market with the competitive award in 2003 of a 10-year, \$525 million indefinite delivery/ indefinite quantity (IDIQ) contract to provide upgraded air combat training capability to the U.S. Air Force, Navy and Marine Corps. The latest ACMI systems permit forces to train on either a fixed geographic range or in a rangeless environment. Many other nations employ Cubic's ACMI systems.

Our Ground Combat Training involves systems analogous to air ranges for ground force training. Cubic provided turnkey systems to instrument two U.S. Army training centers in past years at Fort Polk, LA (Joint Readiness Training Center - JRTC) and Hohenfels, Germany (Combat Maneuver Training Center - CMTC) and is engaged in a multiyear effort to expand capability of the Alaska Training Range. The unit also built ranges in recent years for the British Army in the U.K. and Canada. We are currently working on similar ground combat training centers for Canada, Australia and for customers in the Middle East and Far East. To meet new customer demand for mobile instrumented training, Cubic has also developed a transportable, deployable system, known as I-HITS. In 2005, Cubic was awarded a five-year \$72 million IDIQ contract to produce I-HITS for the U.S. Army.

Electro-optics includes laser-based tactical engagement simulation systems, generally known as MILES (Multiple Integrated Laser Engagement Simulators), which are used at combat training centers (CTC) and in other training environments to permit weapons to be used realistically, registering hits or kills, without live ammunition. We supply MILES equipment as part of CTC contracts and as an independent product line. Cubic MILES systems are being heavily utilized by U.S. Army and Marine Corps forces, as well as Air Force security forces, other U.S. agencies and many international customers. We produce MILES equipment in the U.S. and at our New Zealand-based subsidiary, Cubic Defence New Zealand. In 2005, Cubic was awarded a 5-year \$113 million IDIQ contract to produce MILES Individual Weapon System (IWS) kits for the U.S. Army.

Our Simulation Systems Division (SSD) produces virtual training systems, employing actual or realistic weapons and systems together with visual imagery to simulate actual battlefield or other environments. SSD also produces combat system and maintenance trainers.

## **Communications**

Our Communications business is a supplier of secure data links, intelligence receivers, high power RF amplifiers, direction finding systems and search and rescue avionics to the U.S. military, other agencies and allied nations. Our products support the strong military trend toward network-centric warfare, intelligence collection and overall modernization initiatives. The unit has long supplied the air/ground secure data link for the U.S. Army/Air Force Joint STARS system and supplies the principal datalink for the United Kingdom's ASTOR program. Capitalizing on a multiyear internal R&D program, we won a competitive contract in fiscal 2003 to develop and produce the next-generation Common Data Link Subsystem (CDLS) for the U.S. Navy. CDLS has been installed on major surface ships of the U.S. fleet. Smaller, tactical versions of our Common Data Link have been selected for both legacy and new military platforms, such as UAVs, which require high performance in a small

package. These contracts include the U.K. Watchkeeper and the U.S. Firescout.

Our Personnel Locator System (PLS) is standard equipment on U.S. aircraft with a search-rescue mission. We have continued to receive orders for an upgraded PLS which has been redesigned to interface with all modern search and rescue system standards, thus positioning us for major platform upgrades expected over the next few years.

We also supply high power amplifiers, intelligence receivers and direction finding systems to major primes and end users for both domestic and international applications. These include systems used by the Canadian Coast Guard, the U.S. Navy and the U.S. Air Force. System level applications of these products to the worldwide Electronic Warfare marketplace is a major thrust for this business area.

**Raw Materials:**

The principal raw materials used by the defense segment are sheet aluminum and steel, copper electrical wire, and composite products. A significant portion of the segment's end products are composed of purchased electronic components and subcontracted parts and supplies. These items are primarily procured from commercial sources. In general, supplies of raw materials and purchased parts are adequate to meet the requirements of the segment.

**Backlog:**

Funded sales backlog of the defense segment at September 30, 2008 was \$593 million compared to \$602 million at September 30, 2007. Total backlog, including unfunded customer orders, was \$1,292 million at September 30, 2008 compared to \$1,247 million at September 30, 2007. Approximately \$805 million of the September 30, 2008 total backlog is not expected to be completed by September 30, 2009.

**Competition:**

Cubic's broad defense business portfolio means we compete with numerous companies, large and small, domestic and international. Well known Cubic competitors include Lockheed Martin, Northrop Grumman, General Dynamics, Boeing, L3 Communications, and SAIC. In many cases, we have also teamed with these same companies on specific bid opportunities. While Cubic is generally smaller than its competitors, we believe our competitive advantages include an outstanding record of past performance, strong incumbent relationships, our ability to control operating costs, and the ability to rapidly focus technology and innovation to solve customer problems.

Projects must compete for funding in the defense budget. While the U.S. defense budget has seen above average increases in recent years, long-term growth will only occur in those segments that offer very high payoff and are consistent with warfighting priorities and growing fiscal restraints. The U.S. defense market today can be characterized as highly dynamic, with priorities and funding shifting in reaction to, or anticipation of, world events much more rapidly than during the Cold War or since. Overarching military priorities include lighter, faster, more lethal forces with the ability and training to rapidly adapt to new situations based on superior knowledge of the battle environment. Superior knowledge is enabled by systems that rapidly collect, process and disseminate the right information to the right place at the right time, resulting in what DoD calls network-centric warfare. We believe Cubic's training systems, training support and intelligence, surveillance and reconnaissance capabilities are well matched to these sustainable defense priorities.

**TRANSPORTATION SYSTEMS**

Cubic Transportation Systems (CTS) is the leading turnkey solution provider of automated fare collection systems for public transport authorities worldwide. We provide a range of service and system solutions for the bus, bus rapid transit, light rail, commuter rail, heavy rail, ferry and parking markets. These solutions and services include system design, central computer systems, equipment design and manufacturing, device-level software, integration, test, installation, warranty, maintenance, computer hosting services, call center services, card management and distribution services, financial clearing and settlement, multi-application support and outsourcing services. In addition, CTS designs, develops and

manufactures special technology components, such as smart card readers and magnetic ticket transports for use within its suite of fare collection equipment consisting of on-bus solutions, access control solutions, vending solutions, retail and card issuing solutions, and mobile inspection and sales solutions.

Over the years, the transportation segment has been awarded over 400 projects in 40 major markets on 5 continents. Active projects include London, and various other cities around the U.K., Miami, Florida, Vancouver, B.C. Canada, the New York / New Jersey region, the Washington, D.C. / Baltimore / Virginia region, the Los Angeles region, the San Diego region, San Francisco, Minneapolis/St. Paul, Chicago, Atlanta, Brisbane, Australia, and Sweden.

These programs provide a base of current business and the potential for additional future business as the systems are expanded. In 1998, Transaction Systems Limited (TranSys), a company in which Cubic has a 37.5% ownership, was awarded a contract called PRESTIGE to outsource the London Transport fare collection services. This contract, now in its tenth year, is the largest automated fare collection contract ever awarded. In August 2008, Transport for London (TfL) notified TranSys that they it would terminate the PRESTIGE fare collection system contract as of August 2010 in accordance with an early termination option in the contract. To replace PRESTIGE, TfL, awarded a contract directly to Cubic for continuing the services until 2013. The new contract, with an initial value of £170 million (\$255 million), will include all the existing operational services as well as laying the groundwork for future ticketing innovations such as mobile phone ticketing and bank card ticketing.

### **Industry Overview**

Transport agencies, particularly those based in the U.S., rely heavily on federal, state and local government for subsidies in capital investments, including new procurements and/or upgrades of automated fare collection systems. The average lifecycle for rail fare collection systems is 12 to 15 years, and for bus systems is 7 to 10 years. Procurements tend to follow a long and strict competitive bid process where low price is a significant factor.

The automated fare collection business is a niche market able to sustain only a relatively few number of suppliers. Because of the long life expectancy of these systems and only a few companies able to supply them, there is fierce competition to win these jobs, often resulting in low initial contract profitability.

Advances in communications, networking and security technologies are enabling interoperability of multiple modes of transportation within a single networked system as well as interoperability of multiple operators within a single networked system. As such, there is a growing trend for regional ticketing systems, usually built around a large transit agency and including neighboring operators, all sharing a common regional smart card. There is an emerging trend for other applications to be added to these regional systems to expand the utility of the smart card, offering higher value and incentives to the end users and lowering costs and creating new revenue streams for the regional system operators. As a result, these regional systems have created opportunities for new levels of systems support and services including call center support, smart card production and distribution, financial clearing and settlement and multi-application support. In some cases, operators are choosing to outsource the ongoing operations and commercialization of these regional ticketing systems. This growing new market provides the opportunity to establish lasting relationships and grow revenues and profits over the long-term.

### **Raw Materials:**

Raw materials used in this segment include sheet steel, composite products, copper electrical wire and castings. A significant portion of the segment's end product is composed of purchased electronic components and subcontracted parts and supplies. All of these items are procured from commercial sources. In general, supplies of raw materials and purchased parts are adequate to meet the requirements of the segment.

**Backlog:**

Funded sales backlog of the transportation systems segment at September 30, 2008 and 2007 amounted to \$481 million and \$787 million, respectively. As mentioned above, TfL exercised an early termination option in the PRESTIGE contract and, as a result, the last five years of our contracts with TranSys and the other major TranSys shareholder were also terminated, effective August 2010. Therefore, this portion of the contract value was removed from backlog as of September 30, 2008. Transportation systems backlog at September 30, 2007 included \$290 million (£142 million) relating to these contracts covering the period from August 2010 through August 2015. In November 2008, TfL awarded Cubic directly a new three year contract that includes virtually all of the services currently being performed by TranSys through the major shareholders. The term of this contract is for the time period from August 2010 to August 2013, with a base value of approximately \$255 million (£170 million), which will be added to backlog in the quarter ending December 31, 2008. Approximately \$221 million of the September 30, 2008 backlog is not expected to be completed by September 30, 2009.

**Competition:**

We are one of several companies involved in providing automated fare collection systems solutions and services for public transport operators worldwide including such foreign competitors as Thales, ACS and Scheidt & Bachmann. In addition, there are many smaller local companies, particularly in European and Asian markets. For large national tenders, our competitors may form consortiums that could include, in addition to the fare collection companies noted above, telecommunications, financial institutions, consulting and computer services companies. These procurement activities are very competitive and require that we have highly skilled and experienced technical personnel to compete. We believe that our competitive advantages include intermodal and interagency regional integration expertise, technical skills, past contract performance, systems quality and reliability, experience in the industry and long-term customer relationships.

**BUSINESS STRATEGY**

Our objective is to consistently grow sales, improve profitability and deliver attractive returns on capital. We intend to build on our position with U.S. and foreign governments as the leading full spectrum supplier of training systems and mission support services, grow our niche position as a supplier of network-centric technologies for communications systems and products, and maintain our position as the leading provider of integrated intermodal regional transit fare collection systems to transit authorities worldwide. Our strategies to achieve these objectives include:

**Leverage Long-Term Relationships**

We seek to maintain long-term relationships with our customers through repeat business by continuing to achieve high levels of performance on our existing contracts. By achieving this goal we can leverage our returns through repeat business with existing customers and expand our presence in the market through sales of similar systems at good value to additional customers.

An example of this in our defense segment is the recent award of a contract to provide the next generation U.S. air combat training system. Starting in 1971 Cubic developed the first generation of Air Combat Maneuvering Instrumentation system, or ACMI, for the U.S. Military for live combat training. In 2003 the company was awarded the P5 \$525 million ID/IQ contract to deliver the latest technology for rangeless live

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training to the U.S. and foreign militaries. In 2007 the company was awarded a \$50.3 million contract to develop the next generation of live training for the F-35 Joint Strike Fighter aircraft using embedded technology. Thus since the initial contract in 1971 the company has successfully and continuously supplied the U.S. and foreign militaries with the latest in air combat training technologies.

In our transportation segment we have had a continuous relationship with Transport for London (TfL) since the 1970 s. Starting with a small trial of magnetic ticketing and gating in 1978, the company has continuously delivered fare collection equipment and systems to TfL as its exclusive fare collection system supplier. Today under the PRESTIGE contract more than 22 million Oyster smart cards have been sold, making this one of the largest transportation smart card systems in the world. In August 2008 TfL notified our 37.5% owned company, TranSys, that it was exercising its option to terminate the PRESTIGE contract for convenience effective in August 2010 and, subsequently, awarded Cubic the follow-on contract to operate and maintain the Oyster system under a contract called the Future Ticket Agreement, thus continuing Cubic s relationship through 2013. Similarly, we are regionalizing integrated fare collection systems in Washington D.C., New York and Southern California.

### **Maintain a Diversified Business Mix**

We have a diverse mix of business in our defense and transportation systems segments. Approximately 54% of our sales are made directly or indirectly to the U.S. government; however, this represents a wide variety of product and service sales to many different U.S. government agencies. The largest single contract in the transportation segment is the PRESTIGE contract in London which represented about 13% of consolidated sales in 2008.

We also seek a reasonable balance between systems and service work in both the defense and transportation segments. In aggregate, approximately 46% of our sales revenue in 2008 was from service type work. We believe that a strong base of service work helps to smooth the revenue fluctuations inherent in systems type work.

### **Pursue Strategic Acquisitions**

We are focused on finding attractive acquisitions to enhance our market positions. We look for specific growth opportunities in the defense and transportation marketplaces, and adjacent markets in smart cards and security. In 2008 we acquired a company whose business included strong positions in training services and logistical support. This acquisition enhanced our position at key U.S. Army installations that will become more important as the Base Realignment and Closing efforts continue. This acquisition should also enable us to expand our service offerings to the U.S. Army

### **OTHER MATTERS**

We pursue a policy of seeking patent protection for our products where deemed advisable, but do not regard ourselves as materially dependent on patents for the maintenance of our competitive position.

We do not engage in any business that is seasonal in nature. Because our revenues are generated primarily from work on contracts performed by our employees and subcontractors, first quarter revenues tend to be lower than the other three quarters due to our policy of providing many of our employees seven holidays in the first quarter, compared to one or two in each of the other quarters of the year. This is not necessarily a consistent pattern as it depends upon actual activities in any given year.

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The cost of Company sponsored research and development (R&D) activities was \$12.2 million, \$5.2 million and \$6.1 million in 2008, 2007 and 2006, respectively. We do not rely heavily on internally funded R&D, as most of our new product development occurs in conjunction with the performance of work on our contracts. The amount of contract-required product development activity was \$55 million in 2008 compared to \$66 million and \$64 million in 2007 and 2006, respectively; however, these costs are included in cost of sales as they are directly related to contract performance.

We comply with federal, state and local laws and regulations regarding discharge of materials into the environment and the handling and disposal of materials classed as hazardous and/or toxic. Such compliance has no material effect upon the capital expenditures, earnings or competitive position of the Company.

We employed approximately 7,000 persons at September 30, 2008.

Our domestic products and services are sold almost entirely by our employees. Overseas sales are made either directly or through representatives or agents.

**Item 1A. RISK FACTORS.**

The following are some of the factors we believe could cause our actual results to differ materially from expected and historical results. Additional risks and uncertainties not presently known to us, or that we currently see as immaterial, may also harm our business. If any of the risks or uncertainties described below or any such additional risks and uncertainties actually occur, our business, results of operations or financial condition could be materially and adversely affected.

*We depend on government contracts for substantially all of our revenues and the loss of government contracts or a delay or decline in funding of existing or future government contracts could adversely affect our sales and cash flows and our ability to fund our growth.*



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Our revenues from contracts, directly or indirectly, with foreign and United States, state, regional and local governmental agencies represented more than 95% of our total revenues in fiscal year 2008. Although these various government agencies are subject to common budgetary pressures and other factors, many of our various government customers exercise independent purchasing decisions. Because of the concentration of business with governmental agencies, we are vulnerable to adverse changes in our revenues, income and cash flows if a significant number of our government contracts or subcontracts or prospects are delayed or canceled for budgetary or other reasons.

The factors that could cause us to lose these contracts or could otherwise materially harm our business, prospects, financial condition or results of operations include:

- re-allocation of government resources as the result of actual or threatened terrorism or hostile activities;
- budget constraints affecting government spending generally, or specific departments or agencies such as U.S. or foreign defense and transit agencies and regional transit agencies, and changes in fiscal policies or a reduction of available funding;
- Disruptions in our customers' ability to access funding from capital markets;
- changes in government programs or requirements or their timing;
- curtailment of government's use of technology products and service providers;
- the adoption of new laws or regulations pertaining to government procurement;
- government appropriations delays or shutdowns;
- suspension or prohibition from contracting with the government or any significant agency with which we conduct business;
- impairment of our reputation or relationships with any significant government agency with which we conduct business;
- impairment of our ability to provide third-party guarantees and letters of credit; and

- delays in the payment of our invoices by government payment offices.

*Government spending priorities may change in a manner adverse to our businesses.*



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In the past, our businesses have been adversely affected by significant changes in government spending during periods of declining budgets. A significant decline in overall spending, or the decision not to exercise options to renew contracts, or the loss of or substantial decline in spending on a large program in which we participate could materially adversely affect our business, prospects, financial condition or results of operations. As an example, the U.S. defense and intelligence budgets generally, and spending

in specific agencies with which we work, such as the Department of Defense, have declined from time to time for extended periods since the 1980s, resulting in program delays, program cancellations and a slowing of new program starts. Although spending on defense-related programs by the U.S. government has recently increased, future levels of expenditures and authorizations for those programs may decrease, remain constant or shift to programs in areas where we do not currently provide products or services.

Even though our contract periods of performance for a program may exceed one year, Congress must usually approve funds for a given program each fiscal year and may significantly reduce funding of a program in a particular year. Significant reductions in these appropriations or the amount of new defense contracts awarded may affect our ability to complete contracts, obtain new work and grow our business. Congress does not always enact spending bills by the beginning of the new fiscal year. Such delays leave the affected agencies under-funded which delays their ability to contract. Future delays and uncertainties in funding could impose additional business risks on us.

*Our contracts with government agencies may be terminated or modified prior to completion, which could adversely affect our business.*



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Government contracts typically contain provisions and are subject to laws and regulations that give the government agencies rights and remedies not typically found in commercial contracts, including providing the government agency with the ability to unilaterally:

- terminate our existing contracts;
- reduce the value of our existing contracts;
- modify some of the terms and conditions in our existing contracts;
- suspend or permanently prohibit us from doing business with the government or with any specific government agency;
- control and potentially prohibit the export of our products;
- cancel or delay existing multiyear contracts and related orders if the necessary funds for contract performance for any subsequent year are not appropriated;
- decline to exercise an option to extend an existing multiyear contract; and
- claim rights in technologies and systems invented, developed or produced by us.

Most U.S. government agencies and some other agencies with which we contract can terminate their contracts with us for convenience, and in that event we generally may recover only our incurred or committed costs, settlement expenses and profit on the work completed prior to termination. If an agency terminates a contract with us for default, we are denied any recovery and may be liable for excess costs incurred by the agency in procuring undelivered items from an alternative source. We may receive show-cause or cure notices under contracts that, if not addressed to the agency's satisfaction, could give the agency the right to terminate those contracts for default or to cease procuring our services under those contracts.

In the event that any of our contracts were to be terminated or adversely modified, there may be significant adverse effects on our revenues, operating costs and income that would not be recoverable.

*Failure to retain existing contracts or win new contracts under competitive bidding processes may adversely affect our revenue.*



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We obtain most of our contracts through a competitive bidding process, and substantially all of the business that we expect to seek in the foreseeable future likely will be subject to a competitive bidding process. Competitive bidding presents a number of risks, including:

- the need to compete against companies or teams of companies with more financial and marketing resources and more experience in bidding on and performing major contracts than we have;
- the need to compete against companies or teams of companies that may be long-term, entrenched incumbents for a particular contract for which we are competing and that have, as a result, greater domain expertise and better customer relations;

- the need to compete to retain existing contracts that have in the past been awarded to us on a sole-source basis;
- the expense and delay that may arise if our competitors protest or challenge new contract awards;
- the need to bid on some programs in advance of the completion of their design, which may result in higher research and development expenditures, unforeseen technological difficulties, or increased costs which lower our profitability;
- the substantial cost and managerial time and effort, including design, development and marketing activities, necessary to prepare bids and proposals for contracts that may not be awarded to us;
- the need to develop, introduce, and implement new and enhanced solutions to our customers' needs;
- the need to locate and contract with teaming partners and subcontractors; and
- the need to accurately estimate the resources and cost structure that will be required to perform any fixed-price contract that we are awarded.

