CUBIC CORP /DE/
Form 10-Q
February 09, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Ended December 31, 2016

001-08931

Commission File Number

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Small Reporting Company

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

As of January 30, 2017, registrant had only one class of common stock of which there were 27,103,016 shares outstanding (after deducting 8,945,300 shares held as treasury stock).

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CUBIC CORPORATION

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended December 31, 2016

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

CUBIC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS) (UNAUDITED)

(amounts in thousands, except per share data)

	Three Months Ended December 31,	
	2016	2015
Net sales:		
Products	$ 144,760	$ 124,969
Services	189,917	188,844
	334,677	313,813
Costs and expenses:		
Products	104,612	99,192
Services	151,142	154,656
Selling, general and administrative expenses	63,758	58,491
Research and development	9,020	3,482
Amortization of purchased intangibles	9,355	6,455
Restructuring costs	891	(386)
	338,778	321,890
Operating loss	(4,101)	(8,077)
Other income (expenses):		
Interest and dividend income	247	398
Interest expense	(3,540)	(1,338)
Other income (expense), net	(547)	175
Loss before income taxes	(7,941)	(8,842)
Income tax benefit	(5,073)	(3,428)
Net loss	$ (2,868)	$ (5,414)
Net loss per share:		
Basic	$ (0.11)	$ (0.20)
Diluted	$ (0.11)	$ (0.20)

Weighted average shares used in per share calculations:		
Basic	27,086	26,964
Diluted	27,086	26,964

See accompanying notes.

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CUBIC CORPORATION

CONDENSED CONSOLIDATED

STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(in thousands)

	Three Months Ended December 31,	
	2016	2015
Net loss	$ (2,868)	$ (5,414)
Other comprehensive income (loss):		
Foreign currency translation	(20,518)	(8,503)
Change in unrealized gains/losses from cash flow hedges:		
Change in fair value of cash flow hedges, net of tax	466	28
Adjustment for net gains/losses realized and included in net income, net of tax	(865)	(969)
Total change in unrealized gains/losses realized from cash flow hedges, net of tax	(399)	(941)
Total other comprehensive loss	(20,917)	(9,444)
Total comprehensive loss	$ (23,785)	$ (14,858)

See accompanying notes.

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CUBIC CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

	December 31, 2016	September 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 166,339	$ 197,127
Restricted cash	79,874	75,648
Marketable securities	12,353	12,996
Accounts receivable - net	342,606	382,581
Recoverable income taxes	4,613	9,706
Inventories - net	98,710	66,362
Other current assets	26,093	38,231
Total current assets	730,588	782,651
Long-term contract receivables	21,130	20,926
Long-term capitalized contract costs	63,492	65,382
Property, plant and equipment, net	96,550	96,316
Deferred income taxes	9,966	2,194
Goodwill	408,372	406,946
Purchased intangibles, net	118,012	123,403
Other assets	7,187	6,590
Total assets	$ 1,455,297	$ 1,504,408
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Short-term borrowings	$ 241,800	$ 240,000
Trade accounts payable	63,441	81,172
Customer advances	57,682	49,481
Accrued compensation and other current liabilities	122,451	147,690
Income taxes payable	2,280	1,450
Current portion of long-term debt	428	450
Total current liabilities	488,082	520,243
Long-term debt	200,165	200,291
Other long-term liabilities	100,959	93,978

Shareholders’ equity:		
Common stock	32,756	32,756
Retained earnings	810,147	813,035
Accumulated other comprehensive loss	(140,734)	(119,817)
Treasury stock at cost	(36,078)	(36,078)
Total shareholders’ equity	666,091	689,896
Total liabilities and shareholders’ equity	$ 1,455,297	$ 1,504,408

See accompanying notes.

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CUBIC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Three Months Ended December 31,	
	2016	2015
Operating Activities:		
Net loss	$ (2,868)	$ (5,414)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,444	8,948
Share-based compensation expense	2,314	2,118
Change in fair value of contingent consideration	(1,314)	809
Changes in operating assets and liabilities, net of effects from acquisitions	(4,478)	(56,048)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	7,098	(49,587)
Investing Activities:		
Acquisition of businesses, net of cash acquired	(12,924)	(29,718)
Purchases of property, plant and equipment	(6,674)	(10,360)
Purchases of marketable securities	(6,246)	(7,541)
Proceeds from sales or maturities of marketable securities	6,246	14,176
Proceeds from sale of fixed assets	1,233	—
NET CASH USED IN INVESTING ACTIVITIES	(18,365)	(33,443)
Financing Activities:		
Proceeds from short-term borrowings	36,800	72,600
Principal payments on short-term borrowings	(35,000)	(22,600)
Principal payments on long-term debt	(107)	(131)
Purchase of common stock	(2,314)	(1,658)
Dividends paid	(20)	—
Contingent consideration payments related to acquisitions of businesses	(1,988)	(1,679)
Net change in restricted cash	(4,226)	(2,412)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(6,855)	44,120
Effect of exchange rates on cash	(12,666)	(8,203)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(30,788)	(47,113)
Cash and cash equivalents at the beginning of the period	197,127	218,476
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 166,339	$ 171,363

Supplemental disclosure of non-cash investing and financing activities:		
Liability incurred to acquire Vocality, net	$ 1,093	$ —
Liability incurred to acquire TeraLogics, net	$ —	$ 5,098
Liability incurred to acquire H4 Global, net	$ —	$ 1,568

See accompanying notes.

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CUBIC CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

December 31, 2016

Note 1 — Basis for Presentation

Cubic Corporation (“we”, “us”, and “Cubic”) has prepared the accompanying unaudited condensed consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

In our opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented. Operating results for the three-month period ended December 31, 2016 are not necessarily indicative of the results that may be expected for the year ending September 30, 2017. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended September 30, 2016.

The preparation of the financial statements in conformity with GAAP requires us to make estimates and assumptions 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. Actual results could differ from those estimates.

Significant Accounting Policies

There have been no material changes to our significant accounting policies as compared with the policies described in our Annual Report on Form 10-K for the year ended September 30, 2016.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 outlines a comprehensive revenue recognition model and supersedes most current revenue recognition guidance and will require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. Adoption of the new rules could affect the timing of revenue recognition for certain transactions. ASU 2014-09 will be effective for us starting in the first quarter of fiscal 2019 as we have determined that we will not adopt ASU 2014-09 early. ASU 2014-09 allows for two methods of adoption: (a) “full retrospective” adoption, meaning the standard is applied to all periods presented, or (b) “modified retrospective” adoption, meaning the cumulative effect of applying ASU 2014-09 is recognized as an adjustment to the opening retained earnings balance in the year of adoption. We have not yet determined which method of adoption we will select. We have assigned a task force within the Company to lead our implementation efforts and we have engaged outside advisors to assist. We are currently in the process of modeling the impact of the adoption of the new standard on certain of our long-term contracts in order to assess the expected impacts. As the new standard will supersede substantially all existing revenue guidance affecting us under GAAP, it could impact revenue and cost recognition on a significant number of contracts across our business segments, in addition to our business processes and our information technology systems. As a result, our evaluation of the effect of the new standard will likely extend over several future periods.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements - Going Concern, which requires management to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide footnote disclosures if conditions give rise to substantial doubt about a company’s ability to continue as a going concern. We adopted ASU 2014-15 on October 1, 2016. This adoption had no significant impact on our financial statements.

