CUBIC CORP /DE/
Form 10-K
December 06, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2007

Commission File Number 1-8931

CUBIC CORPORATION

Exact Name of Registrant as Specified in its Charter

Delaware	**95-1678055**
State of Incorporation	IRS Employer Identification No.

9333 Balboa Avenue

San Diego, California 92123

Telephone (858) 277-6780

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

Common Stock	**American Stock Exchange, Inc.**
Title of each class	Name of exchange on which registered

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

None

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

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

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

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The aggregate market value of 15,549,143 shares of voting stock held by non-affiliates of the registrant was: $336,483,455 as of March 31, 2007, based on the closing stock price on that date.

Number of shares of common stock outstanding as of November 9, 2007 including shares held by affiliates is: 26,719,663 (after deducting 8,945,066 shares held as treasury stock).

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant s Proxy Statement for its 2008 Annual Meeting of Shareholders to be held on February 26, 2008, are incorporated by reference into Part III of this Annual Report on Form 10-K.

PART I

Item 1. BUSINESS.

GENERAL

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

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

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

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

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

During fiscal year 2007, approximately 54% of our total business was conducted, either directly or indirectly, with various agencies of the United States government. Most of the remainder of our revenue was from local, regional and foreign governments or agencies.

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

BUSINESS SEGMENTS

Information regarding the amounts of revenue, operating profit and loss and identifiable assets attributable to each of our business segments, is set forth in Note 10 to the Consolidated Financial Statements for the year ended September 30, 2007. Additional information regarding the amounts of revenue and operating profit and loss attributable to major classes of products and services is set forth in Management s Discussion and Analysis which follows at Item 7.

DEFENSE

Cubic s defense business segment consists of three market-focused business units: Readiness Systems, Mission Support Services, and Communications & Electronics. Our products include customized military range instrumentation systems, tactical engagement simulation systems, firearm simulation systems, communications and surveillance systems, surveillance receivers, power amplifiers, and avionics systems. Our services include training mission support, computer simulation training, distributed interactive simulation, development of military training doctrine, and field operations and maintenance. We market our capabilities directly to various U.S. government departments and agencies and foreign governments. In addition, we frequently contract or team with other leading defense suppliers. In addition to the three business units, we formed a joint venture with Rafael Armament Development Authority Ltd., an Israeli company, to produce certain Rafael defense systems in the United States for Israel and for U.S. customers.

Our Training Systems Business Unit changed its name this year to Readiness Systems Business Unit which we believe reflects defense market trends and our broadening capabilities. Readiness Systems better describes the market we serve and encompasses not only our heritage in training systems and products, but the value and opportunities for these systems and underlying technologies to transition into operational equipment.

Readiness Systems

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

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

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

Laser-based Tactical Engagement Simulation systems, generally known as MILES (Multiple Integrated

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

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

Mission Support Services

Our Mission Support Services Business Unit (MSBU) is a leading provider of tactical knowledge-based services to the U.S. Government and allied nations, with an emphasis on military training. MSBU consists of approximately 3,800 people at more than 100 locations throughout the world. Our personnel serve with clients in their actual environments and prepare forces through comprehensive training, exercises, education, and operational support to meet the full scope of their missions, from large scale combat operations, to special operations, peacekeeping, consequence management, and humanitarian assistance operations worldwide. We also plan, prepare, execute and document realistic and focused mission rehearsal exercises (including live and computer-based) as final preparation of forces prior to their deployment to mission areas. In addition, we provide high level consultation and advisory services to the governments and militaries of allied nations. U.S. government service contracts are typically awarded on a competitive basis with options for multiple years. In this competitive market, Cubic is viewed as a premier service provider and formidable competitor. We typically compete as prime contractors to the government, but also team with other companies depending on the skills required. Much of our early work centered on battle command training and simulation, in which military commanders are taught to make correct decisions in battle situations. More recently, the business base has broadened to include integrated live, virtual, and constructive training support, distance learning, knowledge management, weapons effects and analytical modeling, intelligence analysis, homeland security training and exercises, and military force modernization.

Our programs include providing mission support services to three of the Army s major combat training centers, to the Joint Readiness Training Center (JRTC) as prime contractor, and to the National Training Center (NTC) and Battle Command Training Program (BCTP) as a principal subcontractor. These services include planning, executing and documenting large scale exercises aimed at stressing U.S. forces in situations as close to actual combat as possible. Cubic also assists the Army National Guard in developing and implementing a similar home station combat training capability at selected Guard locations in the U.S.

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

Cubic initiated and has continued to operate the Korea Battle Simulation Center (KBSC) since its inception in 1991. KBSC prepares U.S. and allied forces in Korea to deal with situations which may develop in their

areas of responsibility and includes support to the world s largest and most complex simulation-based training events.

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

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

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

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

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

Communications & Electronics

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

CEBU s Personnel Locator System (PLS) is standard equipment on U.S. aircraft with a search-rescue mission. We have continued to receive orders for an upgraded PLS which has been redesigned to interface with all modern search and rescue system

standards, thus positioning us for major platform upgrades expected over the next few years.

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

Raw Materials:

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

Backlog:

Funded sales backlog of the defense segment at September 30, 2007 was $602 million compared to $509 million at September 30, 2006. Total backlog, including unfunded customer orders, was $1,247 million at September 30, 2007 compared to $763 million at September 30, 2006. Approximately $770 million of the September 30, 2007 total backlog is not expected to be completed by September 30, 2008.

Competition:

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

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

TRANSPORTATION SYSTEMS

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

fare collection equipment consisting of on-bus solutions, access control solutions, vending solutions, retail and card issuing solutions, and mobile inspection and sales solutions.

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

These programs provide a base of current business and the potential for additional future business as the systems are expanded. In 1998, Transaction Systems Limited (TranSys), a joint venture company in which Cubic has a 37.5% ownership, was awarded a contract called PRESTIGE to outsource the London Transport fare collection services. This 17-year contract, now in its tenth year, is the largest automated fare collection contract ever awarded. Our share of the work, including all contract change orders to date, exceeds $1 billion over the 17-year life of the contract.

Industry Overview

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

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

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

Raw Materials:

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

Backlog:

Funded sales backlog of the transportation systems segment at September 30, 2007 and 2006 amounted to $787 million and $716 million, respectively. Approximately $578 million of the September 30, 2007 backlog is not expected to be completed by September 30, 2008.

