Woodward, Inc.
Form 10-Q
July 24, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from to

Commission file number 0-8408

WOODWARD, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-1984010**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
1000 East Drake Road, Fort Collins, Colorado	**80525**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(970) 482-5811

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 x 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 x No ¨

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

As of July 19, 2012, 68,728,097 shares of the common stock with a par value of $0.001455 per share were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share amounts)

(Unaudited)

	Three-Months Ending June 30, 2012	Three-Months Ending June 30, 2011	Nine-Months Ending June 30, 2012	Nine-Months Ending June 30, 2011
Net sales	$ 460,241	$ 438,467	$ 1,336,930	$ 1,222,408
Costs and expenses:				
Cost of goods sold	329,451	304,441	936,354	858,138
Selling, general and administrative expenses	39,627	38,470	118,984	109,581
Research and development costs	38,958	29,273	107,197	80,061
Amortization of intangible assets	8,139	8,935	24,691	26,020
Interest expense	6,611	6,361	19,471	19,161
Interest income	(265)	(117)	(475)	(325)
Other (income) expense, net (Note 15)	12	249	(1,214)	955
Total costs and expenses	422,533	387,612	1,205,008	1,093,591
Earnings before income taxes	37,708	50,855	131,922	128,817
Income tax expense	9,406	14,799	36,452	38,272
Net earnings	**$ 28,302**	**$ 36,056**	**$ 95,470**	**$ 90,545**
Earnings per share (Note 3):				
Basic earnings per share	$ 0.41	$ 0.52	$ 1.38	$ 1.32
Diluted earnings per share	$ 0.40	$ 0.51	$ 1.36	$ 1.29
Weighted Average Common Shares Outstanding (Note 3):				
Basic	68,922	68,793	68,973	68,785
Diluted	70,319	70,166	70,446	70,155
Cash dividends per share paid to Woodward common stockholders	$ 0.08	$ 0.07	$ 0.23	$ 0.20

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2012	**2011**	**2012**	**2011**
Net earnings	$ 28,302	$ 36,056	$ 95,470	$ 90,545
Other comprehensive earnings:				
Foreign currency translation adjustments	(13,565)	8,414	(14,018)	17,043
Taxes on changes on foreign currency translation adjustments	(1,166)	(875)	2,127	(1,791)
	(14,731)	7,539	(11,891)	15,252
Reclassification of realized losses on derivatives to earnings	43	57	131	172
Taxes on changes on derivative transactions	(16)	(22)	(50)	(65)
	27	35	81	107
Minimum retirement benefit liability foreign currency exchange rate changes	9	(90)	91	(268)
Total comprehensive earnings	$ 13,607	$ 43,540	$ 83,751	$ 105,636

See accompanying Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

WOODWARD, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	June 30, 2012	September 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,903	$ 74,539
Accounts receivable, less allowance for losses of $4,891 and $2,322, respectively	300,661	297,614
Inventories	423,994	381,555
Income taxes receivable	8,300	2,456
Deferred income tax assets	38,692	38,270
Other current assets	40,689	23,359
Total current assets	852,239	817,793
Property, plant and equipment, net	214,146	206,725
Goodwill	460,509	462,282
Intangible assets, net	243,493	268,897
Deferred income tax assets	8,100	10,466
Other assets	15,750	15,271
Total assets	$ 1,794,237	$ 1,781,434
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 5,000	$
Current portion of long-term debt	7,549	18,374
Accounts payable	120,893	123,453
Income taxes payable	3,394	5,440
Deferred income tax liabilities	800	74
Accrued liabilities	98,556	133,516
Total current liabilities	236,192	280,857
Long-term debt, less current portion	401,250	406,875
Deferred income tax liabilities	85,547	85,911
Other liabilities	90,589	88,694
Total liabilities	813,578	862,337
Commitments and contingencies (Note 19)		
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	95,913	81,453
Accumulated other comprehensive (loss) earnings	(8,093)	3,626
Deferred compensation	4,323	4,581
Retained earnings	1,029,188	949,573
	1,121,437	1,039,339

