

Woodward, Inc.
Form 10-Q
July 22, 2014
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 quarterly period ended June 30, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 000-08408
WOODWARD, INC.
(Exact name of registrant as specified in its charter)

Delaware 36-1984010
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1000 East Drake Road, Fort Collins, Colorado 80525
(Address of principal executive offices) (Zip Code)
(970) 482-5811

(Registrant's telephone number, including area code)

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).

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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. See 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 Exchange Act).

Yes No

As of July 17, 2014, 65,490,433 shares of the registrant’s common stock with a par value of \$0.001455 per share were outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share amounts)

(Unaudited)

	Three-Months Ended		Nine-Months Ended	
	June 30,	2013	June 30,	2013
	2014		2014	
Net sales	\$ 524,284	\$ 483,759	\$ 1,435,793	\$ 1,377,611
Costs and expenses:				
Cost of goods sold	372,571	349,482	1,028,065	987,155
Selling, general and administrative expenses	40,468	46,747	113,079	120,371
Research and development costs	34,990	35,487	100,219	99,505
Amortization of intangible assets	8,357	9,769	25,498	27,249
Interest expense	5,972	6,723	18,219	20,196
Interest income	(73)	(68)	(189)	(205)
Other (income) expense, net (Note 16)	(469)	122	(1,266)	(1,030)
Total costs and expenses	461,816	448,262	1,283,625	1,253,241
Earnings before income taxes	62,468	35,497	152,168	124,370
Income tax expense	16,467	11,834	37,986	30,893
Net earnings	\$ 46,001	\$ 23,663	\$ 114,182	\$ 93,477
Earnings per share (Note 3):				
Basic earnings per share	\$ 0.70	\$ 0.35	\$ 1.71	\$ 1.36
Diluted earnings per share	\$ 0.69	\$ 0.34	\$ 1.68	\$ 1.34
Weighted Average Common Shares Outstanding (Note 3):				
Basic	65,845	68,323	66,736	68,506
Diluted	67,147	69,430	68,030	69,698
Cash dividends per share paid to Woodward common stockholders	\$ 0.08	\$ 0.08	\$ 0.24	\$ 0.24

See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

	Three-Months Ended June 30,		Nine-Months Ended June 30,	
	2014	2013	2014	2013
Net earnings	\$ 46,001	\$ 23,663	\$ 114,182	\$ 93,477
Other comprehensive earnings:				
Foreign currency translation adjustments	(72)	1,056	4,159	(5,002)
Taxes on changes in foreign currency translation adjustments	74	387	368	806
	2	1,443	4,527	(4,196)
Reclassification of net realized losses on derivatives to earnings	24	42	73	128
Unrealized gain on derivatives arising during the period	-	546	-	546
Taxes on changes in derivative transactions	(9)	(223)	(27)	(256)
	15	365	46	418
Minimum retirement benefit liability adjustments (Note 18)				
Net gain (loss) arising during the period	1,193	-	1,193	-
Curtailment arising during the period	(915)	-	(915)	-
Amortization of:				
Net prior service benefit	(22)	(23)	(66)	(69)
Net loss	199	440	588	1,332
Foreign currency exchange rate changes on minimum retirement benefit liabilities	(263)	170	(483)	1,355
Taxes on changes in minimum retirement liability adjustments	31	(214)	(14)	(939)
	223	373	303	1,679
Total comprehensive earnings	\$ 46,241	\$ 25,844	\$ 119,058	\$ 91,378

See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	June 30, 2014	September 30, 2013 (a)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 95,842	\$ 48,556
Accounts receivable, less allowance for uncollectible amounts of \$7,260 and \$8,872, respectively	322,463	381,065
Inventories	469,036	431,744
Income taxes receivable	6,641	14,071
Deferred income tax assets	44,246	43,027
Other current assets	47,971	38,650
Total current assets	986,199	957,113
Property, plant and equipment, net	436,474	350,048
Goodwill	562,691	561,458
Intangible assets, net	263,490	288,775
Deferred income tax assets	17,210	13,926
Other assets	57,009	47,198
Total assets	\$ 2,323,073	\$ 2,218,518
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ -	\$ 100,000
Accounts payable	179,420	145,541
Income taxes payable	14,107	7,848
Deferred income tax liabilities	800	800
Accrued liabilities	130,252	161,741
Total current liabilities	324,579	415,930
Long-term debt, less current portion	665,000	450,000
Deferred income tax liabilities	102,909	104,533
Other liabilities	96,588	105,510
Total liabilities	1,189,076	1,075,973
Commitments and contingencies (Note 20)		
Stockholders' equity:		
Preferred stock, par value \$0.003 per share, 10,000 shares authorized, no shares issued	-	-
Common stock, par value \$0.001455 per share, 150,000 shares authorized, 72,960 shares issued	106	106
Additional paid-in capital	110,237	101,147
Accumulated other comprehensive earnings	19,991	15,115
Deferred compensation	3,878	4,007
Retained earnings	1,292,048	1,193,887
	1,426,260	1,314,262

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Treasury stock at cost, 7,477 shares and 4,883 shares, respectively	(288,385)	(167,710)
Treasury stock held for deferred compensation, at cost, 198 shares and 232 shares, respectively	(3,878)	(4,007)
Total stockholders' equity	1,133,997	1,142,545
Total liabilities and stockholders' equity	\$ 2,323,073	\$ 2,218,518

(a) Retrospectively adjusted as discussed in Note 4, Business acquisitions
See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine-Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net earnings	\$ 114,182	\$ 93,477
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	57,680	56,220
Net (gain) loss on sales of assets	116	(78)
Stock-based compensation	8,739	7,355
Excess tax benefits from stock-based compensation	(2,638)	(4,755)
Deferred income taxes	(5,749)	(36)
Loss on derivatives reclassified from accumulated comprehensive earnings into earnings	73	128
Changes in operating assets and liabilities, net of business acquisitions:		
Accounts receivable	57,151	24,584
Inventories	(38,860)	(20,164)
Accounts payable and accrued liabilities	(6,434)	(16,320)
Current income taxes	16,130	(2,543)
Retirement benefit obligations	(2,676)	(3,290)
Other	(13,824)	(1,561)
Net cash provided by operating activities	183,890	133,017
Cash flows from investing activities:		
Payments for purchase of property, plant, and equipment	(104,530)	(78,515)
Proceeds from sale of assets	258	354
Business acquisitions, net of cash acquired	-	(198,860)
Net cash used in investing activities	(104,272)	(277,021)
Cash flows from financing activities:		
Cash dividends paid	(16,021)	(16,421)
Proceeds from sales of treasury stock	8,380	7,439
Payments for repurchases of common stock	(141,488)	(45,754)
Excess tax benefits from stock compensation	2,638	4,755
Borrowings on revolving lines of credit and short-term borrowings	356,071	97,072
Payments on revolving lines of credit and short-term borrowings	(191,069)	(62,329)
Proceeds from issuance of long-term debt	250,000	200,000
Payments of long-term debt	(300,000)	(41,875)
Payments of debt financing costs	(1,297)	-
Net cash provided by (used in) financing activities	(32,786)	142,887
Effect of exchange rate changes on cash and cash equivalents	454	260
Net change in cash and cash equivalents	47,286	(857)
Cash and cash equivalents at beginning of period	48,556	61,829

Cash and cash equivalents at end of period	\$ 95,842	\$ 60,972
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See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Number of shares				Stockholders' equity					
	Preferred stock	Common stock	Treasury stock	Treasury stock held for deferred compensation	Common stock	Additional paid-in capital	Foreign currency translation adjustments	Unrealized derivative gains (losses)	Minimum retirement benefit liability adjustments	Total accumulated other comprehensive (loss) earnings
Balances as of October 1, 2012	-	72,960	(4,536)	(276)	\$ 106	\$ 97,826	\$ 17,447	\$ (376)	\$ (28,794)	\$ (11,000)
Net earnings	-	-	-	-	-	-	-	-	-	-
Other comprehensive income (loss), net of tax	-	-	-	-	-	-	(4,196)	418	1,679	(2,000)
Cash dividends paid	-	-	-	-	-	-	-	-	-	-
Purchases of treasury stock	-	-	(1,395)	-	-	-	-	-	-	-
Sales of treasury stock	-	-	750	-	-	(12,653)	-	-	-	-
Common shares issued from treasury stock for benefit plans	-	-	250	-	-	1,923	-	-	-	-
Tax benefit attributable to exercise of stock options	-	-	-	-	-	4,755	-	-	-	-
Stock-based compensation	-	-	-	-	-	7,355	-	-	-	-
Transfer of stock to deferred	-	-	2	(2)	-	24	-	-	-	-