Competition:

We are one of several companies involved in providing automated fare collection systems solutions and services for public transport operators worldwide including such foreign competitors as Thales, ACS, Scheidt & Bachmann and ERG. In addition, there are many smaller local companies, particularly in European and Asian markets. For large national tenders, it is common practice to form consortiums that include, in addition to the fare collection companies noted above, telecommunications, consulting and computer services companies including Keane, Siemens, Accenture, Metropolitan Transit Railway Corporation, and EDS. These procurement activities are very competitive and require that we have highly skilled and experienced technical personnel to compete. We believe that our competitive

advantages include intermodal and interagency regional integration expertise, technical skills, past contract performance, systems quality and reliability, experience in the industry and long-term customer relationships.

BUSINESS STRATEGY

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

Leverage Long-Term Relationships

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

An example of this in our defense segment is the recent award of a contract to provide the next generation U.S. air combat training system. Starting in 1971 Cubic developed the first generation of Air Combat Maneuvering Instrumentation system, or ACMI, for the U.S. Military for live combat training. In 2003 the company was awarded the P5 $525 million ID/IQ contract to deliver the latest technology for rangeless live training to the U.S. and foreign militaries. In 2007 the company was awarded a $50.3 million contract to develop the next generation of live training for the F35 joint Strike Fighter aircraft using embedded technology. Thus since the initial contract in 1971 the company has successfully and continuously supplied the U.S. and foreign militaries the latest in air combat training technologies

In our transportation segment we have had a continuous relationship with Transport for London (TfL) since the 1970 s. Starting with a small trial of magnetic ticketing and gating in 1978, the company has continuously delivered fare collection equipment and systems to TfL as its exclusive fare collection system supplier. Today under the PRESTIGE contract there are 10 million Oyster smart cards in circulation making this one of the largest transportation smart card systems in the world. In 2007 the company began trial applications of a new combination Oyster Card and bank credit/debit card known as the Barclaycard OnePulse card. Looking forward into 2008 this new card will be launched throughout the United Kingdom and this upgrade will continue to enhance the system we have developed for TfL. Similarly, we are regionalizing integrated fare collection systems in Washington D.C., New York and Southern California.

Maintain a Diversified Business Mix

We have a diverse mix of business in our defense and transportation systems segments. Approximately 54% of our sales are made directly or indirectly to the U.S. government; however, this represents a wide variety of product and service sales to many different U.S. government agencies. The largest single contract in the transportation segment is the PRESTIGE contract in London which represented about 8% of consolidated sales in 2007.

We also seek a reasonable balance between systems and service work in both the defense and transportation segments. In aggregate, approximately 42% of our sales revenue in 2007 was from service type work. We believe that a strong base of service work helps to smooth the revenue fluctuations inherent in systems type work.

Pursue Strategic Acquisitions

With our strong financial position we are focused on finding attractive acquisitions to enhance our market position. We are focused on specific growth opportunities in the defense marketplace in the communications and services areas, specific market opportunities in transportation and opportunities in adjacent markets in smart cards and security that leverage our customer base and skills.

OTHER MATTERS

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

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

The cost of Company sponsored research and development (R&D) activities was $5.2 million, $6.1 million and $8.1 million in 2007, 2006 and 2005, respectively. We do not rely heavily on independent R&D, as most of our new product development occurs in conjunction with the performance of work on our contracts. The amount of contract-required product development activity was $66 million in 2007 compared to $64 million and $65 million in 2006 and 2005, respectively; however, these costs are included in cost of sales as they are directly related to contract performance.

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

We employed approximately 6,000 persons at September 30, 2007.

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

RISK FACTORS

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

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

Our revenues from contracts, directly or indirectly, with foreign and United States, state, regional and local governmental agencies represented more than 95% of our total revenues in fiscal year 2007. Although these various government agencies are subject to common budgetary pressures and other factors, many of our various government customers exercise independent purchasing decisions. Because of the concentration of business with governmental agencies, we are vulnerable to adverse changes in our revenues, income and cash flows if a significant number of our government contracts or subcontracts or prospects are delayed or canceled for budgetary or other reasons.

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

- re-allocation of government resources as the result of actual or threatened terrorism or hostile activities;

- budget constraints affecting government spending generally, or specific departments or agencies such as U.S. or foreign defense and transit agencies and regional transit agencies, and changes in fiscal policies or a reduction of available funding;

- changes in government programs or requirements or their timing;

- curtailment of government s use of technology products and service providers;

- the adoption of new laws or regulations pertaining to government procurement;

- government appropriations delays or shutdowns;

- suspension or prohibition from contracting with the government or any significant agency with which we conduct business;

- impairment of our reputation or relationships with any significant government agency with which we conduct business;

- impairment of our ability to provide third-party guarantees and letters of credit; and

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

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

In the past, our businesses have been adversely affected by significant changes in government spending during periods of declining budgets. A significant decline in overall spending, or the decision not to exercise options to renew contracts, or the loss of or substantial decline in spending on a large program in which we participate could materially adversely affect our business, prospects, financial condition or results of operations. As an example, the U.S. defense and intelligence budgets generally, and spending in specific agencies with which we work, such as the Department of Defense, have declined from time to time for extended periods since the 1980s, resulting in program delays, program cancellations and a slowing of new program starts. Although spending on defense-related programs by the U.S. government has recently increased, future levels of expenditures and authorizations for those programs may decrease, remain constant or shift to programs in areas where we do not currently provide products or services.

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

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

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

- terminate our existing contracts;

- reduce the value of our existing contracts;

- modify some of the terms and conditions in our existing contracts;

- suspend or permanently prohibit us from doing business with the government or with any specific government agency;

control and potentially prohibit the export of our products;

cancel or delay existing multiyear contracts and related orders if the necessary funds for contract performance for any subsequent year are not appropriated;

decline to exercise an option to extend an existing multiyear contract; and

claim rights in technologies and systems invented, developed or produced by us.

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

The PRESTIGE contract with TfL, through the TranSys joint venture, contains a termination for convenience clause that provides for possible termination of the contract after twelve years, which would be in August of 2010. This termination clause outlines the obligations of the customer should they elect to exercise this contract provision, including penalty payments to TranSys and early payment of the debt, among other requirements. Because of these onerous requirements, we do not believe it would be in the best interests of TfL to terminate the contract early; however, they may do so. The contract is now in its tenth year and the customer must notify TranSys by October 2008 if they should elect to terminate the contract at the end of year twelve.