We may not be afforded the opportunity in the future to bid on contracts that are held by other companies and are scheduled to expire if the agency decides to extend the existing contract. If we are unable to win particular contracts that are awarded through the competitive bidding process, we may not be able to operate in the market for services that are provided under those contracts for a number of years. If we win a contract, and upon expiration, if the customer requires further services of the type provided by the contract, there is frequently a competitive rebidding process and there can be no assurance that we will win any particular bid, or that we will be able to replace business lost upon expiration or completion of a contract.

Because of the complexity and scheduling of contracting with government agencies, we occasionally incur costs before receiving contractual funding by the government agency. In some circumstances, we may not be able to recover these costs in whole or in part under subsequent contractual actions.

If we are unable to consistently retain existing contracts or win new contract awards, our business prospects, financial condition and results of operations will be adversely affected.

*Government audits of our contracts could result in a material charge to our earnings and have a negative effect on our cash position following an audit adjustment.*

Many of our government contracts are subject to cost audits which may occur several years after the period to which the audit relates. If an audit identifies significant unallowable costs, we could incur a material charge to our earnings or reduction in our cash position.

*Our international business exposes us to additional risks, including exchange rate fluctuations, foreign tax and legal regulations and political or economic instability that could harm our operating results.*

Our international operations, including our contract for the London Transport fare collection system, subject us to risks associated with operating in and selling products or services in foreign countries, including:

- devaluations and fluctuations in currency exchange rates;
  
- changes in foreign laws that adversely affect our ability to sell our products or services or our ability to repatriate profits to the United States;
  
- increases or impositions of withholding and other taxes on remittances and other payments by foreign subsidiaries or joint ventures to us;
  
- increases in investment and other restrictions or requirements by foreign governments in order to operate in the territory or own the subsidiary;
  
- costs of compliance with local laws, including labor laws;
  
- export control regulations and policies which govern our ability to supply foreign customers;
  
- unfamiliar and unknown business practices and customs;

- domestic and foreign government policies, including requirements to expend a portion of program funds locally and governmental industrial cooperation requirements;
- the complexity and necessity of using foreign representatives and consultants;
- the uncertainty of the ability of foreign customers to finance purchases;
- imposition of tariffs or embargoes, export controls and other trade restrictions;
- the difficulty of management and operation of an enterprise in various countries; and
- economic and geopolitical developments and conditions, including international hostilities, acts of terrorism and governmental reactions, inflation, trade relationships and military and political alliances.

Our foreign subsidiaries generally conduct business in foreign currencies and enter into contracts and make purchase commitments that are denominated in foreign currencies. Accordingly, we are exposed to fluctuations in exchange rates, which could have a significant impact on our results of operations. We have no control over the factors that generally affect this risk, such as economic, financial and political events and the supply of and demand for applicable currencies. While we use foreign exchange forward and option contracts to hedge significant contract sales and purchase commitments that are denominated in foreign currencies, our hedging strategy may not prevent us from incurring losses due to exchange fluctuations.

***Our operating margins may decline under our fixed-price contracts if we fail to estimate accurately the time and resources necessary to satisfy our obligations.***

Approximately 73% of our revenues in 2008 were from fixed-price contracts under which we bear the risk of cost overruns. Our profits are adversely affected if our costs under these contracts exceed the assumptions we used in bidding for the contract. Sometimes we are required to fix the price for a contract before the project specifications are finalized, which increases the risk that we will incorrectly price these contracts. The complexity of many of our engagements makes accurately estimating the time and resources required more difficult.

***We may be liable for civil or criminal penalties under a variety of complex laws and regulations, and changes in governmental regulations could adversely affect our business and financial position.***



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Our businesses must comply with and are affected by various government regulations that impact our operating costs, profit margins and our internal organization and operation of our businesses. These regulations affect how we do business and, in some instances, impose added costs. Any changes in applicable laws could adversely affect our financial performance. Any material failure to comply with applicable laws could result in contract termination, price or fee reductions or suspension or debarment from contracting. The more significant regulations include:

- the Federal Acquisition Regulations and all department and agency supplements, which comprehensively regulate the formation, administration and performance of U.S. government contracts;
- the Truth in Negotiations Act and implementing regulations, which require certification and disclosure of all cost and pricing data in connection with contract negotiations;
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data;
- regulations of most state and regional agencies and foreign governments similar to those described above;
- the Sarbanes-Oxley Act of 2002; and
- tax laws and regulations in the U.S. and in other countries in which we operate.

*Our failure to identify, attract and retain qualified technical and management personnel could adversely affect our existing businesses.*



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We may not be able to attract and retain the highly qualified technical personnel, including engineers, computer programmers, and personnel with security clearances required for classified work, or management personnel to supervise such activities that are necessary for maintaining and growing our existing businesses.

*We may incur significant costs in protecting our intellectual property which could adversely affect our profit margins. Our inability to protect our patents and proprietary rights could adversely affect our businesses prospects and competitive positions.*



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We seek to protect proprietary technology and inventions through patents and other proprietary-right protection. The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States. If we are unable to obtain or maintain these protections, we may not be able to prevent third parties from using our proprietary rights. In addition, we may incur significant expense both in protecting our intellectual property and in defending or assessing claims with respect to intellectual property owned by others.

We also rely on trade secrets, proprietary know-how and continuing technological innovation to remain competitive. We have taken measures to protect our trade secrets and know-how, including the use of confidentiality agreements with our employees, consultants and advisors. These agreements may be breached and remedies for a breach may not be sufficient to compensate us for damages incurred. We generally control and limit access to our product documentation and other proprietary information. Other parties may independently develop our know-how or otherwise obtain access to our technology.

***We compete primarily for government contracts against many companies that are larger, better capitalized and better known than us. If we are unable to compete effectively, our business and prospects will be adversely affected.***

Our businesses operate in highly competitive markets. Many of our competitors are larger, better financed and better known companies who may compete more effectively than we can. In order to remain competitive, we must keep our capabilities technically advanced and compete on price and on value added to our customers. Our ability to compete may be adversely affected by limits on our capital resources and our ability to invest in maintaining and expanding our market share.

***The terms of our financing arrangements may restrict our financial and operational flexibility, including our ability to invest in new business opportunities.***



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We currently have unsecured borrowing arrangements. The terms of these borrowing arrangements include provisions that require and/or limit our levels of working capital, debt and net worth and coverage of fixed charges. We also have provided performance guarantees to various customers that include financial covenants including limits on working capital, debt, tangible net worth and cash flow coverage.

We may incur future obligations that would subject us to additional covenants that affect our financial and operational flexibility or subject us to different events of default.

Our current \$150 million unsecured revolving credit facility expires in March 2010. Based on current capital market conditions we anticipate paying higher interest rates, increased fees and having reduced leverage capacity when we negotiate a new facility. At the present time there are no borrowings under our present revolving facility and \$24.1 million of outstanding letters of credit.

*Our revenues could be less than expected if we are not able to deliver services or products as scheduled due to disruptions in supply.*



Because our internal manufacturing capacity is limited, we use contract manufacturers. While we use care in selecting our manufacturers, we have less control over the reliability of supply, quality and price of products or components than if we manufactured them. In some cases, we obtain products from a sole supplier or a limited group of suppliers. Consequently, we risk disruptions in our supply of key products and components if our suppliers fail or are unable to perform because of strikes, natural disasters,

financial condition or other factors. Any material supply disruptions could adversely affect our ability to perform our obligations under our contracts and could result in cancellation of contracts or purchase orders, penalties, delays in realizing revenues, payment delays, as well as adversely affect our ongoing product cost structure.

*Failure to perform by one of our subcontractors could materially and adversely affect our contract performance and our ability to obtain future business.*

Our performance of contracts may involve subcontractors, upon which we rely to deliver the products to our customers. We may have disputes with subcontractors. A failure by a subcontractor to satisfactorily deliver products or services may adversely affect our ability to perform our obligations as a prime contractor. Any subcontractor performance deficiencies could result in the customer terminating our contract for default, which could expose us to liability for excess costs of reprocurement by the customer and have a material adverse effect on our ability to compete for other contracts.

*We may acquire other companies, which could increase our costs or liabilities or be disruptive.*

Part of our strategy involves the acquisition of other companies. We may not be able to integrate acquired entities successfully without substantial expense, delay or operational or financial problems. The acquisition and integration of new businesses involves risk. The integration of acquired businesses may be costly and may adversely impact our results of operations or financial condition:

- we may need to divert management resources to integration, which may adversely affect our ability to pursue other more profitable activities;
- integration may be difficult as a result of the necessity of coordinating geographically separated organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures;
- we may not eliminate redundant costs in selecting acquisition candidates; and
- one or more of our acquisition candidates may also have unexpected liabilities or adverse operating issues that we fail to discover through our due diligence procedures prior to the acquisition.

*Our results of operations have historically fluctuated and may continue to fluctuate significantly in the future, which could adversely affect the market price of our common stock.*



Our revenues are affected by factors such as the unpredictability of contract awards due to the long procurement process for most of our products and services, the potential fluctuation of governmental agency budgets, the time it takes for the new markets we target to develop and for us to develop and provide products and services for those markets, competition and general economic conditions. Our contract type/product mix and unit volume, our ability to keep expenses within budget, and our pricing affect our operating margins. Significant growth in costs to complete our contracts may adversely affect our results of operations in future periods. These factors and other risk factors described herein may adversely affect our results of operations and cause our financial results to fluctuate significantly on a quarterly or annual basis. Consequently, we do not believe that comparison of our results of operations from period to period is necessarily meaningful or predictive of our likely future results of operations. In some future financial period our operating results may be below the expectations of public market analysts or investors. If so, the market price of our securities may decline significantly.

**CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING INFORMATION**

This report, including the documents that we incorporate by reference, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, that are subject to the safe harbor created by those sections. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or our future financial and/or operating performance are not historical and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as may, will, anticipate, estimate, plan, project, continuing, ongoing, expect, believe, intend, predict, potential, opportunity and similar words or phrases. These statements involve estimates, assumptions and uncertainties, including those discussed in Risk Factors and elsewhere throughout this filing and in the documents incorporated by reference into this filing that could cause actual results to differ materially from those expressed in these statements.

Because the risk factors referred to above could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us or on our behalf, you should not place undue reliance on any forward-looking statements. In addition, past financial and/or operating performance is not necessarily a reliable indicator of future performance and you should not use our historical performance to anticipate results or future period trends. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which factors will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

**Item 1B. UNRESOLVED STAFF COMMENTS.**

None

**Item 2. PROPERTIES.**

We conduct our operations in approximately 1.5 million square feet of both owned and leased properties located in the United States and foreign countries. We own approximately 75% of the square footage, including 498,000 square feet located in San Diego, California and 467,000 square feet located in Orlando, Florida. All owned and leased properties are considered in good condition and, with the exception of the Orlando facility, adequately utilized. The following table identifies significant properties by business segment:

| Location of Property                  | Owned or Leased  |
|---------------------------------------|------------------|
| <b><u>Corporate Headquarters:</u></b> |                  |
| San Diego, CA                         | Owned            |
| <b><u>Defense:</u></b>                |                  |
| Aitkenvale, Australia                 | Leased           |
| Arlington, VA                         | Leased           |
| Auckland, New Zealand                 | Leased           |
| Columbus, GA                          | Leased and owned |
| Cummings, GA                          | Leased           |
| El Paso, TX                           | Leased           |
| Hampton, VA                           | Leased           |
| Honolulu, HI                          | Leased           |
| Kingstowne, VA                        | Leased           |
| Lacey, WA                             | Leased           |
| Leavenworth, KS                       | Leased           |
| Orlando, FL                           | Leased and owned |
| Prince George, VA                     | Leased           |
| San Diego, CA                         | Leased and owned |
| San Jose, CA                          | Leased           |
| Shalimar, FL                          | Leased           |
| Singapore                             | Leased           |
| Tijuana, Mexico                       | Leased           |
| <b><u>Transportation Systems:</u></b> |                  |
| Atlanta, GA                           | Leased           |
| Brisbane, Australia                   | Leased           |
| Glostrup, Denmark                     | Leased           |
| Chantilly, VA                         | Leased           |
| Frankfurt, Germany                    | Leased           |
| London, England                       | Leased           |
| Los Angeles, CA                       | Leased           |
| Merthsham, Surrey, England            | Leased           |
| Montreal, Canada                      | Leased           |
| New York, NY                          | Leased and owned |
| Ontario, Canada                       | Leased           |
| Salfords, Surrey, England             | Owned            |
| San Diego, CA                         | Owned            |
| Tullahoma, TN                         | Owned            |
| <b><u>Investment properties:</u></b>  |                  |
| Teterboro, NJ                         | Leased           |
| Vancouver, Canada                     | Leased           |



**Item 3. LEGAL PROCEEDINGS.**

In 1991, the government of Iran commenced an arbitration proceeding against the Company seeking \$12.9 million for reimbursement of payments made for equipment that was to comprise an Air Combat Maneuvering Range pursuant to a sales contract and an installation contract executed in 1977, and an additional \$15 million for unspecified damages. The Company contested the action and brought a counterclaim for compensatory damages of \$10.4 million. In May 1997, the arbitral tribunal awarded the government of Iran \$2.8 million, plus simple interest at the rate of 12% per annum from September 21, 1991 through May 5, 1997. In December 1998, the United States District Court granted a motion by the government of Iran confirming the arbitral award but denied Iran's request for additional interest and costs. Both parties have appealed. In October 2004, the 9<sup>th</sup> Circuit Court of Appeals issued a decision in the case of two interveners who are attempting to claim an attachment on the amount that was awarded to Iran in the original arbitration. The Court denied one of the interveners' liens but confirmed the second one's lien. Iran asked the U.S. Supreme Court to review the 9<sup>th</sup> Circuit decision and to void the initial judgment against it. In 2006, the Supreme Court returned the case to the 9<sup>th</sup> Circuit for reconsideration, suggesting that the claimed lien cannot be enforced. The Court of Appeal then ruled that the lien was valid under the Terrorism Risk Insurance Act. Subsequently, Iran's petition for review by the Supreme Court was granted; therefore, while the dispute between Iran and Cubic is on hold in the 9<sup>th</sup> Circuit the obligation upon Cubic to pay is stayed. Under current United States law and policy, any payment to the Revolutionary Government of Iran must first be licensed by the U.S. government. The Company is unaware of the likelihood of the U.S. government granting such a license. The Company is continuing to pursue its appeal in the 9<sup>th</sup> Circuit case against Iran, and management believes that a license from the U.S. government would be required in any case to make payment to or on behalf of Iran. However, in light of the 9<sup>th</sup> Circuit Court's decision in the related interveners' case, in 2004 the Company established a reserve of \$6 million for the estimated potential liability and will continue to accrue interest on this amount until the ultimate outcome of the case is determined.

In January 2005, a bus fare collection system customer in North America issued a cure notice to the Company, alleging that its performance was not in accord with the contract. After unsuccessful negotiations with the customer, in March 2005, the Company filed for a temporary restraining order requesting that the customer be restrained from further interfering with the Company's performance and from issuing a termination notice. The next business day, the customer issued a letter terminating the contract for default. In April 2005, the customer filed a claim for breach of contract, seeking damages for all actual, consequential and liquidated damages sustained as well as attorney's fees. The contract limits liability to the contract value of \$8.2 million, but the customer appears to be attempting to avoid that limitation. In May 2005, the Company filed an answer and general denial and subsequently filed a verified petition alleging breach of contract and other substantive claims, claiming the amount owed under the contract of \$4.2 million, plus interest and attorney's fees. Management believes that both the customer's default notice and claim for damages are unsupported and the Company is vigorously defending against the allegations. Based on the advice of counsel, management believes the Company had substantially completed the contract prior to termination and that the remaining contract value is due and that the Company will prevail at trial; therefore, no liability has been recorded for the former customer's claim as of September 30, 2008. However, due to the uncertainty of collecting the outstanding receivable balance an allowance for doubtful accounts of \$4.2 million was established and all costs incurred in the performance of the contract and costs incurred outside the scope of the contract were expensed in the year ended September 30, 2005.

In June 2005, a company that Cubic had an alleged agreement with to potentially bid on a portion of automated fare collection contracts, filed a court claim for breach of contract, fraud, negligent misrepresentation, theft of trade secrets, and other related allegations. The claim seeks \$15.0 million in compensatory damages, punitive damages, disgorgement of profits and a permanent injunction. In November 2008 the Company agreed to settle this claim for a nominal amount. Documents are expected to be finalized in December 2008.

In May 2007 the Company filed a claim with the U.S. Navy for \$6.2 million arising out of allegedly defective specifications, the late delivery of government-furnished equipment and the Navy's attempt to unilaterally impose additional contract requirements in connection with a contract whose initial award value was \$31.8 million. In February 2008, the Navy asserted a counter-claim seeking a \$4.1 million reduction in the contract price because it allegedly relaxed certain specifications, provided more government-furnished equipment than was required and had to revise certain equipment and manuals furnished by the Company. In November 2008 a negotiated settlement agreement was reached whereby the Company will receive payment of approximately \$4.0 million for its additional costs incurred in performance of the contract and will furnish additional equipment in satisfaction of the customer's requirements. The settlement also resolves the Navy's \$4.1 million counterclaim. In the year ended September 30, 2008, inventoried costs related to this claim were reduced to the settlement amount and a provision was made for the Company's remaining obligations arising from the settlement agreement.

From time-to-time, agencies of the U.S. and foreign governments may investigate whether the Company's operations are being conducted in accordance with applicable regulatory requirements. Such investigations, whether relating to government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon the Company, or could lead to suspension or debarment from future government contracting. Government investigations often take years to complete and most result in no adverse action against the Company.

The Company is not a party to any other material pending proceedings and management considers all other matters to be ordinary proceedings incidental to the business. Management believes the outcome of these proceedings and the proceedings described above will not have a materially adverse effect on the Company's financial position.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

Information regarding submission of matters to a vote of security holders is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**PART II**

**Item 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS.**

As of September 2008, the principal market on which our common stock is being traded is the New York Stock Exchange under the symbol CUB. Our stock previously was traded on the American Stock Exchange under the same symbol. The closing high and low sales prices for the stock, as reported in the consolidated transaction reporting systems of the American and New York stock exchanges for the quarterly periods during the past two fiscal years, and dividend information for those periods, are as follows:

MARKET AND DIVIDEND INFORMATION

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| Quarter | Sales Price of Common Shares |          |             |          | Dividends per Share |             |
|---------|------------------------------|----------|-------------|----------|---------------------|-------------|
|         | Fiscal 2008                  |          | Fiscal 2007 |          | Fiscal 2008         | Fiscal 2007 |
|         | High                         | Low      | High        | Low      |                     |             |
| First   | \$ 47.80                     | \$ 34.90 | \$ 22.82    | \$ 19.06 |                     |             |
| Second  | 35.99                        | 25.42    | 22.37       | 19.99    | \$ 0.09             | \$ 0.09     |
| Third   | 28.72                        | 20.12    | 30.14       | 20.12    |                     |             |
| Fourth  | 29.58                        | 21.43    | 46.43       | 27.23    | \$ 0.09             | \$ 0.09     |

On November 12, 2008, the closing price of our common stock on the New York Stock Exchange was \$19.98. There were approximately 1,000 shareholders of record of our common stock as of November 12, 2008.

