

CUBIC CORP /DE/
Form 10-K
November 22, 2016
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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, 2016

Commission File Number 001-08931

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	New York 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 No

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), 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 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 registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

The aggregate market value of 24,881,839 shares of common stock held by non-affiliates of the registrant was: \$994,278,286 as of March 31, 2016, based on the closing stock price on that date. Shares of common stock held by each officer and director and by each person or group who owns 10% or more of the outstanding common stock have been excluded in that such persons or groups may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares of common stock outstanding as of November 4, 2016 including shares held by affiliates is: 27,085,927 (after deducting 8,945,300 shares held as treasury stock).

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with its 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K. Such Proxy Statement will be filed with the Securities and Exchange Commission subsequent to the date hereof but not later than 120 days after registrant's fiscal year ended September 30, 2016.

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CUBIC CORPORATION

ANNUAL REPORT ON FORM 10-K

For the Year Ended September 30, 2016

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PART I

Item 1. BUSINESS.

GENERAL

CUBIC CORPORATION (Cubic) designs, integrates and operates systems, products and services that increase situational awareness for our customers in the transportation and defense industries. We believe that we have significant transportation and defense industry expertise which, combined with our innovative technology capabilities, contributes to our leading customer positions and allows us to deepen and further expand each of our business segments in key markets. We operate in three reportable business segments across the global transportation and defense markets.

Our Cubic Transportation Systems (CTS) business accounted for approximately 40% of our sales in fiscal year 2016. CTS specializes in the design, development, production, installation, maintenance and operation of automated fare payment, traffic management and enforcement solutions, real-time information systems, and revenue management infrastructure and technologies for transportation agencies. As part of our turnkey solutions, CTS also provides these customers with a comprehensive suite of business process outsourcing (BPO) services and expertise, such as card and payment media management, central systems and application support, retail network management, customer call centers and financial clearing and settlement support. As transportation authorities seek to optimize their operations by outsourcing bundled systems and services, CTS has transformed itself from a provider of automated fare collection (AFC) systems into a systems integrator and services company focused on the intelligent transportation market.

In February 2015, we implemented a plan to restructure our defense services and defense systems businesses into a single business called Cubic Global Defense (CGD) to better align our defense business organizational structure with customer requirements, increase operational efficiencies and improve collaboration and innovation across the company. After this restructuring there is now a single, combined management structure for our legacy Cubic Defense Systems (CDS) and legacy Mission Support Services (MSS) segments. However, for segment financial reporting purposes, we continue to report the financial results of our defense systems and defense services segments separately. These two reporting segments have been renamed Cubic Global Defense Systems (CGD Systems) and Cubic Global Defense Services (CGD Services), respectively. To date, there have been no significant changes in the operations that are included in each of these reporting segments as a result of the restructuring.

Our complementary defense businesses, CGD Services and CGD Systems, provided approximately 60% of our sales in fiscal year 2016. CGD Services provides comprehensive training and exercise, operations analysis, and modeling and simulation support, as well as training analysis, curriculum design, and operations and maintenance services to all four branches of the U.S. military, including the special operations forces, as well as to allied nations. In addition,

CGD Services offers a broad range of highly specialized national security solutions to the intelligence community. CGD Systems is a leading provider of realistic, high-fidelity air, ground and surface combat training systems for the U.S. and allied nations. These training solutions offer the latest live, virtual, constructive, and game-based technology, integrated to optimize training effectiveness. CGD Systems is also a key supplier of secure communications solutions, including Intelligence, Surveillance and Reconnaissance (ISR) data links, personnel locator systems for search and rescue missions, high power amplifiers for HF communications and cross domain products. In 2015 and 2016, we acquired DTECH LABs, Inc. (DTECH), GATR Technologies Inc. (GATR), and TeraLogics, LCC (TeraLogics) in connection with our strategic efforts to build and expand our command, control, communication, computers, intelligence, surveillance and reconnaissance (C4ISR) business. In the third quarter of fiscal 2016 we formalized the structure of Cubic Mission Solutions (CMS), our business unit which combines and integrates our C4ISR and secure communications operations within the CGD Systems segment.