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

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

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

- the need to compete against companies or teams of companies with more financial and marketing resources and more experience in bidding on and performing major contracts than we have;
- the need to compete against companies or teams of companies that may be long-term, entrenched incumbents for a particular contract for which we are competing and that have, as a result, greater domain expertise and better customer relations;
- the need to compete to retain existing contracts that have in the past been awarded to us on a sole-source basis;
- the expense and delay that may arise if our competitors protest or challenge new contract awards;
- the need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties, cost overruns or both;
- the substantial cost and managerial time and effort, including design, development and marketing activities, necessary to prepare bids and proposals for contracts that may not be awarded to us;
- the need to develop, introduce, and implement new and enhanced solutions to our customers needs;
- the need to locate and contract with teaming partners and subcontractors; and
- the need to accurately estimate the resources and cost structure that will be required to perform any fixed-price contract that we are awarded.

We may not be afforded the opportunity in the future to bid on contracts that are held by other companies and are scheduled to expire if the agency decides to extend the existing contract. If we are unable to win

particular contracts that are awarded through the competitive bidding process, we may not be able to operate in the market for services that are provided under those contracts for a number of years. If we win a contract, and upon expiration, if the customer requires further services of the type provided by the contract, there is frequently a competitive rebidding process and there can be no assurance that we will win any particular bid, or that we will be able to replace business lost upon expiration or completion of a contract.

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

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

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

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

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

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

devaluations and fluctuations in currency exchange rates;

changes in foreign laws that adversely affect our ability to sell our products or services or our ability to repatriate profits to the United States;

increases or impositions of withholding and other taxes on remittances and other payments by foreign subsidiaries or joint ventures to us;

increases in investment and other restrictions or requirements by foreign governments in order to operate in the territory or own the subsidiary;

costs of compliance with local laws, including labor laws;

export control regulations and policies which govern our ability to supply foreign customers;

unfamiliar and unknown business practices and customs;

domestic and foreign government policies, including requirements to expend a portion of program funds locally and governmental industrial cooperation requirements;

the complexity and necessity of using foreign representatives and consultants;

the uncertainty of the ability of foreign customers to finance purchases;

imposition of tariffs or embargoes, export controls and other trade restrictions;

the difficulty of management and operation of an enterprise in various countries; and

economic and geopolitical developments and conditions, including international hostilities, acts of terrorism and governmental reactions, inflation, trade relationships and military and political alliances.

Our foreign subsidiaries and joint ventures generally conduct business in foreign currencies and enter into contracts and make purchase commitments that are denominated in foreign currencies. Accordingly, we are exposed to fluctuations in exchange rates, which could have a significant impact on our results of operations. We have no control over the factors that generally affect this risk, such as economic, financial and political events and the supply of and demand for applicable currencies. While we use foreign exchange forward and option contracts to hedge significant contract sales and purchase commitments that

are denominated in foreign currencies, our hedging strategy may not prevent us from incurring losses due to exchange fluctuations.

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

Approximately 68% of our revenues in 2007 were from fixed-price contracts under which we bear the risk of cost overruns. Our profits are adversely affected if our costs under these contracts exceed the assumptions we used in bidding for the contract. Often, we are required to fix the price for a contract before the project specifications are finalized, which increases the risk that we will incorrectly price these contracts. The complexity of many of our engagements makes accurately estimating the time and resources required more difficult.

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

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

the Federal Acquisition Regulations and all department and agency supplements, which comprehensively regulate the formation, administration and performance of U.S. government contracts;

the Truth in Negotiations Act and implementing regulations, which require certification and disclosure of all cost and pricing data in connection with contract negotiations;

laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data;

regulations of most state and regional agencies and foreign governments similar to those described above;

the Sarbanes-Oxley Act of 2002; and

tax laws and regulations in the U.S. and in other countries in which we operate.

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

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

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

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

We also rely on trade secrets, proprietary know-how and continuing technological innovation to remain competitive. We have taken measures to protect our trade secrets and know-how, including the use of

confidentiality agreements with our employees, consultants and advisors. These agreements may be breached and remedies for a breach may not be sufficient to compensate us for damages incurred. We generally control and limit access to our product documentation and other proprietary information. Other parties may independently develop our know-how or otherwise obtain access to our technology.

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

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

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

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

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

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

Because our internal manufacturing capacity is limited, we use contract manufacturers. While we use care in selecting our manufacturers, we have less control over the reliability of supply, quality and price of products or components than if we manufactured them. In some cases, we obtain products from a sole supplier or a limited group of suppliers. Consequently, we risk disruptions in our supply of key products and components if our suppliers fail or are unable to perform because of strikes, natural disasters, financial condition or other factors. Any material supply disruptions could adversely affect our ability to perform our obligations under our contracts and could result in cancellation of contracts or purchase orders, penalties, delays in realizing revenues, payment delays, as well as adversely affect our ongoing product cost structure.

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

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

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

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

we may need to divert management resources to integration, which may adversely affect our ability to pursue other more profitable activities;

integration may be difficult as a result of the necessity of coordinating geographically separated organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures;

we may not eliminate redundant costs in selecting acquisition candidates; and

one or more of our acquisition candidates may also have unexpected liabilities or adverse operating issues that we fail to discover through our due diligence procedures prior to the acquisition.

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

Our revenues are affected by factors such as the unpredictability of contract awards due to the long procurement process for most of our products and services, the potential fluctuation of governmental agency budgets, the time it takes for the new markets we target to develop and for us to develop and provide products and services for those markets, competition and general economic conditions. Our contract type/product mix and unit volume, our ability to keep expenses within budget, and our pricing affect our operating margins. Significant growth in costs to complete our contracts, such as we experienced in our transportation systems business in 2005 and 2006, may adversely affect our results of operations in future periods. These factors and other risk factors described herein may adversely affect our results of operations and cause our financial results to fluctuate significantly on a quarterly or annual basis. Consequently, we do not believe that comparison of our results of operations from period to period is necessarily meaningful or predictive of our likely future results of operations. In some future financial period our operating results may be below the expectations of public market analysts or investors. If so, the market price of our securities may decline significantly.

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING INFORMATION

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

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

Item 2. PROPERTIES.