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compensation plan										
Purchases of stock by deferred compensation plan	-	-	-	(2)	-	-	-	-	-	-
Distribution of stock from deferred compensation plan	-	-	-	42	-	-	-	-	-	-
Balances as of June 30, 2013	-	72,960	(4,929)	(238)	\$ 106	\$ 99,230	\$ 13,251	\$ 42	\$ (27,115)	\$ (13,900)
Balances as of October 1, 2013	-	72,960	(4,883)	(232)	\$ 106	\$ 101,147	\$ 25,742	\$ 43	\$ (10,670)	\$ 15,100
Net earnings	-	-	-	-	-	-	-	-	-	-
Other comprehensive income (loss), net of tax	-	-	-	-	-	-	4,527	46	303	4,876
Cash dividends paid	-	-	-	-	-	-	-	-	-	-
Purchases of treasury stock	-	-	(3,309)	-	-	-	-	-	-	-
Sales of treasury stock	-	-	455	-	-	(4,949)	-	-	-	-
Common shares issued from treasury stock for benefit plans	-	-	260	-	-	2,837	-	-	-	-
Tax benefit attributable to exercise of stock options	-	-	-	-	-	2,463	-	-	-	-
Stock-based compensation	-	-	-	-	-	8,739	-	-	-	-
Purchases of stock by deferred compensation plan	-	-	-	(7)	-	-	-	-	-	-
Distribution of stock from deferred compensation plan	-	-	-	41	-	-	-	-	-	-
	-	72,960	(7,477)	(198)	\$ 106	\$ 110,237	\$ 30,269	\$ 89	\$ (10,367)	\$ 19,900

Balances as of
June 30, 2014

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 1. Basis of Presentation

The Condensed Consolidated Financial Statements of Woodward, Inc. (“Woodward” or the “Company”) as of June 30, 2014 and for the three and nine-months ended June 30, 2014 and June 30, 2013, included herein, have not been audited by an independent registered public accounting firm. These Condensed Consolidated Financial Statements reflect all normal recurring adjustments that, in the opinion of management, are necessary to present fairly Woodward’s financial position as of June 30, 2014, and the statements of earnings, comprehensive earnings, cash flows, and changes in the statement of stockholders’ equity for the periods presented herein. The results of operations for the three and nine-months ended June 30, 2014 are not necessarily indicative of the operating results to be expected for other interim periods or for the full fiscal year. Dollar amounts contained in these Condensed Consolidated Financial Statements are in thousands, except per share amounts.

The Condensed Consolidated Balance Sheet as of September 30, 2013 was derived from Woodward’s Annual Report on Form 10-K for the fiscal year then ended. During the three-months ended December 31, 2013, Woodward completed purchase accounting valuation estimates related to the acquisition of the Duarte Business (as defined below in Note 4, Business acquisitions) and as a result, retrospectively adjusted the valuations of certain liabilities with a corresponding increase to goodwill and intangible assets as of the acquisition date. The retrospective adjustments amounted to approximately \$12,800 and primarily relate to long-term performance obligations and other accrued liabilities. Changes since the acquisition date to the valuations of the assets and liabilities acquired resulted in insignificant changes to Woodward’s previously reported earnings and therefore prior reported earnings have not been restated.

The Condensed Consolidated Financial Statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to such rules and regulations.

These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto included in Woodward’s most recent Annual Report on Form 10-K filed with the SEC and other financial information filed with the SEC.

Management is required to use estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements, the reported revenues and expenses recognized during the reporting period, and certain financial statement disclosures, in the preparation of the Condensed Consolidated Financial Statements included herein. Significant estimates in these Condensed Consolidated Financial Statements include allowances for losses on receivables, net realizable value of inventories, warranty reserves, cost of sales incentives, useful lives of property and identifiable intangible assets, the evaluation of impairments of property, valuation of identifiable intangible assets and goodwill, income tax and valuation reserves, the valuation of assets and liabilities acquired in business combinations, assumptions used in the determination of the funded status and annual expense of pension and postretirement employee benefit plans, the valuation of stock compensation instruments granted to employees and

board members, and contingencies. Actual results could vary materially from Woodward's estimates.

Note 2. Recent accounting pronouncements

From time to time, the Financial Accounting Standards Board ("FASB") or other standards setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification ("ASC") are communicated through issuance of an Accounting Standards Update ("ASU").

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." The purpose of ASU 2014-09 is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. The amendments (i) remove inconsistencies and weaknesses in revenue requirements, (ii) provide a more robust framework for addressing revenue issues, (iii) improve comparability of revenue recognition across entities, industries, jurisdictions, and capital markets, (iv) provide more useful information to users of financial statements through improved disclosure requirements, and (v) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016 (fiscal year 2018 for Woodward), including interim periods within that reporting period. Early adoption is not permitted. An entity should adopt the amendments using one of the following methods: retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying ASU 2014-09

recognized at the date of initial application. Woodward is currently assessing the impact that this guidance may have on its Consolidated Financial Statements.

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in financial statements; however, the amendments require companies to provide information about the amounts reclassified out of accumulated comprehensive income by component. ASU 2013-02 requires a company to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated comprehensive income by respective line items of net income, but only if the amount so reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, a company is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 is effective prospectively for annual reporting periods beginning after December 15, 2012 (fiscal year 2014 for Woodward). The disclosure requirement of ASU 2013-02, which Woodward has adopted, had no material impact on its Consolidated Financial Statements.

Note 3. Earnings per share

Basic earnings per share is computed by dividing net earnings available to common stockholders by the weighted-average number of shares of common stock outstanding for the period.

Diluted earnings per share reflects the weighted-average number of shares outstanding after consideration of the dilutive effect of stock options.

The following is a reconciliation of net earnings to basic earnings per share and diluted earnings per share:

	Three-Months Ended		Nine-Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2014	2013	2014	2013
Numerator:				
Net earnings	\$ 46,001	\$ 23,663	\$ 114,182	\$ 93,477
Denominator:				
Basic shares outstanding	65,845	68,323	66,736	68,506
Dilutive effect of stock options and restricted stock	1,302	1,107	1,294	1,192
Diluted shares outstanding	67,147	69,430	68,030	69,698
Income per common share:				
Basic earnings per share	\$ 0.70	\$ 0.35	\$ 1.71	\$ 1.36
Diluted earnings per share	\$ 0.69	\$ 0.34	\$ 1.68	\$ 1.34

The following stock option grants were outstanding during the three and nine-months ended June 30, 2014 and 2013, but were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

	Three-Months		Nine-Months	
	Ended		Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Options	677	722	236	239
Weighted-average option price	\$ 40.99	\$ 34.06	\$ 41.05	\$ 34.83

The weighted-average shares of common stock outstanding for basic and diluted earnings per share included the weighted-average treasury stock shares held for deferred compensation obligations of the following:

	Three-Months		Nine-Months	
	Ended		Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Weighted-average treasury stock shares held for deferred compensation obligations	206	247	220	262

Note 4. Business acquisitions

Duarte Business Acquisition

On December 27, 2012, Woodward entered into a definitive asset purchase agreement (the “Asset Purchase Agreement”) with GE Aviation Systems LLC (the “Seller”) and General Electric Company for the acquisition of substantially all of the assets and certain liabilities related to the Seller’s thrust reverser actuation systems business located in Duarte, California (the “Duarte Business”) for an aggregate purchase price of \$200,000. The acquisition was completed on December 28, 2012 and, based on customary purchase price adjustments, Woodward paid cash at closing in the amount of \$198,900. Woodward and the Seller have finalized the purchase price adjustment based on the customary post-closing provisions of the Asset Purchase Agreement.

The purchase price of the Duarte Business was as follows:

Cash paid to Seller	\$ 198,900
Less cash acquired	(40)
Total purchase price	\$ 198,860

The allocation of the purchase price to the assets acquired and liabilities assumed was accounted for under the purchase method of accounting in accordance with ASC Topic 805, “Business Combinations.” Assets acquired and liabilities assumed in the transaction were allocated and recorded at their estimated acquisition date fair values using management’s best estimate based on available data. Transaction costs associated with the acquisition were expensed as incurred. The Company incurred transaction costs of \$304 and \$2,011 for the three and nine-months ended June 30, 2013, respectively, which are included in “Selling, general and administrative expenses” in the Condensed Consolidated Statements of Earnings. No additional transaction costs were incurred in the three and nine-months ended June 30, 2014.

During the three-months ended December 31, 2013, Woodward completed its purchase accounting valuation estimates and as a result, retrospectively adjusted the valuations of certain liabilities with a corresponding increase to goodwill and intangible assets as of the acquisition date. The retrospective adjustments amounted to approximately \$12,800 and primarily relate to long-term performance obligations and other accrued liabilities. Changes since the acquisition date to the valuations of the assets and liabilities acquired resulted in insignificant changes to Woodward’s previously reported earnings and therefore prior reported earnings have not been restated. The allocation of the purchase price to the assets and liabilities assumed was finalized as of December 27, 2013.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition of the Duarte Business:

Accounts receivable	\$ 14,245
Inventories	30,149
Other current assets	10,370
Property, plant, and equipment	11,804

Goodwill	98,310
Intangible assets	89,700
Other noncurrent assets	18,097
Total assets acquired	272,675
Other current liabilities	32,509
Other noncurrent liabilities	41,306
Total liabilities assumed	73,815
Net assets acquired	\$ 198,860

Goodwill recorded in connection with the acquisition of the Duarte Business, which is deductible for income tax purposes, represents the estimated value of potential expansion with new customers, the opportunity to further develop sales opportunities with new and acquired Duarte Business customers, and other synergies expected to be achieved through the integration of the Duarte Business into Woodward's Aerospace segment.