We have a broad customer base across our businesses, with approximately 60% of our fiscal year 2016 sales generated from U.S. federal, state and local governments. Approximately 5% of these domestic sales were attributable to Foreign Military Sales, which are sales to allied foreign governments facilitated by the U.S. government. The remainder of our fiscal year 2016 sales were attributable to sales to foreign government and municipal agencies. In fiscal year 2016, 55% of our total sales were derived from services, with product sales accounting for the remaining 45%. Headquartered in San

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Diego, California, we had approximately 8,500 employees working on 5 continents and in 26 countries as of September 30, 2016.

We were incorporated in the State of California in 1949 and began operations in 1951. In 1984, we moved our corporate domicile to the State of Delaware. Our 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. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports can be found on our internet website under the heading “Investor Relations”. We make these reports readily available free of charge in a reasonably practicable time after we electronically file these materials with the Securities and Exchange Commission (the SEC).

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 16 to the Consolidated Financial Statements for the year ended September 30, 2016. 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 of Financial Condition and Results of Operations,” which follows in Item 7 of this Form 10-K.

TRANSPORTATION SYSTEMS SEGMENT

CTS is a systems integrator of payment and information technology and services for intelligent travel solutions. We deliver integrated systems for transportation and traffic management, delivering tools for travelers to choose the smartest and easiest way to travel and pay for their journeys, and enabling transportation authorities and agencies to manage demand across the entire transportation network — all in real time. We offer fare collection and revenue management devices, software, systems and multiagency, multimodal integration technologies, as well as a full suite of operational services that help agencies and operators efficiently collect fares and revenue, manage operations, reduce revenue leakage and make transportation more convenient. Through our NextBus and Intelligent Transport Management Solutions (ITMS) businesses, respectively, we also deliver real-time passenger information systems for tracking and predicting vehicle bus arrival times and we are a leading provider of urban and inter-urban intelligent transportation and enforcement solutions and technology and infrastructure maintenance services to UK and other international city, regional and national road and transportation agencies. Through our Urban Insights business we use big data and predictive analytics technology and a consulting model to help the transportation industry improve operations, reduce costs and better serve travelers.

CTS is comprised of approximately 2,400 employees working in major transportation markets worldwide. As an established partner with transportation authorities and operators, we have installed over 130,000 devices and deployed

over 20 regional central systems which in total process approximately 24 billion revenue-related transactions per year, generating more than \$18 billion of revenue per year for such transportation authorities and operators. Products accounted for 48% of the segment's fiscal year 2016 sales, with services accounting for the remaining 52%.

We believe that we hold the leading market position in large-scale automated fare payment and revenue management systems and services for major metropolitan areas. CTS has delivered over 20 regional back office operations which together serve over 38 million people every day in major markets around the world. We have implemented and, in many cases, operate, automated fare payment and revenue management systems for some of the world's largest transportation systems, examples include London (Oyster/Contactless Payment), the Chicago region (Ventra), the San Francisco Bay Area (Clipper), the Los Angeles region (TAP), the New York region (Metrocard), the Washington D.C. region (Smartrip), the Vancouver region (Compass), the Sydney region (Opal Card) and the Brisbane region (Go Card). In the first quarter of fiscal 2016 we were awarded a contract by the New Hampshire State Department of Transportation to deploy our back-office system for the purposes of toll revenue collection.

Through our NextBus, ITMS and Urban Insights businesses we provide advanced transportation operational management and analytics capabilities and related services to over 150 customers including organizations such as Transport for London, Transport Scotland, Highways England, Transport for Greater Manchester, Transport for New

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South Wales, Los Angeles Metro, San Francisco Muni, the Toronto Transit Commission and the Metropolitan Boston Transit Administration.