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs which requires that all costs incurred to issue debt be presented in the balance sheet as a direct reduction from the carrying value of the debt,

similar to the presentation of debt discounts. We adopted ASU 2015-03 on October 1, 2016. This adoption had no significant impact on our financial statements.

In April 2015, the FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted ASU 2015-05 on October 1, 2016. This adoption had no significant impact on our financial statements.

In January 2016, the FASB issued Accounting Standards Update ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10) which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for us beginning October 1, 2018 and, with the exception of a specific portion of the amendment, early adoption is not permitted. We are currently evaluating the impact this guidance will have on our financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases. Under the new guidance, leasees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (a) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (b) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The ASU will be effective for us beginning October 1, 2019 with early adoption permitted. ASU 2016-02 will be adopted on a modified retrospective transition basis for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements as well as whether to adopt the new guidance early.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation. The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this standard are effective for our annual year and first fiscal quarter beginning on October 1, 2017 with early adoption permitted. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements. We do not intend to adopt the new guidance early.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which provides clarifying guidance on how entities should classify certain cash receipts and cash payments on the statement of cash flows. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance will be effective for us in our fiscal year beginning October 1, 2018, and early adoption is permitted. We are currently evaluating the impact of the

application of this accounting standard update on our consolidated financial statements as well as whether to adopt the new guidance early.

In October 2016, the FASB issued ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The guidance will be effective for us in our fiscal year beginning October 1, 2018, and early adoption is permitted. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements as well as whether to adopt the new guidance early.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash, which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The guidance will be effective for us in our fiscal year beginning October 1, 2018, and early adoption is permitted. The adoption of this standard is anticipated to affect our presentation of restricted cash within out statement of cash flows. We are currently evaluating whether to adopt the new guidance early.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805) Clarifying the Definition of a Business. This ASU clarifies the definition of a business with the objective of adding guidance to assist entities with

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evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The guidance will be effective for us in our fiscal year beginning October 1, 2018 and early adoption is allowed for certain transactions. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. This standard removes the second step of the goodwill impairment test, where a determination of the fair value of individual assets and liabilities of a reporting unit was needed to measure the goodwill impairment. Under this updated standard, goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance will be effective for us in our fiscal year beginning October 1, 2020 with early adoption permitted. We are currently evaluating the impact of the application of this accounting standard update on our consolidated financial statements as well as whether to adopt the new guidance early.

Note 2 — Acquisitions

Each of the following acquisitions has been treated as a business combination for accounting purposes. The results of operations of each acquired business has been included in our consolidated financial statements since the respective date of each acquisition.

Vocality

On November 30, 2016, we acquired all of the outstanding capital stock of Vocality International (Vocality), based in Shackleford, United Kingdom, a provider of embedded technology which unifies communications platforms, enhances voice quality, increases video performance and optimizes data throughput. Vocality contributes to our Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) portfolio of products for our Cubic Global Defense Systems (CGD Systems) segment and expands our defense customer base. Vocality also sells its technology in the broadcast, oil and gas, mining, and maritime markets.

Vocality's sales totaled $0.1 million since the acquisition date. Prior to our acquisition of Vocality, Vocality had a number of share-based payment awards in place to its employees. Due to the structure of some of these share-based payment awards and the acceleration of vesting of certain of these awards in connection with our acquisition of Vocality, we were required to recognize compensation expense, rather than purchase consideration, for the portion of our purchase price that we paid to the seller that was distributed to the recipients of these awards. Consequently, we recognized $0.4 million of compensation expense within general and administrative expenses during the quarter ended

December 31, 2016 related to this matter. In addition, during the quarter ended December 31, 2016, we incurred charges of $0.4 million for acquisition costs which have been reflected in Vocality's earnings. The Vocality net loss after taxes for the period from the acquisition date through December 31, 2016 totaled $0.9 million, which included the impact of the charges above.

The estimated acquisition date fair value of consideration is $9.6 million, which was comprised of cash paid of $8.9 million plus additional held back consideration to be paid in the future estimated at $1.1 million, less the $0.4 million of cash paid to the seller recorded as compensation expense described above.

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The acquisition of Vocality was paid for with funds from existing cash resources. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in millions):

Customer relationships	$ 2.1
Technology	2.4
Trade name	0.4
Inventory	1.7
Accounts payable and accrued expenses	(0.4)
Other net assets acquired (liabilities assumed)	(0.3)
Net identifiable assets acquired	5.9
Goodwill	3.7
Net assets acquired	$ 9.6

The preliminary estimated fair values of assets acquired and liabilities assumed, including purchased intangibles, inventory and deferred revenue are preliminary estimates pending the finalization of our valuation analyses. The preliminary estimated fair values of purchased intangibles were determined using the valuation methodology deemed to be the most appropriate for each type of asset being valued. The customer relationships valuation used the excess earnings approach, and the technology and trade name asset valuations used the relief from royalty approach.

The intangible assets are being amortized using a combination of straight-line and accelerated methods based on the expected cash flows from the assets, over a weighted average useful life of nine years from the date of acquisition.

The goodwill resulting from the acquisition consists primarily of the synergies expected from combining the operations of Vocality with our existing CGD Systems business, including the synergies expected from combining its communication unification technologies with our C4ISR products and other products in our CGD Systems portfolio. The goodwill also includes the value of the assembled workforce that became our employees following the close of the acquisition. The amount recorded as goodwill is allocated to our CGD Systems segment and is generally not expected to be deductible for tax purposes.

The estimated amortization expense related to the intangible assets recorded in connection with our acquisition of Vocality for fiscal years 2017 through 2021 and thereafter is as follows (in millions):

Year Ended September 30,

2017	$ 0.6
2018	0.8
2019	0.7
2020	0.6
2021	0.5
Thereafter	1.7

GATR

On February 2, 2016, we acquired all of the outstanding capital stock of GATR Technologies, LLC (GATR), a defense systems business based in Huntsville, Alabama which manufactures deployable satellite communication terminal solutions. GATR expands our satellite communications and networking applications technologies for our CGD Systems segment and expands our customer base.

GATR's sales and net loss after taxes included in our Condensed Consolidated Statements of Income (Loss) totaled $18.5 million and $0.3 million, respectively, for the quarter ended December 31, 2016. The GATR operating results for the quarter includes a gain of $0.4 million for the decrease in the fair value of contingent consideration and charges of $3.6 million for the amortization of intangibles.