We conduct our operations in approximately 1.5 million square feet of both owned and leased properties located in the United States and foreign countries. We own approximately 76% of the square footage, including 498,000 square feet located in San Diego, California and 467,000 square feet located in Orlando, Florida. All owned and leased properties are considered in good condition and, with the exception of the Orlando facility, adequately utilized. The following table identifies significant properties by business segment:

Location of Property	Owned or Leased
Corporate Headquarters:	
San Diego, CA	Owned
Defense:	
Arlington, VA	Leased
Auckland, New Zealand	Leased
Hampton, VA	Leased
Honolulu, HI	Leased
Kingstowne, VA	Leased
Lacey, WA	Leased
Leavenworth, KS	Leased
Orlando, FL	Leased and owned
San Diego, CA	Leased and owned
Shalimar, FL	Leased
Singapore	Leased
Tijuana, Mexico	Leased
Cummings, GA	Leased
Transportation Systems:	
Brisbane, Australia	Leased
Glostrup, Denmark	Leased
Chantilly, VA	Leased
Frankfurt, Germany	Leased
London, England	Leased
Los Angeles, CA	Leased
Montreal, Canada	Leased
New York, NY	Leased and owned
Merthsham, Surrey, England	Leased
Salfords, Surrey, England	Owned
San Diego, CA	Owned
Tullahoma, TN	Owned
Investment properties:	
Teterboro, NJ	Leased
Vancouver, Canada	Leased

Item 3. **LEGAL PROCEEDINGS.**

In 1991, the government of Iran commenced an arbitration proceeding against the Company seeking $12.9 million for reimbursement of payments made for equipment that was to comprise an Air Combat Maneuvering Range pursuant to a sales contract and an installation contract executed in 1977, and an additional $15 million for unspecified damages. The Company contested the action and brought a counterclaim for compensatory damages of $10.4 million. In May 1997, the arbitral tribunal awarded the government of Iran $2.8 million, plus simple interest at the rate of 12% per annum from September 21, 1991 through May 5, 1997. In December 1998, the United States District Court granted a motion by the government of Iran confirming the arbitral award but denied Iran s request for additional interest and costs. Both parties have appealed. In October 2004, the 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. We believe that Iran will seek further review from the Supreme Court; 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, 2007. 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. The claim is now in arbitration. Based on information currently available, management believes there is no merit to the claim and that it will prevail in this matter. Therefore, no liability has been recorded as of September 30, 2007.

From time-to-time, agencies of the U.S. and foreign governments may investigate whether the Company s

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

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

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

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

PART II

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

The principal market on which our common stock is being traded is the American Stock Exchange under the symbol CUB. The closing high and low sales prices for the stock, as reported in the consolidated transaction reporting system on the American Stock Exchange for the quarterly periods during the past two fiscal years, and dividend information for those periods, are as follows:

MARKET AND DIVIDEND INFORMATION

	Sales Price of Common Shares				Dividends per Share	
	Fiscal 2007		Fiscal 2006			
Quarter	High	Low	High	Low	Fiscal 2007	Fiscal 2006
First	$ 22.82	$ 19.06	$ 20.56	$ 15.63		
Second	22.37	19.99	23.94	20.74	$ 0.09	$ 0.09
Third	30.14	20.12	24.40	18.27		
Fourth	46.43	27.23	20.74	18.30	$ 0.09	$ 0.09

On November 9, 2007, the closing price of our common stock on the American Stock Exchange was $41.23.

There were approximately 1,000 shareholders of record of our common stock as of November 9, 2007.

Item 6. SELECTED FINANCIAL DATA.

FINANCIAL HIGHLIGHTS AND SUMMARY OF CONSOLIDATED OPERATIONS

(amounts in thousands, except per share data)

	Years Ended September 30,				
	2007	2006	2005	2004	2003
Results of Operations:					
Sales	$ 889,870	$ 821,386	$ 804,372	$ 722,012	$ 634,061
Cost of sales	727,540	687,213	672,541	549,170	493,377
Selling, general and administrative expenses	95,054	97,166	110,644	107,139	87,888
Interest expense	3,403	5,112	5,386	4,658	3,659
Income taxes	23,662	12,196	453	19,394	18,514
Net income	41,586	24,133	11,628	36,911	36,519
Average number of shares outstanding	26,720	26,720	26,720	26,720	26,720
Per Share Data:					
Net income	$ 1.56	$ 0.90	$ 0.44	$ 1.38	$ 1.37
Cash dividends	0.18	0.18	0.18	0.16	0.14
Year-End Data:					
Shareholders equity	$ 382,771	$ 323,226	$ 297,158	$ 298,767	$ 255,292
Equity per share	14.33	12.10	11.12	11.18	9.55
Total assets	592,565	548,071	547,280	542,924	460,226
Long-term debt	32,699	38,159	43,776	50,037	47,142

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

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

Our two primary businesses are in the defense and transportation industries. For the year ended September 30, 2007, 72% of sales were derived from defense, while 28% 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 2007 compared to 52% in 2006 and 53% in 2005.

Our defense segment is organized into three market-focused business units: Readiness Systems (formerly known as Training Systems) Business Unit (RSBU), Mission Support Services Business Unit (MSBU), and Communications & Electronics Business Unit (CEBU). 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. The segment also has a 50% interest in a joint venture which produces components of advanced tactical systems for the U.S. and Israel.

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 2007 increased by 8% to $889.9 million compared to $821.4 million in 2006. Sales in 2006 had increased 2% over 2005 sales of $804.4 million. Sales growth in the three year period from 2005 to 2007 all came from our defense segment, while transportation systems sales trended slightly downward during the three year period. Nearly all the growth in defense sales was organic, coming from existing subsidiaries, with an immaterial amount coming from a small strategic acquisition we made in 2006. See the segment discussions following for further analysis of segment sales.

Operating income doubled in fiscal 2007 to $62.1 million from $30.9 million in 2006, after having more than doubled in 2006 from $13.1 million in 2005. The improvement in 2007 came from both segments with transportation systems increasing significantly from a low level in 2006 and defense improving by more than 40%. In fiscal 2006 the primary reason for the improvement was that our transportation business returned to profitability after having incurred an operating loss in fiscal 2005. Defense operating income also increased in 2006, at a slightly better rate than the growth in defense sales. See the segment discussions following for further details of segment operating results.

Net income increased 72% in fiscal 2007 to $41.6 million ($1.56 per share) from $24.1 million ($.90 per share) in 2006. Net income in 2006 had more than doubled from $11.6 million ($0.44 per share) in 2005. Included in 2007 was a gain on the sale of our corrugated box business in the fourth quarter of approximately $0.6 million, after applicable income taxes. We had owned this small business since the 1960 s and over the years realized a high rate of return on our investment; however, in recent years competition and raw material prices had driven profit margins down. Since this business is not a part of our core mission, we determined that it was time for us to divest it. Approximately $4.3 million, after applicable income taxes, of the 2006 net income was from a gain on the sale of real estate that had been held for investment purposes for many years, but was sold in the first fiscal quarter of 2006. Reductions in tax contingency reserves accounted for approximately $0.9 million, $1.1 million and $2.8 million,

respectively, of the 2007, 2006 and 2005 net income.