In addition to helping us secure similar projects in new markets, our comprehensive suite of new technologies and capabilities enables us to benefit from a recurring stream of revenues in established markets resulting from operations, innovative new services, technology obsolescence, equipment refurbishment and the introduction of new or adjacent applications.

Consistent with our history of creating next-generation, state-of-the-art technologies and systems, we are in the process of developing and implementing our NextCity initiative, which envisions integrated payment and information technology and services across all modes of transport. NextCity comprises a fully integrated solution offering innovative fare payment and revenue management technologies, the creation and distribution of real-time and predictive information through the integration of payment and information systems, applications that enable agencies and operators to plan for and manage demand and applications that allow customers to manage their travel through seamless access to predictive and relevant information and convenient payment methods.

Industry Overview

We define our addressable transportation market as large-scale, multi-modal transportation revenue management systems (e.g. public transit fare collection, toll collection), Real-Time Passenger Information and Intelligent Transportation Systems and services. We project the long-term growth for this market to be driven primarily by customer infrastructure expansion as well as technological obsolescence and advancement which will lead to replacements and upgrades. The average lifecycle of our revenue management systems is approximately 10 years, providing long-term recurring sales visibility and opportunities for future replacements and upgrades. Together with additional opportunities that stem from our other businesses as well as entry into new geographies, we believe our overall addressable market to be approximately \$12 billion. We believe industry experience, past performance, technological innovation and price are the key factors customers consider in awarding programs and such factors can serve as barriers to entry to potential competitors when coupled with scale and the upfront investments required for these programs.

The transportation systems and services business breaks into niche market segments, each of which is only capable of sustaining a relatively few number of suppliers. Due to the long life expectancy of these systems and the few companies with the capabilities to supply them, there is fierce competition to win new contracts, 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 transportation operators within

a single networked system. As such, there is a growing trend for regional payment systems, usually built around a large agency and including neighboring operators, all sharing a common regional payment media. Recent procurements for open payment systems will extend the acceptance of payment media from smart cards, to contactless bank cards and Near Field Communication (NFC) enabled smart phones.

There is also an emerging trend for other applications to be added to these regional systems to expand the utility of the payment media and back-office system, offering higher value and incentives to the end users, and lowering costs and creating new revenue streams through the integration of multi-modal and multi-operator systems for the regional system operators. As a result, these regional systems have created opportunities for new levels of systems support and services including customer support call centers and web support services, smart card production and distribution, financial clearing and settlement, retail merchant network management, transit benefit support, and software application support. In some cases, operators are choosing to outsource the ongoing operations and commercialization of these regional payment systems. This growing new market provides the opportunity to establish lasting relationships and grow revenues and profits over the long term.

Our NextBus business uses a software-as-a-service solution. NextBus' technologies provide transit passengers with accurate, real-time predicted arrival information about buses, subways and trains, and include real-time management and dispatch tools that enable transit operators to effectively manage their systems.

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ITMS has a portfolio of information based solutions and transportation agency customers. ITMS is a provider of traffic management systems technology, traffic and road enforcement and the maintenance of traffic signals, emergency equipment and other critical road and tunnel infrastructure.

Urban Insights combines a consulting and services team with specific data science methods and a cloud-based big data and predictive analytics platform to generate business insight discovery that helps transportation planners and administrators quickly comprehend what needs to be done to advance service quality for their customers and optimize urban transportation networks. Urban Insights harnesses the power of big data and predictive analytics to help the transportation industry improve operations, reduce costs and better serve travelers.

Raw Materials — CTS

Raw materials used by CTS include sheet steel, composite products, copper electrical wire and castings. A significant portion of our end product is composed of purchased electronic components and subcontracted parts and supplies. We procure all of these items from third-party suppliers. In general, supplies of raw materials and purchased parts are adequate to meet our requirements.

