Woodward, Inc.
Form 10-Q
July 26, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

o **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 incorporation or organization)	(I.R.S. Employer 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 þ No o

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 þ No o

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

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

As of July 22, 2011, 68,810,043 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 Ending June 30,		Nine-Months Ending June 30,	
	2011	**2010**	**2011**	**2010**
Net sales	$ 438,467	$ 356,367	$ 1,222,408	$ 1,045,027
Costs and expenses:				
Cost of goods sold	304,441	249,966	858,138	733,834
Selling, general and administrative expenses	38,470	31,394	109,581	98,359
Research and development costs	29,273	21,419	80,061	59,431
Amortization of intangible assets	8,935	8,635	26,020	26,471
Interest expense	6,361	6,949	19,161	22,524
Interest income	(117)	(97)	(325)	(327)
Other (income) expense, net	249	49	955	(625)
Total costs and expenses	387,612	318,315	1,093,591	939,667
Earnings before income taxes	50,855	38,052	128,817	105,360
Income tax expense	14,799	6,187	38,272	26,873
Net earnings	**36,056**	**31,865**	**90,545**	**78,487**
Earnings attributable to noncontrolling interest, net of taxes		**(120)**		**(318)**
Net earnings attributable to Woodward	**$ 36,056**	**$ 31,745**	**$ 90,545**	**$ 78,169**
Earnings per share (Note 3):				
Basic earnings per share attributable to Woodward	$ 0.52	$ 0.46	$ 1.32	$ 1.14
Diluted earnings per share attributable to Woodward	$ 0.51	$ 0.45	$ 1.29	$ 1.12
Weighted Average Common Shares Outstanding (Note 3):				
Basic	68,793	68,489	68,785	68,428
Diluted	70,166	69,987	70,155	69,871
Cash dividends per share paid to Woodward common stockholders	$ 0.07	$ 0.06	$ 0.20	$ 0.18

See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS
(In thousands)
(Unaudited)

	Three-Months Ending June 30, 2011	Three-Months Ending June 30, 2010	Nine-Months Ending June 30, 2011	Nine-Months Ending June 30, 2010
Comprehensive earnings attributable to Woodward:				
Net earnings attributable to Woodward	$ 36,056	$ 31,745	$ 90,545	$ 78,169
Other comprehensive earnings:				
Foreign currency translation adjustments	8,414	(15,705)	17,043	(29,525)
Reclassification of realized losses on derivatives to earnings	57	70	172	211
Minimum retirement benefit liability adjustment	(139)	(84)	(413)	396
Taxes on changes in other comprehensive earnings	(848)	1,269	(1,711)	1,832
Comprehensive earnings attributable to Woodward	43,540	17,295	105,636	51,083
Comprehensive earnings attributable to noncontrolling interest:				
Net earnings attributable to noncontrolling interest		120		318
Foreign currency translation adjustments,net of tax		22		105
Comprehensive earnings attributable to noncontrolling interest		142		423
Total comprehensive earnings	$ 43,540	$ 17,437	$ 105,636	$ 51,506

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(Unaudited)

	June 30, 2011	September 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 72,598	$ 105,579
Accounts receivable, less allowance for losses of $2,173 and $2,228, respectively	265,420	248,513
Inventories	387,768	295,034
Income taxes receivable	10,328	18,170
Deferred income tax assets	37,104	33,689
Other current assets	26,381	18,157
Total current assets	799,599	719,142
Property, plant and equipment, net	200,042	193,524
Goodwill	465,832	438,594
Intangible assets, net	279,228	292,149
Deferred income tax assets	1,979	8,623
Other assets	15,820	11,201
Total assets	$ 1,762,500	$ 1,663,233
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 41,577	$ 22,099
Current portion of long-term debt	18,459	18,493
Accounts payable	100,769	107,468
Income taxes payable	5,501	5,453
Accrued liabilities	109,726	109,052
Total current liabilities	276,032	262,565
Long-term debt, less current portion	408,750	425,250
Deferred income tax liabilities	88,367	88,249
Other liabilities	91,053	83,975
Total liabilities	864,202	860,039
Commitments and contingencies (Note 18)		
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	80,145	73,915
Accumulated other comprehensive earnings	21,433	6,342
Deferred compensation	4,571	4,888
Retained earnings	912,700	835,919
	1,018,955	921,170
Treasury stock at cost, 4,153 shares and 4,223 shares, respectively	(116,086)	(113,088)
Treasury stock held for deferred compensation, at cost, 315 shares and 356 shares, respectively	(4,571)	(4,888)
Total stockholders equity	898,298	803,194
Total liabilities and stockholders equity	$ 1,762,500	$ 1,663,233