Treasury stock at cost, 4,232 shares and 4,070 shares, respectively	(136,455)	(115,661)
Treasury stock held for deferred compensation, at cost, 275 shares and 315 shares, respectively	(4,323)	(4,581)
Total stockholders equity	980,659	919,097
Total liabilities and stockholders equity	$ 1,794,237	$ 1,781,434

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine-Months Ending June 30, 2012	Nine-Months Ending June 30, 2011
Cash flows from operating activities:		
Net earnings	$ 95,470	$ 90,545
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	53,870	57,299
Net (gain) loss on sales of assets	(84)	429
Stock-based compensation	6,680	5,370
Excess tax benefits from stock-based compensation	(3,778)	(2,581)
Deferred income taxes	91	(1,011)
Loss on derivatives reclassified from accumulated comprehensive earnings into earnings	131	172
Changes in operating assets and liabilities:		
Accounts receivable	(8,003)	(11,922)
Inventories	(46,918)	(77,389)
Accounts payable and accrued liabilities	(19,284)	(16,126)
Current income taxes	(4,168)	10,434
Retirement benefit obligations	(766)	(3,230)
Other	(9,588)	(5,190)
Net cash provided by operating activities	63,653	46,800
Cash flows from investing activities:		
Payments for purchase of property, plant, and equipment	(44,224)	(32,640)
Proceeds from sale of assets	231	30
Business acquisitions, net of cash and marketable securities acquired		(38,698)
Business acquisitions, marketable securities acquired		(8,463)
Proceeds from the sale of marketable securities		8,217
Net cash used in investing activities	(43,993)	(71,554)
Cash flows from financing activities:		
Cash dividends paid	(15,855)	(13,764)
Proceeds from sales of treasury stock	5,754	2,078
Payments for repurchases of common stock	(31,881)	(6,837)
Excess tax benefits from stock compensation	3,778	2,581
Borrowings on revolving lines of credit and short-term borrowings	185,129	126,098
Payments on revolving lines of credit and short-term borrowings	(180,189)	(103,158)
Payments of long-term debt	(16,440)	(16,500)
Payment of debt financing costs	(2,185)	
Net cash used in financing activities	(51,889)	(9,502)
Effect of exchange rate changes on cash and cash equivalents	(2,407)	1,275
Net change in cash and cash equivalents	(34,636)	(32,981)

Cash and cash equivalents at beginning of period		74,539		105,579
Cash and cash equivalents at end of period	$	39,903	$	72,598

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands)

(Unaudited)

	Number of shares				Stockholders equity										
							Accumulated other comprehensive (loss) earnings								
	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	Deferred compensaton	Retained earnings	Treasury stock at cost	Treasury stock held for deferred compensation	Total stockholders equity
Balances as of October 1, 2010		72,960	(4,223)	(356)	$ 106	$ 73,915	$ 23,152	$ (627)	$ (16,183)	$ 6,342	$ 4,888	$ 835,919	$ (113,088)	$ (4,888)	$ 803,194
Net earnings												90,545			90,545
Cash dividends paid												(13,764)			(13,764)
Purchases of treasury stock			(242)										(7,961)		(7,961)
Sales of treasury stock			310			(1,754)							4,963		3,209
Tax benefit attributable to exercise of stock options						2,581									2,581
Stock-based compensation						5,370									5,370
Purchases of stock by deferred compensation plan			2	(2)		33					128			(128)	33
Distribution of stock from deferred compensation plan				43							(445)			445	
Foreign currency translation adjustments							17,043			17,043					17,043
Reclassification of unrecognized derivative losses to earnings								172		172					172
Minimum retirement benefits liability adjustments									(413)	(413)					(413)
Taxes on changes in accumulated							(1,791)	(65)	145	(1,711)					(1,711)