Backlog — CTS

Funded sales backlog of CTS at September 30, 2016 and 2015 amounted to \$1.793 billion and \$1.894 billion, respectively. We expect that approximately \$522 million of the September 30, 2016 backlog will be converted into sales by September 30, 2017.

CTS Competitive Environment:

We are one of several companies specializing in the transportation systems and services market. Our competitors in various market segments include Thales, Xerox, Kapsch, Accenture, IBM, Indra, Init, Siemens, Transcore, Trapeze, Parkeon and Scheidt & Bachmann.

For large tenders, our competitors may form consortiums that could include telecommunications companies, financial institutions and consulting companies in addition to the companies noted above. 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.

CUBIC GLOBAL DEFENSE SYSTEMS SEGMENT

CGD Systems is focused on two primary lines of business: training systems and secure communications (SC) products. The first line of business, training systems, is well diversified and supplies to the Department of Defense (DoD) and 34 allied nations. It is a market leader in live and virtual military training systems and has launched an emerging and fast growing presence in game-based training systems. Training systems provided by CGD Systems include customized military range instrumentation systems, live-fire range design and maintenance, laser-based training systems, virtual simulation systems, and game-based synthetic training environments. The second line of business, SC, includes ISR data links, satellite ground terminals, modular networking and broadband communications equipment, power amplifiers, avionics systems, and cross domain products to solve data access challenges across multi-level security designations. CGD Systems is comprised of approximately 2,000 employees working in 20 nations on 4 continents.

Training Systems

Our training systems business is a pioneer and market leader in the design, innovation, and manufacture of instrumented training systems and products for the U.S. military and the militaries of allied nations. We design and manufacture

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realistic, high-fidelity air, ground, and surface systems. They are implemented in both live and synthetic training environments, and are used to effectively deliver a range of training objectives, such as training for fighter pilots, ground troops, infantry, armored vehicles, ship operation and maintenance personnel, cyber warriors, and special operations forces. These systems deliver stressful scenarios and weapons' effects, collect event and tactical performance data, record simulated engagements and tactical actions, and deliver after actions reviews to evaluate individual and collective training effectiveness.

Strategically CGD Systems is very well positioned to lead the increasing trend to fully integrated solutions that connect live, virtual, constructive, and game-based training environments into a seamless training event. Our training business portfolio is currently organized into air combat, ground combat, virtual training, and game-based advanced learning systems.

Air Combat Training Systems

In air combat, Cubic was the initial developer and supplier of Air Combat Maneuvering Instrumentation (ACMI) capability during the Vietnam War, which provides advanced live training to fighter pilots of the U.S. military and allies around the world. The ACMI product line has progressed through five generations of technologies and capabilities. The latest generation, the P5 ACMI, provides advanced air combat training capability to the U.S. Air Force, Navy and Marine Corps, and has solidified Cubic's market leading position. We have been awarded a series of contracts to produce and enhance ACMI for the F-35 Joint Strike Fighter. In May 2016, Cubic and its industry partners were selected by the U.S. Air Force Research Laboratory for Warfighter Readiness and Training Research to develop technologies for next-generation readiness capabilities. We have also developed a broad international base for our ACMI product, particularly in Asia Pacific and the Middle East. In addition to procuring the ACMI training system, many nations also rely on Cubic for on-site operations and maintenance support.

Ground Combat Training Systems

CGD Systems is a leading provider of realistic, easy-to-use, high-fidelity, reliable, and cost effective tactical engagement simulation systems that minimize user set-up time and increase training effectiveness. Our leadership role in instrumented training was established during the 1990s when Cubic provided turnkey systems for U.S. Army training centers including the Joint Readiness Training Center (JRTC) at Fort Polk, Louisiana, and the Combat Maneuver Training Center (CMTTC) at Hohenfels, Germany, now known as the Joint Multinational Readiness Center. Since the completion of these original contracts, we have significantly expanded our market footprint with the sale of fixed, mobile and urban operation training centers to uniformed military and security forces in the U.S. and allied nations around the world. Our ground combat training systems operate at over 25 combat training centers (CTCs) worldwide. Our laser-based tactical engagement simulation systems, widely known as the Multiple Integrated Laser Engagement Systems (MILES), are used at CTCs to enable realistic training without live ammunition. Cubic MILES are being utilized by all branches of the U.S. Armed Services, as well as the Department of Energy, and numerous international government customers. We have increased our focus on joint training solutions and those that can

