

# FINANCIAL STATEMENTS



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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

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 transportation 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 \$0.03 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 \$0.02 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

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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>Defense Segment Sales</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
	<u>\$ 607.8</u>	<u>\$ 641.1</u>	<u>\$ 562.8</u>
<b>Defense Segment Operating Income</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)
	<u>\$ 18.3</u>	<u>\$ 44.2</u>	<u>\$ 31.4</u>

As depicted in the table on page 27, 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 on page 27 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 Corps 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

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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	2007
	(in millions)	
<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	<u>1,291.9</u>	<u>1,247.0</u>
Total	<u>\$ 1,772.5</u>	<u>\$ 2,034.3</u>
<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	<u>592.5</u>	<u>601.6</u>
<b>Total</b>	<u>\$ 1,073.1</u>	<u>\$ 1,388.9</u>

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In addition to the amounts identified on page 30, 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 on page 30 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.

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 on page 28. 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:

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



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

continued

## 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.

## Income Taxes - continued

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:

<b>September 30,</b>	<b>2008</b>	<b>2007</b>
	<b>(in millions)</b>	
Defense systems and products	<b>\$ 16.1</b>	\$ 16.9
Defense services	<b>36.7</b>	9.7
Transportation systems	<b>8.2</b>	9.4
Total goodwill	<b><u>\$ 61.0</u></b>	<b><u>\$ 36.0</u></b>

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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

continued



## 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.

September 30,

**2008**

**2007**

(in thousands)

**ASSETS**

**CURRENT ASSETS**

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)
	<b>268,884</b>	305,672
Inventories	45,118	27,342
Deferred income taxes	27,082	18,492
Prepaid expenses and other current assets	21,548	21,105

**TOTAL CURRENT ASSETS**

**475,328** **473,374**

**LONG-TERM CONTRACT RECEIVABLES**

**19,930** 16,650

**PROPERTY, PLANT AND EQUIPMENT**

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)
	<b>53,887</b>	57,251

**OTHER ASSETS**

Deferred income taxes	4,631	195
Goodwill	61,032	36,003
Purchased intangibles	19,060	1,922
Miscellaneous other assets	7,384	7,170
	<b>92,107</b>	45,290

**TOTAL ASSETS**

**\$ 641,252** **\$ 592,565**

*See accompanying notes*

# CONSOLIDATED BALANCE SHEETS

September 30,

2008

2007

(in thousands)

## LIABILITIES AND SHAREHOLDERS' EQUITY

### CURRENT LIABILITIES

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>

### LONG-TERM DEBT

25,700 32,699

### OTHER LIABILITIES

Accrued pension liability	16,451	1,530
Deferred compensation	7,821	8,148
Income taxes payable	6,283	-

### COMMITMENTS AND CONTINGENCIES

### SHAREHOLDERS' EQUITY

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>

## TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

\$ 641,252 \$ 592,565

# 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
	<u>881,135</u>	<u>889,870</u>	<u>821,386</u>
<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
	<u>827,871</u>	<u>827,772</u>	<u>790,491</u>
<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
	<u>(216)</u>	<u>771</u>	<u>985</u>
<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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended September 30,

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(in thousands)		
<b>Operating Activities:</b>			
<b>Net income</b>	\$ 36,854	\$ 41,586	\$ 24,133
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
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>	<u>92,655</u>	<u>69,156</u>	<u>31,330</u>
<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>	<u>(35,261)</u>	<u>(20,791)</u>	<u>(11,909)</u>
<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>	<u>(10,796)</u>	<u>(20,922)</u>	<u>(27,302)</u>
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	<u>73,563</u>	<u>42,380</u>	<u>48,860</u>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<u>\$ 112,696</u>	<u>\$ 73,563</u>	<u>\$ 42,380</u>