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The estimated acquisition-date fair value of consideration is $220.5 million, which is comprised of cash paid of $236.1 million plus the estimated fair value of contingent consideration of $2.5 million, less $18.1 million of cash paid to the seller that was recognized as expense in fiscal 2016. Under the purchase agreement, we will pay the sellers up to $7.5 million of contingent consideration if GATR meets certain gross profit goals for the 12 month periods ended February 28, 2017 and 2018. The contingent consideration liability will be re-measured to fair value at each reporting date until the contingencies are resolved and any changes in fair value are recognized in earnings.

The acquisition of GATR was paid for predominantly with the proceeds of borrowings on our revolving credit agreement, described below, in the second quarter of fiscal 2016. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in millions):

Customer relationships	$ 51.7
Backlog	3.4
Technology	10.7
Non-compete agreements	1.2
Trade name	4.7
Accounts receivable	10.6
Inventory	3.4
Income tax receivable	5.1
Accounts payable and accrued expenses	(2.4)
Deferred tax liabilities	(23.8)
Net identifiable assets acquired	64.6
Goodwill	155.9
Net assets acquired	$ 220.5

The fair values of purchased intangibles were determined using the valuation methodology deemed to be the most appropriate for each type of asset being valued. The customer relationships and backlog valuation used the excess earnings approach, the non-compete agreements used the with-and-without approach, and the technology and trade name asset valuations used the relief from royalty approach.

The intangible assets are being amortized using a combination of straight-line and accelerated methods based on the expected cash flows from the assets, over a weighted average useful life of nine years from the date of acquisition.

The goodwill resulting from the acquisition consists primarily of the synergies expected from combining the operations of GATR with our existing CGD Systems business, including the synergies expected from combining its satellite communications and networking applications technologies with our C4ISR products and other products in our CGD Systems portfolio. The goodwill also includes the value of the assembled workforce that became our employees following the close of the acquisition. The amount recorded as goodwill is allocated to our CGD Systems segment and is generally not expected to be deductible for tax purposes.

The estimated amortization expense related to the intangible assets recorded in connection with our acquisition of GATR for fiscal years 2017 through 2021 and thereafter is as follows (in millions):

Year Ended September 30,	
2017	$ 12.7
2018	11.1
2019	9.8
2020	8.3
2021	6.9
Thereafter	13.2

TeraLogics

On December 21, 2015, we acquired all of the assets of TeraLogics, LLC, an Ashburn, Virginia-based provider of real-time full motion video processing, exploitation and dissemination for the Department of Defense, the intelligence

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community and commercial customers. TeraLogics' ability to develop real-time video analysis and delivery software for full motion video complements the existing tactical communications portfolio of our CGD Systems segment and expands our customer base. For the three months ended December 31, 2016, the amounts of TeraLogics sales and net loss after taxes included in our Condensed Consolidated Statements of Income (Loss) were $6.2 million and $0.1 million, respectively. During the three months ended December 31, 2016, TeraLogics incurred charges of $1.0 million for the amortization of intangibles. For the quarter ended December 31, 2015, TeraLogics did not have significant sales and we incurred $0.4 million of transaction and acquisition expenses and a $1.3 million charge for compensation expense incurred related to amounts paid to TeraLogics employees upon the close of the acquisition. Primarily as a consequence of these charges, the net loss after taxes related to the TeraLogics acquisition was $1.5 million in the first quarter of fiscal 2016.

The estimated acquisition-date fair value of consideration is $33.9 million, which is comprised of cash paid of $28.9 million plus the estimated acquisition-date fair value of contingent consideration of $5.0 million. Under the purchase agreement, we will pay the sellers up to $9.0 million of contingent consideration. Of this amount, up to $6.0 million will be paid if TeraLogics meets certain revenue thresholds in fiscal years 2016, 2017 and 2018; and up to $3.0 million will be paid if specific contract extensions are exercised by TeraLogics customers through fiscal 2018. The contingent consideration liability will be re-measured to fair value at each reporting date until the contingencies are resolved and any changes in fair value are recognized in earnings.

Through December 31, 2016 we have paid $32.4 million to the seller. At December 31, 2016 we have recorded a liability of $2.9 million as an estimate of the additional cash consideration that will be due to the seller in the future.

The acquisition of TeraLogics is being paid for with a combination of funds from our existing cash resources and borrowings on our revolving credit facility. The following table summarizes the fair values of the assets acquired and liabilities assumed at the acquisition date (in millions):

Customer relationships	$ 6.7
Backlog	5.6
Software	2.5
Non-compete agreements	0.1
Accounts receivable	1.4
Accounts payable and accrued expenses	(0.5)
Other net assets acquired (liabilities assumed)	(0.1)
Net identifiable assets acquired	15.7
Goodwill	18.2
Net assets acquired	$ 33.9

The fair values of purchased intangibles were determined using the valuation methodology deemed to be the most appropriate for each type of asset being valued. The customer relationships and backlog valuation used the excess

earnings approach, the non-compete agreements used the with-and-without approach, and the software used the replacement cost new less cost decrements for obsolescence approach.

The intangible assets are being amortized using a combination of straight-line and accelerated methods based on the expected cash flows from the assets, over a weighted average useful life of seven years from the date of acquisition.

The goodwill resulting from the acquisition consists primarily of the synergies expected from combining the operations of TeraLogics with our existing CGD Systems business, including the synergies expected from combining TeraLogics real-time video capabilities with our existing tactical communications product portfolio. The goodwill also includes the value of the assembled workforce who became our employees following the close of the acquisition. The amount recorded as goodwill is allocated to our CGD Systems segment and is expected to be deductible for tax purposes.

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The estimated amortization expense amounts related to the intangible assets recorded in connection with our acquisition of TeraLogics for fiscal years 2017 through 2021 and thereafter is as follows (in millions):

Year Ended September 30,	
2017	$ 3.5
2018	2.8
2019	2.1
2020	1.4
2021	0.8
Thereafter	1.4

H4 Global

On November 4, 2015, we acquired all of the assets of H4 Global, a U.K.-based provider of simulation-based training solutions which complements our CGD Systems segment training portfolio. For the three months ended December 31, 2016, the amounts of H4 Global's sales and net income after taxes included in our Condensed Consolidated Statements of Income (Loss) were $0.7 million and $0.2 million, respectively. In the short time period between our acquisition of H4 Global and December 31, 2015, H4 Global did not have significant sales or net income. During the quarter ended December 31, 2015, we incurred $0.1 million of transaction costs to acquire H4 Global.

The acquisition-date fair value of consideration is $1.9 million, which is comprised of cash paid of $0.9 million plus the fair value of contingent consideration of $1.0 million. Under the purchase agreement, we will pay the sellers up to $4.1 million of contingent consideration, based upon the value of contracts entered over the five-year period beginning on the acquisition date. The contingent consideration liability will be re-measured to fair value at each reporting date until the contingencies are resolved and any changes in fair value will be recognized in earnings. There has been no significant change in the fair value of contingent consideration since the date of the acquisition.

The fair value of the net assets acquired and liabilities assumed was not material. Consequently, virtually the entire purchase price of $1.9 million was recorded as goodwill, which is comprised of expected synergies and assembled workforce. The amount recorded as goodwill is allocated to our CGD Systems segment and is not expected to be deductible for tax purposes.