other comprehensive earnings														
Balances as of June 30, 2011	72,960	(4,153)	(315)	$ 106	$ 80,145	$ 38,404	$ (520)	$ (16,451)	$ 21,433	$ 4,571	$ 912,700	$ (116,086)	$ (4,571)	$ 898,298
Balances as of October 1, 2011	72,960	(4,070)	(315)	$ 106	$ 81,453	$ 22,103	$ (484)	$ (17,993)	$ 3,626	$ 4,581	$ 949,573	$ (115,661)	$ (4,581)	$ 919,097
Net earnings											95,470			95,470
Cash dividends paid											(15,855)			(15,855)
Purchases of treasury stock		(792)										(31,881)		(31,881)
Sales of treasury stock		418			(1,295)							6,941		5,646
Common shares issued from treasury stock for benefit plans		209			5,238							4,097		9,335
Tax benefit attributable to exercise of stock options					3,778									3,778
Stock-based compensation					6,680									6,680
Purchases of stock by deferred compensation plan		3	(4)		59					179		49	(179)	108
Distribution of stock from deferred compensation plan			44							(437)			437	
Foreign currency translation adjustments						(14,018)			(14,018)					(14,018)
Reclassification of unrecognized derivative losses to earnings							131		131					131
Minimum retirement benefits liability adjustments								141	141					141
Taxes on changes in accumulated other comprehensive earnings						2,127	(50)	(50)	2,027					2,027
Balances as of June 30, 2012	72,960	(4,232)	(275)	$ 106	$ 95,913	$ 10,212	$ (403)	$ (17,902)	$ (8,093)	$ 4,323	$ 1,029,188	$ (136,455)	$ (4,323)	$ 980,659

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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, 2012 and for the three and nine-months ending June 30, 2012 and June 30, 2011, 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, 2012, and the statements of earnings, comprehensive earnings, cash flows, and changes in the statement of stockholders equity for the periods presented herein. The Condensed Consolidated Balance Sheet as of September 30, 2011 was derived from Woodward s Annual Report on Form 10-K for the fiscal year then ended. The results of operations for the three and nine-months ending June 30, 2012 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 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. Significant estimates in these Condensed Consolidated Financial Statements include allowances for losses on receivables, net realizable value of inventories, warranty reserves, timing of recognition on percentage complete on long-term contracts, cost of sales incentives, useful lives of property and identifiable intangible assets, the evaluation of impairments of property, 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.

Woodward serves two significant markets the aerospace market and the energy market. In order to better serve these markets, Woodward completed a realignment of its reportable segments at September 30, 2011 and now reports its financial results through two reportable segments Aerospace and Energy. The Aerospace segment combines the aircraft propulsion portion of the former Turbine Systems business group, now referred to as the Aircraft Turbine Systems business group, with the Airframe Systems business group. The Energy segment combines the industrial turbine portion of the former Turbine Systems business group, now referred to as the Industrial Turbomachinery Systems business group, with the Engine Systems and Electrical Power Systems business groups.

Prior period information has been revised to be consistent with the Company s current reportable segment structure, which is based upon how it managed its business as of September 30, 2011 and during the first nine months of fiscal year 2012.

Note 2. Recent accounting pronouncements

From time to time, the Financial Accounting Standards Board (FASB) or other standard-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 September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment. ASU 2011-08 allows companies to perform a qualitative assessment to determine whether or not the current two-step quantitative testing method, in which a company compares the fair value of reporting units to its carrying amount including goodwill, must be followed. If a qualitative assessment indicates that it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, then the quantitative impairment test is not required. A company may choose to use the qualitative assessment on none, some, or all if its reporting units or to bypass the qualitative assessment and proceed directly to the two-step quantitative testing method. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011; however, early adoption is permitted. Woodward does not anticipate that the adoption of ASU 2011-08 will have a material impact on Woodward s Condensed Consolidated Financial Statements.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 the assumed conversion of all dilutive securities.

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

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2012	2011	2012	2011
Numerator:				
Net earnings	$ 28,302	$ 36,056	$ 95,470	$ 90,545
Denominator:				
Basic shares outstanding	68,922	68,793	68,973	68,785
Dilutive effect of stock options	1,397	1,373	1,473	1,370
Diluted shares outstanding	70,319	70,166	70,446	70,155
Income per common share:				
Basic earnings per share	$ 0.41	$ 0.52	$ 1.38	$ 1.32
Diluted earnings per share	$ 0.40	$ 0.51	$ 1.36	$ 1.29

The following stock option grants were outstanding during the three and nine-months ending June 30, 2012 and 2011, but were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2012	2011	2012	2011
Options	31	678	45	679
Weighted-average option price	$ 41.53	$ 32.06	$ 35.87	$ 32.03

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

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2012	2011	2012	2011
Weighted-average treasury stock shares held for deferred compensation obligations	284	324	299	340

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 4. Business acquisitions

IDS Acquisition

During the third quarter of fiscal year 2011, Woodward acquired all of the outstanding stock of Integral Drive Systems AG and its European companies, including their respective holding companies (IDS), and the assets of IDS s business in China (collectively, the IDS Acquisition) for an aggregate cash purchase price of $48,412 paid to the sellers.