A summary of the estimated intangible assets acquired, weighted-average useful lives, and amortization methods follows:

	Estimated Amounts	Weighted-Average Useful Life	Amortization Method
Customer relationships and contracts	\$ 77,000	20 years	Straight-line
Process technology	5,000	25 years	Straight-line
Backlog	7,700	3 years	Accelerated
Total	\$ 89,700		

Assumed liabilities include \$4,758 and \$17,939 of current and long-term performance obligations, respectively, for contractual commitments that are expected to result in future economic losses.

The Asset Purchase Agreement included commitments for the Duarte Business to continue to provide services to the Seller unrelated to the core business acquired, for which Woodward will continue to be paid by the Seller. Assumed liabilities include \$12,985 and \$23,215 of current and long-term performance obligations, respectively, for services to be provided to the Seller, offset by \$8,103 and \$18,097 of current and long-term assets, respectively, related to contractual payments due from the Seller.

Net sales for the Duarte Business subsequent to the date it was acquired by Woodward were \$37,929 and \$107,062 for the three and nine-months ended June 30, 2014, respectively, and \$34,723 and \$69,813 for the three and nine-months ended June 30, 2013, respectively. Earnings of the Duarte Business subsequent to the date it was acquired by Woodward for the three and nine-months ended June 30, 2014 cannot be determined on a stand-alone basis due to the integration of the Duarte Business into Woodward's Aerospace segment. Earnings of the Duarte Business subsequent to the date it was acquired by Woodward for the three and nine-months ended June 30, 2013 were slightly accretive to the consolidated net earnings of Woodward. Due to the timing of the acquisition, there were no net sales or operating expenses from the Duarte Business included in the Condensed Consolidated Statements of Earnings for the three-months ended December 31, 2012.

Pro forma results for Woodward giving effect to the acquisition of the Duarte Business

The following unaudited pro forma financial information presents the combined results of operations of Woodward and the Duarte Business as if the acquisition had occurred as of October 1, 2011, the beginning of fiscal year 2012.

The pro forma information is presented for information purposes only and is not indicative of the results of operations that would have been achieved if the acquisition and the borrowings used to finance it had taken place at the beginning of fiscal year 2012. The pro forma information combines the historical results of Woodward with the historical results of the Duarte Business for that period.

Prior to the acquisition of the Duarte Business, the Duarte Business was a wholly owned business of the Seller, and as such was not a stand-alone entity for financial reporting purposes. Accordingly, the historical operating results of the Duarte Business may not be indicative of the results that might have been achieved, historically or in the future, if the Duarte Business had been a stand-alone entity. The unaudited pro forma results for the three and nine-months ended June 30, 2014 and June 30, 2013 include amortization charges for acquired intangible assets, eliminations of intercompany transactions, adjustments for depreciation expense for property, plant and equipment, adjustments for acquired performance obligations, transaction costs incurred, adjustments to interest expense, and related tax effects.

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The unaudited pro forma results for the three and nine-month periods ended June 30, 2014 and June 30, 2013, compared to the actual results reported in these Condensed Consolidated Financial Statements, were as follows:

	Three-Months Ended June 30, 2014		Three-Months Ended June 30, 2013	
	As reported	Pro forma	As reported	Pro forma
Net sales	\$ 524,284	\$ 524,284	\$ 483,759	\$ 483,759
Net earnings	46,001	46,289	23,663	24,639
Earnings per share:				
Basic earnings per share	\$ 0.70	\$ 0.70	\$ 0.35	\$ 0.36
Diluted earnings per share	0.69	0.69	0.34	0.35

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	Nine-Months Ended June 30, 2014		Nine-Months Ended June 30, 2013	
	As reported	Pro forma	As reported	Pro forma
Net sales	\$ 1,435,793	\$ 1,435,793	\$ 1,377,611	\$ 1,408,011
Net earnings	114,182	115,059	93,477	98,609
Earnings per share:				
Basic earnings per share	\$ 1.71	\$ 1.72	\$ 1.36	\$ 1.44
Diluted earnings per share	1.68	1.69	1.34	1.41

Note 5. Financial instruments and fair value measurements

Financial assets and liabilities recorded at fair value in the Condensed Consolidated Balance Sheets are categorized based upon a fair value hierarchy established by U.S. GAAP, which prioritizes the inputs used to measure fair value into the following levels:

Level 1: Inputs based on quoted market prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable and can be corroborated by observable market data.

Level 3: Inputs reflect management's best estimates and assumptions of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the valuation of the instruments.

The table below presents information about Woodward's financial assets that are measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques Woodward utilized to determine such fair value. Woodward had no financial liabilities required to be measured at fair value on a recurring basis as of June 30, 2014 or September 30, 2013.

	At June 30, 2014				At September 30, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets:								
Cash	\$ 76,260	\$ -	\$ -	\$ 76,260	\$ 35,839	\$ -	\$ -	\$ 35,839
Investments in money market funds	10,209	-	-	10,209	2,950	-	-	2,950
	9,373	-	-	9,373	9,767	-	-	9,767

Investments in reverse repurchase agreements

Equity securities	9,803	-	-	9,803	8,285	-	-	8,285
Total financial assets	\$ 105,645	\$ -	\$ -	\$ 105,645	\$ 56,841	\$ -	\$ -	\$ 56,841

Investments in money market funds: Woodward sometimes invests excess cash in money market funds not insured by the Federal Deposit Insurance Corporation (“FDIC”). Woodward believes that the investments in money market funds are on deposit with creditworthy financial institutions and that the funds are highly liquid. The investments in money market funds are reported at fair value, with realized gains from interest income realized in earnings and are included in “Cash and cash equivalents.” The fair values of Woodward’s investments in money market funds are based on the quoted market prices for the net asset value of the various money market funds.

Investments in reverse repurchase agreements: Woodward sometimes invests excess cash in reverse repurchase agreements. Under the terms of Woodward’s reverse repurchase agreements, Woodward purchases an interest in a pool of securities and is granted a security interest in those securities by the counterparty to the reverse repurchase agreement. At an agreed upon date, generally the next business day, the counterparty repurchases Woodward’s interest in the pool of securities at a price equal to what Woodward paid to the counterparty plus a rate of return determined daily per the terms of the reverse repurchase agreement. Woodward believes that the investments in these reverse repurchase agreements are with creditworthy financial institutions and that the funds invested are highly liquid. The investments in reverse repurchase agreements are reported at fair value, with realized gains from interest income realized in earnings, and are included in “Cash

and cash equivalents.” Since the investments are generally overnight, the carrying value is considered to be equal to the fair value as the amount is deemed to be a cash deposit with no risk of change in value as of the end of each fiscal quarter.

Equity securities: Woodward holds marketable equity securities, through investments in various mutual funds, related to its deferred compensation program. Based on Woodward’s intentions regarding these instruments, marketable equity securities are classified as trading securities. The trading securities are reported at fair value, with realized gains and losses recognized in “Other (income) expense, net.” The trading securities are included in “Other assets.” The fair values of Woodward’s trading securities are based on the quoted market prices for the net asset value of the various mutual funds.

Accounts receivable and accounts payable are not remeasured to fair value, as the carrying cost of each approximates its respective fair value. The estimated fair values and carrying costs of other financial instruments that are not required to be remeasured at fair value in the Condensed Consolidated Balance Sheets were as follows:

	Fair Value Hierarchy Level	At June 30, 2014		At September 30, 2013	
		Estimated Fair Value	Carrying Cost	Estimated Fair Value	Carrying Cost
Assets:					
Notes receivable from municipalities	2	15,812	15,103	6,718	8,114
Liabilities:					
Long-term debt, including current portion	2	(711,318)	(665,000)	(588,297)	(550,000)

In fiscal years 2013 and 2014, Woodward received long-term notes from a municipality within the state of Illinois in connection with certain economic incentives related to Woodward’s development of a second campus in the greater-Rockford, Illinois area for its Aerospace segment. The fair value of the long-term notes was estimated based on a model that discounted future principal and interest payments received at an interest rate available to the Company at the end of the period for similarly rated municipal notes of similar maturity, which is a level 2 input as defined by the U.S. GAAP fair value hierarchy. The interest rates used to estimate the fair value of the long-term notes were 3.3% at June 30, 2014 and 4.3% at September 30, 2013.

In fiscal year 2013, Woodward received a long-term note from a municipality within the state of Colorado in connection with certain economic incentives related to Woodward’s development of a new campus at its corporate headquarters in Fort Collins, Colorado. The fair value of the long-term note was estimated based on a model that discounted future principal and interest payments received at an interest rate available to the Company at the end of the period for similarly rated municipality notes of similar maturity, which is a level 2 input as defined by the U.S. GAAP fair value hierarchy. The interest rates used to estimate the fair value of the long-term note were 3.3% at June 30, 2014 and 4.3% at September 30, 2013.

The fair value of long-term debt was estimated based on a model that discounted future principal and interest payments at interest rates available to the Company at the end of the period for similar debt of the same maturity, which is a level 2 input as defined by the U.S. GAAP fair value hierarchy. The weighted-average interest rates used to estimate the fair value of long-term debt were 2.4% and 2.0% as of June 30, 2014 and September 30, 2013,

respectively.