**Item 6. SELECTED FINANCIAL DATA.**

## FINANCIAL HIGHLIGHTS AND SUMMARY OF CONSOLIDATED OPERATIONS

(amounts in thousands, except per share data)

|  | 2008       | 2007       | Years Ended September 30, |            | 2005       | 2004 |
|--|------------|------------|---------------------------|------------|------------|------|
|  |            |            | 2006                      |            |            |      |
| <b>Results of Operations:</b>                |            |            |                           |            |            |      |
| Sales  | \$ 881,135 | \$ 889,870 | \$ 821,386                | \$ 804,372 | \$ 722,012 |      |
| Cost of sales                                | 709,481    | 727,540    | 687,213                   | 672,541    | 549,170    |      |
| Selling, general and administrative expenses | 99,956     | 95,054     | 97,166                    | 110,644    | 107,139    |      |
| Interest expense                             | 2,745      | 3,403      | 5,112                     | 5,386      | 4,658      |      |
| Income taxes                                 | 20,385     | 23,662     | 12,196                    | 453        | 19,394     |      |
| Net income                                   | 36,854     | 41,586     | 24,133                    | 11,628     | 36,911     |      |
| Average number of shares outstanding         | 26,725     | 26,720     | 26,720                    | 26,720     | 26,720     |      |
| <b>Per Share Data:</b>                       |            |            |                           |            |            |      |
| Net income                                   | \$ 1.38    | \$ 1.56    | \$ 0.90                   | \$ 0.44    | \$ 1.38    |      |
| Cash dividends                               | 0.18       | 0.18       | 0.18                      | 0.18       | 0.16       |      |
| <b>Year-End Data:</b>                        |            |            |                           |            |            |      |
| Shareholders' equity                         | \$ 388,852 | \$ 382,771 | \$ 323,226                | \$ 297,158 | \$ 298,767 |      |
| Equity per share                             | 14.55      | 14.33      | 12.10                     | 11.12      | 11.18      |      |
| Total assets                                 | 641,252    | 592,565    | 548,071                   | 547,280    | 542,924    |      |
| Long-term debt                               | 25,700     | 32,699     | 38,159                    | 43,776     | 50,037     |      |

This summary should be read in conjunction with the related consolidated financial statements and accompanying notes.

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

Our two primary businesses are in the defense and transportation industries. For the year ended September 30, 2008, 69% of sales were derived from defense, while 31% were derived from transportation fare collection systems and other commercial operations. These are high technology businesses that design, manufacture and integrate complex systems to meet the needs of various federal and regional government agencies in the U.S. and other nations around the world. The U.S. Government remains our largest customer, accounting for approximately 54% of sales in 2008 and 2007 compared to 52% in 2006.

Our defense segment is focused on three primary lines of business: Training Systems (formerly known as Readiness Systems), Mission Support Services, and Communications. The segment is a diversified supplier of constructive, live and virtual military training systems, services and communication systems and products to the U.S. Department of Defense, other government agencies and allied nations. We design instrumented range systems for fighter aircraft, armored vehicles and infantry force-on-force live training; weapons effects simulations; laser-based tactical and communication systems; and precision gunnery solutions. Our services are focused on training mission support, computer simulation training, distributed interactive simulation, development of military training doctrine, force modernization services for NATO entrants and field operations and maintenance. Our communications products are aimed at intelligence, surveillance, and search and rescue markets.

Cubic Transportation Systems develops and delivers innovative fare collection systems for public transit authorities worldwide. We provide hardware, software and multiagency, multimodal transportation integration technologies and services that allow the agencies to efficiently collect fares, manage their operations, reduce shrinkage and make using public transit a more convenient and attractive option for commuters.

**Consolidated Overview**

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Sales in fiscal 2008 were down slightly from 2007 because of the sale of our corrugated box business in the fourth quarter of 2007. Sales in 2008 were \$881.1 million compared to \$889.9 million in 2007, a 1% decrease. Sales in 2007 had increased 8% over 2006 sales of \$821.4 million. In 2008 transportation systems sales increased 15% over 2007, while defense sales decreased 5%. In contrast, 2007 sales from defense were up 14% and transportations systems sales were down 3%. See the segment discussions following for further analysis of segment sales.

Operating income decreased 14% in fiscal 2008 to \$53.3 million from \$62.1 million in 2007. Operating income in 2007 had doubled from \$30.9 million in 2006. Operating income in the transportation systems segment increased significantly in 2008, more than doubling from the 2007 level. However, operating income from defense was down 59%, more than offsetting the improvement from transportation systems. In addition, in the fourth quarter of 2008 we recorded a restructuring charge of \$6.2 million as the result of a reduction in force in our defense systems subsidiary and corporate headquarters in San Diego, California. This cost-cutting measure is intended to streamline operations and enhance competitiveness in the defense-related marketplace. The improvement in 2007 had come from both segments with transportation systems increasing significantly from a low level in 2006 and defense improving by more than 40%. See the segment discussions following for further details of segment operating results.

Net income decreased 11% in fiscal 2008 to \$36.9 million (\$1.38 per share) from \$41.6 million (\$1.56 per share) in 2007. Net income had increased 72% in fiscal 2007 from \$24.1 million (\$.90 per share) in 2006. Lower net income in 2008 resulted primarily from the decrease in defense operating income and the restructuring costs mentioned above, which impacted net income by approximately \$3.7 million after applicable income taxes, or \$0.14 per share. Also included in 2008 was a gain of \$1.2 million in the fourth quarter on the sale of our investment in a defense-related joint venture that added approximately \$0.8 million to net income, after applicable income taxes, or \$.03 per share. In 2007 we sold our corrugated box business, also in the fourth quarter, for a gain of approximately \$0.6 million, after applicable income taxes, or \$.02 per share. Approximately \$4.3 million, after applicable income taxes, of

the 2006 net income was from a gain on the sale of real estate that added \$0.16 per share. Reductions in tax contingency reserves accounted for approximately \$1.2 million, \$0.9 million and \$1.1 million, respectively, of the 2008, 2007 and 2006 net income.

The gross margin from product sales improved in 2008 to 21.4% from 19.6% in 2007 and 16.0% in 2006. Improved performance from our transportation systems segment in both 2007 and 2008 and improvement in defense training systems in 2007 contributed to the higher margin from product sales. The gross margin from service sales was 17.2% in 2008, compared to 16.3% in 2007 and 16.9% in 2006. Higher sales and margins from transportation systems service contracts in Europe contributed to the improvement in 2008, while the completion of a high margin transportation service contract in Europe resulted in the decrease in 2007 compared to 2006.

Selling, general and administrative (SG&A) expenses increased to \$100.0 million, or 11.3% of sales, in 2008, compared to \$95.1 million, or 10.7% of sales, in 2007 and \$97.2 million, or 11.8% of sales, in 2006. In 2008, SG&A increased in the defense segment due to increased bid and proposal efforts and the acquisition of a new subsidiary.

Company sponsored research and development (R&D) spending increased to \$12.2 million in 2008 from \$5.2 million in 2007 and \$6.1 million in 2006. The increase came primarily from projects to develop new data link technologies and transportation security-related development initiatives. Our R&D spending continues to be incurred primarily in connection with customer funded activities. We do not rely heavily on company sponsored R&D, as most of our new product development occurs in conjunction with the performance of work on our contracts. The amount of contract required development activity in 2008 was \$55 million, compared to \$66 million in 2007 and \$64 million in 2006; however, these costs are included in cost of sales, rather than R&D, as they are directly related to contract performance.

Interest and dividend income increased to \$6.4 million in 2008 from \$3.4 million in 2007 and \$1.9 million in 2006 due primarily to higher available cash balances for investment. Other Income (Expense) netted to an expense of \$0.6 million in 2008 compared to income of \$1.3 million in 2007 and \$0.4 million in 2006 primarily due to foreign currency exchange losses on advances to our foreign subsidiaries. Interest expense decreased to \$2.7 million in 2008 compared to \$3.4 million in 2007 and \$5.1 million in 2006 because of a reduction in both short- and long-term borrowings.

Our effective tax rate for 2008 was 35.6% of pretax income compared to 36.3% in 2007 and 33.6% in 2006. Our effective rate in 2008 decreased primarily because more of our income came from foreign tax jurisdictions where we do not incur state tax expenses and tax rates are generally lower. Partially offsetting this benefit was a \$3.9 million provision for U.S. taxes on \$26.7 million in dividends from our U.K. and New Zealand subsidiaries that were paid in 2008 compared to a similar provision of \$2.6 million in 2007 and \$1.6 million in 2006. Tax credits were lower in 2008 than in 2007 and 2006, primarily because the Research and Experimentation (R&E) credit had expired as of December 31, 2007. Subsequent to the end of the year, in October 2008, the U.S. Congress reinstated the R&E credit retroactive to January 1, 2008, however, the benefit of this credit for the nine months ended September 30, 2008, estimated to be about \$0.8 million, will not be recorded until the first quarter of fiscal 2009. The effective rate in 2008, 2007 and 2006 also benefited from the reversal of tax contingency provisions amounting to \$1.2 million, \$0.9 million and \$1.1 million, respectively. Our effective tax rate could be affected in future years by, among other factors, the mix of business between U.S. and foreign jurisdictions, our ability to take advantage of available tax credits, and audits of our records by taxing authorities.

#### **Restructuring Activity**

As mentioned earlier, in the fourth quarter of 2008 we reduced our defense segment workforce in San Diego by 139 employees. In addition, 6 corporate office positions were eliminated. This action was the result of a cost cutting initiative designed to streamline operations, enhance our competitiveness and better position us in the defense-related marketplace. Affected employees received severance pay and outplacement assistance, as well as company paid medical coverage for a defined period based on years of service. The cost of this restructuring was \$6.2 million (\$3.7 million after applicable income taxes) and is reflected in our results for the fourth quarter. We estimate this cost-cutting action will yield an annual savings of approximately \$15 million, before applicable income taxes.

**Business Acquisition**

In July 2008, we acquired all outstanding capital stock of the privately-held Omega Training Group, Inc. (Omega). The purchase was for \$61.0 million in cash which was funded from existing cash reserves. Omega provides training, testing, analysis, logistics and staffing services to U.S. Army locations at the U.S. Army Infantry School at Fort Benning, Fort Bliss, Fort Jackson and Fort Hood. Founded in 1990, Omega now has 790 employees. We believe this acquisition will enhance our position in the defense services market place and add revenues of approximately \$60 -70 million in 2009.

**Defense Segment**

| Years ended September 30,                      | 2008     | 2007          | 2006     |
|--|----------|---------------|----------|
|  |          | (in millions) |          |
| <b><u>Defense Segment Sales</u></b>            |          |               |          |
| Mission support services                       | \$ 332.5 | \$ 308.0      | \$ 262.9 |
| Training systems                               | 227.7    | 263.4         | 228.0    |
| Communications                                 | 36.0     | 57.4          | 64.6     |
| Tactical systems and other                     | 11.6     | 12.3          | 7.3      |
|  | \$ 607.8 | \$ 641.1      | \$ 562.8 |
| <b><u>Defense Segment Operating Income</u></b> |          |               |          |
| Mission support services                       | \$ 27.8  | \$ 27.6       | \$ 20.6  |
| Training systems                               | 6.8      | 18.9          | 9.7      |
| Communications                                 | (15.6)   | (0.7)         | 3.9      |
| Tactical systems and other                     | (0.7)    | (1.6)         | (2.8)    |
|  | \$ 18.3  | \$ 44.2       | \$ 31.4  |

As depicted in the table above, sales from our defense segment decreased 5% to \$607.8 million in 2008, compared to \$641.1 million in 2007, after having increased 14% in 2007 from \$562.8 million in 2006. Lower sales from Training Systems and Communications resulted in the decrease in 2008, while Mission Support Services sales increased. Sales from Mission Support Services and Training Systems were both higher in 2007 than in 2006, however, Communications sales decreased in 2007 from the 2006 level. The caption

Tactical systems and other in the table above includes advanced programs for the development of new defense technologies and the operating results of the joint venture company in which we previously owned a 50% interest. We sold our interest in the JV to our former partner in August 2008, as we no longer believe the venture has the growth potential we had anticipated at its inception.

Operating income in our defense segment decreased to \$18.3 million in 2008 from \$44.2 million in 2007, a 59% decrease. In 2007, operating income had increased 41% from 2006 operating income of \$31.4 million. Operating income was sharply lower in 2008 from Training Systems, while the operating loss from Communications increased significantly from the small operating loss posted in 2007. Mission Support Services operating income increased slightly in 2008 over the 2007 level. Growth in 2007 operating income had come from both Training Systems and Mission Support Services, while Communications had generated an operating loss in 2007 compared to operating income in 2006. The joint venture company made a small operating profit of \$0.4 million in 2008, prior to its sale, after having incurred operating losses of \$1.4 million and \$1.9 million in 2007 and 2006, respectively.



### **Mission Support Services**

Mission Support Services sales increased 8% in 2008, after having increased 17% in 2007 compared to 2006. About half of the sales increase in 2008 came from Omega, the company we acquired at the end of July 2008. We believe the addition of Omega enhances our capability and strategic position in the defense services marketplace and are pleased with the results from the business thus far. We also realized higher sales from our contract with the U.S. Marine Corps that was expanded as a result of the contract renewal in 2008 and from a new contract at the U.S. Army Quartermaster School. These increases were partially offset by a decrease in activity during 2008 at the Joint Readiness Training Center (JRTC) in Fort Polk, LA. The increase in 2007 sales had come from the expansion of existing programs and from new contracts won in 2007. Sales were higher in 2007 compared to 2006 by nearly \$14 million from the JRTC contract, due to an increase in training exercises conducted by the customer. In addition, increased activity from the U.S. Marine Corps contract and higher sales from contracts for modeling the effects of weapons of mass destruction had added to the 2007 sales.

Operating income from Mission Support Services increased only 1% in 2008, after increasing 34% in 2007. The new company, Omega, contributed over \$2 million to operating profits in the first two months we owned it. In addition, higher sales from the U.S. Marine Corps contract also contributed to operating income growth in 2008. However, these increases were nearly offset by lower sales and profit margins from the JRTC contract and from other Mission Support Services contracts that had experienced particularly strong performance in 2007. Higher sales volume and award fees helped to increase profitability in 2007 compared to 2006 and improved operating income as a percentage of sales to 8.9%, compared to 7.8%. The most significant increases in 2007 operating income had come from the U.S. Marine Corp. and JRTC contracts mentioned above.

### **Training Systems**

Training Systems sales decreased 14% in 2008, returning to the level of 2006, after having increased 16% in 2007. The decrease in 2008 sales came from each of the major product lines, including air combat training, ground combat training, electro-optics (laser-based tactical engagement systems) and small arms virtual training systems. Sales were lower by \$23.0 million from the air combat training system contract known as P5 and from an air combat training system in Australia that was completed in the first quarter. Partially offsetting these sales decreases was an increase in sales from the new Joint Strike Fighter (JSF) development contract and other air combat training contracts. Sales were also lower from a ground combat training system contract in the Far East and from small arms training systems. Sales in three of the Training Systems product lines have been impacted by a transition from the development phase, where revenue is recognized on a cost-to-cost percentage completion basis, to the production phase, where we recognize revenues from production orders on a units-of-delivery percentage completion basis, resulting in the recording of sales when the product is delivered and accepted by the customer. This includes the P5 air combat training contract, electro-optics and small arms training systems. This transition also resulted in an increase in inventories of \$30.3 million, offset by customer advances of \$11.5 million from these product lines in fiscal 2008. Most of the increase in 2007 sales compared to 2006 had come from air combat training systems, while ground combat training and small arms virtual training systems sales grew slightly.

Training Systems operating income decreased 64% in 2008 compared to 2007 after having nearly doubled in 2007 from 2006. Lower sales from the P5 and Australian air combat training contracts and small arms virtual training systems contributed to the decrease in operating income. However, the primary cause of the decrease was cost growth of \$9.6 million on the electro-optics contract to develop the next generation laser-based tactical engagement system. This cost

growth stemmed from problems encountered in the second quarter during system integration testing and resulted in greater difficulties than we had previously anticipated. In addition to increased engineering development costs for design changes, these changes also resulted in higher manufacturing costs and rework costs. We also experienced further cost growth of \$4.2 million in 2008 on a contract for the development of a ground combat training system in the Middle East. This compares to cost growth of \$5.1 million in 2007 on the same contract. Improved profit margins from a ground combat training system in Canada partially offset the impact from this contract. The increase in 2007 operating income compared to 2006 had come from higher profit margins on higher sales of air combat training systems and improvements in profitability of ground combat training systems and small arms training systems. Higher profit margins from a ground combat training system in the Far East in 2007 were offset by cost growth on the ground combat training system in the Middle East mentioned above, while operating income from other ground combat training systems improved slightly. Operating income from small arms training systems had improved in 2007 due to somewhat higher sales and completion of the development of new weapons simulations systems in 2006, resulting in decreased costs in 2007.

## Communications

Sales from Communications decreased 37% in 2008, after having decreased 11% in 2007 from the 2006 level. Sales decreased in 2008 from contracts for the development of data links for unmanned aerial vehicles in the U.S. and U. K. and from a contract for the development of a data link for the U.S. Navy. These decreases were partially offset by higher sales of personnel locator systems and power amplifiers. In 2007 sales increased from the contract for the supply of data links for unmanned aerial vehicles in the U.K.; however, this increase was more than offset by decreases in sales from other data link contracts that neared completion in 2007. Sales of personnel locator systems and power amplifiers also decreased in 2007.

Communications incurred an operating loss of \$15.6 million in 2008 compared to an operating loss of \$0.7 million in 2007 and operating income of \$3.9 million in 2006. The primary cause of the loss in 2008 was cost growth of \$9.5 million from a contract to develop new data link technology for unmanned aerial vehicles for a U.K. customer. We have encountered significant difficulties in performing this firm fixed-price contract due in part to customer-caused delay and disruption, directed changes and due to delays caused by two subcontractors. We have completed discussions with the customer to substantially restructure the contract and believe we have now established a reasonable basis for completion of the contract and resolution of the issues with the most problematic subcontractor. The contract modification, when signed, will add additional contract value for a portion of the out-of-scope costs we have incurred and anticipate incurring and remove our responsibility for the subcontractor's performance. We continue to have performance risks going forward but we anticipate that the contract value added by the modification will be sufficient to cover those risks. Cost growth on two other data link development contracts impacted profitability by \$6.2 million in 2008. One of these is a contract with the U.S. Navy for which we had inventoried costs of \$5.2 million in 2005 that were the subject of a legal proceeding before the U.S. Armed Services Board of Contract Appeals. We reached a settlement agreement with this customer whereby we will be paid for \$4.0 million of the \$5.2 million in costs and have expensed the remainder. As a part of the settlement we provided other concessions to the customer, which also were expensed, in exchange for them dropping all claims against us. In addition, we started work on several research and development projects for new data link technology during 2008, which added \$2.7 million to the operating loss for the year. Partially offsetting these increased costs was higher operating income on higher sales of power amplifiers and personnel locator systems.

Communications had generated an operating loss of \$0.7 million in 2007 due primarily to cost growth of \$4.3 million on a contract for the development of new data link technology. Profit margins on other data link contracts were also lower than in 2006; however, this decrease was partially offset by improved profit margins from sales of power amplifiers and personnel locator systems in 2007. Operating income in 2006 had come primarily from the sale of power amplifiers and data links, in addition to the favorable settlement of a long-standing dispute with a customer during the year, which added \$1.2 million to operating income.

## Transportation Systems Segment

| Years ended September 30,               | 2008     | 2007          | 2006     |
|---|----------|---------------|----------|
|   |          | (in millions) |          |
| Transportation Segment Sales            | \$ 272.3 | \$ 236.6      | \$ 243.9 |
| Transportation Segment Operating Income | \$ 43.0  | \$ 20.1       | \$ 2.8   |

Transportation systems sales increased 15% in 2008 after having decreased 3% in 2007. Sales increased in 2008 primarily due to additional work from change orders on the PRESTIGE contract and from other contracts in the U.K. Sales were also higher from system installation work on a contract in Australia and increased sales of spare parts in North America. These increases were partially offset by decreased sales from system installation contracts in North America and Sweden. The exchange rate between the British Pound and the U.S. Dollar had no impact on sales for 2008, when

compared to 2007, as the average rate for the year was virtually the same as in 2007.