Pro forma information

The following unaudited pro forma information presents our consolidated results of operations as if Vocality, GATR, TeraLogics and H4 Global had been included in our consolidated results since October 1, 2015 (in millions):

	Three Months Ended December 31,	
	2016	2015
Net sales	$ 334.9	$ 334.1
Net loss	$ (3.1)	$ (5.8)

The pro forma information includes adjustments to give effect to pro forma events that are directly attributable to the acquisitions and have a continuing impact on operations including the amortization of purchased intangibles and the elimination of interest expense for the repayment of debt. No adjustments were made for transaction expenses, other adjustments that do not reflect ongoing operations or for operating efficiencies or synergies. The pro forma financial information is not necessarily indicative of what the consolidated financial results of our operations would have been had the acquisitions been completed on October 1, 2015, and it does not purport to project our future operating results.

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Changes in goodwill for the three months ended December 31, 2016 were as follows (in millions):

	Transportation Systems	Cubic Global Defense Systems	Cubic Global Defense Services	Total
Net balances at September 30, 2016	$ 49,630	$ 262,966	$ 94,350	$ 406,946
Acquisitions	—	3,647	—	3,647
Foreign currency exchange rate changes	(1,882)	(339)	—	(2,221)
Net balances at December 31, 2016	$ 47,748	$ 266,274	$ 94,350	$ 408,372

Goodwill represents the purchase price paid in excess of the fair value of net tangible and intangible assets acquired. Goodwill is not amortized but is subject to an impairment test on an annual basis and when circumstances indicate that an impairment is more-likely-than-not. Such circumstances include a significant adverse change in the business climate for one of our reporting units or a decision to dispose of a reporting unit or a significant portion of a reporting unit. The test for goodwill impairment is a two-step process. The first step of the test is performed by comparing the fair value of each reporting unit to its carrying value, including recorded goodwill. If the carrying value of a reporting unit exceeds its fair value, the second step is performed to measure the amount of the impairment, if any, by comparing the implied fair value of goodwill to its carrying value. Any resulting impairment determined would be recorded in the current period.

Our most recent annual goodwill impairment test was our 2016 annual impairment test completed on July 1, 2016. Subsequent to the effective date of that test, we do not believe that circumstances have occurred that indicate that an impairment is more-likely-than-not. As such, no subsequent interim impairment test has been performed. The results of our 2016 annual impairment test indicated that the estimated fair values for our CGD Services and Transportation Systems reporting units each exceeded their carrying values by over 20%, while the estimated value of our CGD Systems reporting unit exceeded its carrying value by over 15%.

Significant management judgment is required in the forecast of future operating results that are used in our impairment analysis. The estimates we used are consistent with the plans and estimates that we use to manage our business. For our CGD Services reporting unit, significant assumptions utilized in our discounted cash flow approach included growth rates for sales and margins at greater levels than we have achieved in the past six years, but at levels that are less than the average annual growth we achieved over the period from fiscal 2000 through fiscal 2010. Although we believe our underlying assumptions supporting this assessment are reasonable, if our forecasted sales and margin growth rates, timing of growth, or the discount rate vary from our forecasts, we may be required to perform an interim analysis in 2017 that could expose us to material impairment charges in the future. Assumptions

used in our discounted cash flow approach for our CGD Systems reporting unit also included growth rates for sales and margins at greater levels than we have achieved in recent years due to our expectation that businesses recently acquired by this reporting unit will achieve growth at higher rates than the unit's legacy operations. While our interim assessment of our reporting units did not indicate that impairment was more-likely-than-not for any reporting unit, we believe that, based on the results achieved by our CGD Services reporting unit in the first quarter of fiscal 2017, there is a heightened risk that a step two impairment test could be required in the future.

Unforeseen negative changes in future business or other market conditions for any of our reporting units including margin compression or loss of business, could cause recorded goodwill to be impaired in the future. Also, changes in estimates and assumptions we make in conducting our goodwill assessment could affect the estimated fair value of our reporting units and could result in a goodwill impairment charge in a future period.

Note 3 — Net Income (Loss) Per Share

Basic net income (loss) per share (EPS) is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period, including vested restricted stock units (RSUs).

In periods with a net income, diluted EPS is computed by dividing the net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of dilutive restricted stock units. Dilutive restricted stock units are calculated based on the average share price for each fiscal period using the treasury stock method. For RSUs with performance-based vesting, no common equivalent shares

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are included in the computation of diluted EPS until the related performance criteria have been met. In periods with a net loss, common equivalent shares are not included in the computation of diluted EPS, because to do so would be anti-dilutive. For the three months ended December 31, 2016 and December 31, 2015, the effect of 1.1 million and 0.8 million shares of restricted stock, respectively, were excluded from diluted loss per share that would have been included if we had been in a net income position.

Basic and diluted EPS are computed as follows (amounts in thousands, except per share data).

	Three Months Ended December 31,	
	2016	2015
Net loss	$ (2,868)	$ (5,414)
Weighted average shares - basic	27,086	26,964
Effect of dilutive securities	—	—
Weighted average shares - diluted	27,086	26,964
Net loss per share, basic	$ (0.11)	$ (0.20)
Effect of dilutive securities	—	—
Net loss per share, diluted	$ (0.11)	$ (0.20)

Note 4 — Balance Sheet Details

Marketable Securities

Marketable securities consist of fixed time deposits with short-term maturities. Marketable securities are classified and accounted for as available-for-sale. These investments are recorded at fair value in the accompanying Condensed Consolidated Balance Sheets and the change in fair value is recorded, net of taxes, as a component of other

comprehensive loss. There have been no significant realized or unrealized gains or losses on these marketable securities to date. Marketable securities have been classified as current assets in the accompanying Condensed Consolidated Balance Sheets based upon the nature of the securities and availability for use in current operations.

Accounts Receivable

The components of accounts receivable are as follows (in thousands):

	December 31, 2016	September 30, 2016
Trade and other receivables	$ 12,494	$ 15,488
Long-term contracts:		
Billed	115,004	146,619
Unbilled	236,558	241,726
Allowance for doubtful accounts	(320)	(326)
Total accounts receivable	363,736	403,507
Less estimated amounts not currently due	(21,130)	(20,926)
Current accounts receivable	$ 342,606	$ 382,581

The amount classified as not currently due is an estimate of the amount of long-term contract accounts receivable that will not be collected within one year from December 31, 2016 under transportation systems contracts in the U.S. and Australia, and under a CGD Systems contract in Italy based upon the payment terms in the contracts. The non-current balance at September 30, 2016 represented non-current amounts due from these same customers.