See accompanying notes

# CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands except per share amounts)	Comprehensive Income	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Common Stock	Number of Shares Outstanding
<b>October 1, 2005</b>		\$ (36,066)	\$ 1,667	\$ 319,200	\$ 12,357	26,720
<b>Comprehensive income:</b>						
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	<u>\$ 30,881</u>					
Purchase of treasury stock		(3)	-	-	-	-
Cash dividends paid -- \$.18 per share of common stock		-	-	(4,810)	-	-
<b>September 30, 2006</b>		(36,069)	8,415	338,523	12,357	26,720
<b>Comprehensive income:</b>						
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	<u>\$ 64,355</u>					
Cash dividends paid -- \$.18 per share of common stock		-	-	(4,810)	-	-
<b>September 30, 2007</b>		(36,069)	31,184	375,299	12,357	26,720
<b>Comprehensive income:</b>						
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	<u>\$ 13,240</u>					
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)	-	-
<b>September 30, 2008</b>		<u>\$ (36,071)</u>	<u>\$ 7,570</u>	<u>\$ 404,868</u>	<u>\$ 12,485</u>	<u>26,727</u>

See accompanying notes





## 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.

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

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

**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.

## NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

**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.

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

	<b>Transportation Segment</b>	<b>Defense Segment</b>	<b>Total</b>
	(in thousands)		
<b>Balances at October 1, 2006</b>	\$ 8,615	\$ 26,135	\$ 34,750
Foreign currency exchange rate changes	747	506	1,253
<b>Balances at September 30, 2007</b>	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)
<b>Balances at September 30, 2008</b>	<u>\$ 8,210</u>	<u>\$ 52,822</u>	<u>\$ 61,032</u>

**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	-	-	-
<b>Total</b>	<u>\$ 22,332</u>	<u>\$ (3,272)</u>	<u>\$ 19,060</u>	<u>\$ 4,732</u>	<u>\$ (2,810)</u>	<u>\$ 1,922</u>

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
	<u>\$ 19,060</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

continued



**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

**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	2007
	(in thousands)	
Adjustment to pension liability	\$ (7,436)	\$ 4,947
Foreign currency translation	15,006	26,237
	<u>\$ 7,570</u>	<u>\$ 31,184</u>

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 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.

**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

## NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

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

**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.

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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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.

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
Trade name		2.8
Customer relationships		14.7
Backlog		2.2
Net assets assumed		14.3
<b>Total</b>	<b>\$</b>	<b>61.0</b>

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.

### 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.

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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED



Summarized unaudited financial information for TranSys is as follows:

September 30,	2008	2007	
	(in millions)		
<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	
Total Assets	<u>\$ 331.6</u>	<u>\$ 410.0</u>	
Current liabilities	\$ 33.9	\$ 66.4	
Long-term debt	297.7	343.6	
Equity	-	-	
Total Liabilities and Equity	<u>\$ 331.6</u>	<u>\$ 410.0</u>	
<b>Statement of Operations:</b>			
Years ended September 30,	2008	2007	2006
	(in millions)		
Sales	\$ 215.3	\$ 210.8	\$ 118.6
Operating profit	\$ -	\$ -	\$ -
Net income	\$ -	\$ -	\$ -

## NOTE 4—ACCOUNTS RECEIVABLE

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

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

#### NOTE 4—ACCOUNTS RECEIVABLE - continued

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	2007
	(in thousands)	
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
	<u>\$ 45,118</u>	<u>\$ 27,342</u>

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.

#### 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
	<u>31,745</u>	38,837
Less current portion	<u>(6,045)</u>	<u>(6,138)</u>
	<u>\$ 25,700</u>	<u>\$ 32,699</u>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

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.

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.