IDS is a developer and manufacturer of innovative power electronic systems predominantly in utility scale wind turbines and photovoltaic power plants. IDS also offers key products for power distribution and marine propulsion systems. In addition to wind turbines and photovoltaic plants, its products are used in offshore oil and gas platforms, energy storage and distribution systems, and a variety of industrial applications. IDS has been integrated into Woodward s Energy segment.

The Company believes the IDS Acquisition expands its presence in wind converter offerings and reduces its time to market with expansion of solar energy, energy storage, and marine drives. Goodwill recorded in connection with the IDS Acquisition, which is not deductible for income tax purposes, represents the estimated value of such future opportunities, the value of potential expansion with new customers, the opportunity to further develop sales opportunities with new and acquired IDS customers, and anticipated synergies expected to be achieved through the integration of IDS into Woodward s Energy segment.

As of June 30, 2012, an amount of $7,659 paid in connection with the IDS Acquisition was deposited into escrow accounts to secure Woodward s ability to recover any amounts owed to Woodward by the sellers as a result of customary indemnities related to representations and warranties made by the sellers. Funds held in escrow will only be released to the sellers as specified in the related purchase agreements.

The purchase price of the IDS Acquisition is as follows:

Cash paid to sellers	$ 48,412
Less cash acquired	(1,251)
Total purchase price	47,161
Less marketable securities acquired	(8,463)
Price paid for business assets	$ 38,698

The allocation of the purchase price to the assets acquired and liabilities assumed was finalized as of March 31, 2012. Assets acquired and liabilities assumed in the transaction were recorded at their acquisition date fair values, while transaction costs associated with the acquisition were expensed as incurred. The Company s allocation was based on an evaluation of the appropriate fair values and represents management s best estimate based on available data.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the IDS Acquisition:

Current assets	$ 14,627
Investments in marketable securities	8,463
Property, plant, and equipment	1,954
Goodwill	24,188
Intangible assets	11,882
Total assets acquired	61,114
Other current liabilities	5,505
Warranty accrual	2,250
Postretirement benefits	434
Deferred tax liabilities	2,472
Other tax noncurrent	3,292
Total liabilities assumed	13,953
Net assets acquired	$ 47,161

There were no changes to the values of assets acquired and liabilities assumed during the nine-months ending June 30, 2012. The fair value of warranty liabilities assumed represents the estimated costs to provide service for contractual warranty obligations on products sold by IDS and IDS s business in China prior to the IDS Acquisition. The fair value of Other tax noncurrent represents the estimated value of gross unrecognized tax benefits assumed.

In connection with the IDS Acquisition, Woodward acquired various marketable securities, which are not classified as cash equivalents under U.S. GAAP. These marketable securities were sold during the fiscal quarter ended June 30, 2011 and reinvested into cash and cash equivalents consistent with Woodward s internal investment and risk management policies. Losses on the sale of marketable securities were included in Other (income) expense, net in the Condensed Consolidated Statements of Earnings for the fiscal quarter ended June 30, 2011.

Also, in connection with the IDS Acquisition, Woodward assumed the net postretirement benefit obligations of five Swiss statutory retirement plans which are considered to be defined benefit plans under U.S. GAAP.