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Inventories

Inventories consist of the following (in thousands):

	December 31, 2016	September 30, 2016
Finished products	$ 9,930	$ 10,018
Work in process and inventoried costs under long-term contracts	90,421	62,570
Materials and purchased parts	10,800	12,102
Customer advances	(12,441)	(18,328)
Net inventories	$ 98,710	$ 66,362

Pursuant to contract provisions, agencies of the U.S. government and certain other customers have title to, or security interest in, inventories related to such contracts as a result of advances, performance-based payments, and progress payments. Contract advances, performance-based payments and progress payments received are recorded as an offset against the related inventory balances for contracts that are accounted for on a percentage-of-completion basis using units-of-delivery as the basis to measure progress toward completing the contract. This determination is performed on a contract by contract basis. Any amount of payments received in excess of the cumulative amount of accounts receivable and inventoried costs for a contract is classified as customer advances, which is classified as a liability on the balance sheet.

At December 31, 2016, work in process and inventoried costs under long-term contracts includes approximately $1.0 million in costs incurred outside the scope of work or in advance of a contract award compared to $0.7 million at September 30, 2016. We believe it is probable that we will recover the costs inventoried at December 31, 2016, plus a profit margin, under contract change orders or awards within the next year.

Long-term Capitalized Costs

Long-term capitalized contract costs include costs incurred on contracts to develop and manufacture transportation systems for customers for which revenue recognition does not begin until the customers begin operating the systems. These capitalized costs are being recognized in cost of sales based upon the ratio of revenue recorded during a period compared to the revenue expected to be recognized over the term of the contracts. Long-term capitalized costs that were recognized as cost of sales totaled $2.4 million and $2.0 million for the quarters ended December 31, 2016 and

2015, respectively.

Capitalized Software

We capitalize certain costs associated with the development or purchase of internal-use software. The amounts capitalized are included in property, plant and equipment in our Condensed Consolidated Balance Sheets and are amortized on a straight-line basis over the estimated useful life of the software, which ranges from three to seven years. No amortization expense is recorded until the software is ready for its intended use.

As a part of our efforts to upgrade our current information systems, early in fiscal 2015 we purchased new enterprise resource planning (ERP) software and began the process of designing and configuring this software and other software applications to manage our operations. Certain components of our ERP system became ready for their intended use and were placed into service on April 1, 2016 and on October 1, 2016 at which time the capitalized costs of developing those components were transferred into completed software and we began amortizing these costs over the seven year estimated useful life of these software components.

We continue to capitalize costs associated with the development of other ERP components that are not yet ready for their intended use. During the quarters ended December 31, 2016 and 2015 we capitalized costs totaling $2.0 million and $7.3 million, respectively, related to ERP components in development.

In addition to software costs that were capitalized, during the three months ended December 31, 2016 and 2015 we recognized expense related to the development and implementation of our ERP system of $6.3 million and $5.3 million,

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respectively, for costs that did not meet the requirements for capitalization. Amounts that were expensed in connection with the development and implementation of these systems are classified within selling, general and administrative expenses in the Condensed Consolidated Statements of Income (Loss).

Deferred Compensation Plan

We have a non-qualified deferred compensation plan offered to a select group of highly compensated employees. The plan provides participants with the opportunity to defer a portion of their compensation in a given plan year. The liabilities associated with the non-qualified deferred compensation plan are included in other long-term liabilities in our Condensed Consolidated Balance Sheets and totaled $11.3 million and $10.6 million at December 31, 2016 and September 30, 2016, respectively.

In the first quarter of fiscal 2015, we began making contributions to a rabbi trust to provide a source of funds for satisfying a portion of these deferred compensation liabilities. The total carrying value of assets set aside to fund deferred compensation liabilities as of December 31, 2016 was $4.8 million, which included life insurance contracts with a carrying value of $3.5 million and marketable securities with a carrying value of $1.3 million. At September 30, 2016, the total carrying value of assets set aside to fund deferred compensation liabilities was $3.6 million, comprised entirely of life insurance contracts. The carrying value of the life insurance contracts is based on the cash surrender value of the policies. The marketable securities in the rabbi trust are carried at fair value, which is based upon quoted market prices for identical securities. Changes in the carrying value of the deferred compensation liability, and changes in the carrying value of the assets held in the rabbi trust are reflected in our Condensed Consolidated Statements of Income (Loss).

Note 5 — Fair Value of Financial Instruments

The valuation techniques required to determine fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect internal market assumptions. The two types of inputs create the following fair value hierarchy:

- Level 1 - Quoted prices for identical instruments in active markets.
- Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3 - Significant inputs to the valuation model are unobservable.

The fair value of certain of our cash equivalents are based upon quoted prices for identical instruments in active markets. The fair value of our other cash equivalents and our available for sale marketable securities is based upon a discounted cash flow model and approximate cost. The marketable securities in the rabbi trust are carried at fair value, which is based upon quoted market prices for identical securities. Derivative financial instruments are measured at fair value, the material portions of which are based on active or inactive markets for identical or similar instruments or model-derived valuations whose inputs are observable. Where model-derived valuations are appropriate, we use the applicable credit spread as the discount rate. Credit risk related to derivative financial instruments is considered minimal and is managed by requiring high credit standards for counterparties and through periodic settlements of positions.

The fair value of our contingent consideration liabilities to the sellers of businesses that we have acquired are revalued to their fair value each period and any increase or decrease is recorded into selling, general and administrative expense. Any changes in the assumed timing and amount of the probability of payment scenarios could impact the fair value.

The fair value of contingent consideration liabilities that are based upon revenue targets or gross margin targets are based upon a real option approach. The contingent consideration liabilities that are valued using this real option approach include a portion of the TeraLogics contingent consideration, the DTECH contingent consideration, and the GATR contingent consideration. Under this real option approach, each payment was modeled using long digital options written on the underlying revenue or gross margin metric. The strike price for each option is the respective revenue or gross margin as specified in the related agreement, and the spot price is calibrated to the revenue or gross margin forecast by calculating the present value of the corresponding projected revenues or gross margins using a risk-adjusted discount rate. The volatility for the underlying revenue metrics was based upon analysis of comparable guideline public companies and the volatility factor used in the December 31, 2016 valuations was 18% for TeraLogics, 20% for DTECH and 17% for GATR. The volatility factor used in the September 30, 2016 valuation was 17% for TeraLogics, 18% for

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DTECH and 17% for GATR. The risk-free rate was selected based on the quoted yields for U.S. Treasury securities with terms matching the earn-out payment period.

The fair value of the portion of the TeraLogics contingent consideration that is based on customer execution of contract extensions was estimated using a probability weighted approach. Subject to the terms and conditions of the TeraLogics Purchase Agreement, contingent consideration will be paid over a period commencing on the closing date and ending on December 21, 2018. The fair value of the contingent consideration was determined by applying probabilities of achieving the periodic payment to each period’s potential payment, and summing the present value of any future payments.

The fair value of the H4 Global contingent consideration was estimated using a probability weighted approach. Subject to the terms and conditions of the H4 Global Purchase Agreement, contingent consideration will be paid over a five year term that commenced on October 1, 2015 and ends on September 30, 2020. The payments will be calculated based on the award of certain contracts during the specified period. The fair value of the contingent consideration was determined by applying probabilities to different scenarios, and summing the present value of any future payments.