The gross margin from product sales improved again in 2007 to 19.6% from 16.0% in 2006, due to improved performance from our defense readiness systems business and the transportation systems segment. The gross margin for product sales had been down to 15.1% in 2005, as a result of cost growth in the transportation systems segment that year. The gross margin from service sales was 16.3% in 2007, compared to 16.9% in 2006 and 18.1% in 2005. The primary cause of the decreasing service gross margin during the three year period was lower sales from a service contract in Europe that had generated higher than average gross margins. This contract was completed in the second quarter of fiscal 2007.

Selling, general and administrative (SG&A) expenses decreased to 10.7% of sales in 2007 compared to 11.8% in 2006 and 13.8% in 2005. SG&A expenses decreased in 2007, to $95.1 million compared to $97.2 million in 2006. SG&A increased in the defense segment due to somewhat higher selling expenses and due to growth of the business, while SG&A decreased in the transportation segment due to cost cutting measures. In 2006 SG&A expenses had decreased $13.5 million from the 2005 level, with the decrease coming from both segments. In 2005, the defense segment had incurred higher than normal selling expenses related to contract proposals, while such activities returned to a more normal level in 2006. Lower transportation systems selling expenses and staffing reductions contributed to reduced SG&A expenses in 2006. In addition, an allowance for doubtful accounts provision of more than $4 million had contributed to higher SG&A expenses in transportation systems in 2005.

Company sponsored research and development (R&D) spending decreased to $5.2 million in 2007, compared to $6.1 million in 2006 and $8.1 million 2005. 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 2007 was $66 million, compared to $64 million in 2006 and $65 million in 2005; however, these costs are included in cost of sales as they are directly related to contract performance.

Interest and dividend income increased in 2007 over both 2006 and 2005 due primarily to higher available cash balances for investment. Other income increased in 2007 over 2006 as a result of foreign currency exchange gains on advances to our foreign subsidiaries. Other income had decreased in 2006 compared to 2005 in part because of lower rental income, resulting from the sale of the real estate mentioned above. Other income in 2005 had also included foreign currency exchange gains on advances to foreign subsidiaries. Interest expense decreased nearly $2 million in 2007 compared to 2006 and 2005 because of a reduction in both short- and long-term borrowings.

Our effective tax rate for 2007 was 36.3% of pretax income compared to 33.6% in 2006 and 3.7% in 2005. Our effective rate in 2007 increased in part because we recorded a provision of $2.6 million for U.S. taxes on a 7 million pound ($14.4 million) dividend from our U.K. subsidiary that was paid in 2007. In December 2006, the U.S. Congress reinstated the Research and Experimentation (R&E) credit retroactive to January 1, 2006. As a result, we recorded a tax benefit of approximately $0.5 million in the first quarter of fiscal 2007 that represents the estimated R&E credit for the nine-month period ended September 30, 2006, which was not previously reflected in our operating results. Tax expense in 2006 had included a provision of $1.6 million for taxes due upon the repatriation of capital to the U.S. from our U.K. subsidiary during the year. The effective rate in 2007, 2006 and 2005 benefited from the reversal of tax contingency provisions amounting to $0.9 million, $1.1 million and $2.8 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.

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Defense Segment

Years ended September 30,	2007	2006 (in millions)	2005
Defense Segment Sales			
Mission support services (MSBU)	$ 308.0	$ 262.9	$ 257.0
Readiness systems (RSBU)	263.4	228.0	227.9
Communications and electronics (CEBU)	57.4	64.6	52.5
Tactical systems and other	12.3	7.3	6.0
	$ 641.1	$ 562.8	$ 543.4
Defense Segment Operating Income			
Mission support services (MSBU)	$ 27.6	$ 20.6	$ 17.9
Readiness systems (RSBU)	18.9	9.7	18.2
Communications and electronics (CEBU)	(0.7)	3.9	(4.8)
Tactical systems and other	(1.6)	(2.8)	(1.2)
	$ 44.2	$ 31.4	$ 30.1

As depicted in the table above, sales from our defense segment increased 14% to $641.1 million in 2007, compared to $562.8 million in 2006. Sales in 2006 had increased 4% from 2005 sales of $543.4 million. Higher sales in 2007 came from RSBU and MSBU, while sales from CEBU decreased in comparison to 2006. In 2006 sales from CEBU had increased from the 2005 level, while sales from the other defense business units grew only slightly. The caption Tactical systems and other in the table above includes operating results of our 50% owned joint venture company as well as advanced programs for the development of new defense technologies.

Operating income in our defense segment increased to $44.2 million in 2007 from $31.4 million in 2006, a 41% increase. In 2006, operating income had increased 4% from 2005 operating income of $30.1 million. Growth in 2007 operating income came from RSBU and MSBU, while CEBU generated an operating loss for the year. The increase in 2006 operating income was primarily due to a turnaround to profitability from CEBU, which had incurred an operating loss in 2005. MSBU operating income increased in 2006, while RSBU operating income decreased by nearly 50%. The joint venture company incurred operating losses of $1.4 million, $1.9 million and $1.3 million in 2007, 2006 and 2005, respectively, although we expect its performance to improve in 2008 as its revenues increase.

Mission Support Services (MSBU)

MSBU sales increased 17% in 2007, after having increased 2% in 2006 from the 2005 level. The increase in 2007 sales came from the expansion of existing programs and from new contracts won in 2007. Sales were higher by nearly $14 million from the Joint Readiness Training Center (JRTC) contract in Fort Polk, LA, due to an increase in training exercises conducted by the customer. In addition, increased activity from our contract with the Marine Corp. and higher sales from contracts for modeling the effects of weapons of mass destruction added to 2007 sales. Sales growth in 2006 was limited by a reduction of training exercises at the JRTC that decreased sales from that program by about $20 million. The most significant growth in 2006 sales came from contracts for modeling the effects of weapons of mass destruction.

Operating income from MSBU increased 34% in 2007 after increasing 15% in 2006. Higher sales volume and award fees helped to increase profitability in 2007 and improved operating income as a percentage of sales to 8.9%, compared to 7.8% in 2006 and 7.0% in 2005. The most

significant increases in 2007 operating income came from the Marine Corp. and JRTC contracts mentioned above. In 2006 a change in the mix of sales to higher profit margin programs helped to improve operating income despite limited sales growth.