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
	<u>\$ 15,097</u>

## 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
Total current	<u>26,588</u>	<u>22,917</u>	<u>11,682</u>
<b>Deferred (credit):</b>			
Federal	(5,440)	670	(594)
State	(1,078)	352	325
Foreign	315	(277)	783
Total deferred	<u>(6,203)</u>	<u>745</u>	<u>514</u>
<b>Total income tax expense</b>	<u>\$ 20,385</u>	<u>\$ 23,662</u>	<u>\$ 12,196</u>

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	-
Deferred tax assets	<u>41,261</u>	<u>27,522</u>
<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
Other	2,499	298
Deferred tax liabilities	<u>9,548</u>	<u>8,835</u>
<b>Net deferred tax asset</b>	<u>\$ 31,713</u>	<u>\$ 18,687</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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	2006
	(in thousands)		
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)
	<u>\$ 20,385</u>	<u>\$ 23,662</u>	<u>\$ 12,196</u>

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:

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

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.

## NOTE 8—INCOME TAXES - continued

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 (in thousands):

<b>Balance at October 1, 2007</b>	\$ 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)
<b>Balance at September 30, 2008</b>	<u><u>\$ 5,845</u></u>

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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	2007
	(in thousands)	
<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	<u>145,440</u>	<u>164,075</u>
<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	<u>128,989</u>	<u>162,545</u>
Unfunded status of the plans	(16,451)	(1,530)
Unrecognized net actuarial (gain) loss	11,439	(7,612)
Net amount recognized	<u>\$ (5,012)</u>	<u>\$ (9,142)</u>
<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)	<u>\$ (7,436)</u>	<u>\$ 4,947</u>

**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:

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

The components of net periodic pension cost were as follows:

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

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED



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

	<b>2008</b>	<b>2007</b>
<b>Equity securities</b>	<b>71%</b>	<b>74%</b>
<b>Debt securities</b>	<b>22%</b>	<b>21%</b>
<b>Real estate</b>	<b>5%</b>	<b>4%</b>
<b>Other</b>	<b>2%</b>	<b>1%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>

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:

<b>Asset Category</b>	<b>Allocation Range</b>
Equity securities	50% to 85%
Debt securities	10% to 60%
Other, primarily cash and cash equivalents	0% to 15%

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

## 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 9th 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 intervener's liens but confirmed the second one's lien. Iran asked the U.S. Supreme Court to review the 9th Circuit decision and to void the initial judgment against it. In 2006, the Supreme Court returned the case to the 9th 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 9th 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 9th 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 9th Circuit Court's decision in the related intervener's 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.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

## NOTE 11—BUSINESS SEGMENT INFORMATION

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

**Factors management used to identify the Company's reportable segments:** 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	2006
	(in millions)		
<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
Total sales	<u>\$ 881.1</u>	<u>\$ 889.9</u>	<u>\$ 821.4</u>
<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)
Total operating income	<u>\$ 53.3</u>	<u>\$ 62.1</u>	<u>\$ 30.9</u>
<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
Total assets	<u>\$ 641.3</u>	<u>\$ 592.6</u>	<u>\$ 548.1</u>
<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
Total depreciation and amortization	<u>\$ 9.7</u>	<u>\$ 8.8</u>	<u>\$ 8.5</u>
<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
Total expenditures for long-lived assets	<u>\$ 8.1</u>	<u>\$ 6.1</u>	<u>\$ 9.8</u>

## 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	<u>\$ 881.1</u>	<u>\$ 889.9</u>	<u>\$ 821.4</u>

(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	<u>\$ 61.3</u>	<u>\$ 64.1</u>	<u>\$ 62.6</u>

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:

	Quarter Ended			
	December 31	March 31	June 30	September 30
	(in thousands, except per share data)			
<b>Fiscal 2008</b>				
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
<b>Fiscal 2007</b>				
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



## 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.

*Ernst + Young LLP*

San Diego, CA

December 2, 2008

## 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.

Based on its assessment, management has concluded that the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2008, based on criteria in Internal Control - Integrated Framework, issued by the COSO. The Company's internal control over financial reporting as of September 30, 2008, has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which follows.

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.