As a result of a decrease in the value of the British Pound compared to the U.S. Dollar in late fiscal 2008 and subsequently, we expect that the dollar value of transportation systems sales and operating income from our U.K. subsidiary will be lower in fiscal 2009 than in 2008.

Sales in North America and Sweden had decreased in 2007 compared to 2006, while sales in Australia and the U.K. had increased. Sales in Australia increased due in part to a settlement reached with the customer during 2007 that increased the value of the contract. In the U.K. sales had been lower in 2007 from a service contract that was phased-out because old ticket issuing equipment was replaced by modern equipment requiring less maintenance; however, this decrease was more than offset by higher sales from other U.K. contracts, including the PRESTIGE contract. A major contributor to the increase in U.K. sales in 2007 had been the strength of the British Pound against the U.S. dollar, which resulted in the dollar value of sales in the U.K. increasing \$10.8 million for the year when compared to average exchange rates experienced in 2006.

Operating income in the transportation systems segment more than doubled in 2008 when compared to 2007, after having improved significantly in 2007 from the low level of 2006. Higher sales and improved performance from U.K. contracts, including bonuses earned on the PRESTIGE contract for system usage, and profits from increased spares sales in the U.S. contributed to the increase in 2008. Cost growth on North American contracts that had been a profit drain in recent years was limited to \$1.6 million in 2008, a significant improvement over 2007 when cost growth on the same contracts had been \$7.0 million. Partially offsetting the profit improvements in 2008 was cost growth of \$3.4 million on a contract in Sweden and an investment in new technology of \$1.8 million we made related to a new contract in North America. These development costs are required for this contract; however, they will benefit future programs as well. A reduction in legal fees of \$2.0 million in 2008 also contributed to the operating income improvement. As mentioned above relating to sales, currency exchange between the British Pound and U.S. Dollar had no impact on 2008 operating income when compared to 2007.

In 2007, settlements reached with three customers added \$8.6 million to operating income; however, we also added \$3.4 million to our estimate of costs to complete two of these contracts that year, yielding a net improvement to operating income of \$5.2 million from these contract settlements. Operating income from the PRESTIGE contract had increased when compared to 2006, including bonuses earned for system usage and the effect of a higher currency exchange rate. Currency exchange differences had resulted in an improvement in operating income of about \$1.8 million from all U.K. contracts, when comparing the 2007 average exchange rate to the 2006 rate. As mentioned above, cost growth on North American system installation contracts in 2007 was \$7.0 million compared to \$21.0 million in 2006, helping to improve operating income. Lower operating income from the U.K. service contract mentioned above and from spare parts sales in the U.S. partially offset these improvements. In addition, cost growth from a contract in Sweden totaling \$6.3 million in 2007 had also impacted operating income. Higher legal fees in 2007 further reduced operating income for the year by \$1.3 million when compared to 2006.

**Backlog**

| September 30,            | 2008 | (in millions) |    | 2007    |
|--------------------------|------|---------------|----|---------|
| <b>Total backlog</b>     |      |               |    |         |
| Transportation systems   | \$   | 480.6         | \$ | 787.3   |
| Defense                  |      |               |    |         |
| Mission support services |      | 880.0         |    | 776.6   |
| Training systems         |      | 363.6         |    | 383.4   |
| Communications           |      | 45.9          |    | 56.4    |
| Other                    |      | 2.4           |    | 30.6    |
| Total defense            |      | 1,291.9       |    | 1,247.0 |
| Total                    | \$   | 1,772.5       | \$ | 2,034.3 |
| <b>Funded backlog</b>    |      |               |    |         |
| Transportation systems   | \$   | 480.6         | \$ | 787.3   |
| Defense                  |      |               |    |         |
| Mission support services |      | 180.6         |    | 131.2   |
| Training systems         |      | 363.6         |    | 383.4   |
| Communications           |      | 45.9          |    | 56.4    |
| Other                    |      | 2.4           |    | 30.6    |
| Total defense            |      | 592.5         |    | 601.6   |
| Total                    | \$   | 1,073.1       | \$ | 1,388.9 |

In addition to the amounts identified above, the company has been selected as a participant in or, in some cases, the sole contractor for several substantial indefinite delivery/ indefinite quantity (IDIQ) contracts. IDIQ contracts are not included in backlog until an order is received.

In August 2008, Transport for London (TfL) notified our 37.5% owned subsidiary, TranSys, that they will be terminating the PRESTIGE fare collection system contract as of August 2010 in accordance with the early termination provision of the contract. As a result of this early termination, the last five years of our contracts with TranSys and the other 37.5% shareholder were also terminated and, therefore, this portion of the contract value was removed from backlog in the table above as of September 30, 2008. Our transportation systems backlog at September 30, 2007 included \$290 million (£142 million) relating to the terminated portion of our contracts with TranSys and the other 37.5% shareholder covering the period from August 2010 through August 2015.

In November 2008, TfL awarded Cubic directly a new three year contract that includes virtually all of the services currently being performed by TranSys through its shareholders. The term of this contract is for the time period from August 2010 to August 2013, with a base value of approximately \$255 million (£170 million), which will be added to our backlog in the quarter ending December 31, 2008. The contract value will be indexed for inflation from August 2008 through its completion and additionally includes variable payments that are contingent upon system usage, similar to provisions that were contained in the PRESTIGE contract.

Aside from the impact of the PRESTIGE contract early termination described above, a decrease in the value of the British Pound vs. the U.S. Dollar between September 30, 2007 and September 30, 2008, resulted in a decrease in transportation systems backlog of approximately \$45 million.

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The difference between total backlog and funded backlog represents options under multiyear service contracts. Funding for these contracts comes from annual operating budgets of the U.S. government and the options are normally exercised annually. Options for the purchase of additional systems or equipment are not included in backlog until exercised.

### **New Accounting Standards**

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which we adopted on October 1, 2007. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with SFAS 109, *Accounting for Income Taxes*. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The effect of adopting FIN 48 on our financial condition at September 30, 2008 has been included in the accompanying consolidated financial statements. See Note 8 for further discussion of the effect of adopting FIN 48.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which we will adopt in the quarter ending December 31, 2008. SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. We currently do not expect that the adoption of SFAS 157 will have a material impact on our results of operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*, which we will adopt in the quarter ending December 31, 2008. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We currently do not expect that the adoption of SFAS 159 will have a material impact on our results of operations, financial position or cash flows.

In December 2007 the FASB issued SFAS No. 141(R), *Business Combinations*, which we will adopt in the fiscal year beginning October 1, 2009. This statement applies to all transactions or other events in which an entity obtains control of one or more businesses. This statement applies to all business entities, including mutual entities that previously used the pooling-of-interests method of accounting for some business combinations. We currently do not expect that the adoption of SFAS 141(R) will have a material impact on our results of operations, financial position or cash flows.

In March 2008 the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*, which we will adopt in the quarter ending March 31, 2009. This statement requires enhanced disclosures about an entity's financial position, financial performance, and cash flows. The statement requires that objectives for using derivative instruments be disclosed in terms of underlying risks and accounting designation. We currently do not expect that the adoption of SFAS 161 will have a material impact on our results of operations, financial position or cash flows.

### **Liquidity and Capital Resources**

Cash flows from operations totaled \$92.7 million in 2008, compared to \$69.2 million in 2007 and \$31.3 million in 2006. In addition to cash generated by earnings, a decrease in accounts receivable in each of the three years amounting to \$40.5 million, \$18.1 million and \$5.8 million in 2008, 2007 and 2006, respectively, contributed to the positive cash flows. In addition, net customer advances of \$17.0 million, \$12.2 million and \$2.3 million in 2008, 2007 and 2006, respectively, added to the positive result. Inventories grew in 2008 and 2007, using cash of \$18.7 million

and \$7.6 million, respectively, reflecting the transition from development type contracts to production contracts described in the defense segment section above. Positive operating cash flows in 2008 came from both segments, with the greater portion coming from transportation systems. All of the operating cash flows in 2007 had come from the transportation systems segment, while defense cash flows were slightly negative for the year. Both the defense and transportation systems segments had generated positive cash flows in 2006, with the larger amount contributed by transportation systems in that year as well.

We have classified certain unbilled accounts receivable balances as noncurrent because we do not expect to receive payment within one year from the balance sheet date. At September 30, 2008, this balance was \$19.9 million compared to \$16.7 million at September 30, 2007.

Cash flows used in investing activities in 2008 included our acquisition of Omega Training Group, Inc., which used cash of \$53.8 million, net of cash acquired. The remaining balance of the purchase price amounting to \$6.1 million was paid subsequent to September 30, 2008 and was included in other current liabilities at that date. We made capital expenditures of \$8.1 million in 2008, partially offset by proceeds of \$1.8 million from the sale of our interest in the joint venture mentioned previously. We liquidated \$27.2 million of short-term investments in the first quarter of fiscal 2008, thereby avoiding much of the turmoil in the credit markets that occurred later in the year. During 2007 we had invested a net of \$18.3 million in these financial instruments, received \$3.8 million from the sale of our former corrugated box business and made \$6.1 million in capital expenditures. Investing activities in 2006 had included capital expenditures of \$9.8 million, proceeds from the sale of investment real estate of \$8.0 million and the addition of \$8.9 million to short-term investments.

Financing activities in 2008 included scheduled payments on long-term borrowings of \$6.1 million and the payment of a dividend to shareholders of \$4.8 million (18 cents per share). Financing activities in 2007 had included the repayment of short term borrowings of \$10.0 million and scheduled payments on long-term borrowings of \$6.1 million, in addition to the payment of a dividend to shareholders of \$4.8 million (18 cents per share). Financing activities in 2006 had included scheduled debt payments of \$6.1 million, repayment of short-term borrowings of \$16.4 million and dividends to shareholders of \$4.8 million.

Accumulated other comprehensive income decreased \$23.6 million in 2008 because of foreign currency translation adjustments of \$11.2 million and an increase in the recorded liability for our pension plans of \$12.4 million, after applicable income taxes. These adjustments decreased the positive balance in accumulated other comprehensive income from \$31.2 million as of September 30, 2007 to \$7.6 million at September 30, 2008.

The pension plan unfunded balance increased from the September 30, 2007 balance of \$1.5 million to \$16.4 million at September 30, 2008. This decrease in the funding position can be attributed to a return on plan assets for the year that was much lower than our assumed rate of return but was partially offset by the effect of an increase in the discount rate we used to calculate the pension liability.

The net deferred tax asset increased to \$31.7 million at September 30, 2008 compared to \$18.7 million at September 30, 2007. The primary reason for the increase is that the effect of recording adjustments to the pension liability through other comprehensive income resulted in a deferred tax asset of \$4.0 million at September 30, 2008 compared to a deferred tax liability of \$2.7 million at September 30, 2007. We expect to generate sufficient taxable income in the future such that the net deferred tax asset will be realized.

Our financial condition remains strong with working capital of \$279 million and a current ratio of 2.4 to 1 at September 30, 2008. We expect that cash on hand and our ability to access the debt markets will be adequate to meet our working capital requirements for the foreseeable future. In addition to the short-term borrowing arrangements we have in the U.K. and New Zealand, we have a committed five year credit facility from a group of financial institutions in the U.S., aggregating \$150 million. As of September 30, 2008, \$24.1 million of this capacity was used for letters of credit, leaving an additional \$125.9 million available. Our total debt to capital ratio at September 30, 2008 was less than 10%. In addition, our cash balance totaled \$112.7 million at September 30, 2008 which exceeded our total long-term debt by \$81.0 million. Our cash is invested primarily in highly liquid government treasury instruments in the U. S. and Europe.



The following is a schedule of our contractual obligations outstanding as of September 30, 2008:

|                       | Total   | Less than 1<br>Year | 1 - 3 years<br>(in millions) | 4 - 5 years | After 5 years |
|-----------------------|---------|---------------------|------------------------------|-------------|---------------|
| Long-term debt        | \$ 31.7 | \$ 6.0              | \$ 9.2                       | \$ 9.2      | \$ 7.3        |
| Interest payments     | 6.5     | 1.7                 | 2.6                          | 1.3         | 0.9           |
| Operating leases      | 15.1    | 5.6                 | 6.2                          | 3.0         | 0.3           |
| Deferred compensation | 8.6     | 0.8                 | 1.2                          | 0.9         | 5.7           |
|                       | \$ 61.9 | \$ 14.1             | \$ 19.2                      | \$ 14.4     | \$ 14.2       |

### **Critical Accounting Policies, Estimates and Judgments**

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We continually evaluate our estimates and judgments, the most critical of which are those related to revenue recognition, income taxes, valuation of goodwill and pension costs. We base our estimates and judgments on historical experience and other factors that we believe to be reasonable under the circumstances. Materially different results can occur as circumstances change and additional information becomes known.

Besides the estimates identified above that are considered critical, we make many other accounting estimates in preparing our financial statements and related disclosures. All estimates, whether or not deemed critical, affect reported amounts of assets, liabilities, revenues and expenses, as well as disclosures of contingent assets and liabilities. These estimates and judgments are also based on historical experience and other factors that are believed to be reasonable under the circumstances. Materially different results can occur as circumstances change and additional information becomes known, even for estimates and judgments that are not deemed critical.

This discussion of critical accounting policies, estimates and judgments should be read in conjunction with other disclosures included in this discussion, and the Notes to the Consolidated Financial Statements related to estimates, contingencies and new accounting standards. Significant accounting policies are identified in Note 1 to the Consolidated Financial Statements. We have discussed each of the critical accounting policies and the related estimates with the audit committee of the Board of Directors.

#### *Revenue Recognition*

A significant portion of our business is derived from long-term development, production and system integration contracts which we account for consistent with the American Institute of Certified Public Accountants (AICPA) audit and accounting guide, *Audits of Federal Government Contractors*, and the AICPA's Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. We consider the nature of these contracts, and the types of products and services provided, when we determine the proper accounting for a particular contract. Generally, we record revenue for long-term fixed price contracts on a percentage of completion basis using the cost-to-cost method to measure progress toward completion. Most of our long-term fixed-price contracts require us to deliver minimal quantities over a long period of time or to perform a substantial level of development effort in relation to the total value of the contract. Under the cost-to-cost method of accounting, we recognize revenue based on a ratio of the costs incurred to the estimated total costs at completion. For certain other long-term, fixed price production contracts not requiring substantial development effort we use the units-of-delivery percentage completion method as the basis to measure progress toward completing the contract and recognizing sales. The units-of-delivery measure is a



modification of the percentage-of-completion method, which recognizes revenues as deliveries are made to the customer generally using unit sales values in accordance with the contract terms. We estimate profit as the difference between total estimated revenue and total estimated cost of a contract and recognize that profit over the life of the contract based on deliveries. Amounts representing contract change orders, claims or other items are included in the contract value only when they can be reliably estimated and realization is considered probable. Provisions are made on a current basis to fully recognize any anticipated losses on contracts.

We record sales under cost-reimbursement-type contracts as we incur the costs. Incentives or penalties and awards applicable to performance on contracts are considered in estimating sales and profits, and are recorded when there is sufficient information to assess anticipated contract performance. Incentive provisions that increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

Sales of products are recorded when a firm sales agreement is in place, delivery has occurred and collectibility of the fixed or determinable sales price is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are recognized when the units of work are completed.

Sales and profits on contracts that specify multiple deliverables are allocated to separate units of accounting when there is objective evidence that each accounting unit has value to the customer on a stand-alone basis.

#### *Income Taxes*

Significant judgment is required in determining our income tax provisions and in evaluating our tax return positions. In accordance with FASB Interpretation No. 48 (FIN 48), we establish reserves when, despite our belief that our tax return positions are fully supportable, we believe it is more-likely-than-not a tax position taken or expected to be taken in a tax return, if examined, would be challenged and that we may not prevail. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit.

Tax regulations require items to be included in the tax return at different times than the items are reflected in the financial statements and are referred to as timing differences. In addition, some expenses are not deductible on our tax return and are referred to as permanent differences. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future years for which we have already recorded the benefit in our income statement. We establish valuation allowances for our deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent deductions we have taken on our tax return but have not yet recognized as expense in our financial statements.

We have not recognized any United States tax expense on undistributed earnings of our foreign subsidiaries since we intend to reinvest the earnings outside the U.S. for the foreseeable future. These undistributed earnings totaled approximately \$52.4 million at September 30, 2008. Annually we evaluate the capital requirements in our foreign subsidiaries and determine the amount of excess capital, if any, that is available for distribution. Whether or not we actually repatriate the excess capital in the form of a dividend, we would provide for U.S. taxes on the amount

determined to be available for distribution. This evaluation is judgmental in nature and, therefore, the amount of U.S. taxes provided on undistributed earnings of our foreign subsidiaries is affected by these judgments. Based on this analysis in 2008, we determined that 11.0 million British pounds (\$21.7 million) was excess capital in the U.K. and that 7.0 million New Zealand Dollars (\$5.0 million) was excess capital in New Zealand and paid dividends in these amounts to the U.S. parent company. U.S. taxes provided on these dividends amounted to \$3.9 million in 2008.

*Valuation of Goodwill*

We evaluate our recorded goodwill balances for potential impairment annually by comparing the fair value of each reporting unit to its carrying value, including recorded goodwill. Our annual testing date is June 30. We have not yet had a case where the carrying value exceeded the fair value; however, if it did, impairment would be measured by comparing the derived fair value of goodwill to its carrying value, and any impairment determined would be recorded in the current period. To date there has been no impairment of our recorded goodwill. Goodwill balances by reporting unit are as follows:

| September 30,                | 2008    | (in millions) | 2007    |
|------------------------------|---------|---------------|---------|
| Defense systems and products | \$ 16.1 |               | \$ 16.9 |
| Defense services             | 36.7    |               | 9.7     |
| Transportation systems       | 8.2     |               | 9.4     |
| Total goodwill               | \$ 61.0 |               | \$ 36.0 |

Determining the fair value of a reporting unit for purposes of the goodwill impairment test is judgmental in nature and involves the use of estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. We currently perform internal valuation analysis and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and comparisons with recent transactions. These approaches use significant estimates and assumptions including projected future cash flows, discount rate reflecting the inherent risk in future cash flows, perpetual growth rate and determination of appropriate market comparables.

For fiscal 2008, the discounted cash flows for each reporting unit were based on discrete three-year financial forecasts developed by management for planning purposes. Cash flows beyond the three-year discrete forecasts were estimated based on projected growth rates and financial ratios, influenced by an analysis of historical ratios, and by calculating a terminal value at the end of ten years. The compound annual growth rates for sales ranged from 4.0% to 8.0% and for operating profit margins ranged from 7.0% to 8.0% for the reporting units, beyond the discrete forecast period. The future cash flows were discounted to present value using a discount rate of 9.1%. We did not recognize any goodwill impairment as a result of performing this annual test. Changes in estimates and assumptions we make in conducting our goodwill assessment could affect the estimated fair value of one or more of our reporting units and could result in a goodwill impairment charge in a future period. However, a 10% decrease in the estimated fair value of any of our reporting units at June 30, 2008 would not have resulted in a goodwill impairment charge.

*Pension Costs*

The measurement of our pension obligations and costs is dependent on a variety of assumptions used by our actuaries. These assumptions include estimates of the present value of projected future pension payments to plan participants, taking into consideration the likelihood of potential future events such as salary increases and demographic experience. These assumptions may have an effect on the amount and timing of future contributions.