Readiness Systems (RSBU)

RSBU sales increased 16% in 2007 over 2006 after having increased only slightly in 2006 from 2005. Most of the increase in 2007 sales compared to 2006 came from air combat training systems, while ground combat training and small arms virtual training systems sales grew slightly. Work continued on the air combat training system contract known as P5 and on a contract for an Australian air combat training system. We are also working on ground combat training ranges in Canada, the Far East and Middle East. In 2006, sales of air combat training systems were also higher when compared to 2005, while both small arms training systems and ground combat training systems sales decreased slightly.

RSBU operating income nearly doubled in 2007 from 2006, back to a level comparable to 2005. The increase in 2007 came 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 were offset by cost growth of more than $5 million on a ground combat training system in the Middle East, while operating income from other ground combat training systems improved slightly. Operating income from small arms training systems improved in 2007 as the development of new weapons simulations systems was completed in 2006, resulting in decreased costs, and because sales increased in 2007. The primary reason for decreased operating income in 2006 was cost growth of $4.6 million on a contract for the development of a ground combat training system in Canada, in addition to the small arms training development costs of $1.9 million mentioned above. Lower sales of small arms training systems further impacted 2006 operating income from this product line.

Communications and Electronics (CEBU)

Sales from CEBU decreased 12% in 2007, after having increased 23% in 2006 from the 2005 level. Sales increased in 2007 from a 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 other data link sales. Several of the data link contracts that had resulted in the sales growth in 2006 neared completion in 2007. Sales of personnel locator systems and power amplifiers also decreased in 2007, after having increased in 2006.

CEBU 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; however, this decrease was partially offset by improved profit margins from sales of power amplifiers and personnel locator systems. In 2006, operating income improved to $3.9 million from the operating loss of $4.8 million incurred in 2005. Operating income in 2006 came 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. The operating loss in communications and electronics in 2005 was primarily due to cost growth totaling nearly $5 million on two contracts, one a program for the development of new data link technology and the other a program involving an intelligence application of our data link and receiver technology. In addition, approximately $2 million in overstocked or obsolete surveillance receiver inventory was written down in value to zero in 2005.

<u>Transportation Systems Segment</u>

-

Years ended September 30,	2007	2006 (in millions)	2005
Transportation Segment Sales	$ 236.6	$ 243.9	$ 245.8
Transportation Segment Operating Income	$ 20.1	$ 2.8	$ (13.8)

Transportation systems sales continued the downward trend of recent years in 2007, decreasing 3% from the 2006 level. Sales in North America and Sweden decreased in 2007 compared to 2006, while sales in

Australia and the U.K. increased. Several system installation contracts in North America were either complete or neared completion in 2007, resulting in decreased sales, while progress on a contract in Sweden was slowed due to cost growth, also resulting in lower sales in 2007 than in 2006. Sales in Australia increased due in part to a settlement reached with the customer during the year that increased the value of the contract. In the U.K sales were lower 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 in London. A major contributor to the increase in U.K. sales was the strength of the British Pound against the U.S. dollar, resulting 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.

In 2006 increased sales from a contract in Sweden helped to offset a decrease in sales from the PRESTIGE contract and from U.K. service contracts. Service sales were lower in the U.K. in 2006 primarily because of the gradual phase-out of ticket issuing equipment mentioned above. In addition, we completed a contract for the maintenance of communications equipment in London at the end of fiscal 2005 which was not renewed in 2006, further impacting service sales.

Operating income in the transportation systems segment improved significantly in 2007 from the low level of 2006. Settlements were reached with three customers, adding $8.6 million to operating income; however, we also added $3.4 million to our estimate of costs to complete two of these contracts, yielding a net improvement to operating income of $5.2 million from these contract settlements. Operating income from the Prestige contract in London increased more than $9 million compared to last year, including bonuses earned for system usage and the effect of a higher currency exchange rate. Currency exchange differences 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. Cost growth on North American system installation contracts in 2007 was about $7.0 million this year compared to approximately $21.0 million last year, 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 more than $6 million for the year also impacted operating income. Higher legal fees in 2007 further reduced operating income for the year by $1.3 million when compared to 2006.

In 2006, improved operating income from contracts in Europe was partially offset by operating losses on contracts in North America and Australia. Projected costs to complete fare collection systems on several North American and one Australian contract increased by approximately $21 million more than had been previously estimated. The primary cause of the cost growth was an increase in engineering hours incurred to complete the projects, in addition to project management costs incurred due to delays in project completion. This compares to cost growth of approximately $28 million on these contracts in 2005. In 2005 we also recorded an allowance of $4.2 million for doubtful collection of an accounts receivable balance with a customer that terminated its contract with us. This provision is included in 2005 SG&A expenses in the consolidated statement of income. We believe that we have substantially performed the requirements of the contract such that this payment is due to us and we believe the termination attempt by this customer is unwarranted.

Backlog

September 30,	2007	2006
	(in millions)	
Total backlog		
Transportation systems	$ 787.3	$ 715.6
Defense		
Mission support services	776.6	366.4
Readiness systems	383.4	285.9
Communications and electronics	56.4	71.9
Tactical systems and other	30.6	38.8
Total defense	1,247.0	763.0
Total	$ 2,034.3	$ 1,478.6
Funded backlog		
Transportation systems	$ 787.3	$ 715.6
Defense		
Mission support services	131.2	112.2
Readiness systems	383.4	285.9
Communications and electronics	56.4	71.9
Tactical systems and other	30.6	38.8
Total defense	601.6	508.8
Total	$ 1,388.9	$ 1,224.4

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

Included in the transportation systems backlog at September 30, 2007 is $510 million from to the PRESTIGE fare collection system contract with TfL, through our joint venture company, TranSys. Of this amount $269 million relates to the last five years of the contract (from August 2010 through August 2015) that is subject to a termination for convenience clause in the contract. This termination clause outlines the obligations of the customer should they elect to exercise this contract provision, including penalty payments to TranSys and early payment of the debt, among other requirements. Because of these onerous requirements, we do not believe it would be in the best interests of TfL to terminate the contract early; however, they may do so. The contract is now in its tenth year and the customer must notify TranSys by October 2008 if they should elect to terminate the contract.

Of the increase in transportation systems backlog between September 30, 2006 and September 30, 2007, approximately $49 million was the result of strengthening of the British Pound vs. the U.S. Dollar between those dates.

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 is effective for fiscal years beginning after December 31, 2006. 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. We will implement this standard in the first quarter of fiscal 2008, however, we are in the process of reviewing and evaluating FIN 48, and therefore the ultimate impact of its adoption is not yet known.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. 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. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact of SFAS 157 on our consolidated results of operations and financial position.