Note 6. Derivative instruments and hedging activities

Woodward is exposed to global market risks, including the effect of changes in interest rates, foreign currency exchange rates, changes in certain commodity prices and fluctuations in various producer indices. From time to time, Woodward enters into derivative instruments for risk management purposes only, including derivatives designated as accounting hedges and/or those utilized as economic hedges. Woodward uses interest rate related derivative instruments to manage its exposure to fluctuations of interest rates. Woodward does not enter into or issue derivatives for trading or speculative purposes.

By using derivative and/or hedging instruments to manage its risk exposure, Woodward is subject, from time to time, to credit risk and market risk on those derivative instruments. Credit risk arises from the potential failure of the counterparty to perform under the terms of the derivative and/or hedging instrument. When the fair value of a derivative contract is positive, the counterparty owes Woodward, which creates credit risk for Woodward. Woodward mitigates this credit risk by entering into transactions with only creditworthy counterparties. Market risk arises from the potential adverse effects on the value of derivative and/or hedging instruments that result from a change in interest rates, commodity prices, or foreign currency

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exchange rates. Woodward minimizes this market risk by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

In June 2013, in connection with Woodward's expected refinancing of current maturities on its existing long-term debt, Woodward entered into a treasury lock agreement with a notional amount of \$25,000 that qualified as a cash flow hedge under ASC Topic 815, "Derivatives and Hedging." The objective of this derivative instrument was to hedge the risk of variability in cash flows attributable to changes in the designated benchmark interest rate over a seven-year period related to the future interest payments on a portion of anticipated future debt issuances. An unrealized gain of \$546 on the derivative instrument was recorded in "Other current assets" as of June 30, 2013 as the fair value of the cash flow hedge with the offset recorded to reduce accumulated other comprehensive loss ("accumulated OCI").

Woodward did not enter into any derivatives or hedging transactions during the three or nine-months ended June 30, 2014.

The remaining unrecognized gains and losses in Woodward's Condensed Consolidated Balance Sheets associated with derivative instruments that were previously entered into by Woodward, which are classified in accumulated OCI, were net gains of \$144 and \$71 as of June 30, 2014 and September 30, 2013, respectively.

The following table discloses the impact of derivative instruments in cash flow hedging relationships on Woodward's Condensed Consolidated Statements of Earnings, recognized in interest expense:

	Three-Months Ended June 30, 2014		Nine-Months Ended June 30, 2013	
Amount of (Income) Expense Recognized in Earnings on Derivative	\$ 24	\$ 42	\$ 73	\$ 128
Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	-	(546)	-	(546)
Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings	24	42	73	128

Based on the carrying value of the realized but unrecognized gains and losses on terminated derivative instruments designated as cash flow hedges as of June 30, 2014, Woodward expects to reclassify \$99 of net unrecognized losses on terminated derivative instruments from accumulated other comprehensive earnings to earnings during the next twelve months.

Note 7. Supplemental statement of cash flows information

	Nine-Months Ended	
	June 30,	
	2014	2013
Interest paid, net of amounts capitalized	\$ 26,619	\$ 25,463
Income taxes paid	36,345	33,923
Income tax refunds received	1,617	3,371
Non-cash activities:		
Purchases of property, plant and equipment on account	19,193	1,026
Common shares issued from treasury for benefit plans (Note 18)	11,193	9,780
Notes receivable from municipalities for economic development incentives	6,596	2,064
Cashless exercise of stock options	715	2,645
Settlement of receivable through cashless acquisition of treasury shares in connection with the cashless exercise of stock options	871	3,447

Note 8. Accounts receivable

Almost all of Woodward's sales are made on credit and result in accounts receivable, which are recorded at the amount invoiced. In the normal course of business, not all accounts receivable are collected and, therefore, an allowance for losses of accounts receivable is provided equal to the amount that Woodward believes ultimately will not be collected. In establishing the amount of the allowance, customer-specific information is considered related to delinquent accounts, past loss experience, bankruptcy filings, deterioration in the customer's operating results or financial position, and current economic conditions. Accounts receivable losses are deducted from the allowance, and the related accounts receivable balances are written off when the receivables are deemed uncollectible. Recoveries of accounts receivable previously written off are recognized when received.

Consistent with business practice common in China, Woodward's Chinese subsidiary accepts from Chinese customers, in settlement of certain customer accounts receivable, bank drafts issued by creditworthy Chinese banks. Bank drafts are financial instruments issued by Chinese financial institutions as part of financing arrangements between the financial institution and a customer of the financial institution. Bank drafts represent a commitment by the issuing financial institution to pay a certain amount of money at a specified future maturity date to the legal owner of the bank draft as of the maturity date. The maturity date of bank drafts varies, but it is Woodward's policy to only accept bank drafts with maturity dates no more than 180 days from the date of Woodward's receipt of such draft. The issuing financial institution is the obligor, not Woodward's customers. Upon Woodward's acceptance of a bank draft from a customer, such customer has no further obligation to pay Woodward for the related accounts receivable balance.

Woodward only accepts bank drafts issued by creditworthy banks as to which the credit risk associated with the bank draft is assessed to be minimal.

The composition of Woodward's accounts receivable at June 30, 2014 and September 30, 2013 follows:

	June 30, 2014	September 30, 2013
Accounts receivable from:		
Customers	\$ 279,579	\$ 316,983
Other (Chinese financial institutions)	50,144	72,954
Allowance for uncollectible customer amounts	(7,260)	(8,872)
	\$ 322,463	\$ 381,065

Note 9. Inventories

June 30,	September 30,
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	2014	2013
Raw materials	\$ 56,642	\$ 67,599
Work in progress	94,204	87,808
Component parts (1)	265,865	229,508
Finished goods	52,325	46,829
	\$ 469,036	\$ 431,744

(1) Component parts include items that can be sold separately as finished goods or included in the manufacture of other products.

Note 10. Property, plant, and equipment

	June 30, 2014	September 30, 2013
Land and land improvements	\$ 57,586	\$ 57,562
Buildings and improvements	199,593	195,008
Leasehold improvements	20,926	18,924
Machinery and production equipment	325,916	305,692
Computer equipment and software	104,972	97,538
Office furniture and equipment	24,433	24,400
Other	18,889	14,197
Construction in progress	159,733	81,428
	912,048	794,749
Less accumulated depreciation	(475,574)	(444,701)
Property, plant and equipment, net	\$ 436,474	\$ 350,048

Woodward is developing a second campus in the greater-Rockford, Illinois area for its Aerospace segment in order to address the growth expected over the next ten years and beyond and to support a substantial number of recently awarded new system platforms, particularly on narrow-body aircraft. Included in construction in progress at June 30, 2014 and September 30, 2013 are \$52,410 and \$15,691, respectively, of costs associated with the construction of the second campus, including \$1,870 and \$444, respectively, of capitalized interest.

Woodward is also developing a new campus at its corporate headquarters in Fort Collins, Colorado to support the continued growth of its Energy segment by supplementing its existing Colorado manufacturing facilities and corporate headquarters. Included in construction in progress at June 30, 2014 and September 30, 2013 are \$23,401 and \$10,514, respectively, of costs associated with the construction of the new campus, including \$1,246 and \$394, respectively, of capitalized interest.

In addition, in September 2013, Woodward invested in a building site in Niles, Illinois. Woodward is building a new facility on this site for its Aerospace segment and will relocate some of its operations currently residing in nearby Skokie, Illinois to this new facility. Included in construction in progress at June 30, 2014 and September 30, 2013 are \$34,130 and \$12,067, respectively, of costs associated with the construction of the new facility, including \$1,095 and \$0 respectively, of capitalized interest.

For the three and nine-months ended June 30, 2014 and June 30, 2013, Woodward recorded depreciation expense of the following:

	Three-Months Ended June 30,		Nine-Months Ended June 30,	
	2014	2013	2014	2013
Depreciation expense	\$ 10,489	\$ 8,559	\$ 32,183	\$ 28,971

For the three and nine-months ended June 30, 2014 and June 30, 2013, Woodward had capitalized interest that would have otherwise been included in interest expense of the following:

	Three-Months Ended June 30, 2014		Nine-Months Ended June 30, 2013	
Capitalized interest	\$ 1,676	\$ 322	\$ 3,965	\$ 510

Note 11. Goodwill

	September 30, 2013	Effects of Foreign Currency Translation	June 30, 2014
Aerospace	\$ 455,107	\$ 316	\$ 455,423
Energy	106,351	917	107,268
Consolidated	\$ 561,458	\$ 1,233	\$ 562,691

Woodward tests goodwill for impairment at the reporting unit level on an annual basis and more often if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Based on the relevant U.S. GAAP authoritative guidance, Woodward sometimes aggregates components of a single operating segment into a reporting unit, if appropriate. The impairment tests consist of comparing the implied fair value of each reporting unit with its carrying amount including goodwill. If the carrying amount of the reporting unit exceeds its implied fair value, Woodward compares the implied fair value of goodwill with the recorded carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss would be recognized to reduce the carrying amount to its implied fair value.