The assumptions used in developing the required estimates include the following key factors:

- Discount rates
- Inflation
- Salary growth
- Expected return on plan assets
- Retirement rates
- Mortality rates

We base the discount rate assumption on investment yields available at year-end on high quality corporate long-term bonds. Our inflation assumption is based on an evaluation of external market indicators. The salary growth assumptions reflect our long-term actual experience in relation to the inflation assumption. The expected return on plan assets reflects asset allocations, our historical experience, our investment

strategy and the views of investment managers and large pension sponsors. Retirement and mortality rates are based primarily on actual plan experience. The effects of actual results differing from our assumptions are accumulated and amortized over future periods, and therefore, generally affect our recognized expense in such future periods.

Changes in the above assumptions can affect our financial statements, although the relatively small size of our defined benefit pension plans in relation to the size of the Company limit the impact any individual assumption changes can have. For example, a 50 basis point change in the assumed rate of return on assets would have changed the pension expense recorded in 2008 by about \$0.8 million, before applicable income taxes.

#### **Item 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

##### **Interest Rate Risk**

We invest in money market instruments and short-term marketable debt securities that are tied to floating interest rates being offered at the time the investment is made. We maintain short-term borrowing arrangements in the U.S., U.K. and New Zealand which are also tied to floating interest rates (LIBOR and the U.S. prime rate and the U.K. and New Zealand base rates). We also have senior unsecured notes payable to insurance companies that are due in annual installments. These notes have fixed coupon interest rates. See Note 6 to the Consolidated Financial Statements for more information.

Interest income earned on our short-term investments is affected by changes in the general level of U.S. and U.K. interest rates. These income streams are generally not hedged. Interest expense incurred under the short-term borrowing arrangements is affected by changes in the general level of interest rates in the U.S., U.K. and New Zealand. The expense related to these cost streams is usually not hedged since it is either revolving, payable within three months and/or immediately callable by the lender at any time. Interest expense incurred under the long-term notes payable is not affected by changes in any interest rate because it is fixed. However, we have in the past, and may in the future, use an interest rate swap to essentially convert this fixed rate into a floating rate for some or all of the long-term debt outstanding. The purpose of a swap would be to tie the interest expense risk related to these borrowings to the interest income risk on our short-term investments, thereby mitigating our net interest rate risk. We believe that we are not significantly exposed to interest rate risk at this point in time. There was no interest rate swap outstanding at September 30, 2008.

##### **Foreign Currency Exchange Risk**

In the ordinary course of business, we enter into firm sale and purchase commitments denominated in many foreign currencies. We have a policy to hedge those commitments greater than \$20,000 by using foreign currency exchange forward and option contracts that are denominated in currencies other than the functional currency of the subsidiary responsible for the commitment, typically the British pound, Canadian dollar, Singapore dollar, Euro, Swedish krona, New Zealand dollar and Australian dollar. These contracts are designed to be effective hedges regardless of the direction or magnitude of any foreign currency exchange rate change, because they result in an equal and opposite income or cost stream that offsets the change in the value of the underlying commitment. See Note 1 to the Consolidated Financial Statements for more information on our foreign currency translation and transaction accounting policies. We also use balance sheet hedges to mitigate foreign exchange risk. This strategy involves incurring British pound denominated debt (See Interest Rate Risk above) and having the option of paying off the debt using U.S. dollar or British pound funds. We do not believe that we are significantly exposed to foreign currency exchange rate risk at this point in time.

Investments in our foreign subsidiaries in the U.K., Australia, New Zealand, and Canada are not hedged because we consider them to be invested indefinitely. In addition, we generally have control over the timing and amount of earnings repatriation, if any, and expect to use this control to mitigate foreign currency exchange risk.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA.**

## CUBIC CORPORATION

## CONSOLIDATED BALANCE SHEETS

|   | 2008              | September 30,<br>(in thousands) | 2007              |
|---|-------------------|---------------------------------|-------------------|
| <b>ASSETS</b>                             |                   |                                 |                   |
| <b>CURRENT ASSETS</b>                     |                   |                                 |                   |
| Cash and cash equivalents                 | \$ 112,696        |                                 | \$ 73,563         |
| Short-term investments                    |                   |                                 | 27,200            |
| Accounts receivable:                      |                   |                                 |                   |
| Trade and other receivables               | 9,014             |                                 | 13,024            |
| Long-term contracts                       | 264,748           |                                 | 297,792           |
| Allowance for doubtful accounts           | (4,878)           |                                 | (5,144)           |
|   | 268,884           |                                 | 305,672           |
| Inventories                               | 45,118            |                                 | 27,342            |
| Deferred income taxes                     | 27,082            |                                 | 18,492            |
| Prepaid expenses and other current assets | 21,548            |                                 | 21,105            |
| <b>TOTAL CURRENT ASSETS</b>               | <b>475,328</b>    |                                 | <b>473,374</b>    |
| <b>LONG-TERM CONTRACT RECEIVABLES</b>     | <b>19,930</b>     |                                 | <b>16,650</b>     |
| <b>PROPERTY, PLANT AND EQUIPMENT</b>      |                   |                                 |                   |
| Land and land improvements                | 15,408            |                                 | 14,601            |
| Buildings and improvements                | 43,379            |                                 | 46,519            |
| Machinery and other equipment             | 83,598            |                                 | 84,149            |
| Leasehold improvements                    | 4,656             |                                 | 4,299             |
| Accumulated depreciation and amortization | (93,154)          |                                 | (92,317)          |
|   | 53,887            |                                 | 57,251            |
| <b>OTHER ASSETS</b>                       |                   |                                 |                   |
| Deferred income taxes                     | 4,631             |                                 | 195               |
| Goodwill                                  | 61,032            |                                 | 36,003            |
| Purchased intangibles                     | 19,060            |                                 | 1,922             |
| Miscellaneous other assets                | 7,384             |                                 | 7,170             |
|   | 92,107            |                                 | 45,290            |
| <b>TOTAL ASSETS</b>                       | <b>\$ 641,252</b> |                                 | <b>\$ 592,565</b> |

See accompanying notes.



## CUBIC CORPORATION

## CONSOLIDATED BALANCE SHEETS continued

|  | 2008      | September 30,<br>(in thousands) | 2007              |
|--|-----------|---------------------------------|-------------------|
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>           |           |                                 |                   |
| <b>CURRENT LIABILITIES</b>                           |           |                                 |                   |
| Trade accounts payable                               | \$        | 23,288                          | \$ 27,992         |
| Customer advances                                    |           | 74,963                          | 58,412            |
| Accrued compensation                                 |           | 41,111                          | 38,183            |
| Other current liabilities                            |           | 44,721                          | 31,787            |
| Income taxes payable                                 |           | 6,017                           | 4,905             |
| Current maturities of long-term debt                 |           | 6,045                           | 6,138             |
| <b>TOTAL CURRENT LIABILITIES</b>                     |           | <b>196,145</b>                  | <b>167,417</b>    |
| <b>LONG-TERM DEBT</b>                                |           | <b>25,700</b>                   | <b>32,699</b>     |
| <b>OTHER LIABILITIES</b>                             |           |                                 |                   |
| Accrued pension liability                            |           | 16,451                          | 1,530             |
| Deferred compensation                                |           | 7,821                           | 8,148             |
| Income taxes payable                                 |           | 6,283                           |                   |
| <b>COMMITMENTS AND CONTINGENCIES</b>                 |           |                                 |                   |
| <b>SHAREHOLDERS EQUITY</b>                           |           |                                 |                   |
| Preferred stock, no par value (in thousands):        |           |                                 |                   |
| Authorized 5,000 shares                              |           |                                 |                   |
| Issued and outstanding none                          |           |                                 |                   |
| Common stock, no par value (in thousands):           |           |                                 |                   |
| Authorized 50,000 shares                             |           |                                 |                   |
| 2008 Issued 35,673 shares, outstanding 26,727 shares |           |                                 |                   |
| 2007 Issued 35,665 shares, outstanding 26,720 shares |           |                                 |                   |
|  |           | 12,485                          | 12,357            |
| Retained earnings                                    |           | 404,868                         | 375,299           |
| Accumulated other comprehensive income               |           | 7,570                           | 31,184            |
| Treasury stock at cost (in thousands):               |           |                                 |                   |
| 2008 8,945 shares; 2007 8,945 shares                 |           |                                 |                   |
|  |           | (36,071)                        | (36,069)          |
|  |           | <b>388,852</b>                  | <b>382,771</b>    |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>     | <b>\$</b> | <b>641,252</b>                  | <b>\$ 592,565</b> |

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

|  | Years Ended September 30,                     |                  |                  |
|--|---|------------------|------------------|
|  | 2008  | 2007             | 2006             |
|  | (amounts in thousands, except per share data) |                  |                  |
| <b>Net sales:</b>                                    |   |                  |                  |
| Products   | \$ 478,478                                    | \$ 517,165       | \$ 489,286       |
| Services   | 402,657                                       | 372,705          | 332,100          |
|  | 881,135                                       | 889,870          | 821,386          |
| <b>Costs and expenses:</b>                           |   |                  |                  |
| Products   | 376,213                                       | 415,729          | 411,181          |
| Services   | 333,268                                       | 311,811          | 276,032          |
| Selling, general and administrative expenses         | 99,956  | 95,054           | 97,166           |
| Restructuring costs                                  | 6,203   |                  |                  |
| Research and development                             | 12,231  | 5,178            | 6,112            |
|  | 827,871                                       | 827,772          | 790,491          |
| <b>Operating income</b>                              | <b>53,264</b>                                 | <b>62,098</b>    | <b>30,895</b>    |
| <b>Other income (expenses):</b>                      |   |                  |                  |
| Gain on sale of assets                               | 1,238   | 1,052            | 7,237            |
| Interest and dividends                               | 6,351   | 3,431            | 1,891            |
| Interest expense                                     | (2,745)                                       | (3,403)          | (5,112)          |
| Other income (expense)                               | (653)   | 1,299            | 433              |
| Minority interest in loss (income) of subsidiary     | (216)   | 771              | 985              |
| <b>Income before income taxes</b>                    | <b>57,239</b>                                 | <b>65,248</b>    | <b>36,329</b>    |
| <b>Income taxes</b>                                  | <b>20,385</b>                                 | <b>23,662</b>    | <b>12,196</b>    |
| <b>Net income</b>                                    | <b>\$ 36,854</b>                              | <b>\$ 41,586</b> | <b>\$ 24,133</b> |
| <b>Basic and diluted net income per common share</b> | <b>\$ 1.38</b>                                | <b>\$ 1.56</b>   | <b>\$ 0.90</b>   |
| <b>Average number of common shares outstanding</b>   | <b>26,725</b>                                 | <b>26,720</b>    | <b>26,720</b>    |

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Years Ended September 30, |                  |                  |
|---|---------------------------|------------------|------------------|
|   | 2008                      | 2007             | 2006             |
|   | (in thousands)            |                  |                  |
| <b>Operating Activities:</b>  |                           |                  |                  |
| Net income  | \$ 36,854                 | \$ 41,586        | \$ 24,133        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                  |                  |
| Depreciation and amortization   | 9,688                     | 8,854            | 8,490            |
| Deferred income taxes   | (6,203)                   | 745              | 514              |
| Provision for doubtful accounts   | (39)                      | 19               | 145              |
| Gain on sale of assets  | (1,238)                   | (1,052)          | (7,237)          |
| Minority interest in income (loss) of subsidiary                                  | 216                       | (771)            | (985)            |
| Changes in operating assets and liabilities, net of effects from acquisitions:    |                           |                  |                  |
| Accounts receivable   | 40,495                    | 18,091           | 5,793            |
| Inventories   | (18,748)                  | (7,610)          | 1,577            |
| Prepaid expenses  | 451                       | (8,048)          | (2,051)          |
| Accounts payable and other current liabilities                                    | 4,037                     | 9,965            | (2,112)          |
| Customer advances   | 16,952                    | 12,181           | 2,279            |
| Income taxes  | 7,835                     | (2,741)          | 155              |
| Other items - net   | 2,355                     | (2,063)          | 629              |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>92,655</b>             | <b>69,156</b>    | <b>31,330</b>    |
| <b>Investing Activities:</b>  |                           |                  |                  |
| Acquisition of businesses, net of cash acquired                                   | (53,776)                  |                  | (785)            |
| Proceeds from sale of assets  | 1,779                     | 3,775            | 8,028            |
| Proceeds from sale of short-term investments                                      | 66,160                    | 241,606          | 4,000            |
| Purchases of short-term investments   | (39,070)                  | (259,935)        | (12,850)         |
| Purchases of property, plant and equipment  | (8,100)                   | (6,098)          | (9,789)          |
| Other items - net   | (2,254)                   | (139)            | (513)            |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                      | <b>(35,261)</b>           | <b>(20,791)</b>  | <b>(11,909)</b>  |
| <b>Financing Activities:</b>  |                           |                  |                  |
| Change in short-term borrowings   |                           | (10,000)         | (16,437)         |
| Principal payments on long-term debt  | (6,112)                   | (6,112)          | (6,052)          |
| Proceeds from issuance of common stock  | 128                       |                  |                  |
| Purchases of treasury stock   | (2)                       |                  | (3)              |
| Dividends paid to shareholders  | (4,810)                   | (4,810)          | (4,810)          |
| <b>NET CASH USED IN FINANCING ACTIVITIES</b>                                      | <b>(10,796)</b>           | <b>(20,922)</b>  | <b>(27,302)</b>  |
| Effect of exchange rates on cash  | (7,465)                   | 3,740            | 1,401            |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                       | <b>39,133</b>             | <b>31,183</b>    | <b>(6,480)</b>   |
| Cash and cash equivalents at the beginning of the year                            | 73,563                    | 42,380           | 48,860           |
| <b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>                           | <b>\$ 112,696</b>         | <b>\$ 73,563</b> | <b>\$ 42,380</b> |

See accompanying notes.

## CUBIC CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

| (in thousands except<br>per share amounts)          | Comprehensive<br>Income | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Common<br>Stock | Number<br>of Shares<br>Outstanding |
|---|-------------------------|-------------------|---|----------------------|-----------------|------------------------------------|
| October 1, 2005                                     |                         | \$ (36,066)       | \$ 1,667  | \$ 319,200           | \$ 12,357       | 26,720                             |
| Comprehensive income:                               |                         |                   |   |                      |                 |                                    |
| Net income  | \$ 24,133               |                   |   | 24,133               |                 |                                    |
| Decrease in minimum pension liability               | 2,435                   |                   | 2,435   |                      |                 |                                    |
| Foreign currency translation adjustment             | 4,321                   |                   | 4,321   |                      |                 |                                    |
| Net unrealized losses from cash flow hedges         | (8)                     |                   | (8)   |                      |                 |                                    |
| Comprehensive income                                | \$ 30,881               |                   |   |                      |                 |                                    |
| Purchase of treasury stock                          |                         | (3)               |   |                      |                 |                                    |
| Cash dividends paid \$.18 per share of common stock |                         |                   |   | (4,810)              |                 |                                    |
| September 30, 2006                                  |                         | (36,069)          | 8,415   | 338,523              | 12,357          | 26,720                             |
| Comprehensive income:                               |                         |                   |   |                      |                 |                                    |
| Net income  | \$ 41,586               |                   |   | 41,586               |                 |                                    |
| Decrease in minimum pension liability               | 13,580                  |                   | 13,580  |                      |                 |                                    |
| Foreign currency translation adjustment             | 9,189                   |                   | 9,189   |                      |                 |                                    |
| Comprehensive income                                | \$ 64,355               |                   |   |                      |                 |                                    |
| Cash dividends paid \$.18 per share of common stock |                         |                   |   | (4,810)              |                 |                                    |
| September 30, 2007                                  |                         | (36,069)          | 31,184  | 375,299              | 12,357          | 26,720                             |
| Comprehensive income:                               |                         |                   |   |                      |                 |                                    |
| Net income  | \$ 36,854               |                   |   | 36,854               |                 |                                    |
| Increase in minimum pension liability               | (12,383)                |                   | (12,383)  |                      |                 |                                    |
| Foreign currency translation adjustment             | (11,231)                |                   | (11,231)  |                      |                 |                                    |
| Comprehensive income                                | \$ 13,240               |                   |   |                      |                 |                                    |
| Adoption of FIN48                                   |                         |                   |   | (2,475)              |                 |                                    |
| Stock issued under equity incentive plan            |                         |                   |   |                      | 128             | 7                                  |
| Purchase of treasury stock                          |                         | (2)               |   |                      |                 |                                    |
| Cash dividends paid \$.18 per share of common stock |                         |                   |   | (4,810)              |                 |                                    |

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|                    |    |          |    |       |    |         |    |        |        |
|--------------------|----|----------|----|-------|----|---------|----|--------|--------|
| September 30, 2008 | \$ | (36,071) | \$ | 7,570 | \$ | 404,868 | \$ | 12,485 | 26,727 |
|--------------------|----|----------|----|-------|----|---------|----|--------|--------|

See accompanying notes.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of the Business: Cubic Corporation (Cubic or the Company) designs, develops and manufactures products which are mainly electronic in nature, provides government services and services related to products previously produced by Cubic and others. The Company's principal lines of business are defense and transportation fare collection systems. Principal customers for defense products and services are the United States and foreign governments. Transportation fare collection systems are sold primarily to large local government agencies in the United States and worldwide.

Principles of Consolidation: The consolidated financial statements include the accounts of Cubic Corporation, its majority-owned subsidiaries and a 50% owned joint venture of which the Company was the primary beneficiary prior to its sale during 2008. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidation of foreign subsidiaries requires translation of their assets and liabilities into U.S. dollars at year-end exchange rates. Statements of income and cash flows are translated at the average exchange rates for each year. Transaction gains and losses on advances to foreign subsidiaries amounted to a \$1.0 million loss in 2008, a gain of \$0.7 million in 2007 and zero in 2006.

Cash Equivalents: The Company considers highly liquid investments with maturity of three months or less when purchased to be cash equivalents.

Concentration of Credit Risk: The Company has established guidelines pursuant to which its cash and cash equivalents are diversified among various money market instruments and investment funds. These guidelines emphasize the preservation of capital by requiring minimum credit ratings assigned by established credit organizations. Diversification is achieved by specifying maximum investments in each instrument type and issuer. The majority of these investments are not on deposit in federally insured accounts.

Fair Value of Financial Instruments: Financial instruments, including cash equivalents, accounts receivable, accounts payable and accrued liabilities, are carried at cost, which management believes approximates the fair value because of the short-term maturity of these instruments. The fair value of long-term debt is based upon quoted market prices for the same or similar debt instruments and approximates the carrying

value of the debt. Receivables consist primarily of amounts due from U.S. and foreign governments for defense products and local government agencies for transportation systems. Due to the nature of its customers, the Company generally does not require collateral. The Company has limited exposure to credit risk as the Company has historically collected substantially all of its receivables from government agencies. The Company generally requires no allowance for doubtful accounts for these customers unless specific contractual circumstances warrant it.

Short-term Investments: Short-term investments include highly liquid, investment grade, institutional money market debt instruments categorized as available-for-sale securities as defined by Statement of Financial Accounting Standards 115, *Accounting for Certain Investments in Debt and Equity Securities*. Any net excess of fair market value over cost would be included in Accumulated Other Comprehensive Income (Loss) on the Consolidated Balance Sheets.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

We record short-term investments at fair value. At year end, our investment portfolio included the following:

| September 30,                        | 2008              |               | 2007              |               |
|--------------------------------------|-------------------|---------------|-------------------|---------------|
|                                      | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|                                      | (in thousands)    |               |                   |               |
| Money market preferred stock         | \$                | \$            | \$ 11,600         | \$ 11,600     |
| Debt securities purchased at auction |                   |               | 15,600            | 15,600        |
|                                      | \$                | \$            | \$ 27,200         | \$ 27,200     |

**Inventories:** Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method, which approximates current replacement cost. Work in process is stated at the actual production and engineering costs incurred to date, including applicable overhead, and is reduced by charging any amounts in excess of estimated realizable value to cost of sales. Where contracts include advances, performance-based payments and progress payments, the advances are reflected as an offset against any related inventory balances. Costs incurred for certain government contracts include general and administrative costs as allowed by government cost accounting standards. The amounts remaining in inventory at September 30, 2008 and 2007 were \$5.1 million and \$0.7 million respectively.