operate simultaneously in multiple simulation environments including live, virtual, constructive and gaming domains. In fiscal year 2013 we acquired the assets of Advanced Interactive Systems (AIS), which provides live fire training solutions to U.S. and international forces, further deepening our training capabilities and expanding our customer base.

Game-Based Learning Systems

The \$298.5 million Littoral Combat Ship (LCS) courseware contract win by the Simulation Systems Division during 2013 has opened a large new market for CGD Systems. A key discriminator in the LCS proposal was the use of a high-fidelity gaming engine that allows avatars to instruct students at their own pace in an immersive environment based on realistic graphics. By integrating instructional material into a gaming environment, we have dramatically reduced instructor costs and provided a platform that is ideal for embedded training. These technologies are easily transferrable to different training domains and subject matter. The experiential learning environment can be augmented with intelligent tutoring and assessment tools increasing the value of this approach. At present, we are investing in the appropriate tool sets and staffing resources to meet the Navy and commercial airline requirements. Near-term opportunities include other

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Navy and other DoD customers and commercial airlines, while longer-term applications under consideration exist in commercial markets such as education, health care, and retail.

Secure Communications

Our secure communications products business supplies secure data links, networking and baseband communications equipment, search and rescue avionics, high power RF amplifiers, cyber security appliances for the U.S. military, government agencies, and allied nations. In 2015 and 2016 we acquired DTECH, GATR, and TeraLogics in connection with our strategic efforts to build and expand our C4ISR business. These new businesses provide deployable satellite communication terminal solutions, full motion video processing and dissemination, and networking and baseband communications equipment. In the third quarter of fiscal 2016 we combined and integrated our C4ISR and other secure communications operations into a new business unit, CMS, which is part of our Cubic Global Defense Systems segment.

GATR

On February 3, 2016, we acquired GATR, a manufacturer of next-generation deployable satellite communication terminal solutions, based in Huntsville, Alabama. GATR expands our satellite communications and networking applications technologies and expands our customer base.

TeraLogics

On December 21, 2015 we acquired TeraLogics, a business based in Ashburn, Virginia, which is a leading provider of real-time full motion video processing, exploitation and dissemination for the DoD, the intelligence community and commercial customers. TeraLogics' ability to develop real-time video analysis and delivery software for full motion video is complementary to Cubic's existing tactical communications portfolio.

DTECH

On December 16, 2014 we acquired DTECH, which is based in Sterling, Virginia, and is a provider of modular networking and baseband communications equipment that adds networking capability to our secure communications business. This acquisition expands the portfolio of product offerings and the customer base of our CGD Systems segment.

Data Links

Our data links portfolio originated with the U.S. Army/Air Force Joint STARS system during the 1980s, and we continue to supply ISR data links to U.S. and international forces today. More recently we have focused on the supply of Common Data Link (CDL) products for ship borne applications, unmanned aerial vehicles (UAV), remote video terminals and hand-held products. Smaller, tactical versions of our Common Data Link have been selected for both UAV and remote video terminal applications such as the U.K.'s Watchkeeper, the U.S. Navy's Fire Scout MQ-8 UAV and common data link programs and the U.S. Marine Corp's (USMC) Small Unmanned Aerial System and Networking-on-the-move system programs.

Personnel Locator System and Power Amplifiers

Our Personnel Locator System (PLS) is standard equipment on U.S. aircraft with a search and rescue mission. PLS is designed to interface with all modern search and rescue system standards. These include systems used by the Canadian Coast Guard, the U.S. Navy, the U.S. Air Force and the French Army. We also supply high power amplifiers and direction finding systems to major prime contractors and end users for both domestic and international applications.