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

	Amount	Weighted-Average Useful Life	Amortization Method
Customer relationships	$ 3,452	9 years	Straight-line
Process technology	7,752	8.5 years	Straight-line

Other	678	2.5 years	Straight-line
Total	$ 11,882	8 years	

The operating results of the IDS Acquisition are included in Woodward s Consolidated Statements of Earnings and Comprehensive Earnings beginning April 15, 2011. Pro forma financial disclosures have not been presented, as the IDS Acquisition was not significant to Woodward s financial position or results of operations. The Company incurred IDS Acquisition related transaction costs of $2,396 during the year ending September 30, 2011, which were included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. No additional IDS Acquisition related transaction costs were incurred in the nine-months ending June 30, 2012.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 5. Financial instruments and fair value measurements

The estimated fair values of Woodward s financial instruments were as follows:

	At June 30, 2012		At September 30, 2011	
	Estimated Fair Value	Carrying Cost	Estimated Fair Value	Carrying Cost
Cash and cash equivalents	$ 39,903	$ 39,903	$ 74,539	$ 74,539
Investments in deferred compensation program	7,024	7,024	5,855	5,855
Short-term borrowings	(5,000)	(5,000)		
Long-term debt, including current portion	(461,123)	(408,799)	(482,776)	(425,246)

The fair values of cash and cash equivalents, which include investments in money market funds and reverse repurchase agreements for the overnight investment of excess cash in U.S. government and government agency obligations, are assumed to be equal to their carrying amounts. Cash and cash equivalents have short-term maturities and market interest rates. Woodward s cash and cash equivalents include funds deposited or invested in the U.S. and overseas that are not insured by the Federal Deposit Insurance Corporation (FDIC). Woodward believes that its deposited and invested funds are held by or invested with credit worthy financial institutions or counterparties.

Investments related to the deferred compensation program used to provide deferred compensation benefits to certain employees are carried at market value.

The fair values of short-term borrowings at variable interest rates are assumed to be equal to their carrying amounts because such borrowings may be repaid or settled for their carrying amounts within a short period of time.

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 below. The weighted-average interest rates used to estimate the fair value of long-term debt were as follows:

	June 30, 2012	September 30, 2011
Weighted-average interest rate used to estimate fair value	2.4%	2.6%

Financial assets and liabilities recorded at fair value in the Condensed Consolidated Balance Sheet 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.

12

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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, 2012 or September 30, 2011.

	At June 30, 2012				At September 30, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets:								
Investments in money market funds	$ 10,135	$	$	$ 10,135	$ 10,823	$	$	$ 10,823
Equity securities	7,024			7,024	5,855			5,855
Total financial assets	$ 17,159	$	$	$ 17,159	$ 16,678	$	$	$ 16,678

Investments in money market funds: Woodward sometimes invests excess cash in money market funds not insured by the 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 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.

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 earnings. The trading securities are included in Other current 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.

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

Derivatives in foreign currency relationships

Woodward did not enter into any hedging transactions during the three or nine-months ending June 30, 2012 and was not a party to any derivative instruments as of June 30, 2012 or September 30, 2011.

In September 2010, Woodward entered into a foreign currency exchange rate contract to purchase 39,000 for approximately $52,549 in early December 2010. An unrealized gain of $579 on this derivative was carried at fair market value in Other current assets as of September 30, 2010. In December 2010, a loss of $1,033 was realized on the settlement of this forward contract and was recorded in Other (income) expense, net.

The objective of this derivative instrument, which was not designated as an accounting hedge, was to limit the risk of foreign currency exchange rate fluctuations on certain short-term intercompany loan balances.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

The following table discloses the remaining unrecognized gains and losses in Woodward s Condensed Consolidated Balance Sheets associated with terminated derivative instruments that were previously entered into by the Company:

Derivatives designated as hedging instruments	June 30, 2012	September 30, 2011
	Unrecognized Gain (Loss)	
Classified in accumulated other comprehensive earnings	$ (651)	$ (781)
Classified in current and long-term debt		3
	$ (651)	$ (778)

The following tables disclose the impact of derivative instruments on Woodward s Condensed Consolidated Statements of Earnings:

		Three-Months Ending June 30, 2012			Three-Months Ending June 30, 2011		
Derivatives in:	Location of (Gain) Loss Recognized in Earnings	Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings	Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings
Fair value hedging relationships	Interest expense	$	$	$	$ (17)	$	$
Cash flow hedging relationships	Interest expense	42		42	57		57
		$ 42	$	$ 42	$ 40	$	$ 57