Woodward completed its annual goodwill impairment test as of July 31, 2013 during the quarter ended September 30, 2013. At that date, Woodward determined it was appropriate to aggregate certain components of the same operating segment into a single aggregated reporting unit. The fair value of each of Woodward's reporting units was determined using a discounted cash flow method. This method represents a Level 3 input and incorporates various estimates and assumptions, the most significant being projected revenue growth rates, earnings margins, and the present value, based on the discount rate and terminal growth rate, of forecasted cash flows. Management projects revenue growth rates, earnings margins and cash flows based on each reporting unit's current operational results, expected performance and operational strategies over a five or ten-year period. These projections are adjusted to reflect current economic conditions and demand for certain products, and require considerable management judgment.

Forecasted cash flows used in the July 31, 2013 impairment test were discounted using weighted-average cost of capital assumptions ranging from 8.85% to 10.32%. The terminal values of the forecasted cash flows were calculated using the Gordon Growth Model and assumed an annual compound growth rate after five or ten years of 4.25% or 4.50%. These inputs, which are unobservable in the market, represent management's best estimate of what market participants would use in determining the present value of the Company's forecasted cash flows. Changes

in these estimates and assumptions can have a significant impact on the fair value of forecasted cash flows. Woodward evaluated the reasonableness of the reporting unit's resulting fair values utilizing a market multiple method.

The results of Woodward's goodwill impairment tests performed as of July 31, 2013 indicated the estimated fair value of each reporting unit was substantially in excess of its carrying value, and accordingly, no impairment existed.

During the three and nine-months ended June 30, 2014 there were no events or changes in operation that triggered a need to assess goodwill for possible impairment. As part of the Company's ongoing monitoring efforts, Woodward will continue to consider the global economic environment and its potential impact on Woodward's business in assessing goodwill for possible indications of impairment. There can be no assurance that Woodward's estimates and assumptions regarding forecasted cash flows of certain reporting units, the current economic environment, or the other inputs used in forecasting the present value of forecasted cash flows will prove to be accurate projections of future performance.

Note 12. Intangible assets, net

	June 30, 2014			September 30, 2013		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Customer relationships and contracts:						
Aerospace	\$ 281,683	\$ (91,729)	\$ 189,954	\$ 282,225	\$ (77,288)	\$ 204,937
Energy	42,077	(31,866)	10,211	42,008	(29,711)	12,297
Total	\$ 323,760	\$ (123,595)	\$ 200,165	\$ 324,233	\$ (106,999)	\$ 217,234
Intellectual property:						
Aerospace	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Energy	20,296	(15,821)	4,475	20,218	(14,722)	5,496
Total	\$ 20,296	\$ (15,821)	\$ 4,475	\$ 20,218	\$ (14,722)	\$ 5,496
Process technology:						
Aerospace	\$ 76,372	\$ (30,077)	\$ 46,295	\$ 76,718	\$ (26,129)	\$ 50,589
Energy	23,571	(12,939)	10,632	23,458	(11,699)	11,759
Total	\$ 99,943	\$ (43,016)	\$ 56,927	\$ 100,176	\$ (37,828)	\$ 62,348
Other intangibles:						
Aerospace	\$ 47,364	\$ (46,205)	\$ 1,159	\$ 47,351	\$ (44,572)	\$ 2,779
Energy	2,654	(1,890)	764	2,631	(1,713)	918
Total	\$ 50,018	\$ (48,095)	\$ 1,923	\$ 49,982	\$ (46,285)	\$ 3,697
Total intangibles:						
Aerospace	\$ 405,419	\$ (168,011)	\$ 237,408	\$ 406,294	\$ (147,989)	\$ 258,305
Energy	88,598	(62,516)	26,082	88,315	(57,845)	30,470
Consolidated Total	\$ 494,017	\$ (230,527)	\$ 263,490	\$ 494,609	\$ (205,834)	\$ 288,775

For the three and nine-months ended June 30, 2014 and June 30, 2013, Woodward recorded amortization expense of the following:

Three-Months Ended June 30,	Nine-Months Ended June 30,
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	2014	2013	2014	2013
Amortization expense	\$ 8,357	\$ 9,769	\$ 25,498	\$ 27,249

Future amortization expense associated with intangibles is expected to be:

Year Ending September 30:	
2014 (remaining)	\$ 8,096
2015	29,442
2016	27,737
2017	25,968
2018	25,139
Thereafter	147,108
	\$ 263,490

Note 13. Credit facilities, short-term borrowings and long-term debt

	June 30, 2014	September 30, 2013
Revolving credit facility - Floating rate (LIBOR plus 0.85% - 1.65%), due July 2018, unsecured	\$ 165,000	\$ -
Series B notes – 5.63%, due October 2013; unsecured	-	100,000
Series C notes – 5.92%, due October 2015; unsecured	50,000	50,000
Series D notes – 6.39%, due October 2018; unsecured	100,000	100,000
Series E notes – 7.81%, due April 2016; unsecured	57,000	57,000
Series F notes – 8.24%, due April 2019; unsecured	43,000	43,000
Series G notes – 3.42%, due November 2020; unsecured	50,000	-
Series H notes – 4.03%, due November 2023; unsecured	25,000	-
Series I notes – 4.18%, due November 2025; unsecured	25,000	-
Series J notes – Floating rate (LIBOR plus 1.25%), due November 2020; unsecured	50,000	-
Series K notes – 4.03%, due November 2023; unsecured	50,000	-
Series L notes – 4.18%, due November 2025; unsecured	50,000	-
Long-term borrowings under Line of Credit - Variable rate of 1.06% at September 30, 2013; unsecured	-	200,000
Total debt	665,000	550,000
Less: current portion of long-term debt	-	(100,000)
Long-term debt, excluding current portion	\$ 665,000	\$ 450,000

Woodward maintains a \$600,000 revolving credit facility established under a revolving credit agreement between Woodward and a syndicate of lenders led by Wells Fargo Bank, National Association, as administrative agent (the

“Revolving Credit Agreement”). The Revolving Credit Agreement provides for the option to increase available borrowings to up to \$800,000, subject to lenders’ participation, and matures in July 2018. Borrowings under the Revolving Credit Agreement generally bear interest at LIBOR plus 0.85% to 1.65%. Under the Revolving Credit Agreement, there were \$165,000 of borrowings outstanding as of June 30, 2014, at an effective interest rate of 1.20%, and no borrowings outstanding as of September 30, 2013. As of June 30, 2014, the entire outstanding balance under the Revolving Credit Agreement was classified as long-term.

The Revolving Credit Agreement contains certain covenants customary with such agreements, which are generally consistent with the covenants applicable to Woodward’s long-term debt agreements, and contains customary events of default, including certain cross default provisions related to Woodward’s other outstanding debt arrangements in excess of

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\$60,000, the occurrence of which would permit the lenders to accelerate the amounts due thereunder. In addition, the Revolving Credit Agreement includes the following financial covenants: (i) a maximum permitted leverage ratio of consolidated net debt to consolidated earnings before interest, taxes, depreciation, stock-based compensation, and amortization, plus any usual non-cash charges to the extent deducted in computing net income minus any usual non-cash gains to the extent added in computing net income (“Leverage Ratio”) for Woodward and its consolidated subsidiaries not to exceed 3.5 to 1.0, which ratio, subject to certain restrictions, may increase to 4.0 to 1.0 for the fiscal quarter (and the immediately following fiscal quarter) during which a permitted acquisition occurs and to 3.75 to 1.0 for the next two succeeding fiscal quarters, and (ii) a minimum consolidated net worth of \$800,000, plus 50% of Woodward’s positive net income for the prior fiscal year and plus 50% of Woodward’s net cash proceeds resulting from certain issuances of stock, subject to certain adjustments.

Woodward’s obligations under the Revolving Credit Agreement are guaranteed by Woodward FST, Inc., Woodward MPC, Inc., and Woodward HRT, Inc., each of which is a wholly owned subsidiary of Woodward.

In October 2008, Woodward entered into a note purchase agreement (the “2008 Note Purchase Agreement”) relating to the Series B, C, and D Notes (the “2008 Notes”). In April 2009, Woodward entered into a note purchase agreement (the “2009 Note Purchase Agreement”) relating to the Series E and F Notes (the “2009 Notes”).

On October 1, 2013, Woodward entered into a note purchase agreement (the “2013 Note Purchase Agreement” and, together with the 2008 Note Purchase Agreement and the 2009 Note Purchase Agreement, the “Note Purchase Agreements”) relating to the sale by Woodward of an aggregate principal amount of \$250,000 of its senior unsecured notes in a series of private placement transactions.

Woodward issued the Series G, H and I Notes (the “First Closing Notes”) on October 1, 2013 and used the proceeds to repay all of the outstanding balance on the Series B Notes due October 1, 2013.

Woodward issued the Series J, K and L Notes (the “Second Closing Notes” and, together with the 2008 Notes, 2009 Notes and First Closing Notes, the “Notes”) on November 15, 2013 and used the proceeds to partially repay the uncommitted line of credit as discussed below.