Cyber Cross-Domain

In June 2010, Cubic acquired Safe Harbor Holdings, a cyber security and information assurance company. This acquisition expanded our service offerings into areas including specialized security and networking infrastructure,

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system certification and accreditation, and enterprise-level network architecture and engineering services. We also provide cross-domain hardware solutions to address multi-level security challenges across common networks.

Raw Materials — CGD Systems

The principal raw materials used by CGD Systems are sheet aluminum and steel, copper electrical wire and composite products. A significant portion of our end products are composed of purchased electronic components and subcontracted parts and supplies. We procure these items primarily from third-party suppliers. In general, supplies of raw materials and purchased parts are adequate to meet our requirements.

Backlog — CGD Systems

Funded and total backlog of CGD Systems at September 30, 2016 was \$577 million compared to \$596 million at September 30, 2015. We expect that approximately \$251 million of the September 30, 2016 backlog will be converted into sales by September 30, 2017.

CUBIC GLOBAL DEFENSE SERVICES SEGMENT

CGD Services is a leading provider of training, operations, intelligence, maintenance, technical, and other support services to the U.S. government and its agencies and allied nations. These services complement the systems and solutions provided by the CGD Systems segment. CGD Services is comprised of approximately 3,700 employees working in 13 nations throughout the world. Our employees serve with clients in actual training and operational environments to help prepare and support forces through the provision of comprehensive training, exercises, staff augmentation, education, operational, intelligence, technical, and logistical assistance to meet the full scope of their assigned missions. The scope of mission support that we provide includes: training and rehearsals for both small and large scale combat operations; training and preparation of military advisor and training teams; combat and material development; military staff augmentation; information technology and information assurance; logistics and maintenance support for fielded and deployed systems; support to national intelligence and special operations activities; peacekeeping; consequence management; and humanitarian assistance operations worldwide. We also plan, prepare, execute and document realistic and focused mission rehearsal exercises (using both live and computer-based exercises) as final preparation of forces prior to deployment. In addition, we provide high level consultation and advisory services to the governments and militaries of allied nations.

U.S. government service contracts are typically awarded on a competitive basis with options for multiple years. We typically compete as a prime contractor to the government, but also team with other companies on select

opportunities. Over the last several years we have experienced a number of challenges in the defense services market, including sequestration, reductions in the U.S. government's budgets, increased price competition, contract awards for shorter performance periods, and we have seen an increased amount of required subcontracting to small businesses as a result of the U.S. government's increased emphasis on meeting small business contracting mandates. In addition, some of the contracts where we were the prime contractor in the past have been set aside at re-compete for participation by small businesses only. Lastly, the government continues to use lowest price, technically acceptable evaluation methods to drive down price in competitions. This has put significant pressure on profit expectations, has diluted our overall services margin, and has caused us to reevaluate whether we will continue to bid some programs that fall within our core competencies.

Our comprehensive business base includes integrated live, virtual and constructive training support; advanced distance learning and other professional military education; comprehensive logistics and maintenance support; weapons effects and analytical modeling; analysis, training, and other support to the national security community, including intelligence and special operations forces; homeland security training and exercises; training and preparation of U.S. Army and Marine Corps foreign service advisor teams; and military force modernization. We provide in-country logistics, maintenance, operational and training support to U.S. Forces deployed in overseas locations.

Our contracts include providing mission support services to all four of the U.S. Army's major combat training centers (CTCs): Joint Readiness Training Center (JRTC) as prime contractor, the National Training Center (NTC) and Mission

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Command Training Program (MCTP) as a principal subcontractor and the Joint Multinational Readiness Center (JMRC) as prime contractor supporting constructive simulations. These services include planning, executing and documenting realistic and stressful large scale exercises and mission rehearsals that increase the readiness of both active and reserve U.S. conventional and special operations forces by placing them in situations as close to actual combat as possible.