		Nine-Months Ending June 30, 2012			Nine-Months Ending June 30, 2011		
Derivatives in:	Location of (Gain) Loss Recognized in Earnings	Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings	Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings
Fair value hedging relationships	Interest expense	$ (3)	$	$	$ (51)	$	$
Cash flow hedging relationships	Interest expense	130		130	172		172
Foreign currency relationships	Other (income) expense				1,612		

$ 127	$	$ 130	$ 1,733	$	$ 172

Based on the carrying value of the unrecognized gains and losses on terminated derivative instruments designated as cash flow hedges as of June 30, 2012, Woodward expects to reclassify $171 of net unrecognized losses on terminated derivative instruments from accumulated other comprehensive earnings to earnings during the next twelve months.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 7. Supplemental statements of cash flows information

	Nine-Months Ending June 30,	
	2012	**2011**
Interest paid, net of amounts capitalized	$ 25,011	$ 25,596
Income taxes paid	41,903	33,549
Income tax refunds received	2,841	9,269
Non-cash activities:		
Purchases of property, plant and equipment on account	1,275	1,881
Common shares issued from treasury stock for benefit plans (Note 17)	9,335	
Cashless exercise of stock options		1,124
Reduction of accounts receivable and short-term borrowing due to the settlement of accounts receivable previously sold with recourse		3,228
Reduction of accounts payable due to the assignment of accounts receivable with recourse		570
Reduction to goodwill due to favorable resolution of lease termination recorded in restructuring reserve		103
Payment of director fees through issuance of treasury stock		38

Note 8. Inventories

	June 30, 2012	September 30, 2011
Raw materials	$ 30,943	$ 43,172
Work in progress	94,112	108,718
Component parts and finished goods	298,939	229,665
	$ 423,994	$ 381,555

Note 9. Property, plant, and equipment, net

	June 30, 2012	September 30, 2011
Land	$ 14,422	$ 14,823
Buildings and improvements	191,774	177,637
Leasehold improvements	20,079	18,765
Machinery and production equipment	265,213	265,898
Computer equipment and software	81,018	66,149
Other	25,330	25,191

Construction in progress	39,814	44,975
	637,650	613,438
Less accumulated depreciation	(423,504)	(406,713)
Property, plant and equipment, net	$ 214,146	$ 206,725

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

	Three-Months Ending June 30, 2012	Three-Months Ending June 30, 2011	Nine-Months Ending June 30, 2012	Nine-Months Ending June 30, 2011
Depreciation expense	$ 9,497	$ 10,955	$ 29,179	$ 31,279

During fiscal year 2010, Woodward began construction of a new forty-eight thousand square foot system test facility in Rockford, Illinois. In the first nine months of fiscal year 2012, Woodward placed into service assets totaling $16,738 associated with the new system test facility, the majority of which is included in Buildings and improvements. As of June 30, 2012, $5,511 of assets related to the system test facility remained as construction in progress and are expected to be placed into service by the end of fiscal year 2012. The facility, which houses numerous environmental system test cells and a vibration lab, will support, among other development projects, Woodward s Aerospace segment development efforts of next generation fuel systems for aircraft turbines.

The increase in Computer equipment and software of $14,869 was primarily related to assets that were placed into service during the first nine months of fiscal year 2012 associated with a new enterprise resource planning (ERP) system for a group within Woodward s Aerospace segment.

For the three and nine-months ending June 30, 2012 and June 30, 2011, Woodward had capitalized interest that would have otherwise been included in interest expense as follows:

	Three-Months Ending June 30, 2012	Three-Months Ending June 30, 2011	Nine-Months Ending June 30, 2012	Nine-Months Ending June 30, 2011
Capitalized interest	$ 147	$ 383	$ 575	$ 896

Note 10. Goodwill

	September 30, 2011	Effects of Foreign Currency Translation	June 30, 2012
Aerospace	$ 356,525	$ 30	$ 356,555
Energy	105,757	(1,803)	103,954
Consolidated	$ 462,282	$ (1,773)	$ 460,509

Woodward tests goodwill for impairment at the individual or aggregate reporting unit level, as appropriate, 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. The impairment tests consist of comparing the implied fair value of each identified 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, 2011 during the quarter ended September 30, 2011. As a part of that test, 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, operating earnings margins, and forecasted cash flows based on the discount rate and terminal growth rate. Management projects revenue growth rates, operating 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 economic conditions and the demand for certain products and require considerable management judgment.