In September 2006, the FASB published SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS 158* requires plan sponsors of defined benefit pension and other postretirement benefit plans to recognize the funded status of those plans in the balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end balance sheet and provide additional disclosures. On September 30, 2007, we adopted the recognition and disclosure provisions of SFAS 158. The effect of adopting SFAS 158 on our financial condition at September 30, 2007 has been included in the accompanying consolidated financial statements. SFAS 158 did not have an effect on our financial condition at September 30, 2006. SFAS 158 s provisions regarding the change in measurement date of postretirement benefit plans are not applicable as we already use a measurement date of September 30 for our pension plans. See Note 8 for further discussion of the effect of adopting SFAS 158 on our consolidated financial statements.

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 is effective for fiscal years beginning after November 15, 2007. 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 are currently evaluating the potential impact of SFAS 159 on our consolidated results of operations and financial position.

Liquidity and Capital Resources

Cash flows from operations totaled $69.2 million in 2007, compared to $31.3 million in 2006 and $54.7 million in 2005. A decrease in accounts receivable in each of the three years amounting to $18.1 million, $5.8 million and $38.5 million in 2007, 2006 and 2005, respectively, contributed to the positive cash flows. All of the operating cash flows in 2007 came from the transportation systems segment, while defense cash flows were slightly negative for the year. Both the defense and transportation systems segments generated positive cash flows in 2006 and 2005, with the larger amount contributed by transportation systems in 2006 and by defense in 2005.

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, 2007, this balance was $16.7 million compared to $2.2 million at September 30, 2006.

Cash flows used in investing activities in 2007 included $6.1 million of capital expenditures, partially offset by proceeds of $3.8 million from the sale of our corrugated box business. During 2007 we also invested a net of $18.3 million in financial instruments that are classified as short-term investments. Investing activities in 2006 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 in short-term investments. In 2005, investing activities included $8.3 million of capital expenditures and the liquidation of $6.2 million of short-term investments.

Financing activities in 2007 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 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. In 2005 we borrowed a net $0.7 million on a short-term basis to fund working capital requirements, made scheduled debt payments of $6.1 million and paid dividends to shareholders of $4.8 million.

Accumulated other comprehensive income increased $22.8 million in 2007 because of foreign currency translation adjustments of $9.2 million and a decrease in the recorded liability for our pension plans of $13.6 million. This increases the positive balance in accumulated other comprehensive income to $31.2 million as of September 30, 2007 compared to $8.4 million at September 30, 2006.

The pension plan under-funded balance improved from the September 30, 2006 balance of $32.2 million to $1.5 million at September 30, 2007. This improvement in the funding position can be attributed primarily to a return on plan assets for the year that was higher than our assumed rate of return and to an increase in the discount rate we used to calculate the pension liability. In accordance with Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, which we implemented in fiscal 2007, the under-funded balance of $1.5 million is reflected on the balance sheet as a liability at September 30, 2007.*

The net deferred tax asset decreased to $18.7 million at September 30, 2007 compared to $26.4 million at September 30, 2006. The primary reason for the decrease is that the effect of recording adjustments to the pension liability through other comprehensive income resulted in a deferred tax liability of $2.7 million at September 30, 2007 compared to a deferred tax asset of $4.7 million at September 30, 2006. 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 $306 million and a current ratio of 2.8 to 1 at September 30, 2007. 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, 2007, $11.1 million of this capacity was used for letters of credit, leaving an additional $138.9 million available. Our total debt to capital ratio at September 30, 2007 was less than 10%. In addition, our cash and short-term investments totaled $100.8 million at September 30, 2007 which exceeded our total debt by $61.9 million.

The following is a schedule of our contractual obligations outstanding as of September 30, 2007:

	Total	Less than 1 Year	1 - 3 years	4 - 5 years	After 5 years
			(in millions)		
Long-term debt	$ 38.8	$ 6.1	$ 10.8	$ 9.4	$ 12.5
Interest payments	7.9	2.2	3.2	1.9	0.6
Operating leases	16.8	5.3	6.6	4.0	0.9
Deferred compensation	8.7	0.5	1.1	0.8	6.3
	$ 72.2	$ 14.1	$ 21.7	$ 16.1	$ 20.3

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. 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. We have accounting policies in place to address these and other complex issues in accounting for long-term contracts.

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. We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are likely to be challenged and that we may not prevail. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit.

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

We have not recognized any United States tax expense on undistributed earnings of our foreign subsidiaries since we intend to reinvest the earnings outside the U.S. for the foreseeable future. These undistributed earnings totaled approximately $44.5 million at September 30, 2007. 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 2007, we determined that 7 million British pounds ($14.4 million) was excess capital in the U.K. and paid a dividend of that amount to the U.S. parent company.

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

September 30,		**2007**		**2006**
		(in millions)		
Defense systems and products	$	16.9	$	16.5
Defense services		9.7		9.7
Transportation systems		9.4		8.6
Total goodwill	$	36.0	$	34.8

Determining the fair value of a reporting unit for purposes of the goodwill impairment test is judgmental in nature and often involves the use of significant 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 2007, 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 9.4%. We did not recognize any goodwill impairment as a result of performing this annual test. A variance in the discount rate, the estimated sales growth rate or the operating profit margin could have a significant impact on the estimated fair value of the reporting

unit and consequently the amount of identified goodwill impairment. For example, a 3% decrease in the assumed operating profit margin in the defense systems and products reporting unit or a 3.5% decrease in the assumed operating profit margin in the transportation systems reporting unit would have resulted in an indication of impairment that would have led us to further quantify the possible impairment and potentially record a charge to write-down these assets.

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 2007 by about $0.7 million, before applicable income taxes.

Item 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest Rate Risk

We invest in money market instruments and short-term marketable debt and equity securities that are tied to floating interest rates being offered at the time the investment is made. We maintain short-term borrowing arrangements in the U.S., U.K. and New Zealand which are also tied to floating interest rates (LIBOR and the U.S. prime rate and the U.K. and New Zealand base rates). We also have senior unsecured notes payable to insurance companies that are due in annual installments. These notes have fixed coupon interest rates. See Note 5 to the Consolidated Financial Statements for more information.

Interest income earned on our short-term investments is affected by changes in the general level of U.S. and U.K. interest rates. These income streams are generally not hedged. Interest expense incurred under the short-term borrowing arrangements is affected by changes in the general level of interest rates in the U.S., U.K. and New Zealand. The expense related to these cost streams is usually not hedged since it is either revolving, payable within three months and/or immediately callable by the lender at any time. Interest expense incurred under the long-term notes payable is not affected by changes in any interest rate because it is fixed. However, we have in the past, and may in the future, use an interest rate swap to essentially convert this fixed rate into a floating rate for some or all of the long-term debt outstanding.