For the U.S. Armed Services, CGD Services is a principal member of the contractor team that supports and helps manage and execute all aspects of the operations of the Joint Force Development (JFD), including support to worldwide joint exercises and the development and fielding of the Joint National Training Capability (JNTC). We also provide contractor maintenance and instructional support necessary to operate and maintain a wide variety of flight simulation and training systems and other facilities worldwide, for U.S. and allied forces under multiple long-term contracts, including direct support to USMC aircrew training systems worldwide instructional support services for the Chief of Naval Aviation Training (CNAT) program and support to the Navy helicopter simulator maintenance program. In addition, we provide a broad range of operational support to the U.S. Navy for Anti-Submarine Warfare (ASW) and counter-mine operations and training.

We provide comprehensive support to help plan, manage and execute Defense Threat Reduction Agency's (DTRA) worldwide consequence management exercise program, which trains senior U.S. and allied civilian and military personnel, first responders and other users of DTRA products. Additionally we support 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. We also support DTRA with modeling and simulations to analyze, assess and predict the effects of such weapons in combat and other environments.

We provide Research, Development and Technical Engineering (RDTE) support to the U.S. Air Force Research Laboratories (AFRL) for assistance in the identification and application of current, new and emerging technologies leading to proof-of-principle evaluations of advanced operational concepts.

We have multiple contracts with all U.S. Armed Services and other government agencies to improve the quality and reach of training and education of individuals and small teams up through collective training of large organizations. Our services, products and capabilities include development and deployment of curriculum and related courseware, computer-based training, knowledge management and distribution, advanced distance learning (e-learning), serious military games for training and other advanced education programs for U.S. and allied forces.

A part of our services business is to provide specialized teams of military experts to advise the governments and militaries of the nations of the former Warsaw Pact and Soviet Union, and other former communist countries in the transformation of their militaries to a NATO environment. These very broad defense modernization contracts involve both the nations' strategic foundation and the detailed planning of all aspects of reform. We also operate battle simulation centers for U.S. forces in Europe, as well as for select countries in Central and Eastern Europe.

In recent years we have expanded our support services to the military and national intelligence communities, as well as for special operations, law enforcement and homeland security clients to broaden our service offerings across the U.S. DoD and national security markets to pursue prime contract opportunities.

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

Backlog — CGD Services

Funded sales backlog of our CGD Services segment at September 30, 2016 was \$139 million compared to \$150 million at September 30, 2015. Total backlog, including unfunded options under multiyear service contracts, was \$570 million at September 30, 2016 compared to \$486 million at September 30, 2015. We expect that approximately \$183 million of the September 30, 2016 total backlog will be converted into sales by September 30, 2017.

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CGD Competitive Environment

Cubic's broad defense business portfolio means we compete with numerous companies, large and small, across the globe. Well known competitors include Lockheed Martin, Northrop Grumman, General Dynamics, Boeing, L3 Communications, Saab Training Systems, SAIC, Leidos, Booz Allen Hamilton, and Engility as well as other smaller companies. In many cases, we have also teamed with several of these companies, in both prime and subcontractor roles, on specific bid opportunities. While we are generally smaller than our principal competitors, we believe our competitive advantages include an outstanding record of past performance, strong incumbent relationships, the ability to control operating costs and rapidly focus technology and innovation to solve customer problems.

In the defense market, we continue to focus on expanding our domestic and international footprint in the global military simulation and training market as well as enabling the convergence and integration of live, virtual and constructive training technologies. U.S. federal budgetary decisions and constraints have put downward pressure on growth in the defense industry and has affected our business. However, we believe that much of our business is well positioned in areas that the DoD has indicated are areas of focus for future defense spending to help the DoD meet its critical future capability requirements for protecting U.S. security and the security of our allies in the years to come.