**Property, Plant and Equipment:** Property, plant and equipment are carried at cost. Depreciation is provided in amounts sufficient to amortize the cost of the depreciable assets over their estimated useful lives. Generally, straight-line methods are used for real property over estimated useful lives ranging from 15 to 39 years or the term of the underlying lease for leasehold improvements. Accelerated methods (declining balance and sum-of-the-years-digits) are used for machinery and equipment over estimated useful lives ranging from five to seven years. Provisions for depreciation of plant and equipment and amortization of leasehold improvements amounted to \$8.3 million, \$7.9 million and \$7.6 million in 2008, 2007 and 2006, respectively.

**Goodwill:** Goodwill is evaluated for potential impairment annually by comparing the fair value of a reporting unit to its carrying value, including recorded goodwill. If the carrying value exceeds the fair value, impairment is measured by comparing the derived fair value of goodwill to its carrying value, and any impairment determined would be recorded in the current period. To date there has been no impairment of the Company's recorded goodwill.

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The changes in the carrying amount of goodwill for the two years ended September 30, 2008 are as follows:

|  | Transportation<br>Segment |    | Defense<br>Segment<br>(in thousands) |    | Total   |
|--|---------------------------|----|--------------------------------------|----|---------|
| Balances at October 1, 2006            | \$ 8,615                  | \$ | 26,135                               | \$ | 34,750  |
| Foreign currency exchange rate changes | 747                       |    | 506                                  |    | 1,253   |
| Balances at September 30, 2007         | 9,362                     |    | 26,641                               |    | 36,003  |
| Goodwill acquired during the year      |                           |    | 27,045                               |    | 27,045  |
| Reduction of acquired tax accrual      |                           |    | (435)                                |    | (435)   |
| Foreign currency exchange rate changes | (1,152)                   |    | (429)                                |    | (1,581) |
| Balances at September 30, 2008         | \$ 8,210                  | \$ | 52,822                               | \$ | 61,032  |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

Purchased Intangible Assets: The table below summarizes the Company's purchased intangible assets as follows:

| (in thousands)                   | September 30, 2008    |                          |                     | September 30, 2007    |                          |                     |
|----------------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                                  | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Contract and program intangibles | \$ 19,545             | \$ (3,139)               | \$ 16,406           | \$ 4,732              | \$ (2,810)               | \$ 1,922            |
| Other purchased intangibles      | 2,787                 | (133)                    | 2,654               |                       |                          |                     |
| Total                            | \$ 22,332             | \$ (3,272)               | \$ 19,060           | \$ 4,732              | \$ (2,810)               | \$ 1,922            |

The company's purchased intangible assets are subject to amortization and are being amortized on a combination of straight-line and sum-of-the-years-digits basis over a weighted average period of 6 years. Total amortization expense for 2008, 2007 and 2006, was \$1.3 million, \$0.9 million and \$0.8 million, respectively.

The table below shows expected amortization for purchased intangibles as of September 30, 2008, for each of the next five years (in thousands):

|            |           |
|------------|-----------|
| 2009       | \$ 5,607  |
| 2010       | 4,690     |
| 2011       | 3,642     |
| 2012       | 2,650     |
| 2013       | 1,734     |
| Thereafter | 737       |
|            | \$ 19,060 |

Impairment of Long-Lived Assets: The carrying values of long-lived assets other than goodwill are generally evaluated for impairment only if events or changes in facts and circumstances indicate that carrying values may not be recoverable. Any impairment determined would be recorded in the current period and would be measured by comparing the fair value of the related asset to its carrying value. Fair value is generally determined by identifying estimated undiscounted cash flows to be generated by those assets. No impairments have been recorded for the years ended September 30, 2008, 2007 and 2006.

Deferred Compensation: Deferred compensation includes amounts due under an arrangement in which participating members of management may elect to defer receiving payment for a portion of their compensation a minimum of five years or until periods after their respective retirements. Interest on deferred compensation accrues at market rates, until such time as it is paid in full. The interest rate is adjusted semi-annually and was 5.125% at September 30, 2008.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

Comprehensive Income: Comprehensive income and its components are presented in the statement of changes in shareholders' equity. Accumulated comprehensive income (loss) consisted of the following:

| September 30,                   | 2008 | (in thousands) | 2007      |
|---------------------------------|------|----------------|-----------|
| Adjustment to pension liability | \$   | (7,436)        | \$ 4,947  |
| Foreign currency translation    |      | 15,006         | 26,237    |
|                                 | \$   | 7,570          | \$ 31,184 |

The adjustment to the pension liability is shown net of a tax benefit of \$4.0 million and a tax provision of \$2.7 million at September 30, 2008 and 2007, respectively. Deferred income taxes are not recognized for translation-related temporary differences of foreign subsidiaries whose undistributed earnings are considered to be permanently invested.

Revenue Recognition: Sales and profits under the Company's long-term fixed-price contracts, which generally require a significant amount of development effort in relation to total contract value, are recognized using the cost-to-cost percentage of completion method of accounting. Sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In the early stages of contract performance, profit is not recognized until progress is demonstrated or contract milestones are reached. For certain other long-term, fixed price production contracts not requiring substantial development effort the Company uses the units-of-delivery percentage of completion method as the basis to measure progress toward completing the contract and recognizing sales.

Sales under cost-reimbursement type contracts are recorded as costs are incurred. Profits are included in earnings based on the ratio of costs incurred to the estimated total costs at completion. Sales of products are recorded when a firm sales agreement is in place, delivery has occurred and collectibility of the fixed or determinable sales price is reasonably assured. Sales for Fixed-Price Service Contracts that do not contain measurable units of work performed are generally recognized on straight-line basis over the contractual service period, unless evidence suggests that the revenue is earned, or obligations fulfilled, in a different manner. Sales for Fixed-Price Service Contracts that contain measurable units of work performed are recognized when the units of work are completed.

Amounts representing contract change orders, claims or other items are included in the contract value only when they can be reliably estimated and realization is considered probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating

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sales and profits, and are recorded when there is sufficient information to assess anticipated contract performance. Incentive provisions that increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

Sales and profits on contracts that specify multiple deliverables are allocated to separate units of accounting when there is objective evidence that each accounting unit has value to the customer on a stand-alone basis.

Provisions are made on a current basis to fully recognize any anticipated losses on contracts. Cash received prior to revenue recognition is classified as customer advances on the balance sheet.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

**Income Taxes:** The provision for income taxes includes federal, state, local, and foreign taxes. Tax credits, primarily for research and development and export programs are recognized as a reduction of the provision for income taxes in the year in which they are available for tax purposes. Deferred income taxes are provided on temporary differences between assets and liabilities for financial reporting and tax purposes as measured by enacted tax rates expected to apply when the temporary differences are settled or realized. Valuation allowances are established for deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent deductions that have been taken on tax returns but have not yet been recognized as expense in the financial statements. Annually the Company evaluates the capital requirements of its foreign subsidiaries and determines the amount of excess capital, if any, that is available for distribution. The Company provides for U.S. taxes on the amount determined to be excess capital available for distribution. The Company has not recognized United States tax expense on \$52.4 million of undistributed earnings of its foreign subsidiaries at September 30, 2008, since it intends to reinvest the earnings outside the United States for the foreseeable future.

**Earnings Per Share:** Per share amounts are based upon the weighted average number of shares of common stock outstanding.

**Restructuring Activity:** In the fourth quarter of 2008 the Company reduced its defense segment facility workforce by 139 employees. In addition, 6 corporate office positions were eliminated. Affected employees received severance pay and outplacement assistance, as well as company paid medical coverage for a defined period based on years of service. The cost of this restructuring was \$6.2 million and is reflected in the company's results for the fourth quarter.

The following table presents a rollforward of the Company's restructuring liability, which is included within other current liabilities in the audited consolidated balance sheets (in thousands):

|                                    |    | <b>Employee<br/>Separation<br/>Expenses</b> |
|------------------------------------|----|---|
| Liability as of September 30, 2007 | \$ |   |
| Additions                          |    | 6,203                                       |
| Cash Payments                      |    | (4,523)                                     |
| Liability as of September 30, 2008 | \$ | 1,680                                       |

**Derivative Financial Instruments:** The Company's use of derivative financial instruments is limited to foreign exchange forward and option contracts used to hedge significant contract sales, purchase Commitments and investments that are denominated in currencies other than the functional currency of the subsidiary responsible for the commitment and to hedge net advances to foreign subsidiaries. The purpose of the Company's foreign currency hedging activities is to fix the dollar value of specific commitments, investments, payments to foreign vendors, and the value of foreign currency denominated receipts from customers. At September 30, 2008, the Company had foreign exchange contracts with a notional value of \$135.6 million outstanding.



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

The Company accounts for derivatives pursuant to SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. This standard requires that all derivative instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resulting designation. The change in fair value of the ineffective portion of a hedge, and changes in fair values of derivatives that are not considered highly effective hedges are immediately recognized in earnings. If the derivative is designated as a fair value hedge, the changes in the estimated fair value of the derivative and the underlying hedged item are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are subsequently recognized in earnings when the hedged item affects earnings. Ineffectiveness between the change in fair value of the derivatives and the change in fair value of hedged items was immaterial for the years ended September 30, 2008, 2007 and 2006.

New Accounting Standards: In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which was effective for the Company on October 1, 2007. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with SFAS 109, *Accounting for Income Taxes*. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The effect of adopting FIN 48 on the Company's financial condition at September 30, 2008 has been included in the accompanying consolidated financial statements. See Note 8 for further discussion of the effect of adopting FIN 48 on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, which for the Company is the quarter ending December 31, 2008. SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. Management does not expect that the adoption of SFAS 157 will have a material impact on the Company's results of operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*, effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, which for the Company is the quarter ending December 31, 2008. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Management does not expect that the adoption of SFAS 159 will have a material impact on the Company's results of operations, financial position or cash flows.

In December 2007 the FASB issued SFAS No. 141(R), *Business Combinations*, effective for fiscal years beginning on or after December 15, 2008, which for the Company is the fiscal year beginning October 1, 2009. This statement applies to all transactions or other events in which an entity obtains control of one or more businesses. This statement applies to all business entities, including mutual entities that previously used the

pooling-of-interests method of accounting for some business combinations. Management does not expect that the adoption of SFAS 141(R) will have a material impact on the Company's results of operations, financial position or cash flows.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

In March 2008 the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, effective for interim periods beginning after November 15, 2008, which for the Company is the quarter ending March 31, 2009. This statement requires enhanced disclosures about an entity's financial position, financial performance, and cash flows. The statement requires that objectives for using derivative instruments be disclosed in terms of underlying risks and accounting designation. Management does not expect that the adoption of SFAS 161 will have a material impact on the Company's results of operations, financial position or cash flows.

Use of Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include the estimated total costs at completion of the Company's long-term contracts, estimated discounted cash flows of reporting units used for goodwill impairment testing, and the estimated rates of return and discount rates related to the Company's defined benefit pension plans. Actual results could differ from those estimates.

Risks and Uncertainties: The Company is subject to the normal risks and uncertainties of performing large, multiyear, often fixed-price contracts. In addition, the Company is subject to audit of incurred costs related to many of its U.S. Government contracts. These audits could produce different results than the Company has estimated; however, the Company's experience has been that its costs are acceptable to the government.

## NOTE 2 ACQUISITION

On July 29, 2008 the Company acquired all outstanding capital stock from the five shareholders of the privately-held Omega Training Group, Inc., headquartered in Columbus, Georgia. The purchase was for \$61.0 million in cash which was funded from existing cash reserves. Cash consideration paid including costs of the acquisition, net of cash acquired, as of September 30, 2008 totaled \$53.8 million. The Company's additional \$6.1 million obligation in accordance with the agreement is included in other current liabilities at September 30, 2008, and has been subsequently paid. Omega provides training, testing, analysis, logistics and staffing services to U.S. Army locations at the U.S. Army Infantry School at Fort Benning, Fort Bliss, Fort Jackson and Fort Hood. None of these locations are significant customers of the Company's defense segment. Founded in 1990, Omega now has 790 employees. Omega will be managed within the Company's Mission Support Services business.

The following table summarizes the allocation of the purchase price for Omega (in millions):

|          |    |      |
|----------|----|------|
| Goodwill | \$ | 27.0 |
|----------|----|------|

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|                        |    |      |
|------------------------|----|------|
| Trade name             |    | 2.8  |
| Customer relationships |    | 14.7 |
| Backlog                |    | 2.2  |
| Net assets assumed     |    | 14.3 |
| Total                  | \$ | 61.0 |

The intangible assets which include trade name, customer relationships, and backlog have a weighted average useful life of 6 years from the date of acquisition. These intangible assets are included in Miscellaneous other assets on the Consolidated Balance sheets. Management expects the purchased intangibles and goodwill to be deductible in its tax returns over a 15 year period, which will generate deferred tax liabilities to the extent the deductions exceed book expense. The operations and assets of Omega for the two month period from July 29, 2008 to September 30, 2008 are included in the defense segment.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 3 INVESTMENTS IN VARIABLE INTEREST ENTITIES

The Company was party to a 50/50 joint venture arrangement with the U.S. subsidiary of Rafael Armament Development Authority Ltd. (Rafael), an Israeli company, to manufacture certain of their products for sale to the U.S. and Israeli defense forces. During the fourth quarter of fiscal year 2008, the Company sold its interest in the joint venture arrangement to Rafael for approximately \$1.8 million, resulting in a gain before applicable income taxes of \$1.2 million, which is included in Gain on sale of assets on the Consolidated Statements of Income. The joint venture generated sales of \$8.3 million, \$6.4 million, and \$1.0 million in 2008, 2007 and 2006, respectively, and generated operating income of \$0.4 million in 2008 and operating losses of \$1.4 million and \$1.9 million in 2007 and 2006, respectively.

Under the provisions of FASB Interpretation No. 46 *Consolidation of Variable Interest Entities*, (FIN46) the Company consolidated the above joint venture, as it was the primary beneficiary of the joint venture arrangement prior to its sale. Minority interest in the net income and loss from this business is reflected in consolidated income.

The Company owns 37.5% of the common stock of Transaction Systems Limited (TranSys), a special-purpose company formed in the United Kingdom to bid on a contract called PRESTIGE (Procurement of Revenue Services, Ticketing, Information, Gates and Electronics), which outsourced most of the functions of the Transport for London (TfL) fare collection system for a period of up to seventeen years. In August 1998, TranSys was awarded the contract and began operations. Cubic and the other 37.5% shareholder participate in the PRESTIGE contract solely through subcontracts from TranSys. All of the work to be performed by TranSys is subcontracted to the two 37.5% shareholders and the arrangement provides for the pass-through of virtually all revenues from TfL to the two shareholders. As a result, TranSys has operated on a break-even basis and is expected to continue to do so. If TranSys were to eventually generate a net income or loss, the shareholders would share in this income or loss in accordance with their percentage ownership in TranSys. The Company's investment in TranSys is immaterial. TranSys is considered a variable interest entity under the provisions of FIN 46; however, the Company does not consolidate TranSys, as it is not considered the primary beneficiary as defined in FIN 46.

In August 2008, TfL notified TranSys that they will be terminating the PRESTIGE fare collection system contract as of August 2010 in accordance with the early termination provision of the contract. As a result of this termination for convenience, upon completion if the contract in 2010, the operations of TranSys will cease.

Financing for the project was provided by a syndicate of banks which participated in creating the project's financial structure. Debt servicing began in 2003 and will continue until the end of the contract in August 2010, at which time TfL is obligated to pay TranSys an amount sufficient to repay the loan, subject to a possible withhold, as described below. This debt is guaranteed by TfL and is nonrecourse to the shareholders of TranSys.

The contract termination notice triggers a requirement for TranSys to engage an independent engineer to produce a report on the state of the assets associated with the PRESTIGE system. The engineer has to deliver a report eleven months before the end of the contract, stating whether,

in their opinion, the fare collection system assets are able to pass a Performance Test for a period of two years beyond the contract termination. The Performance Test requires the assets to perform at contractual minimum levels with broadly the same level of maintenance as that performed under the contract. If the engineer determines that the assets may fail the Performance Test then TranSys and its subcontractors have an eleven month period to carry out the necessary remediation of the assets.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 3 INVESTMENTS IN VARIABLE INTEREST ENTITIES Continued

Following the termination of the contract in August 2010, the same engineer will deliver a Supplementary Report which is a follow up assessment to take into account the remediation efforts of TranSys and its subcontractors, and to give an opinion on the remaining level of remediation work required in order to allow the system to pass the Performance Test for the two year period. The contract allows TfL to withhold an amount up to approximately £40 million (currently approximately \$60 million) from its final payment to TranSys pending the delivery of the Supplementary Report and the completion of any remediation work identified in the report. This process is not expected to take longer than six months and TfL would be required to pay interest on any funds withheld.

TranSys is required to repay the banks in August 2010 and, to the extent that there is a funding shortfall in TranSys because of a withhold by TfL, the 37.5% shareholders are each required to provide TranSys with 50% of the cash required to fully repay the debt until the funds are returned to TranSys by TfL, at which time the shareholders would be repaid by TranSys. While there is the possibility that TfL will withhold some amount from TranSys upon contract termination, Cubic management does not believe this will be necessary. In recent years the fare collection system has consistently exceeded the contractual performance levels and Cubic management believes that sufficient costs have been included in its estimated costs to complete the contract to continue this level of performance for the required period. In addition, since Cubic has been selected as the successor contractor to the PRESTIGE contract, management believes TfL will have no reason to withhold funds to assure any required remediation will be completed.

The Company has provided certain performance guarantees to various parties related to the PRESTIGE contract and TranSys, including TfL, the banks and the TranSys shareholders. The other TranSys shareholders have provided similar performance guarantees to the same parties and to Cubic.

Summarized unaudited financial information for TranSys is as follows:

| September 30,                                    | 2008        | (in millions) |           | 2007         |
|--|-------------|---------------|-----------|--------------|
| <b>Balance Sheets:</b>                           |             |               |           |              |
| Cash   | \$          | 43.7          | \$        | 66.1         |
| Other current assets                             |             | 116.3         |           | 121.4        |
| Noncurrent unbilled contract accounts receivable |             | 171.6         |           | 222.5        |
| <b>Total Assets</b>                              | <b>\$</b>   | <b>331.6</b>  | <b>\$</b> | <b>410.0</b> |
| Current liabilities                              | \$          | 33.9          | \$        | 66.4         |
| Long-term debt                                   |             | 297.7         |           | 343.6        |
| Equity   |             |               |           |              |
| <b>Total Liabilities and Equity</b>              | <b>\$</b>   | <b>331.6</b>  | <b>\$</b> | <b>410.0</b> |
| <b>Years ended September 30,</b>                 | <b>2008</b> | <b>2007</b>   |           | <b>2006</b>  |

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(in millions )

**Statement of Operations:**

|                  |    |       |    |       |    |       |
|------------------|----|-------|----|-------|----|-------|
| Sales            | \$ | 215.3 | \$ | 210.8 | \$ | 118.6 |
| Operating profit | \$ |       | \$ |       | \$ |       |
| Net income       | \$ |       | \$ |       | \$ |       |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 4 ACCOUNTS RECEIVABLE

The components of accounts receivable under long-term contracts are as follows:

| September 30,  | 2008       | (in thousands) | 2007       |
|--|------------|----------------|------------|
| <b>U.S. Government Contracts:</b>                                      |            |                |            |
| Amounts billed   | \$ 60,016  |                | \$ 55,362  |
| Recoverable costs and accrued profits on progress completed not billed | 50,600     |                | 61,620     |
|  | 110,616    |                | 116,982    |
| <b>Commercial Customers:</b>   |            |                |            |
| Amounts billed   | 47,209     |                | 45,692     |
| Recoverable costs and accrued profits on progress completed not billed | 126,853    |                | 151,768    |
|  | 174,062    |                | 197,460    |
|  | 284,678    |                | 314,442    |
| Less unbilled amounts not currently due commercial customers           | (19,930)   |                | (16,650)   |
|  | \$ 264,748 |                | \$ 297,792 |

A portion of recoverable costs and accrued profits on progress completed is billable under progress payment provisions of the related contracts. The remainder of these amounts is billable upon delivery of products or furnishing of services, with an immaterial amount subject to retainage provisions of the contracts. It is anticipated that substantially all of the unbilled portion of receivables identified as current assets will be billed and collected under progress billing provisions of the contracts or upon completion of performance tests and/or acceptance by the customers during fiscal 2009.