16

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Forecasted cash flows used in the July 31, 2011 impairment test were discounted using weighted-average cost of capital assumptions from 10.0% to 10.2%. 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 4.3%. 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 units resulting fair values utilizing a market multiple method.

The results of Woodward s goodwill impairment tests performed as of July 31, 2011 indicated the estimated fair value of each reporting unit was substantially in excess of its carrying value, and accordingly, no impairment existed.

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 at a reporting unit level in assessing goodwill recoverability. There can be no assurance that Woodward s estimates and assumptions regarding forecasted cash flows of certain reporting units, the period or strength of the current economic recovery, or the other inputs used in forecasting the present value of forecasted cash flows will prove to be accurate projections of future performance.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 11. Other intangibles, net

	June 30, 2012			September 30, 2011		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Customer relationships:						
Aerospace	$ 205,177	$ (54,880)	$ 150,297	$ 205,171	$ (41,652)	$ 163,519
Energy	41,711	(25,857)	15,854	41,991	(23,696)	18,295
Total	$ 246,888	$ (80,737)	$ 166,151	$ 247,162	$ (65,348)	$ 181,814
Intellectual property:						
Aerospace	$	$	$	$	$	$
Energy	19,919	(12,843)	7,076	20,162	(11,918)	8,244
Total	$ 19,919	$ (12,843)	$ 7,076	$ 20,162	$ (11,918)	$ 8,244
Process technology:						
Aerospace	$ 71,694	$ (19,309)	$ 52,385	$ 71,691	$ (15,380)	$ 56,311
Energy	23,100	(9,179)	13,921	23,451	(7,657)	15,794
Total	$ 94,794	$ (28,488)	$ 66,306	$ 95,142	$ (23,037)	$ 72,105
Other intangibles:						
Aerospace	$ 39,637	$ (36,985)	$ 2,652	$ 39,635	$ (34,655)	$ 4,980
Energy	2,504	(1,196)	1,308	2,621	(867)	1,754
Total	$ 42,141	$ (38,181)	$ 3,960	$ 42,256	$ (35,522)	$ 6,734
Total intangibles:						
Aerospace	$ 316,508	$ (111,174)	$ 205,334	$ 316,497	$ (91,687)	$ 224,810
Energy	87,234	(49,075)	38,159	88,225	(44,138)	44,087
Consolidated Total	$ 403,742	$ (160,249)	$ 243,493	$ 404,722	$ (135,825)	$ 268,897

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2012	2011	2012	2011
Amortization expense	$ 8,139	$ 8,935	$ 24,691	$ 26,020

Future amortization expense associated with intangibles is expected to be:

Year Ending September 30:	
2012 (remaining)	$ 8,124
2013	30,418
2014	27,270
2015	24,764
2016	23,397
Thereafter	129,520
	$ 243,493

18

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 12. Credit facilities, short-term borrowings and long-term debt

As of December 31, 2011, Woodward had a $225,000 revolving credit facility related to unsecured financing arrangements with a syndicate of U.S. banks. The revolving credit facility agreement provided for an option to increase available borrowings to $350,000, subject to the lenders participation, and had an expiration date of October 2012. The interest rate on borrowings under the revolving credit facility agreement varied with LIBOR, the federal funds rate, or the prime rate.

On January 4, 2012, the $225,000 revolving credit facility was amended and restated by the Third Amended and Restated Credit Agreement (the Amended and Restated Revolver Agreement) entered into between Woodward and a syndicate of nine lenders led by JPMorgan Chase Bank, N.A., as administrative agent. The Amended and Restated Revolver Agreement extended the existing revolving credit facility s maturity to January 2017. The borrowing capacity increased from $225,000 to $400,000 and the option, subject to the lenders participation, to expand the commitment increased from $125,000 to $200,000, for a total borrowing capacity of up to $600,000. Borrowings under the Amended and Restated Revolver Agreement generally bear interest at LIBOR plus 0.95% to 1.525%. There were no outstanding borrowings under the revolving credit facility as of June 30, 2012.