Interest on the 2008 Notes, the First Closing Notes, and the Series K and L Notes is payable semi-annually on April 1 and October 1 of each year until all principal is paid. Interest on the 2009 Notes is payable semi-annually on April 15 and October 15 of each year until all principal is paid. Interest on the Series J Notes is payable quarterly on January 1, April 1, July 1 and October 1 of each year until all principal is paid. As of June 30, 2014, the Series J Notes bore interest at an effective rate of 1.48%.

None of the Notes were registered under the Securities Act of 1933 and they may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. Holders of the Notes do not have any registration rights.

All of the issued Notes are held by multiple institutions.

Woodward’s obligations under the Notes are guaranteed by Woodward FST, Inc., Woodward MPC, Inc., and Woodward HRT, Inc., each of which is a wholly owned subsidiary of Woodward. Woodward’s obligations under the Notes rank equal in right of payment with all of Woodward’s other unsecured unsubordinated debt, including its outstanding debt under its revolving credit facility.

On October 1, 2013, Woodward also entered into amendments to the 2008 Note Purchase Agreement and 2009 Note Purchase Agreement that, among other things, conform certain of the affirmative and negative covenants in the 2008

Note Purchase Agreement and the 2009 Note Purchase Agreement, respectively, to the corresponding covenant provisions in the 2013 Note Purchase Agreement.

The Note Purchase Agreements contain restrictive covenants customary for such financings, including, among other things, covenants that place limits on Woodward's ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell Woodward's assets, merge or consolidate with other persons and enter into material transactions with affiliates. Under the financial covenants contained in the Note Purchase Agreements, Woodward's priority debt may not exceed, at any time, 25% of its consolidated net worth. Woodward's Leverage Ratio cannot exceed 4.0 to 1.0 during any material acquisition period, or 3.5 to 1.0 at any other time on a rolling four quarter basis. In the event that Woodward's Leverage Ratio exceeds 3.5 to 1.0 during any material acquisition period, the interest rate on each series of Notes will increase. Further, Woodward's consolidated net worth must at all times equal or exceed \$800,000 plus 50% of Woodward's consolidated net earnings for each fiscal year beginning with the fiscal year ending September 30, 2013. The Note Purchase Agreements also contain customary events of default, including certain cross-default provisions

related to Woodward's other outstanding debt arrangements in excess of \$60,000, the occurrence of which would permit the holders of the respective Notes to accelerate the amounts due.

Woodward, at its option, is permitted at any time to prepay all, or from time to time to prepay any part of, the then outstanding principal amount of any series of the Notes at 100% of the principal amount of the series of Notes to be prepaid (but, in the case of partial prepayment, not less than \$1,000), together with interest accrued on such amount to be prepaid to the date of payment, plus any applicable prepayment compensation amount. The prepayment compensation amount, as to the Notes other than the floating rate Notes, is computed by discounting the remaining scheduled payments of interest and principal of the Notes being prepaid at a discount rate equal to the sum of 50 basis points and the yield to maturity of U.S. Treasury securities having a maturity equal to the remaining average life of the Notes being prepaid. The prepayment compensation amount, as to the floating rate Notes, generally is computed as a percentage of the principal amount of such floating rate Notes equal to (a) 2%, on or prior to November 15, 2014, (b) 1%, after November 15, 2014 and on or prior to November 15, 2015, and (c) 0% after November 15, 2015.

In connection with the 2013 Note Purchase Agreement, Woodward incurred approximately \$1,400 in financing costs, which will be deferred and amortized using the straight-line method over the life of the agreement.

Required future principal payments of the Notes as of June 30, 2014 are as follows:

Year Ending September 30:	
2014 (remaining)	\$ -
2015	-
2016	107,000
2017	-
2018	-
Thereafter	393,000
	\$ 500,000

In connection with the acquisition of the Duarte Business, on December 21, 2012 Woodward entered into a 364 day uncommitted line of credit with JPMorgan Chase Bank, N.A. (the "Line of Credit"). The Line of Credit provided for unsecured loans to Woodward of up to \$200,000 on a revolving basis. Loans made under the Line of Credit bore interest at a floating rate based, at the Company's option, on either the prime rate or an adjusted LIBOR. The Line of Credit was repaid in full and terminated on December 20, 2013.

Short-term borrowings

A Chinese subsidiary of Woodward has a local credit facility with the Hong Kong and Shanghai Banking Company under which it has the ability to borrow up to either \$22,700, or the local currency equivalent of \$22,700. Any cash borrowings under the local Chinese credit facility are secured by a parent guarantee from Woodward. The Chinese subsidiary may utilize the local facility for cash borrowings to support its operating cash needs. Local currency borrowings on the Chinese credit facility are charged interest at the prevailing interest rate offered by the People's Bank of China on the date of borrowing, plus a margin equal to 25% of that prevailing rate. U.S. dollar borrowings on

the credit facility are charged interest at the lender's cost of borrowing rate at the date of borrowing, plus 3%. The Chinese subsidiary had no outstanding cash borrowings against the local credit facility at June 30, 2014 and September 30, 2013.

Woodward also has other foreign lines of credit and foreign overdraft facilities at various financial institutions, which are generally reviewed annually for renewal and are subject to the usual terms and conditions applied by the financial institutions. Pursuant to the terms of the related facility agreements, Woodward's foreign performance guarantee facilities are limited in use to providing performance guarantees to third parties. There were no borrowings outstanding as of June 30, 2014 and September 30, 2013 on Woodward's other foreign lines of credit and foreign overdraft facilities.

Note 14. Accrued liabilities

	June 30, 2014	September 30, 2013
Salaries and other member benefits	\$ 54,177	\$ 66,212
Warranties	16,796	15,224
Interest payable	6,166	11,437
Current portion of acquired performance obligations and unfavorable contracts (1)	14,607	23,977
Accrued retirement benefits	2,251	2,276
Deferred revenues	4,879	6,304
Taxes, other than income	6,941	6,504
Other	24,435	29,807
	\$ 130,252	\$ 161,741

(1) For more information about acquired performance obligations and unfavorable contracts, see Note 4, Business acquisitions.

Warranties

Provisions of Woodward's sales agreements include product warranties customary to these types of agreements. Accruals are established for specifically identified warranty issues that are probable to result in future costs. Warranty costs are accrued on a non-specific basis whenever past experience indicates a normal and predictable pattern exists. Changes in accrued product warranties were as follows:

	Nine-Months Ended June 30,	
	2014	2013
Warranties, beginning of period	\$ 15,224	\$ 15,742
Expense	7,006	7,996
Increases due to acquisition of Duarte Business	-	157

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Reductions for settling warranties	(5,552)	(9,165)
Foreign currency exchange rate changes	118	(20)
Warranties, end of period	\$ 16,796	\$ 14,710

Note 15. Other liabilities

	June 30, 2014	September 30, 2013
Net accrued retirement benefits, less amounts recognized within accrued liabilities	\$ 37,409	\$ 39,956
Total unrecognized tax benefits, net of offsetting adjustments	13,451	20,343
Acquired performance obligations and unfavorable contracts		
(1)	14,622	23,951
Other	31,106	21,260
	\$ 96,588	\$ 105,510

(1) For more information about acquired performance obligations and unfavorable contracts, see Note 4, Business acquisitions.

Note 16. Other (income) expense, net

	Three-Months		Nine-Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
Net (gain) loss on sales of assets	\$ (20)	\$ 152	\$ 116	\$ (78)
Rent income	(124)	(127)	(418)	(387)
Net gain on investments in deferred compensation program	(306)	(20)	(879)	(546)
Other	(19)	117	(85)	(19)
	\$ (469)	\$ 122	\$ (1,266)	\$ (1,030)

Note 17. Income taxes

U.S. GAAP requires that the interim period tax provision be determined as follows:

- At the end of each quarter, Woodward estimates the tax that will be provided for the current fiscal year stated as a percentage of estimated “ordinary income.” The term ordinary income refers to earnings from continuing operations before income taxes, excluding significant unusual or infrequently occurring items.

The estimated annual effective rate is applied to the year-to-date ordinary income at the end of each quarter to compute the estimated year-to-date tax applicable to ordinary income. The tax expense or benefit related to ordinary income in each quarter is the difference between the most recent year-to-date and the prior quarter year-to-date computations.

- The tax effects of significant unusual or infrequently occurring items are recognized as discrete items in the interim period in which the events occur. The impact of changes in tax laws or rates on deferred tax amounts, the effects of changes in judgment about beginning of the year valuation allowances, and changes in tax reserves resulting from the finalization of tax audits or reviews are examples of significant unusual or infrequently occurring items that are recognized as discrete items in the interim period in which the event occurs.

The determination of the annual effective tax rate is based upon a number of significant estimates and judgments, including the estimated annual pretax income of Woodward in each tax jurisdiction in which it operates, and the development of tax planning strategies during the year. In addition, as a global commercial enterprise, Woodward’s tax expense can be impacted by changes in tax rates or laws, the finalization of tax audits and reviews, changes in the estimate of the amount of undistributed foreign earnings that Woodward considers indefinitely reinvested, as well as other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

The following table sets forth the tax expense and the effective tax rate for Woodward’s income from operations:

	Three-Months Ended		Nine-Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Earnings before income taxes	\$ 62,468	\$ 35,497	\$ 152,168	\$ 124,370
Income tax expense	16,467	11,834	37,986	30,893
Effective tax rate	26.4%	33.3%	25.0%	24.8%

The decrease in the year-over-year effective tax rate for the three-months ended June 30, 2014 is attributable to higher earnings in jurisdictions with lower tax rates, reduced taxes on current and anticipated future distributions of foreign earnings to the U.S, and the favorable impact of reviews by tax authorities. This overall year-over-year decrease was partially offset by the lack of a U.S. research and experimentation credit in the three months ended June 30, 2014, as discussed below.