Walter J. Zable  
Chairman of the Board  
President and Chief Executive Officer



William W. Boyle  
Senior Vice President and  
Chief Financial Officer



Mark A. Harrison  
Vice President and  
Corporate Controller



## 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.

*Ernst & Young LLP*

San Diego, California

December 2, 2008

# DIRECTORS AND OFFICERS

## DIRECTORS

### **Walter J. Zable**

Director  
Chairman of the Board, President and  
Chief Executive Officer  
(Executive Committee)

### **Walter C. Zable**

Director  
Vice Chairman, Vice President  
Chairman of Transportation Systems  
(Executive Committee)

### **Bruce G. Blakely**

Independent Director  
Managing Partner in San Diego Office of  
PriceWaterhouseCoopers, Retired  
(Chair-Audit and Compliance Committee,  
Executive Compensation Committee)

### **William W. Boyle**

Director  
Senior Vice President and  
Chief Financial Officer  
(Executive Committee)

### **Edwin A. Guiles**

Independent Director  
Executive Vice President of Corporate  
Development with Sempra Energy  
(Audit and Compliance Committee)

### **Raymond L. de Kozan**

Director  
Senior Group Vice President

### **Raymond E. Peet**

Independent Director  
Vice Admiral, USN, Retired  
(Audit and Compliance Committee,  
Executive Compensation Committee)

### **Robert S. Sullivan**

Lead Independent Director  
Dean of the Rady School of Management,  
University of California, San Diego  
(Chair - Executive Compensation Committee,  
Audit and Compliance Committee,  
Nominating and Corporate Governance  
Committee, Executive Committee)

### **John H. Warner, Jr.**

Independent Director  
Retired Executive Vice President and  
Director, Science Applications International  
Corporation  
(Audit and Compliance Committee,  
Chair - Nominating and Corporate  
Governance Committee)

## OFFICERS

### **Walter J. Zable**

Chairman of the Board, President and  
Chief Executive Officer

### **Walter C. Zable**

Vice Chairman, Vice President  
Chairman of Transportation Systems

### **William W. Boyle**

Senior Vice President and  
Chief Financial Officer

### **Raymond L. de Kozan**

Senior Group Vice President

### **Mark A. Harrison**

Vice President and Corporate Controller  
(Principal Accounting Officer)

### **William L. Hoese**

Vice President, Corporate Secretary,  
General Counsel

### **Daniel A. Jacobsen**

Vice President Ethics and Compliance

### **Bernard A. Kulchin**

Vice President Human Resources

### **John A. Minter**

Vice President Information Technologies

### **John D. Thomas**

Vice President Finance and  
Corporate Development

### **Gregory L. Tanner**

Treasurer

## OFFICE OF THE CEO

### **Walter J. Zable**

Chairman of the Board,  
President and Chief Executive Officer

### **Walter C. Zable**

Vice Chairman, Vice President

### **William W. Boyle**

Senior Vice President and  
Chief Financial Officer

### **Raymond L. de Kozan**

Senior Group Vice President



## Listing

New York Stock Exchange (NYSE)

## Symbol

CUB

## Shareholders of Record at September 30, 2008

1,000

## Registrar and Transfer Agent

American Stock Transfer and Trust Company  
Brooklyn, New York

The American Stock Transfer and Trust Company may be contacted through its toll free number, web site or e-mail:

- ▶ Shareholder services (800) 937-5449
- ▶ [www.amstock.com](http://www.amstock.com)
- ▶ [info@amstock.com](mailto:info@amstock.com)

## Auditors

Ernst & Young LLP

## Information for Shareholders

Web Site: [www.cubic.com](http://www.cubic.com)

Click on "Investor Info" for

- ▶ Corporate governance information
- ▶ Company ethics policy
- ▶ Contact information
- ▶ Annual reports
- ▶ Committee Charters

Investor Line: (858) 505-2222

E-mail: [investor.relations@cubic.com](mailto:investor.relations@cubic.com)

## Certifications

Cubic has filed as an exhibit to its most recent Form 10-K the required certifications regarding the quality of its public disclosures.

