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	Three Months Ended December 31, 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.

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,

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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