The inputs to each of the contingent consideration fair value models include significant unobservable inputs and therefore represent Level 3 measurements within the fair value hierarchy. Significant judgment is employed in determining the appropriateness of these assumptions as of the acquisition dates and each subsequent period. Accordingly, changes in the assumptions described above can materially impact the amount of contingent consideration expense we record in any period.

As of December 31, 2016, the following table summarizes the change in fair value of our Level 3 contingent consideration liability (in thousands):

	DTECH	H4	TeraLogics (Contract Extensions)	TeraLogics (Revenue Targets)	GATR	Total
Balance as of September 30, 2016	$ 2,000	$ 567	$ 1,400	$ 4,100	$ 3,200	$ 11,267
Cash paid to seller	—	—	—	(2,500)	—	(2,500)
Total remeasurement (gain) loss recognized in earnings	(700)	(114)	100	(200)	(400)	(1,314)
Balance as of December 31, 2016	$ 1,300	$ 453	$ 1,500	$ 1,400	$ 2,800	$ 7,453

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The following table presents assets and liabilities measured and recorded at fair value on our balance sheets on a recurring basis (in thousands):

	December 31, 2016				September 30, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Cash equivalents	$ 65,773	$ —	$ —	$ 65,773	$ 57,455	$ —	$ —	$ 57,455
Marketable securities	—	12,353	—	12,353	—	12,996	—	12,996
Current derivative assets	—	4,473	—	4,473	—	14,770	—	14,770
Noncurrent derivative assets	—	1,151	—	1,151	—	1,201	—	1,201
Marketable securities in rabbi trust	1,297	—	—	1,297	4	—	—	4
Total assets measured at fair value	67,070	17,977	—	85,047	57,459	28,967	—	86,426
Liabilities								
Current derivative liabilities	—	4,066	—	4,066	—	13,752	—	13,752
Noncurrent derivative liabilities	—	1,151	—	1,151	—	1,334	—	1,334
Contingent consideration to seller of GATR	—	—	2,800	2,800	—	—	3,200	3,200
Contingent consideration to seller of TeraLogics - contract extensions	—	—	1,500	1,500	—	—	1,400	1,400
Contingent consideration to seller of TeraLogics - revenue targets	—	—	1,400	1,400	—	—	4,100	4,100

Contingent consideration to seller of H4 Global	—	—	453	453	—	—	567	567
Contingent consideration to seller of DTECH	—	—	1,300	1,300	—	—	2,000	2,000
Total liabilities measured at fair value	$ —	$ 5,217	$ 7,453	$ 12,670	$ —	$ 15,086	$ 11,267	$ 26,353

We carry certain financial instruments, including accounts receivable, short-term borrowings, accounts payable and accrued liabilities at cost, which we believe approximates fair value because of the short-term maturity of these instruments.

The fair value of long-term debt is calculated by discounting the value of the note based on market interest rates for similar debt instruments, which is a Level 2 technique. The following table presents the estimated fair value and carrying value of our long-term debt (in millions):

	December 31, 2016	September 30, 2016
Fair value	$ 199.3	$ 210.0
Carrying value	$ 200.9	$ 201.0

Note 6 — Financing Arrangements

In March 2013, we entered into a note purchase and private shelf agreement pursuant to which we issued $100.0 million of senior unsecured notes, bearing interest at a rate of 3.35% and maturing on March 12, 2025. In addition, pursuant to the agreement, on July 17, 2015, we issued an additional $25.0 million of senior unsecured notes bearing interest at a rate of 3.70% and maturing on March 12, 2025. Interest payments on the notes issued in 2013 and 2015 are due semi-annually and principal payments are due from 2021 through 2025. On February 2, 2016, we revised the note purchase agreement and we issued an additional $75.0 million of senior unsecured notes bearing interest at 3.93% and maturing on March 12, 2026. Interest payments on these notes are due semi-annually and principal payments are due from 2020

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through 2026. At the time of the issuance of the last series of notes, certain terms and conditions of the note purchase and private shelf agreement were revised in coordination with the revision and expansion of the revolving credit agreement as discussed below in order to increase our leverage capacity.

We have a committed revolving credit agreement with a group of financial institutions in the amount of $400.0 million which expires in August 2021 (Revolving Credit Agreement). At December 31, 2016, the weighted average interest rate on outstanding borrowings under the Revolving Credit Agreement was 2.96%. Debt issuance costs of $2.3 million and $1.3 million were incurred in connection with February 2, 2016 and August 11, 2016 amendments to the Revolving Credit Agreement, respectively. Debt issuance costs incurred in connection with establishment of and amendments to this credit agreement are recorded in prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets, and are being amortized as interest expense using the effective interest method over the stated term of the Revolving Credit Agreement. At December 31, 2016, the Company's total debt issuance costs have an unamortized balance of $2.9 million. The available line of credit is reduced by any letters of credit issued under the Revolving Credit Agreement. As of December 31, 2016, there were borrowings totaling $241.8 million under this agreement and there were letters of credit outstanding totaling $17.1 million, which reduce the available line of credit to $141.1 million.

We have a secured letter of credit facility agreement with a bank (Secured Letter of Credit Facility) which is cancellable by us at any time upon the completion of certain conditions to the satisfaction of the bank. At December 31, 2016, there were letters of credit outstanding under this agreement of $62.1 million. Restricted cash at December 31, 2016 of $69.5 million was held on deposit in the U.K. as collateral in support of this Secured Letter of Credit Facility. We are required to leave the cash in the restricted account so long as the bank continues to maintain associated letters of credit under the facility. The maximum amount of letters of credit currently allowed by the facility is $63.2 million, and any increase above this amount would require bank approval and additional restricted funds to be placed on deposit. We may choose at any time to terminate the facility and move the associated letters of credit to another credit facility. Letters of credit outstanding under the Secured Letter of Credit Facility do not reduce the available line of credit under the Revolving Credit Agreement.

We maintain a cash account with a bank in the United Kingdom for which the funds are restricted as to use. The account is required to secure the customer's interest in cash deposited in the account to fund our activities related to our performance under a fare collection services contract in the United Kingdom. The balance in the account as of December 31, 2016 was $10.3 million and is classified as restricted cash in our Condensed Consolidated Balance Sheets.

As of December 31, 2016, we had letters of credit and bank guarantees outstanding totaling $75.2 million, including the letters of credit outstanding under the Revolving Credit Agreement and the Secured Letter of Credit Facility, which guarantee either our performance or customer advances under certain contracts. In addition, we had financial letters of credit outstanding totaling $17.0 million as of December 31, 2016, which primarily guarantee our payment of certain self-insured liabilities. We have never had a drawing on a letter of credit instrument, nor are any anticipated; therefore, we estimate the fair value of these instruments to be zero.

We maintain short-term borrowing arrangements in New Zealand and Australia totaling $0.5 million New Zealand dollars (equivalent to approximately $0.4 million) and $3.0 million Australian dollars (equivalent to approximately $2.2 million) to help meet the short-term working capital requirements of our subsidiaries in those countries. At December 31, 2016, no amounts were outstanding under these borrowing arrangements.