## NOTE 5 INVENTORIES

Inventories are classified as follows:

| September 30,   | 2008      | (in thousands) | 2007      |
|---|-----------|----------------|-----------|
| Finished products   | \$ 172    |                | \$ 240    |
| Work in process and inventoried costs under long-term contracts | 64,179    |                | 25,005    |
| Customer advances   | (20,783)  |                |           |
| Materials and purchased parts                                   | 1,550     |                | 2,097     |
|   | \$ 45,118 |                | \$ 27,342 |

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At September 30, 2008 and 2007, work in process and inventoried costs under long-term contracts included approximately \$1.6 million and \$8.4 million, respectively, in costs incurred outside the scope of work on several contracts in the defense segment. Management believes it is probable these costs, plus a profit margin, will be recovered under contract change orders within the next year. \$5.2 million of the September 30, 2007 balance related to a contract claim with the U.S. Navy for which a contract modification was received in November 2008 and is, therefore, no longer at risk.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 6 FINANCING ARRANGEMENTS

Long-term debt consists of the following:

| September 30,  | 2008           | 2007      |
|--|----------------|-----------|
|  | (in thousands) |           |
| Unsecured notes payable to a group of insurance companies, with annual principal payments of \$4,000,000 due in November. Interest at 6.31% is payable semiannually in November and May. | \$ 24,000      | \$ 28,000 |
| Unsecured note payable to an insurance company, with annual principal payments of \$1,428,571 due in November. Interest at 6.11% is payable semiannually in November and May.            | 1,429          | 2,857     |
| Mortgage note from a UK financial institution, with quarterly installments of principal and interest at 6.5%   | 6,316          | 7,980     |
|  | 31,745         | 38,837    |
| Less current portion   | (6,045)        | (6,138)   |
|  | \$ 25,700      | \$ 32,699 |

The terms of the notes payable and other financial instruments include provisions that require and/or limit, among other financial ratios and measurements, the permitted levels of working capital, debt and tangible net worth and coverage of fixed charges. The Company has also provided certain performance guarantees to various parties related to the PRESTIGE contract and the TranSys arrangement. As consideration for the performance guarantee, the Company has agreed to certain financial covenants including limits on working capital, debt, tangible net worth and cash flow coverage. At September 30, 2008, the most restrictive covenant under these agreements leaves consolidated retained earnings of \$170 million available for the payment of dividends to shareholders, purchases of the Company's common stock and other charges to shareholders' equity. To date, there have been no covenant violations.

The Company maintains a short-term borrowing arrangement totaling 6 million British pounds (equivalent to approximately \$10.7 million) with a U.K. financial institution to help meet the short-term working capital requirements of its subsidiary, Cubic Transportation Systems Ltd. Any outstanding balances are guaranteed by Cubic Corporation, are repayable on demand, and bear interest at the bank's base rate, as defined, plus one percent. At September 30, 2008, no amounts were outstanding under this borrowing arrangement.

The Company maintains a short-term borrowing arrangement in New Zealand totaling \$0.5 million New Zealand dollars (equivalent to approximately \$0.3 million) to help meet the short-term working capital requirements of its subsidiary in that country. At September 30, 2008, no amounts were outstanding under this borrowing arrangement.



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 6 FINANCING ARRANGEMENTS Continued

The Company has a \$150 million revolving line of credit arrangement with a group of U.S. banks which expires in March 2010. Commitment fees associated with this financing arrangement are 0.15% of the unutilized balance per annum. As of September 30, 2008 the Company had no short-term debt outstanding under this line of credit and \$24.1 million in outstanding letters of credit.

Maturities of long-term debt for each of the five years in the period ending September 30, 2013, are as follows: 2009 \$6.0 million; 2010 \$4.6 million; 2011 \$4.6 million; 2012 \$4.6 million; 2013 \$4.6 million.

Interest paid amounted to \$2.8 million, \$3.6 million, and \$4.7 million in 2008, 2007 and 2006, respectively.

As of September 30, 2008 the Company had letters of credit and bank guarantees outstanding totaling \$74.5 million, which guarantee either the Company's performance or customer advances under certain contracts. In addition, the Company had financial letters of credit outstanding totaling \$6 million as of September 30, 2008, which primarily guarantee the Company's payment of certain self-insured liabilities. The Company has never had a drawing on a letter of credit instrument, nor are any anticipated; therefore, the fair value of these instruments is estimated to be zero.

The Company's self-insurance arrangements are limited to certain workers' compensation plans, automobile liability, and product liability claims primarily related to a business the Company sold in 1993. Under these arrangements, the Company self-insures only up to the amount of a specified deductible for each claim. Self-insurance liabilities included in other current liabilities on the balance sheet amounted to \$5.4 million and \$3.3 million as of September 30, 2008 and 2007, respectively.

NOTE 7 COMMITMENTS

The Company leases certain office, manufacturing and warehouse space, and miscellaneous computer and other office equipment under noncancelable operating leases expiring in various years through 2018. These leases, some of which may be renewed for periods up to 10 years, generally require the lessee to pay all maintenance, insurance and property taxes. Several leases are subject to periodic adjustment based on price indices or cost increases. Rental expense, net of sublease income, for all operating leases amounted to \$6.2 million, \$6.7 million, and \$6.9 million in 2008, 2007 and 2006, respectively.

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Future minimum payments, net of minimum sublease income, under noncancelable operating leases with initial terms of one year or more consist of the following at September 30, 2008 (in thousands):

|            |    |        |
|------------|----|--------|
| 2009       | \$ | 5,573  |
| 2010       |    | 3,462  |
| 2011       |    | 2,753  |
| 2012       |    | 2,145  |
| 2013       |    | 825    |
| Thereafter |    | 339    |
|            | \$ | 15,097 |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES

Significant components of the provision for income taxes are as follows:

| Years ended September 30,       | 2008             | 2007             | 2006             |
|---------------------------------|------------------|------------------|------------------|
|                                 | (in thousands)   |                  |                  |
| <b>Current:</b>                 |                  |                  |                  |
| Federal                         | \$ 8,474         | \$ 9,695         | \$ 4,623         |
| State                           | 2,063            | 2,793            | 1,526            |
| Foreign                         | 16,051           | 10,429           | 5,533            |
| <b>Total current</b>            | <b>26,588</b>    | <b>22,917</b>    | <b>11,682</b>    |
| <b>Deferred (credit):</b>       |                  |                  |                  |
| Federal                         | (5,440)          | 670              | (594)            |
| State                           | (1,078)          | 352              | 325              |
| Foreign                         | 315              | (277)            | 783              |
| <b>Total deferred</b>           | <b>(6,203)</b>   | <b>745</b>       | <b>514</b>       |
| <b>Total income tax expense</b> | <b>\$ 20,385</b> | <b>\$ 23,662</b> | <b>\$ 12,196</b> |

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Significant components of the Company's deferred tax assets and liabilities are as follows:

| September 30,  | 2008           | 2007          |
|--|----------------|---------------|
|  | (in thousands) |               |
| <b>Deferred tax assets:</b>                            |                |               |
| Accrued employee benefits                              | \$ 9,796       | \$ 7,608      |
| Allowance for doubtful accounts                        | 1,833          | 1,896         |
| Long-term contracts and inventory valuation reductions | 14,185         | 8,401         |
| Allowances for loss contingencies                      | 4,506          | 4,257         |
| Deferred compensation                                  | 3,145          | 3,205         |
| Book over tax depreciation                             | 2,295          | 2,155         |
| Adjustment to pension liability                        | 4,003          |               |
| Other  | 1,498          |               |
| <b>Deferred tax assets</b>                             | <b>41,261</b>  | <b>27,522</b> |
| <b>Deferred tax liabilities:</b>                       |                |               |
| Adjustment to pension liability                        |                | 2,665         |
| Amortization of goodwill and intangibles               | 3,726          | 2,972         |
| Prepaid expenses                                       | 2,007          | 1,925         |
| State taxes  | 1,316          | 975           |

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|                          |    |        |    |        |
|--------------------------|----|--------|----|--------|
| Other                    |    | 2,499  |    | 298    |
| Deferred tax liabilities |    | 9,548  |    | 8,835  |
| Net deferred tax asset   | \$ | 31,713 | \$ | 18,687 |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES Continued

The reconciliation of income tax computed at the U.S. federal statutory tax rate to income tax expense is as follows:

| Years ended September 30,                         | 2008      | 2007<br>(in thousands) | 2006      |
|---|-----------|------------------------|-----------|
| Tax at federal statutory rate                     | \$ 20,034 | \$ 22,837              | \$ 12,715 |
| State income taxes, net of federal tax effect     | 640       | 2,044                  | 1,203     |
| Income exclusion on export sales                  |           | (192)                  | (727)     |
| Nondeductible expenses                            | 152       | 157                    | 292       |
| Reversal of reserve accrued for tax contingencies | (1,205)   | (911)                  | (1,060)   |
| Tax effect from foreign earnings repatriation     | 3,856     | 2,626                  | 1,660     |
| Tax effect from foreign subsidiaries              | (2,651)   | (1,368)                | (866)     |
| Tax credits and other                             | (441)     | (1,531)                | (1,021)   |
|   | \$ 20,385 | \$ 23,662              | \$ 12,196 |

The Company is subject to ongoing audits from various taxing authorities in the jurisdictions in which it does business. As of September 30, 2008, the Company's open tax years in significant jurisdictions include 2005-2008 in both the U.S. and the U.K. The Company believes it has adequately provided for uncertain tax issues not yet resolved with federal, state and foreign tax authorities. Although not probable, the most adverse resolution of these issues could result in additional charges to earnings in future periods. Based upon a consideration of all relevant facts and circumstances, the company does not believe the ultimate resolution of uncertain tax issues for all open tax periods will have a materially adverse effect upon its results of operations or financial condition. As of September 30, 2008 and 2007 the Company had income tax reserves of \$6.3 million and \$5.4 million, respectively, included in Non-current Income Taxes Payable at September 30, 2008, and Current Income Taxes Payable at September 30, 2007.

As indicated in the table above, in 2008, 2007 and 2006 the Company was able to reverse \$1.2 million, \$0.9 million and \$1.1 million, respectively, of tax reserves established in previous years due to the resolution of uncertain tax issues.

The Company made income tax payments, net of refunds, totaling \$18.2 million, \$26.2 million and \$11.6 million in 2008, 2007 and 2006, respectively.

Income before income taxes includes the following components:

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| Years ended September 30, | 2008      | 2007<br>(in thousands) | 2006      |
|---------------------------|-----------|------------------------|-----------|
| United States             | \$ 4,920  | \$ 33,412              | \$ 17,346 |
| Foreign                   | 52,319    | 31,836                 | 18,983    |
| Total                     | \$ 57,239 | \$ 65,248              | \$ 36,329 |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 8 INCOME TAXES Continued

Management evaluates the Company's capital requirements in its foreign subsidiaries on an annual basis to determine what level of capital is needed for the long-term operations of the businesses. U.S. taxes are provided on the amount of capital that is determined to be in excess of the long-term requirements of the business and is, therefore, available for distribution. In 2008, management determined that 11 million British Pounds (\$21.7 million) was excess capital in the U.K. and 7 million New Zealand Dollars (\$5.0 million) was excess capital in New Zealand and paid dividends of those amounts to the U.S. parent company in 2008. U.S. taxes provided on these dividends amounted to approximately \$3.9 million in 2008. The remainder of the capital in the Company's foreign operations is considered indefinitely reinvested; therefore, no additional amount for taxes due upon repatriation has been provided.

Undistributed earnings of all the Company's foreign subsidiaries amounted to approximately \$52.4 million at September 30, 2008. Those earnings are considered to be indefinitely reinvested, and accordingly, no provision for U.S. federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes and withholding taxes payable to the foreign countries, but would also be able to offset unrecognized foreign tax credit carryforwards. Determination of the total amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with its hypothetical calculation.

Effective October 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance in de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. The cumulative effects of applying this interpretation were to increase non-current tax liabilities by \$5.0 million, decrease retained earnings by \$2.5 million and increase net deferred income tax assets by \$2.5 million as of October 1, 2007.

The Company has recorded liabilities for unrecognized tax benefits related to permanent and temporary tax adjustments which totaled \$5.8 million at September 30, 2008 and \$10.0 million at October 1, 2008, after the adjustment to the beginning balance of retained earnings. The net decrease in the liability of \$4.2 million resulted from the following:

| Years ended September 30,                                       | 2008<br>(in thousands) |
|---|------------------------|
| Balance at October 1, 2007                                      | \$ 10,001              |
| Increase (decrease) related to tax positions in prior years     |                        |
| Recognition of benefits from change in tax method of accounting | (1,577)                |
| Recognition of benefits from expiration of statutes             | (2,673)                |
| Tax positions related to the current year                       | 1,008                  |
| Decreases related to settlements with taxing authorities        | (914)                  |
| Balance at September 30, 2008                                   | \$ 5,845               |



CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 8 INCOME TAXES Continued

At September 30, 2008, the amount of unrecognized tax benefits from permanent tax adjustments that, if recognized, would affect the effective rate was \$2.9 million, and \$2.9 million would decrease goodwill. Over the next year, the Company does not expect a significant increase or decrease in the unrecognized tax benefits recorded as of September 30, 2008. The amount of net interest and penalties recognized as a component of income tax expense during the years ended September 30, 2008, 2007 and 2006 was not material. Interest and penalties accrued at September 30, 2008 amounted to \$0.5 million.

NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS

The Company has profit sharing and other defined contribution retirement plans that provide benefits for most employees in the U.S. An employee is eligible to participate in these plans after six months to one year of service, and may make additional contributions to the plans from their date of hire. These plans provide for full vesting of benefits over periods from zero to five years. More than half of the Company contributions to these plans are discretionary with the Board of Directors. Company contributions to the plans aggregated \$14.2 million, \$13.6 million and \$11.6 million in 2008, 2007 and 2006, respectively.

Approximately one-fourth of the Company's non-union employees in the U.S. are covered by a noncontributory defined benefit pension plan. The Company amended the plan to freeze plan benefits as of December 31, 2006 (curtailment). The effect of the curtailment is that no new benefits will be accrued after that date. The financial impact of this curtailment is reflected in the following disclosures. Approximately one-half of the Company's European employees are covered by a contributory defined benefit pension plan. The Company's funding policy provides that contributions will be at least equal to the minimum amounts mandated by statutory requirements. September 30 is used as the measurement date for these plans.

The unrecognized amounts recorded in accumulated other comprehensive income will be subsequently recognized as net periodic pension cost, consistent with the Company's historical accounting policy for amortizing those amounts. Actuarial gains and losses that arise in future periods and are not recognized as net periodic pension cost in those periods will be recognized as increases or decreases in other comprehensive income, net of tax, in the period they arise. Actuarial gains and losses recognized in other comprehensive income are adjusted as they are subsequently recognized as a component of net periodic pension cost.

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The following table sets forth changes in the projected benefit obligation and fair value of plan assets and the funded status for these defined benefit plans:

| September 30,  | 2008        | (in thousands) | 2007       |
|--|-------------|----------------|------------|
| <b>Change in benefit obligations:</b>                  |             |                |            |
| Net benefit obligation at the beginning of the year    | \$ 164,075  |                | \$ 168,500 |
| Service cost   | 3,520       |                | 5,056      |
| Interest cost  | 9,761       |                | 9,581      |
| Actuarial gain   | (19,898)    |                | (21,405)   |
| Participant contributions                              | 1,211       |                | 1,185      |
| Gross benefits paid                                    | (5,148)     |                | (4,584)    |
| Foreign currency exchange rate changes                 | (8,081)     |                | 5,742      |
| Net benefit obligation at the end of the year          | 145,440     |                | 164,075    |
| <b>Change in plan assets:</b>                          |             |                |            |
| Fair value of plan assets at the beginning of the year | 162,542     |                | 136,345    |
| Actual return on plan assets                           | (24,913)    |                | 19,209     |
| Employer contributions                                 | 3,380       |                | 6,372      |
| Participant contributions                              | 1,211       |                | 1,185      |
| Gross benefits paid                                    | (5,148)     |                | (4,584)    |
| Administrative expenses                                | (809)       |                | (693)      |
| Foreign currency exchange rate changes                 | (7,274)     |                | 4,711      |
| Fair value of plan assets at the end of the year       | 128,989     |                | 162,545    |
| Unfunded status of the plans                           | (16,451)    |                | (1,530)    |
| Unrecognized net actuarial (gain) loss                 | 11,439      |                | (7,612)    |
| Net amount recognized                                  | \$ (5,012)  |                | \$ (9,142) |
| <b>Amounts recognized in Accumulated OCI</b>           |             |                |            |
| Liability adjustment to OCI                            | \$ (11,439) |                | \$ 7,612   |
| Deferred tax asset (liability)                         | 4,003       |                | (2,665)    |
| Accumulated other comprehensive income (loss)          | \$ (7,436)  |                | \$ 4,947   |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The accumulated benefit obligation (ABO) for all defined benefit pension plans was approximately \$133.6 million at September 30, 2008. For the defined benefit pension plan in which the ABO was in excess of the fair value of plan assets, the projected benefit obligation, ABO and fair value of plan assets were as follows:

| September 30,                  | 2008      | (in thousands) | 2007       |
|--------------------------------|-----------|----------------|------------|
| Projected benefit obligation   | \$ 91,988 |                | \$ 102,162 |
| Accumulated benefit obligation | 91,988    |                | 102,162    |
| Fair value of plan assets      | 82,534    |                | 101,816    |

The components of net periodic pension cost were as follows:

| Years ended September 30,      | 2008     | 2007           | 2006     |
|--------------------------------|----------|----------------|----------|
|                                |          | (in thousands) |          |
| Service cost                   | \$ 3,520 | \$ 5,056       | \$ 8,041 |
| Interest cost                  | 9,761    | 9,581          | 8,930    |
| Expected return on plan assets | (12,706) | (11,323)       | (9,687)  |
| Amortization of:               |          |                |          |
| Prior service cost             |          | 7              | 27       |
| Actuarial loss                 | (243)    | 458            | 2,393    |
| Curtailment charge             |          |                | 131      |
| Administrative expenses        | 112      | 114            | 127      |
| Net pension cost               | \$ 444   | \$ 3,893       | \$ 9,962 |

| Years ended September 30,  | 2008 | 2007 | 2006 |
|--|------|------|------|
| Weighted-average assumptions used to determine benefit obligation at September 30:                         |      |      |      |
| Discount rate  | 7.3% | 6.2% | 5.6% |
| Rate of compensation increase  | 4.8% | 4.4% | 4.5% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30: |      |      |      |
| Discount rate  | 6.2% | 5.6% | 5.4% |
| Expected return on plan assets   | 8.0% | 8.1% | 8.2% |
| Rate of compensation increase  | 4.4% | 4.5% | 4.5% |



## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 9 PENSION, PROFIT SHARING AND OTHER RETIREMENT PLANS Continued

The Company's pension plans weighted average asset allocations by asset category as of September 30 were as follows:

|                   | 2008 | 2007 |
|-------------------|------|------|
| Equity securities | 71%  | 74%  |
| Debt securities   | 22%  | 21%  |
| Real estate       | 5%   | 4%   |
| Other             | 2%   | 1%   |
| Total             | 100% | 100% |

The Company has the responsibility to formulate the investment policies and strategies for the plans' assets. The overall policies and strategies include: maintain the highest possible return commensurate with the level of assumed risk, preserve benefit security for the plans' participants, and minimize the necessity of Company contributions by maintaining a ratio of plan assets to liabilities in excess of 1.0.