The Amended and Restated Revolver 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 $30,000, the occurrence of which would permit the lenders to accelerate the amounts due thereunder. In addition, the Amended and Restated Revolver Agreement increases the minimum required consolidated net worth of Woodward to a base of $725,000, 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 also made amendments to its existing Term Loan Credit Agreement, dated as of October 1, 2008 (the Term Loan Agreement), that provided for certain changes to, among other things, the affirmative, negative and financial covenants of the Term Loan Agreement consistent with the covenant provisions in the Amended and Restated Revolver Agreement.

Woodward s obligations under the Amended and Restated Revolver Agreement and the Term Loan Agreement are guaranteed by Woodward FST, Inc., MPC Products Corporation and Woodward HRT, Inc., each of which is a wholly owned subsidiary of Woodward.

In connection with the Amended and Restated Revolver Agreement, Woodward incurred $2,185 in financing costs, which were deferred and will be amortized to Interest expense using the straight-line method over the life of the agreement. The remaining $100 of deferred financing costs incurred in connection with the prior $225,000 revolving credit facility were expensed in the first quarter of fiscal year 2012 and are included in Interest expense in the Condensed Consolidated Statements of Earnings.

On January 5, 2012, a Chinese subsidiary of Woodward entered into a local credit facility with the Hong Kong and Shanghai Banking Company under which it has the ability to borrow up to either $5,000, or the local currency equivalent of $5,000. 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 local 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 lenders cost of borrowing rate at the date of borrowing, plus a margin of 3%.

At June 30, 2012, the Chinese subsidiary had outstanding cash borrowings of $5,000 which were fully secured by a $5,000 parent guarantee issued by Woodward. The U.S. dollar borrowings were made at an effective interest rate of 7.45%.

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.

As of June 30, 2012 and September 30, 2011, there were no outstanding borrowings from Woodward s other foreign lines of credit and foreign overdraft facilities.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

At June 30, 2012, Woodward held $39,903 in cash and cash equivalents, and had total outstanding debt of $413,799 with additional borrowing availability of $393,667 under its revolving credit facility, net of outstanding letters of credit, and $14,797 under its other foreign lines of credit and foreign overdraft facilities.

Management believes that Woodward was in compliance with all its debt covenants at June 30, 2012.

Note 13. Accrued liabilities

	June 30, 2012	September 30, 2011
Salaries and other member benefits	$ 38,843	$ 70,965
Current portion of restructuring and other charges	961	2,489
Warranties	13,979	14,083
Interest payable	5,715	11,611
Accrued retirement benefits	2,555	2,560
Deferred revenues	7,881	8,160
Taxes, other than income	9,833	5,097
Other	18,789	18,551
	$ 98,556	$ 133,516

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:

Warranties, September 30, 2011	$ 14,083
Increases to accruals related to warranties during the period	2,616
Settlements of amounts accrued	(2,308)
Foreign currency exchange rate changes	(412)
Warranties, June 30, 2012	$ 13,979

Restructuring and other charges

The main components of accrued non-acquisition related restructuring charges, which were recognized in fiscal year 2009, include workforce management costs associated with the early retirement and the involuntary separation of employees in connection with a strategic realignment of global workforce capacity. Restructuring charges related to fiscal year 2009 business acquisitions include a number of items such as those associated with integrating similar operations, workforce management, vacating certain facilities, and the cancellation of some contracts.

Table of Contents

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

The summary of the activity in accrued restructuring charges during the three and nine-months ending June 30, 2012 is as follows:

	Three-Months Ending June 30, 2012		
	Restructuring Charges	Business Acquisitions	Total
Accrued restructuring charges, March 31, 2012	$ 247	$ 2,454	$ 2,701
Payments	(74)	(45)	(119)
Non-cash adjustments	6	(516)	(510)
Foreign currency exchange rates	(1)		(1)
Accrued restructuring charges, June 30, 2012	$ 178	$ 1,893	$ 2,071

Nine-Months Ending