The terms of certain of our lending and credit agreements include provisions that require and/or limit, among other financial ratios and measurements, the permitted levels of debt, coverage of cash interest expense, and under certain circumstances, payments of dividends or other distributions to shareholders. As of December 31, 2016, these agreements restrict such distributions to shareholders to a maximum of $46.4 million in fiscal year 2017.

Our self-insurance arrangements are limited to certain workers' compensation plans, automobile liability and product liability claims. Under these arrangements, we self-insure only up to the amount of a specified deductible for each claim. Self-insurance liabilities included in other current liabilities on the balance sheet amounted to $7.9 million and $8.2 million as of December 31, 2016 and September 30, 2016, respectively.

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Note 7 — Pension Plans

The components of net periodic pension cost are as follows (in thousands):

	Three Months Ended December 31,	
	2016	2015
Service cost	$ 151	$ 158
Interest cost	1,759	2,261
Expected return on plan assets	(3,199)	(3,472)
Amortization of actuarial loss	910	413
Administrative expenses	47	41
Net pension benefit	$ (332)	$ (599)

Note 8 - Stockholders' Equity

Long-Term Equity Incentive Plan

In 2013, the Executive Compensation Committee of our Board of Directors (Compensation Committee) approved a long-term equity incentive award program. Through December 31, 2016, the Compensation Committee has granted 907,573 RSUs with time-based vesting and 993,298 RSUs with performance-based vesting under this program.

Each RSU represents a contingent right to receive one share of our common stock. Dividend equivalent rights accrue with respect to the RSUs when and as dividends are paid on our common stock and vest proportionately with the RSUs to which they relate. Vested shares are delivered to the recipient following each vesting date.

The RSUs granted with time-based vesting generally vest in four equal installments on each of the four October 1 dates following the grant date, subject to the recipient's continued service through such vesting date.

The performance-based RSUs granted to participants vest over three-year performance periods based on Cubic's achievement of performance goals established by the Compensation Committee over the performance periods, subject to the recipient's continued service through the end of the respective performance periods. For the performance-based RSUs granted to date, the vesting will be contingent upon Cubic meeting one of three types of vesting criteria over the performance period. These three categories of vesting criteria consist of revenue growth targets, earnings growth targets, and return on equity targets. The level at which Cubic's performs against scalable targets over the performance periods will determine the percentage of the RSUs that will ultimately vest.

Through December 31, 2016, Cubic has granted 1,900,871 RSUs of which 442,836 have vested. The grant date fair value of each RSU is the fair market value of one share of our common stock at the grant date. At December 31, 2016, the total number of unvested RSUs that are ultimately expected to vest, after consideration of expected forfeitures and estimated vesting of performance-based RSUs, is 568,965.

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The following table summarizes our RSU activity:

	Unvested Restricted Stock Units	
	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested at September 30, 2016	889,129	$ 45.98
Granted	455,334	46.12
Vested	(149,577)	46.36
Forfeited	(60,022)	49.01
Unvested at December 31, 2016	1,134,864	$ 45.83

Note 9 - Stock-Based Compensation

We recorded non-cash compensation expense related to stock-based awards for the three-month period ended December 31, 2016 and 2015 as follows (in thousands):

	Three Months Ended December 31,	
	2016	2015
Cost of sales	$ 175	$ 319
Selling, general and administrative	2,139	1,799
	$ 2,314	$ 2,118

As of December 31, 2016, there was $48.4 million of unrecognized compensation cost related to unvested RSUs. Based upon the expected forfeitures and the expected vesting of performance based RSUs, the aggregate fair value of RSUs expected to ultimately vest is $26.1 million. This amount is expected to be recognized over a weighted-average period of 1.6 years.

We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods on a cumulative basis in the period the estimated forfeiture rate changes for all stock-based awards when significant events occur. We consider our historical experience with employee turnover as the basis to arrive at our estimated forfeiture rate. The forfeiture rate was estimated to be 12.5% per year as of December 31, 2016. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation related to these awards will be different from our expectations.

Note 10 – Income Taxes

Our effective tax rate for the three months ended December 31, 2016 was 64% as compared to123% for the year ended September 30, 2016. The effective tax rate for the three months ended December 31, 2016 was lower than the prior full year effective tax rate primarily due to benefits recorded in the prior year related to the release of a portion of the existing valuation allowance against U.S. deferred tax assets due to deferred tax liabilities acquired in business combinations, offset by nondeductible acquisition related compensation expenses. In addition, the effective tax rate for the three months ended December 31, 2016 differs from the U.S. statutory tax rate of 35% primarily due to an increased valuation allowance on U.S. deferred tax assets offset by expected benefits from research and development tax credits.

The amount of net unrecognized tax benefits was $11.5 million as of December 31, 2016 and $10.2 million as of September 30, 2016, exclusive of interest and penalties. The increase in net unrecognized tax benefits was primarily related to the reclassification of tax contingencies from contra deferred tax assets to FASB Interpretation No. 48 liabilities, as those deferred tax assets are expected to be utilized. At December 31, 2016, the amount of net unrecognized tax benefits from permanent tax adjustments that, if recognized, would favorably impact the effective rate was $8.7 million. During the next 12 months, it is reasonably possible that resolution of reviews by taxing authorities, both domestic and international, could be reached with respect to approximately $6.3 million of the net unrecognized tax benefits depending on the timing of examinations and expiration of statute of limitations, either because our tax positions are sustained or because we agree to their disallowance and pay the related income tax.

We are subject to ongoing audits from various taxing authorities in the jurisdictions in which we do business. As of December 31, 2016, the years open under the statute of limitations in significant jurisdictions include fiscal years 2012-

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2016 in the U.S. We believe we have adequately provided for uncertain tax issues that have not yet been resolved with federal, state and foreign tax authorities.

The Company evaluated its net deferred income taxes, which included an assessment of the cumulative income or loss over the prior-three year period and future periods, to determine if a valuation allowance is required. After considering its recent history of U.S. losses, the Company recorded a valuation allowance during fiscal year 2015 on its net U.S. deferred tax assets, with a corresponding charge to its income tax provision of $35.8 million. As of December 31, 2016, the Company maintained a valuation allowance against its U.S. deferred tax assets as realization of such assets does not meet the more-likely-than-not threshold required under accounting guidelines. The Company will continue to assess the need for a valuation allowance on deferred tax assets by evaluating positive and negative evidence that may exist. Through December 31, 2016, a total valuation allowance of $43.3 million has been established for U.S. net deferred tax assets, certain foreign operating losses and other foreign assets.

If sufficient positive evidence arises in the future, such as a sustained return to profitability in the U.S., any existing valuation allowance could be reversed as appropriate, decreasing income tax expense in the period that such conclusion is reached. Until the Company re-establishes a pattern of continuing profitability in the U.S. tax jurisdiction, in accordance with the applicable accounting guidance, U.S. income tax expense or benefit related to the recognition of deferred tax assets in the condensed consolidated statement of operations for future periods will be offset by decreases or increases in the valuation allowance with no net effect on the Consolidated Condensed Statements of Income (Loss).