On January 2, 2013, the American Taxpayer Relief Act of 2012 (the "Taxpayer Relief Act") was enacted, which retroactively extended the U.S. research and experimentation tax credit through December 31, 2013. As a result, income taxes for the nine-months ended June 30, 2013 included a net expense reduction of \$6,558 related to the retroactive impact of

the U.S. research and experimentation tax credit pursuant to the Taxpayer Relief Act. The slight increase in effective tax rate for the nine-months ended June 30, 2014 is due to the lack of the retroactive benefit of the research and experimentation credit, offset by larger net favorable resolutions and reviews of tax matters and lapses of applicable statutes of limitations, higher earnings in jurisdictions with lower tax rates, and reduced taxes on current and anticipated future distributions of foreign earnings to the U.S in the current year.

Gross unrecognized tax benefits as of June 30, 2014 and September 30, 2013 were \$14,582 and \$22,694, respectively. Included in the balance of unrecognized tax benefits as of June 30, 2014 and September 30, 2013 are \$11,628 and \$17,838, respectively, of tax benefits that, if recognized, would affect the effective tax rate. At this time, Woodward estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as \$113 in the next twelve months due to the completion of reviews by tax authorities and the expiration of certain statutes of limitations. Woodward accrues for potential interest and penalties related to unrecognized tax benefits in tax expense. Woodward had accrued interest and penalties of \$1,473 as of June 30, 2014 and \$2,066 as of September 30, 2013.

Woodward's tax returns are audited by U.S., state, and foreign tax authorities, and these audits are at various stages of completion at any given time. Reviews of tax matters by authorities and lapses of the applicable statutes of limitations may result in changes to tax expense. During the three-month period ended June 30, 2014, such reviews of tax matters resulted in a net favorable amount of \$1,986. With a few exceptions, Woodward's fiscal years remaining open to examination in the United States include fiscal years 2011 and thereafter, and fiscal years remaining open to examination in significant foreign jurisdictions include 2005 and thereafter.

Note 18. Retirement benefits

Woodward provides various benefits to eligible members of the Company, including contributions to various defined contribution plans, pension benefits associated with defined benefit plans, postretirement medical benefits and postretirement life insurance benefits. Eligibility requirements and benefit levels vary depending on employee location.

Defined contribution plans

Most of the Company's U.S. employees are eligible to participate in the U.S. defined contribution plan. The U.S. defined contribution plan allows employees to defer part of their annual income for income tax purposes into their personal 401(k) accounts. The Company makes contributions to eligible employee accounts, which are also deferred for employee personal income tax purposes. Certain foreign employees are also eligible to participate in foreign plans.

Most of Woodward's U.S. employees with at least two years of service receive an annual contribution of Woodward stock, equal to 5% of their eligible prior year wages, to their personal Woodward Retirement Savings Plan accounts. In the second quarter of fiscal years 2014 and 2013, Woodward fulfilled its annual Woodward stock contribution obligation using shares held in treasury stock by issuing 260 shares of common stock for a total value of \$11,193 and 250 shares of common stock for a total value of \$9,780, respectively.

The amount of expense associated with defined contribution plans was as follows:

	Three-Months Ended June 30,		Nine-Months Ended June 30,	
	2014	2013	2014	2013
Company costs	\$ 5,537	\$ 5,404	\$ 16,219	\$ 14,777

Defined benefit plans

Woodward has defined benefit plans that provide pension benefits for certain retired employees in the United States, the United Kingdom, Japan, and Switzerland. Woodward also provides other postretirement benefits to its employees including postretirement medical benefits and life insurance benefits. Postretirement medical benefits are provided to certain current and retired employees and their covered dependents and beneficiaries in the United States and the United Kingdom. Life insurance benefits are provided to certain retirees in the United States under frozen plans, which are no longer available to current employees. A September 30 measurement date is utilized to value plan assets and obligations for all of Woodward's defined benefit pension and other postretirement benefit plans.

U.S. GAAP requires that, for obligations outstanding as of September 30, 2013, the funded status reported in interim periods shall be the same asset or liability recognized in the previous year end statement of financial position adjusted for (a) subsequent accruals of net periodic benefit cost that exclude the amortization of amounts previously recognized in other

comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (b) contributions to a funded plan or benefit payments.

The components of the net periodic retirement pension costs recognized are as follows:

	Three-Months Ended June 30,					
	United States		Other Countries		Total	
	2014	2013	2014	2013	2014	2013
Service cost	\$ 872	\$ 1,273	\$ 263	\$ 254	\$ 1,135	\$ 1,527
Interest cost	1,602	1,393	616	518	2,218	1,911
Expected return on plan assets	(2,432)	(2,046)	(781)	(639)	(3,213)	(2,685)
Amortization of:						
Net actuarial (gain) loss	83	344	166	113	249	457
Prior service cost (benefit)	19	19	(1)	(2)	18	17
Curtailment (gain) loss	-	-	(915)	-	(915)	-
Net periodic retirement pension (benefit) cost	\$ 144	\$ 983	\$ (652)	\$ 244	\$ (508)	\$ 1,227
Contributions paid	\$ 100	\$ 1,550	\$ 176	\$ 439	\$ 276	\$ 1,989

	Nine-Months Ended June 30,					
	United States		Other Countries		Total	
	2014	2013	2014	2013	2014	2013
Service cost	\$ 2,616	\$ 3,487	\$ 784	\$ 797	\$ 3,400	\$ 4,284
Interest cost	4,815	4,177	1,816	1,591	6,631	5,768
Expected return on plan assets	(7,299)	(6,136)	(2,308)	(1,966)	(9,607)	(8,102)
Amortization of:						
Net actuarial (gain) loss	248	1,031	490	352	738	1,383
Prior service cost (benefit)	56	56	(3)	(6)	53	50
Curtailment (gain) loss	-	-	(915)	-	(915)	-
Net periodic retirement pension (benefit) cost	\$ 436	\$ 2,615	\$ (136)	\$ 768	\$ 300	\$ 3,383
Contributions paid	\$ 400	\$ 4,550	\$ 2,343	\$ 2,696	\$ 2,743	\$ 7,246

The curtailment gain in the three and nine-months ended June 30, 2014 pertained to workforce reductions related to the closure of Woodward's Swiss facility in connection with the realignment of the renewable power business that occurred in the third quarter of fiscal year 2013.

The components of the net periodic other postretirement benefit costs recognized are as follows:

	Three-Months Ended June 30,		Nine-Months Ended June 30,	
	2014	2013	2014	2013
Service cost	\$ 11	\$ 18	\$ 35	\$ 54
Interest cost	358	311	1,074	933
Amortization of:				
Net actuarial (gain) loss	(50)	(17)	(150)	(51)
Prior service cost (benefit)	(40)	(40)	(119)	(119)
Net periodic other postretirement (benefit) cost	\$ 279	\$ 272	\$ 840	\$ 817
Contributions paid	\$ 481	\$ 490	\$ 1,849	\$ 1,833

The amount of cash contributions made to these plans in any year is dependent upon a number of factors, including minimum funding requirements in the jurisdictions in which Woodward operates and arrangements made with trustees of certain foreign plans. As a result, the actual funding in fiscal year 2014 may differ from the current estimate. Woodward estimates its remaining cash contributions in fiscal year 2014 will be as follows:

Retirement pension benefits:	
United States	\$ 100
United Kingdom	694
Japan	-
Switzerland	-
Other postretirement benefits	2,105

Multiemployer defined benefit plans

Woodward operates two multiemployer defined benefit plans for certain employees in the Netherlands and Japan. The amounts of contributions associated with the multiemployer plans were as follows:

	Three-Months Ended June 30,		Nine-Months Ended June 30,	
	2014	2013	2014	2013
Company contributions	\$ 180	\$ 188	\$ 555	\$ 599

Note 19. Stock-based compensation

Stock options

Woodward's 2006 Omnibus Incentive Plan (the "2006 Plan"), which has been approved by Woodward's stockholders, provides for the grant of up to 7,410 stock options to its employees and directors. Woodward believes that these stock options align the interests of its employees and directors with those of its stockholders. Stock option awards are granted with an exercise price equal to the market price of Woodward's stock at the date of grant, a ten-year term, and a four-year vesting schedule at a rate of 25% per year.

The fair value of options granted was estimated on the date of grant using the Black-Scholes-Merton option-valuation model using the assumptions in the following table. Woodward calculates the expected term, which represents the period of time that stock options granted are expected to be outstanding, based upon historical experience of plan participants. Expected volatility is based on historical volatility using daily stock price observations. The estimated dividend yield is

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based upon Woodward's historical dividend practice and the market value of its common stock. The risk-free rate is based on the U.S. treasury yield curve, for periods within the contractual life of the stock option, at the time of grant.