We are also well positioned in large, relatively stable markets. According to the 2016 Global Military Simulation and Virtual Training Market report, the value of the global military simulation and virtual training programs market is \$13.3 billion in 2016. The value of the market is expected to increase at a compound annual growth rate of 2.9% over the forecast period, to reach a value of \$17.7 billion by 2026. In the U.S., we believe that there are near term pressures on training budgets for systems and services due to cost pressures resulting from sequestration. However, we believe that changes in training doctrine and the use of new types of training that are cost effective will be essential for the military to fulfill its mission. Globally, we are focused on the emerging economies within the Asia Pacific region and the Middle East, which are expected to be strong markets for simulation and training products and services with projected growth rates in excess of the overall market. In addition, new platforms and the significant increase in unmanned vehicles and other advanced weapon systems could generate significant demand for operator training on these new platforms.

Our secure communications products address the large and broadly defined C4ISR market, with an estimated addressable market of approximately \$2 billion annually. We believe that our products and technologies address mission critical requirements such as: integrated communications suites for unmanned aerial vehicles (UAV), ships and the dismounted soldier, battlefield awareness, and secure and encrypted communications. We believe that these technologies will continue to experience strong demand as the U.S. military maintains a smaller, more agile force structure.

BUSINESS STRATEGY

Cubic's strategy remains guided by our objectives of winning the customer to create market-leading positions, delivering superior operational performance, and investing our capital and talent to enhance our market-leading businesses. All of this is supported by our One Cubic initiative: sharing resources across the company to achieve superior talent management, absolute customer focus, innovation, collaboration, cost-effective enterprise systems and impeccable ethics.

In transportation, we have developed our NextCity vision for the future of transportation. We are repositioning ourselves from being a leading provider of mass transit fare collection systems to be a leading provider of integrated payment and information systems across all modes of transportation. We will continue to grow our portfolio beyond fare collection to include industries such as tolling, analytics, parking and traffic management.

In defense, we have developed our vision for NextTraining — a capability that will allow us to better prepare our customers for their NextMission by ensuring we apply the most effective training methodologies based on state-of-the-art learning methods and neurological science in a cost-effective manner. In 2015 and 2016 we acquired DTECH, GATR, and TeraLogics in connection with our strategic efforts to build and expand our C4ISR business and we formalized the structure of our CMS business unit which combines and integrates our C4ISR and secure communications operations within the CGD Systems segment.

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As part of our strategic planning process, we conducted a portfolio review and are already reshaping our portfolio to allow us to consistently grow sales, improve profitability and deliver attractive returns on capital. Our acquisition strategy remains focused on opportunities that align with our NextCity strategy and building our C4ISR business both in the U.S. and internationally. We are reviewing larger transformational opportunities that would leverage our strategy to invest in higher margin niche markets and utilize our strong capital position.

We believe implementing our strategy will improve Cubic's competitive advantage and deliver superior value to our customers as well as superior returns to our shareholders.

Maintain Niche Market Leadership

We seek to defend our leadership positions in core markets by ensuring all our businesses are absolutely customer facing, thereby maintaining our long-term relationships with our customers. By achieving this goal, we can leverage our returns through follow-on business with existing customers and expand our presence in the market through sales of similar systems at competitive prices to new customers. The length of relationship with many of our customers exceeds 30 years and further supports our industry-wide leadership and technological capabilities. In addition, as a result of maintaining a high level of performance, we continue to provide a combination of support services for our long-term customers. Such long-term relationships include the following:

Business Area	Year
Automated Fare Collection	1972, provided the San Francisco Bay Area Rapid Transit (BART) ticket encoding and vending technology.
Air Combat Training	1973, supplied first "Top Gun" Air Combat Maneuvering Instrumentation system for the Marine Corps Air Station at Yuma, AZ.
Ground Combat Training	1990, pioneered the world's first turnkey ground combat-instrumentation system at Hohenfels, Germany for the U.S. Army.

MILES