The purpose of a swap would be to tie the interest expense risk related to these borrowings to the interest income risk on our short-term investments, thereby mitigating our net interest rate risk. We believe that we are not significantly exposed to interest rate risk at this point in time. There was no interest rate swap outstanding at September 30, 2007.

Foreign Currency Exchange Risk

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

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

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA.

CUBIC CORPORATION

CONSOLIDATED BALANCE SHEETS

	September 30, 2007	2006
	(in thousands)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 73,563	$ 42,380
Short-term investments	27,200	8,874
Accounts receivable:		
Trade and other receivables	13,024	15,686
Long-term contracts	297,792	319,847
Allowance for doubtful accounts	(5,144)	(5,086)
	305,672	330,447
Inventories	27,342	20,209
Deferred income taxes	18,492	19,042
Prepaid expenses and other current assets	21,105	17,117
TOTAL CURRENT ASSETS	473,374	438,069
LONG-TERM CONTRACT RECEIVABLES	16,650	2,200
PROPERTY, PLANT AND EQUIPMENT		
Land and land improvements	14,601	14,412
Buildings and improvements	46,519	43,779
Machinery and other equipment	84,149	83,301
Leasehold improvements	4,299	5,368
Accumulated depreciation and amortization	(92,317)	(92,296)
	57,251	54,564
OTHER ASSETS		
Deferred income taxes	195	7,360
Goodwill	36,003	34,750
Miscellaneous other assets	9,092	11,128
	45,290	53,238
TOTAL ASSETS	$ 592,565	$ 548,071

See accompanying notes.

	September 30,	
	2007	2006
	(in thousands)	
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$	$ 10,000
Trade accounts payable	27,992	23,240
Customer advances	58,412	43,752
Accrued compensation	38,183	37,176
Accrued pension liability		6,283
Other current liabilities	31,787	26,919
Income taxes payable	4,905	7,099
Current maturities of long-term debt	6,138	6,078
TOTAL CURRENT LIABILITIES	167,417	160,547
LONG-TERM DEBT	32,699	38,159
OTHER LIABILITIES		
Accrued pension liability	1,530	18,208
Deferred compensation	8,148	7,565
MINORITY INTEREST		366
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY		
Preferred stock, no par value:		
Authorized 5,000,000 shares		
Issued and outstanding none		
Common stock, no par value:		
Authorized 50,000,000 shares		
Issued 35,664,729 shares, outstanding 26,719,663 shares	234	234
Additional paid-in capital	12,123	12,123
Retained earnings	375,299	338,523
Accumulated other comprehensive income	31,184	8,415
Treasury stock at cost 8,945,066 shares	(36,069)	(36,069)
	382,771	323,226
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 592,565	$ 548,071

See accompanying notes.

CUBIC CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended September 30,		
	2007	**2006**	**2005**
	(amounts in thousands, except per share data)		
Net sales:			
Products	$ 517,165	$ 489,286	$ 459,050
Services	372,705	332,100	345,322
	889,870	821,386	804,372
Costs and expenses:			
Products	415,729	411,181	389,555
Services	311,811	276,032	282,986
Selling, general and administrative expenses	95,054	97,166	110,644
Research and development	5,178	6,112	8,083
	827,772	790,491	791,268
Operating income	62,098	30,895	13,104
Other income (expenses):			
Gain on sale of assets	1,052	7,237	
Interest and dividends	3,431	1,891	1,046
Interest expense	(3,403)	(5,112)	(5,386)
Other income	1,299	433	2,668
Minority interest in loss of subsidiary	771	985	649
Income before income taxes	65,248	36,329	12,081
Income taxes	23,662	12,196	453
Net income	$ 41,586	$ 24,133	$ 11,628
Basic and diluted net income per common share	$ 1.56	$ 0.90	$ 0.44
Average number of common shares outstanding	26,720	26,720	26,720

See accompanying notes.

CUBIC CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended September 30, (in thousands)		
	2007	2006	2005
Operating Activities:			
Net income	$ 41,586	$ 24,133	$ 11,628
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	8,854	8,490	8,631
Deferred income taxes	745	514	(7,967)
Provision for doubtful accounts	19	145	4,136
Gain on sale of assets	(1,052)	(7,237)	
Minority interest in loss of subsidiary	(771)	(985)	(649)
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	18,091	5,793	38,480
Inventories	(7,610)	1,577	3,048
Prepaid expenses	(8,048)	(2,051)	(4,865)
Accounts payable and other current liabilities	9,965	(2,112)	12,122
Customer advances	12,181	2,279	(9,893)
Income taxes	(2,741)	155	885
Other items - net	(2,063)	629	(843)
NET CASH PROVIDED BY OPERATING ACTIVITIES	69,156	31,330	54,713
Investing Activities:			
Acquisition of businesses, net of cash acquired		(785)	(358)
Proceeds from sale of assets	3,775	8,028	
Proceeds from sale of marketable securities	241,606	4,000	31,760
Purchases of marketable securities	(259,935)	(12,850)	(25,560)
Purchases of property, plant and equipment	(6,098)	(9,789)	(8,311)
Other items - net	(139)	(513)	(3,256)
NET CASH USED IN INVESTING ACTIVITIES	(20,791)	(11,909)	(5,725)
Financing Activities:			
Change in short-term borrowings	(10,000)	(16,437)	683
Principal payments on long-term debt	(6,112)	(6,052)	(6,069)
Purchases of treasury stock		(3)	
Dividends paid to shareholders	(4,810)	(4,810)	(4,809)
NET CASH USED IN FINANCING ACTIVITIES	(20,922)	(27,302)	(10,195)
Effect of exchange rates on cash	3,740	1,401	(555)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	31,183	(6,480)	38,238
Cash and cash equivalents at the beginning of the year	42,380	48,860	10,622
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$ 73,563	$ 42,380	$ 48,860

See accompanying notes.

CUBIC CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(in thousands except per share amounts)	Comprehensive Income	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Additional Paid-in Capital	Common Stock
October 1, 2004		$ (36,066)	$ 10,095	$ 312,381	$ 12,123	$ 234
Comprehensive income:						
Net income	$ 11,628			11,628		
Increase in minimum pension liability	(4,027)		(4,027)			
Foreign currency translation adjustment	(3,970)		(3,970)			
Net unrealized losses from cash flow hedges	(431)					