Within 30 days following the annual meeting of shareholders, our CEO intends to provide an unqualified certification to the NYSE that he is not aware of any violation by Cubic of the NYSE's corporate governance listing standards.

## Annual Meeting

The 2009 Annual Meeting will be held in the main conference room at Cubic's headquarters.

## Location

Cubic Corporation  
9333 Balboa Avenue  
San Diego, California 92123

## Date and Time

February 24, 2009  
11:30 a.m. Pacific Standard Time

Shareholders of record on December 26, 2008 are being sent the required Notice & Access letter for the Annual Meeting.

**Cubic will furnish its 2008 Annual Report to shareholders and its annual SEC Form 10-K (excluding exhibits) without charge to shareholders upon their written request by mail or e-mail.**

## Mailing Address

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## E-mail Address

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President

#### Thomas A. Echols

Senior Vice President,  
Business Operations & Controller

#### Raymond C. Barker

Executive Vice President,  
Business Development and Strategy

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President

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Vice President & General Manager

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#### David A. Williams

Regional Director

## Mission Support Services

### Cubic Applications, Inc. (CAI)

Cubic Worldwide Technical Services, Inc.  
(CWTS)

### Omega Training Group, Inc. (Omega)

4550 Third Ave S.E., Suite B  
Lacey, WA 98503  
360-493-6275 • 360-493-6195 Fax

#### Jimmie L. Balentine

President

#### Ruth Van Sickle

Executive Vice President

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Vice President & General Manager

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#### John R. Schmader

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#### Jack W. Liddle

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## **Cubic Transportation Systems**

### **Worldwide Headquarters**

#### **Cubic Transportation Systems, Inc.**

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**Walter C. Zable**  
Chairman

**Stephen O. Shewmaker**  
President

**Matt Cole**  
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**Basil Kyriadakis**  
General Manager

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Chairman

**Stephen O. Shewmaker**  
Managing Director

**Roger Crow**  
General Manager

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Limited

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**Robert A. Ruff**  
President

# PEER GROUP CONSTITUENTS, TRADEMARKS & CREDITS

## Peer Group Constituents - See Stock Performance Graph on page 24

The defense, homeland security and space index named SPADE is made up of the following companies as of September 30, 2008:

- ▶ AAR
- ▶ AeroVironment
- ▶ Alliant Techsystems
- ▶ American Science & Engineering
- ▶ Applied Signal
- ▶ Argon ST
- ▶ Axsys Technologies
- ▶ Ball Corporation
- ▶ Boeing
- ▶ CACI International
- ▶ Ceradyne
- ▶ Cogent
- ▶ Computer Sciences
- ▶ Cubic Corporation
- ▶ DRS Technologies
- ▶ Ducommun
- ▶ DynCorp International
- ▶ Elbit Systems
- ▶ Esterline Technology
- ▶ Flir Systems
- ▶ Garmin
- ▶ Gencorp
- ▶ General Dynamics
- ▶ GeoEye
- ▶ Goodrich
- ▶ Harris
- ▶ Honeywell International
- ▶ ITT
- ▶ L-1 Identity Solutions
- ▶ L-3 Communications
- ▶ Ladish
- ▶ Lockheed Martin
- ▶ Mantech International
- ▶ Mercury Computer Systems
- ▶ MOOG
- ▶ NCI
- ▶ Northrop Grumman
- ▶ Orbital Sciences
- ▶ Oshkosh
- ▶ OSI Systems
- ▶ Precision Castparts
- ▶ Raytheon
- ▶ Rockwell Collins
- ▶ SAIC
- ▶ SI International
- ▶ SRA International
- ▶ Stanley
- ▶ TASER International
- ▶ Teledyne Technologies
- ▶ Textron
- ▶ Trimble Navigation
- ▶ Triumph Group
- ▶ United Technologies
- ▶ URS Corporation
- ▶ ViaSat

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### *Australian Government*

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