Note 11 — Derivative Instruments and Hedging Activities

In order to manage our exposure to fluctuations in interest and foreign currency exchange rates we utilize derivative financial instruments such as forward starting swaps and foreign currency forwards for periods typically up to three years. We do not use any derivative financial instruments for trading or other speculative purposes.

All derivatives are recorded at fair value, however, the classification of gains and losses resulting from changes in the fair values of derivatives are dependent on the intended use of the derivative and its resulting designation. If a derivative is designated as a fair value hedge, then a change in the fair value of the derivative is offset against the change in the fair value of the underlying hedged item and only the ineffective portion of the hedge, if any, is recognized in earnings. If a derivative is designated as a cash flow hedge, then the effective portion of a change in the fair value of the derivative is recognized as a component of accumulated other comprehensive loss until the underlying hedged item is recognized in earnings, or the forecasted transaction is no longer probable of occurring. If a derivative does not qualify as a highly effective hedge, any change in fair value is immediately recognized in earnings. We formally document all hedging relationships for all derivative hedges and the underlying hedged items, as well as the risk management objectives and strategies for undertaking the hedge transactions. We classify the fair value of all derivative contracts as current or non- current assets or liabilities, depending on the realized and unrealized gain or loss position of the hedged contract at the balance sheet date, and the timing of future cash flows. The cash flows from

derivatives treated as hedges are classified in the Condensed Consolidated Statements of Cash Flows in the same category as the item being hedged.

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The following table shows the notional principal amounts of our outstanding derivative instruments as of December 31, 2016 and September 30, 2016 (in thousands):

	Notional Principal	
	December 31, 2016	September 30, 2016
Instruments designated as accounting hedges:		
Foreign currency forwards	$ 142,209	$ 158,664
Instruments not designated as accounting hedges:		
Foreign currency forwards	$ 110,844	$ 115,070

Included in the amounts not designated as accounting hedges above at December 31, 2016 and September 30, 2016 are foreign currency forwards with notional principal amounts of $81.1 million and $78.4 million, respectively, that have been designed to manage exposure to foreign currency exchange risks, and for which the gains or losses of the changes in fair value of the forwards has approximately offset an equal and opposite amount of gains or losses related to the foreign currency exposure. Unrealized losses of $3.3 million and $4.9 million were recognized in other income (expense), net for the three months ended December 31, 2016 and 2015, respectively, related to foreign currency forwards not designated as accounting hedges.

The notional principal amounts for outstanding derivative instruments provide one measure of the transaction volume outstanding and do not represent the amount of the Company’s exposure to credit or market loss. Credit risk represents the Company’s gross exposure to potential accounting loss on derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current interest or currency exchange rates at each respective date. The Company’s exposure to credit loss and market risk will vary over time as a function of interest and currency exchange rates. The amount of credit risk from derivative instruments and hedging activities was not material for the periods ended December 31, 2016 and September 30, 2016. Although the table above reflects the notional principal amounts of the Company’s foreign exchange instruments, it does not reflect the gains or losses associated with the exposures and transactions that the foreign exchange instruments are intended to hedge. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The Company generally enters into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. The Company presents its derivative assets and derivative liabilities at their gross fair values. The Company did not have any derivative instruments with credit-risk related contingent features that would require it to post collateral as of December 31, 2016 or September 30, 2016.

The table below presents the fair value of our derivative financial instruments that qualify for hedge accounting as well as their classification in the Condensed Consolidated Balance Sheets as of December 31, 2016 and September 30, 2016 (in thousands):

		Fair Value	
	Balance Sheet Location	December 31, 2016	September 30, 2016
Asset derivatives:			
Foreign currency forwards	Other current assets	$ 4,472	$ 14,769
Foreign currency forwards	Other noncurrent assets	1,151	1,201
		$ 5,623	$ 15,970
Liability derivatives:			
Foreign currency forwards	Other current liabilities	$ 4,065	$ 13,752
Foreign currency forwards	Other noncurrent liabilities	1,151	1,333
Total		$ 5,216	$ 15,085

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The tables below present gains and losses recognized in other comprehensive loss for the three months ended December 31, 2016 and 2015 related to derivative financial instruments designated as cash flow hedges, as well as the amount of gains and losses reclassified into earnings during those periods (in thousands):

	Three Months Ended December 31, 2016		December 31, 2015	
Derivative Type	Gains (losses) recognized in OCI	Gains (losses) reclassified into earnings - Effective Portion	Gains (losses) recognized in OCI	Gains (losses) reclassified into earnings - Effective Portion
Foreign currency forwards	$ (614)	$ 1,331	$ (1,448)	$ 1,490

The amount of gains and losses from derivative instruments and hedging activities classified as not highly effective did not have a material impact on the results of operations for the three months ended December 31, 2016 and 2015. The amount of estimated unrealized net gains from cash flow hedges which are expected to be reclassified to earnings in the next twelve months is $0.3 million, net of income taxes.

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Note 12 — Segment Information

Business segment financial data is as follows (in millions):

	Three Months Ended December 31,	
	2016	2015
Sales:		
Cubic Transportation Systems	$ 131.9	$ 125.8
Cubic Global Defense Systems	112.5	95.9
Cubic Global Defense Services	90.3	92.1
Total sales	$ 334.7	$ 313.8
Operating income (loss):		
Cubic Transportation Systems	$ 9.7	$ 3.6
Cubic Global Defense Systems	(0.5)	(3.4)
Cubic Global Defense Services	(0.4)	0.2
Unallocated corporate expenses	(12.9)	(8.5)
Total operating income (loss)	$ (4.1)	$ (8.1)
Depreciation and amortization:		
Cubic Transportation Systems	$ 2.4	$ 2.5
Cubic Global Defense Systems	8.8	4.1
Cubic Global Defense Services	1.0	2.0
Corporate	1.2	0.3
Total depreciation and amortization	$ 13.4	$ 8.9

The increase in unallocated corporate costs includes the increase in costs incurred in the first quarter of 2017 for strategic and IT system resource planning as part of our One Cubic Initiatives totaling $8.7 million compared to $6.5 million in the first quarter of last year. Unallocated corporate costs for the first quarter of fiscal 2017 also included a loss of $0.4 million on the sale of real estate.

Changes in estimates on contracts for which revenue is recognized using the cost-to-cost-percentage-of-completion method decreased operating income by $6.4 million and $2.4 million for the three months ended December 31, 2016 and 2015, respectively.

These adjustments increased our net loss by $3.9 million ($0.14 per share) and $1.5 million ($0.06 per share) for the three months ended December 31, 2016 and 2015, respectively.

Note 13 — Legal Matters

In October 2014, a lawsuit was filed in the United States District Court, Northern District of Illinois against us and one of our transit customers alleging infringement of various patents held by the plaintiff, seeking judgment that we have infringed on plaintiff's patents; regular and treble damages; requiring an accounting of sales, profits, royalties and damages owed plaintiffs;