	Three-Months Ended		Nine-Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Expected term (years)	n/a	5.8	5.8 - 8.6	5.8 - 8.6
Estimated volatility	n/a	54.4%	38.5%	48.7% - 54.9%
Estimated dividend yield	n/a	0.9%	0.8%	0.8% - 1.0%
Risk-free interest rate	n/a	0.9%	1.7% - 2.5%	0.8% - 1.3%

The following is a summary of the activity for stock option awards during the three and nine-months ended June 30, 2014:

	Three-Months Ended		Nine-Months Ended	
	June 30, 2014	June 30, 2014	June 30, 2014	June 30, 2014
	Number of options	Weighted-Average Exercise Price per Share	Number of options	Weighted-Average Exercise Price per Share
Options, beginning balance	4,722	\$ 27.74	4,423	\$ 25.06
Options granted	-	n/a	694	40.99
Options exercised	(101)	22.16	(455)	20.00
Options forfeited	(6)	33.87	(47)	34.64
Options, ending balance	4,615	27.86	4,615	27.86

Changes in non-vested stock options during the three and nine-months ended June 30, 2014 were as follows:

	Three-Months Ended		Nine-Months Ended	
	June 30, 2014	June 30, 2014	June 30, 2014	June 30, 2014
	Number of options	Weighted-Average Exercise Price per	Number of options	Weighted-Average Exercise Price per

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	options	Share		options	Share
		\$			
Options, beginning balance	1,707	\$ 34.80		1,737	\$ 29.97
Options granted	-	n/a		694	40.99
Options vested	(14)	32.76		(697)	28.90
Options forfeited	(5)	33.90		(46)	34.66
Options, ending balance	1,688	34.82		1,688	34.82

Information about stock options that have vested, or are expected to vest, and are exercisable at June 30, 2014 was as follows:

	Number	Weighted- Average Exercise Price	Weighted- Average Remaining Life in Years	Aggregate Intrinsic Value
Options outstanding	4,615	\$ 27.86	5.7	\$ 103,020
Options vested and exercisable	2,927	23.85	4.3	77,085
Options vested and expected to vest	4,512	27.66	5.6	101,609
Restricted Stock				

In the first quarter of fiscal year 2014, Woodward granted an award of 24 shares of restricted stock to its Chief Executive Officer and President, Thomas Gendron. Subject to Mr. Gendron's continued employment by the Company, these shares of restricted stock will vest 100% following the end of the Company's fiscal year 2017 if a cumulative earnings per share ("EPS") target is met or exceeded for fiscal years 2014 through 2017. If this EPS target is not met, all shares of restricted stock will be forfeited by Mr. Gendron.

The shares of restricted stock were awarded to Mr. Gendron pursuant to a form restricted stock agreement approved by Woodward's Compensation Committee (the "Committee"), which generally provides that: if the recipient of a restricted stock award is terminated from the Company for any reason other than death or disability during the restricted period, all shares of restricted stock will be immediately forfeited; if the recipient dies or becomes permanently disabled prior to the recipient's termination and during the restricted period, all restrictions will lapse and the shares of restricted stock will fully vest immediately; similarly, in the event of a Change in Control (as defined in the form of restricted stock agreement) of the Company during the restricted period and prior to the recipient's termination for any reason, all restrictions will lapse and the shares of restricted stock will fully vest immediately; during the restricted period, a recipient may exercise full voting rights with respect to the shares of restricted stock; dividends on the shares of restricted stock will accrue, but will not be paid, during the restricted period; and all dividends accrued during the restricted period will be paid upon any vesting of the shares of restricted stock, without payment of interest, provided that if the shares of restricted stock are forfeited for any reason, all accrued dividends will likewise be forfeited. The form of restricted stock agreement also includes adjustment provisions in the event the Company engages in certain recapitalization or similar transactions or in the event of a change of law or regulation. Upon vesting, shares become freely transferrable.

Woodward recognizes stock compensation on a straight-line basis over the requisite service period.

A summary of the activity for restricted stock awards in the three and nine-months ended June 30, 2014 follows:

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	Three-Months Ended		Nine-Months Ended	
	June 30, 2014		June 30, 2014	
	Number	Fair Value per Share	Number	Fair Value per Share
Beginning balance	24	\$ 39.43	-	\$ n/a
Shares granted	-	n/a	24	39.43
Shares vested	-	n/a	-	n/a
Shares forfeited	-	n/a	-	n/a
Ending balance	24	39.43	24	39.43

At June 30, 2014, there was approximately \$13,792 of total unrecognized compensation cost related to non-vested stock-based compensation arrangements, both stock options and restricted stock awards, granted under the 2002 Plan (for which no further grants will be made) and the 2006 Plan. The pre-vesting forfeiture rates for purposes of determining stock-based compensation cost recognized were estimated to be 0% for members of Woodward's board of directors and 9% for all others. The remaining unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 1.9 years.

Note 20. Commitments and contingencies

Woodward is currently involved in claims, pending or threatened litigation, other legal proceedings, investigations and/or regulatory proceedings arising in the normal course of business, including, among others, those relating to product liability claims, employment matters, worker's compensation claims, contractual disputes, product warranty claims and alleged violations of various laws and regulations. Woodward accrues for known individual matters where it believes that it is probable the matter will result in a loss when ultimately resolved using estimates of the most likely amount of loss.

Legal costs are expensed as incurred and are classified in "Selling, general and administrative expenses" on the Condensed Consolidated Statements of Earnings.

Woodward is partially self-insured in the United States for healthcare and worker's compensation up to predetermined amounts, above which third party insurance applies. Management regularly reviews the probable outcome of these claims and proceedings, the expenses expected to be incurred, the availability and limits of the insurance coverage, and the established accruals for liabilities.

While the outcome of pending claims, legal and regulatory proceedings, and investigations cannot be predicted with certainty, management believes that any liabilities that may result from these claims, proceedings and investigations will not have a material effect on Woodward's liquidity, financial condition, or results of operations.

In the event of a change in control of Woodward, as defined in change-in-control agreements with its current corporate officers, Woodward may be required to pay termination benefits to such officers.

Note 21. Segment information

Woodward serves the aerospace market and the energy market through its two reportable segments - Aerospace and Energy. Woodward's reportable segments are aggregations of Woodward's operating segments. Woodward uses reportable segment information internally to manage its business, including the assessment of business segment performance and decisions for the allocation of resources between segments.

The accounting policies of the reportable segments are the same as those of the Company. Woodward evaluates segment profit or loss based on internal performance measures for each segment in a given period. In connection with that assessment, Woodward excludes matters such as charges for restructuring costs, interest income and expense, and certain gains and losses from asset dispositions.

A summary of consolidated net sales and earnings by segment follows:

	Three-Months Ended		Nine-Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Segment external net sales:				
Aerospace	\$ 274,923	\$ 272,218	\$ 765,816	\$ 754,100

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Energy	249,361	211,541	669,977	623,511
Total consolidated net sales	\$ 524,284	\$ 483,759	\$ 1,435,793	\$ 1,377,611
Segment earnings:				
Aerospace	\$ 39,357	\$ 38,949	\$ 102,195	\$ 111,740
Energy	40,203	12,430	99,162	60,573
Total segment earnings	79,560	51,379	201,357	172,313
Nonsegment expenses	(11,193)	(9,227)	(31,159)	(27,952)
Interest expense, net	(5,899)	(6,655)	(18,030)	(19,991)
Consolidated earnings before income taxes	\$ 62,468	\$ 35,497	\$ 152,168	\$ 124,370

Segment assets consist of accounts receivable, inventories, property, plant, and equipment, net, goodwill, and other intangibles, net. A summary of consolidated total assets by segment follows:

	June 30, 2014	September 30, 2013
Segment assets:		
Aerospace	\$ 1,385,207	\$ 1,361,861
Energy	600,974	599,007
Total segment assets	1,986,181	1,960,868
Unallocated corporate property, plant and equipment, net	64,990	50,115
Other unallocated assets	271,902	207,535
Consolidated total assets	\$ 2,323,073	\$ 2,218,518

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Amounts in thousands, except per share amounts)

Forward Looking Statements

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains forward-looking statements regarding future events and our future results within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are statements that are deemed forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of management. Words such as "anticipate," "believe," "estimate," "seek," "goal," "expect," "forecast," "intend," "continue," "project," "target," "strive," "can," "could," "may," "should," "will," "would," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characteristics of future events or circumstances are forward-looking statements. Forward-looking statements may include, among others, statements relating to:

- future sales, earnings, cash flow, uses of cash, and other measures of financial performance;
- descriptions of our plans and expectations for future operations;
- the effect of economic downturns or growth in particular regions;
- the effect of changes in the level of activity in particular industries or markets;
- the availability and cost of materials, components, services, and supplies;
- the scope, nature, or impact of acquisition activity and integration of such acquisitions into our businesses;
- the development, production, and support of advanced technologies and new products and services;
- new business opportunities;
- restructuring and alignment costs and savings;
- our plans, objectives, expectations and intentions with respect to recent acquisitions and expected business opportunities that may be available to us;
- the outcome of contingencies;
- future repurchases of common stock;
- future levels of indebtedness.