The Company does not involve itself with the day-to-day operations and selection process of individual securities and investments, and, accordingly, has retained the professional services of investment management organizations to fulfill those tasks. The investment management organizations have investment discretion over the assets placed under their management. The Company provides each investment manager with specific investment guidelines relevant to its asset class. The table below presents the ranges for each major category of the plans' assets at September 30, 2008:

| Asset Category                             | Allocation<br>Range |
|--|---------------------|
| Equity securities                          | 35% to 65%          |
| Debt securities                            | 15% to 65%          |
| Other, primarily cash and cash equivalents | 0% to 40%           |

The pension plans held no positions in Cubic Corporation common stock as of September 30, 2008 and 2007.

The Company expects to contribute approximately \$3.2 million to its pension plans in 2009.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

|           |         |
|-----------|---------|
| 2009      | \$6,572 |
| 2010      | 7,282   |
| 2011      | 7,742   |
| 2012      | 8,384   |
| 2013      | 8,822   |
| 2014-2018 | 54,212  |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 10 LEGAL MATTERS

In 1991, the government of Iran commenced an arbitration proceeding against the Company seeking \$12.9 million for reimbursement of payments made for equipment that was to comprise an Air Combat Maneuvering Range pursuant to a sales contract and an installation contract executed in 1977, and an additional \$15 million for unspecified damages. The Company contested the action and brought a counterclaim for compensatory damages of \$10.4 million. In May 1997, the arbitral tribunal awarded the government of Iran \$2.8 million, plus simple interest at the rate of 12% per annum from September 21, 1991 through May 5, 1997. In December 1998, the United States District Court granted a motion by the government of Iran confirming the arbitral award but denied Iran's request for additional interest and costs. Both parties have appealed. In October 2004, the 9<sup>th</sup> Circuit Court of Appeals issued a decision in the case of two interveners who are attempting to claim an attachment on the amount that was awarded to Iran in the original arbitration. The Court denied one of the interveners' liens but confirmed the second one's lien. Iran asked the U.S. Supreme Court to review the 9<sup>th</sup> Circuit decision and to void the initial judgment against it. In 2006, the Supreme Court returned the case to the 9<sup>th</sup> Circuit for reconsideration, suggesting that the claimed lien cannot be enforced. The Court of Appeal then ruled that the lien was valid under the Terrorism Risk Insurance Act and Iran's petition for review by the Supreme Court was granted; therefore, while the dispute between Iran and Cubic is on hold in the 9<sup>th</sup> Circuit the obligation upon Cubic to pay is stayed. Under current United States law and policy, any payment to the Revolutionary Government of Iran must first be licensed by the U.S. government. The Company is unaware of the likelihood of the U.S. government granting such a license. The Company is continuing to pursue its appeal in the 9<sup>th</sup> Circuit case against Iran, and management believes that a license from the U.S. government would be required in any case to make payment to or on behalf of Iran. However, in light of the 9<sup>th</sup> Circuit Court's decision in the related interveners' case, in 2004 the Company established a reserve of \$6 million for the estimated potential liability and will continue to accrue interest on this amount until the ultimate outcome of the case is determined.

In January 2005, a bus fare collection system customer in North America issued a cure notice to the Company, alleging that its performance was not in accord with the contract. After unsuccessful negotiations with the customer, in March 2005, the Company filed for a temporary restraining order requesting that the customer be restrained from further interfering with the Company's performance and from issuing a termination notice. The next business day, the customer issued a letter terminating the contract for default. In April 2005, the customer filed a claim for breach of contract, seeking damages for all actual, consequential and liquidated damages sustained as well as attorney's fees. The contract limits liability to the contract value of \$8.2 million, but the customer appears to be attempting to avoid that limitation. In May 2005, the Company filed an answer and general denial and subsequently filed a verified petition alleging breach of contract and other substantive claims, claiming the amount owed under the contract of \$4.2 million, plus interest and attorney's fees. Management believes that both the customer's default notice and claim for damages are unsupported and the Company is vigorously defending against the allegations. Based on the advice of counsel, management believes the Company had substantially completed the contract prior to termination and that the remaining contract value is due and that the Company will prevail at trial; therefore, no liability has been recorded for the former customer's claim as of September 30, 2008. However, due to the uncertainty of collecting the outstanding receivable balance an allowance for doubtful accounts of \$4.2 million was established and all costs incurred in the performance of the contract and costs incurred outside the scope of the contract were expensed in the year ended September 30, 2005.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 10 LEGAL MATTERS Continued

In June 2005, a company that Cubic had an alleged agreement with, to potentially bid on a portion of automated fare collection contracts, filed a court claim for breach of contract, fraud, negligent misrepresentation, theft of trade secrets, and other related allegations. The claim seeks \$15.0 million in compensatory damages, punitive damages, disgorgement of profits and a permanent injunction. In November 2008 the Company agreed to settle this claim for a nominal amount. Documents are expected to be finalized in December 2008.

In May 2007 the Company filed a claim with the U.S. Navy for \$6.2 million arising out of allegedly defective specifications, the late delivery of government-furnished equipment and the Navy's attempt to unilaterally impose additional contract requirements in connection with a contract whose initial award value was \$31.8 million. In February 2008, the Navy asserted a counter-claim seeking a \$4.1 million reduction in the contract price because it allegedly relaxed certain specifications, provided more government-furnished equipment than was required and had to revise certain equipment and manuals furnished by the Company. In November 2008 a negotiated settlement agreement was reached whereby the Company will receive payment of approximately \$4.0 million for its additional costs incurred in performance of the contract and will furnish additional equipment in satisfaction of the customer's requirements. The settlement also resolves the Navy's \$4.1 million counterclaim. In the year ended September 30, 2008, inventoried costs related to this claim were reduced to the settlement amount and a provision was made for the Company's remaining obligations arising from the settlement agreement.

From time-to-time, agencies of the U.S. and foreign governments may investigate whether the Company's operations are being conducted in accordance with applicable regulatory requirements. Such investigations, whether relating to government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon the Company, or could lead to suspension or debarment from future government contracting. Government investigations often take years to complete and most result in no adverse action against the Company.

The Company is not a party to any other material pending proceedings and management considers all other matters to be ordinary proceedings incidental to the business. Management believes the outcome of these proceedings and the proceedings described above will not have a materially adverse effect on the Company's financial position.

NOTE 11 BUSINESS SEGMENT INFORMATION

**Description of the types of products and services from which each reportable segment derives its revenues:**



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The Company has two primary business segments: transportation systems and defense. The transportation systems segment designs, produces, installs and services electronic revenue collection systems for mass transit projects, including railways and buses. The defense segment performs work under U.S. and foreign government contracts relating to electronic defense systems and equipment, computer simulation training, development of training doctrine, and field operations and maintenance. Products include customized range instrumentation and training systems, simulators, communications and surveillance systems, avionics systems, power amplifiers and receivers.

### **Measurement of segment profit or loss and segment assets:**



The Company evaluates performance and allocates resources based on total segment operating profit or loss. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are immaterial.

CUBIC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 11 BUSINESS SEGMENT INFORMATION Continued

**Factors management used to identify the Company's reportable segments:**



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The Company's reportable segments are business units that offer different products and services. The reportable segments are each managed separately because they develop and manufacture distinct products with different customer bases.

Business segment financial data is as follows:

| Years ended September 30,                       | 2008            | 2007<br>(in millions) | 2006            |
|---|-----------------|-----------------------|-----------------|
| <b>Sales:</b>                                   |                 |                       |                 |
| Transportation systems                          | \$ 272.3        | \$ 236.6              | \$ 243.9        |
| Defense   | 607.8           | 641.1                 | 562.8           |
| Other   | 1.0             | 12.2                  | 14.7            |
| <b>Total sales</b>                              | <b>\$ 881.1</b> | <b>\$ 889.9</b>       | <b>\$ 821.4</b> |
| <b>Operating income:</b>                        |                 |                       |                 |
| Transportation systems                          | \$ 43.0         | \$ 20.1               | \$ 2.8          |
| Defense   | 18.3            | 44.2                  | 31.4            |
| Restructuring activity                          | (6.2)           |                       |                 |
| Unallocated corporate expenses and other        | (1.8)           | (2.2)                 | (3.3)           |
| <b>Total operating income</b>                   | <b>\$ 53.3</b>  | <b>\$ 62.1</b>        | <b>\$ 30.9</b>  |
| <b>Assets:</b>                                  |                 |                       |                 |
| Transportation systems                          | \$ 144.5        | \$ 170.6              | \$ 207.8        |
| Defense   | 357.2           | 293.1                 | 255.1           |
| Corporate and other                             | 139.6           | 128.9                 | 85.2            |
| <b>Total assets</b>                             | <b>\$ 641.3</b> | <b>\$ 592.6</b>       | <b>\$ 548.1</b> |
| <b>Depreciation and amortization:</b>           |                 |                       |                 |
| Transportation systems                          | \$ 1.8          | \$ 2.2                | \$ 2.6          |
| Defense   | 7.4             | 6.1                   | 5.3             |
| Corporate and other                             | 0.5             | 0.5                   | 0.6             |
| <b>Total depreciation and amortization</b>      | <b>\$ 9.7</b>   | <b>\$ 8.8</b>         | <b>\$ 8.5</b>   |
| <b>Expenditures for long-lived assets:</b>      |                 |                       |                 |
| Transportation systems                          | \$ 1.0          | \$ 1.8                | \$ 0.9          |
| Defense   | 4.8             | 4.3                   | 8.5             |
| Corporate and other                             | 2.3             |                       | 0.4             |
| <b>Total expenditures for long-lived assets</b> | <b>\$ 8.1</b>   | <b>\$ 6.1</b>         | <b>\$ 9.8</b>   |

## CUBIC CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

## NOTE 11 BUSINESS SEGMENT INFORMATION Continued

| Years ended September 30,      | 2008     | 2007          | 2006     |
|--------------------------------|----------|---------------|----------|
|                                |          | (in millions) |          |
| <b>Geographic Information:</b> |          |               |          |
| Sales (a):                     |          |               |          |
| United States                  | \$ 532.3 | \$ 606.6      | \$ 566.8 |
| United Kingdom                 | 189.6    | 153.1         | 120.2    |
| Canada                         | 25.4     | 26.5          | 28.6     |
| Australia                      | 43.0     | 26.9          | 27.3     |
| Middle East                    | 37.8     | 17.2          | 18.6     |
| Far East                       | 38.1     | 43.4          | 26.1     |
| Other                          | 14.9     | 16.2          | 33.8     |
| Total sales                    | \$ 881.1 | \$ 889.9      | \$ 821.4 |

(a) Sales are attributed to countries or regions based on the location of customers.

|                              |         |         |         |
|------------------------------|---------|---------|---------|
| Long-lived assets, net:      |         |         |         |
| United States                | \$ 47.4 | \$ 48.0 | \$ 48.3 |
| United Kingdom               | 12.0    | 14.1    | 12.5    |
| Other foreign countries      | 1.9     | 2.0     | 1.8     |
| Total long-lived assets, net | \$ 61.3 | \$ 64.1 | \$ 62.6 |

Defense segment sales include \$477.8 million, \$484.4 million and \$427.2 million in 2008, 2007 and 2006, respectively, of sales to U.S. Government agencies. Transportation systems sales include \$110.7 million, \$71.4 million, and \$49.7 million of sales to TranSys in 2008, 2007 and 2006, respectively. No other single customer accounts for 10% or more of the Company's revenue.

## NOTE 12 SUMMARY OF QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended September 30, 2008 and 2007:

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|                                       | Quarter Ended |            |            |              |
|---------------------------------------|---------------|------------|------------|--------------|
|                                       | December 31   | March 31   | June 30    | September 30 |
| (in thousands, except per share data) |               |            |            |              |
| <u>Fiscal 2008</u>                    |               |            |            |              |
| Net sales                             | \$ 202,722    | \$ 210,280 | \$ 232,892 | \$ 235,241   |
| Operating income                      | 17,088        | 13,886     | 11,475     | 10,815       |
| Net income                            | 10,676        | 9,646      | 8,478      | 8,054        |
| Net income per share                  | 0.40          | 0.36       | 0.32       | 0.30         |
| <u>Fiscal 2007</u>                    |               |            |            |              |
| Net sales                             | \$ 202,935    | \$ 230,041 | \$ 233,749 | \$ 223,145   |
| Operating income                      | 11,691        | 17,799     | 16,560     | 16,048       |
| Net income                            | 8,325         | 11,211     | 11,177     | 10,873       |
| Net income per share                  | 0.31          | 0.42       | 0.42       | 0.41         |

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Cubic Corporation

We have audited the accompanying consolidated balance sheets of Cubic Corporation as of September 30, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended September 30, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cubic Corporation at September 30, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 2008, in conformity with U.S. generally accepted accounting principles.

As disclosed in Note 9 in the notes to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pensions and Other Postretirement Plans*, an amendment to SFAS No. 87, 88, 106, and 132(R) during the year ended September 30, 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Cubic Corporation's internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 2, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, CA

December 2, 2008

**Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**Item 9a. CONTROLS AND PROCEDURES.**

*Evaluation of Disclosure Controls and Procedures* The Company's management conducted an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2008. Based on this evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed in the reports the Company files and submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required.

In designing and evaluating the Company's disclosure controls and procedures, the Company's management recognizes that any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

***Management's Report on Internal Control over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, management has conducted an assessment, including testing, using the criteria in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's system of internal control over financial reporting is 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. 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.

Management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Omega Training Group, Inc. (Omega), acquired in the fourth quarter of 2008. Omega is included in the consolidated financial statements of Cubic Corporation and constituted \$72.0 million and \$9.6 million of total assets and liabilities, respectively, as of September 30, 2008 and \$12.6 million and \$2.3 million of total revenues and operating income, respectively, for the fiscal year then ended. Management did not assess the effectiveness of internal control over financial reporting at the entity listed above due to the timing of the acquisition.

***Changes in Internal Controls Over Financial Reporting*** There were no changes in the Company's internal control over financial reporting that occurred during the fourth fiscal quarter of 2008 that have materially affected, or are

reasonably likely to materially affect the Company's internal control over financial reporting. The Company acquired Omega in the fourth quarter of 2008, as mentioned in the preceding paragraph; however, the Company does not believe this acquisition will have a material affect on the Company's internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Cubic Corporation

We have audited Cubic Corporation's internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Cubic Corporation's management is responsible 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 Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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.

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.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Omega Training Group, Inc., which is included in the 2008 consolidated financial statements of Cubic Corporation and constituted \$72.0 million and \$9.6 million of total assets and total liabilities, respectively, as of September 30, 2008 and \$12.6 million and \$1.4 million of total revenues and net income, respectively, for the fiscal year then ended. Our audit of internal control over financial reporting of Cubic Corporation also did not include an evaluation of internal control over financial reporting of the entity listed above.

In our opinion, Cubic Corporation maintained, in all material respects, effective internal control over financial reporting as of September 30, 2008, based on the COSO criteria.



We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Cubic Corporation as of September 30, 2008 and 2007, and the related statements of income, shareholders' equity, and cash flows for each of the three years in the period ended September 30, 2008 of Cubic Corporation and our report dated December 2, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, California  
December 2, 2008

**PART III**

**Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

Certain information regarding directors and executive officers is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

The Company has adopted a code of ethics that applies to its principle executive officer, principle financial officer, and its principle accounting officer. Such code of ethics appears on our web site at: <http://www.cubic.com/corp1/invest/governance.html>.

**Item 11. EXECUTIVE COMPENSATION.**

Information regarding executive compensation is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.**

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

Information regarding certain relationships and related transactions is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

Information regarding principal accountant fees and services is incorporated herein by reference from our definitive Proxy Statement, which will be filed no later than 30 days prior to the date of the Annual Meeting of Shareholders.



**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of this Report:

(1) The following consolidated financial statements of Cubic Corporation, as referenced in Item 8:

Consolidated Balance Sheets

September 30, 2008 and 2007

Consolidated Statements of Income

Years ended September 30, 2008, 2007 and 2006

Consolidated Statements of Changes in Shareholders' Equity

Years ended September 30, 2008, 2007 and 2006

Consolidated Statements of Cash Flows

Years ended September 30, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

September 30, 2008

(2) The following consolidated financial statement schedules of Cubic Corporation and subsidiaries, as referenced in Item 15(d):

None are required under the applicable accounting rules and regulations of the Securities and Exchange Commission.

(b) Exhibits:

- 3.1 Amended and Restated Certificate of Incorporation. Incorporated by reference from Form 10-Q for the quarter ended June 30, 2006, file No. 1-8931, Exhibit 3.1.
- 3.2 Bylaws. Incorporated by reference to Form 10-K filed for the fiscal year ended September 30, 2004, file No. 1-8931, Exhibit 3(ii).
- 10.1 2005 Equity Incentive Plan. Incorporated by reference from Form 10-K filed for the fiscal year ended September 30, 2005, file No. 1-8931, Exhibit 10.1
- 10.2 Amended Transition Protection Plan. Incorporated by reference from Form 10-K filed for the fiscal year ended September 30, 2007, file No. 1-8931, Exhibit 10.2
- 10.3 Credit Agreement dated March 10, 2005. Incorporated by reference from Form 10-Q for the quarter ended March 31, 2005, file No. 1-8931, Exhibit 10.
- 10.4 Revised Deferred Compensation Plan. Incorporated by reference to Form 10-Q for the quarter ended March 31, 2008, file No. 1-8931, Exhibit 10.4
- 21.1 List of Subsidiaries
- 23.1 Consent of Independent Registered Accounting Firm.
- 31.1 Section 302 Certifications.
- 32.1 Section 906 Certifications.

**SIGNATURES**

Pursuant to the requirements of Sections 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:

|              |                            |
|--------------|----------------------------|
| (Registrant) | CUBIC CORPORATION          |
| 12/2/08      | /s/ Walter J. Zable        |
| Date         | WALTER J. ZABLE, President |

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:

|         |   |
|---------|---|
| 12/2/08 | /s/ Walter J. Zable   |
| Date    | WALTER J. ZABLE,<br>President, Chief Executive Officer<br>and Chairman of the Board of<br>Directors |

|         |   |
|---------|---|
| 12/2/08 | /s/ Walter C. Zable   |
| Date    | WALTER C. ZABLE,<br>Vice President and Vice Chairman<br>of the Board of Directors |

|         |   |
|---------|---|
| 12/2/08 | /s/ Raymond L. deKozan  |
| Date    | RAYMOND L. deKOZAN,<br>Director, Senior Group Vice<br>President |

|         |                              |
|---------|------------------------------|
| 12/2/08 | /s/ Raymond E. Peet          |
| Date    | RAYMOND E. PEET,<br>Director |

|         |                             |
|---------|-----------------------------|
| 12/2/08 | /s/ John H. Warner          |
| Date    | JOHN H. WARNER,<br>Director |

|         |                                 |
|---------|---------------------------------|
| 12/2/08 | /s/ Robert S. Sullivan          |
| Date    | ROBERT S. SULLIVAN,<br>Director |

|         |                               |
|---------|-------------------------------|
| 12/2/08 | /s/ Bruce G. Blakley          |
| Date    | BRUCE G. BLAKLEY,<br>Director |

|         |                      |
|---------|----------------------|
| 12/2/08 | /s/ William W. Boyle |
|---------|----------------------|

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Date WILLIAM W. BOYLE,  
Director, Senior Vice President and  
Chief Financial Officer

*12/2/08* /s/ Mark A. Harrison  
Date MARK A. HARRISON,  
Vice President and Corporate  
Controller (Principal Accounting  
Officer)