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 Ending June 30, 2011	Nine-Months Ending June 30, 2010
Cash flows from operating activities:		
Net earnings	$ 90,545	$ 78,487
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	57,299	56,455
Net loss (gain) on sales of assets	429	(99)
Stock-based compensation	5,370	5,186
Excess tax benefits from stock-based compensation	(2,581)	(1,588)
Deferred income taxes	(1,011)	5,135
Loss on derivatives reclassified from accumulated comprehensive earnings into earnings	172	185
Changes in operating assets and liabilities, net of business acquisitions:		
Accounts receivable	(11,922)	7,342
Inventories	(77,389)	6,347
Accounts payable and accrued liabilities	(16,126)	10,587
Current income taxes	10,434	6,871
Retirement benefit obligations	(3,230)	(277)
Other	(5,190)	(13,022)
Net cash provided by operating activities	46,800	161,609
Cash flows from investing activities:		
Payments for property, plant and equipment	(32,640)	(18,834)
Proceeds from the sale of assets	30	268
Business acquisitions, net of cash and marketable securities acquired	(38,698)	(25,000)
Business acquisition, marketable securities acquired	(8,463)	
Proceeds from the sale of marketable securities	8,217	
Proceeds from disposal of Fuel & Pneumatics product line		660
Net cash used in investing activities	(71,554)	(42,906)
Cash flows from financing activities:		
Cash dividends paid	(13,764)	(12,971)
Proceeds from sales of treasury stock	2,078	2,709
Payments for repurchases of common stock	(6,837)	(2,383)
Excess tax benefits from stock compensation	2,581	1,588
Purchase of noncontrolling interest		(8,120)
Borrowings on revolving lines of credit and short-term borrowings	126,098	71,653
Payments on revolving lines of credit and short-term borrowings	(103,158)	(71,653)

Payments of long-term debt	(16,500)	(118,492)
Net cash used in financing activities	(9,502)	(137,669)
Effect of exchange rate changes on cash and cash equivalents	1,275	(3,189)
Net change in cash and cash equivalents	(32,981)	(22,155)
Cash and cash equivalents at beginning of period	105,579	100,863
Cash and cash equivalents at end of period	$ 72,598	$ 78,708

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In thousands)
(Unaudited)

Number of shares				Stockholders equity										
						Accumulated other comprehensive earnings								
rred ck	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 earnings	Deferred compensation	Retained earnings	Treasury stock at cost	Treasury stock held for deferred compensation	Nonco int conso subs
	72,960	(4,621)	(389)	$ 106	$ 73,197	$ 29,464	$ (801)	$ (18,534)	$ 10,129	$ 4,904	$ 741,505	$ (115,478)	$ (4,904)	$ 2
											78,169			
											(12,316)			
		(85)										(2,383)		
		266			(1,114)							3,760		
					(6,180)	(116)			(116)					(
					1,588									
					5,186									
		3	(3)		24					144		41	(144)	
			35							(175)			175	
						(29,525)			(29,525)					

						211		211					
							396	396					
					2,233	(80)	(321)	1,832					
72,960	(4,437)	(357)	$ 106	$ 72,701	$ 2,056	$ (670)	$ (18,459)	$ (17,073)	$ 4,873	$ 807,358	$ (114,060)	$ (4,873)	$
72,960	(4,223)	(356)	$ 106	$ 73,915	$ 23,152	$ (627)	$ (16,183)	$ 6,342	$ 4,888	$ 835,919	$ (113,088)	$ (4,888)	$
										90,545			
										(13,764)			
	(242)										(7,961)		
	310			(1,754)							4,963		
				2,581									
				5,370									
	2	(2)		33					128			(128)	
		43							(445)			445	
					17,043			17,043					

						172			172				
								(413)	(413)				
					(1,791)	(65)		145	(1,711)				
72,960	(4,153)	(315)	$ 106	$ 80,145	$ 38,404	$ (520)	$ (16,451)	$ 21,433	$ 4,571	$ 912,700	$ (116,086)	$ (4,571)	$

See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts 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, 2011 and for the three and nine-months ending June 30, 2011 and June 30, 2010, included herein, have not been audited by an independent registered public accounting firm. These Condensed Consolidated Financial Statements reflect all normal recurring adjustments which, in the opinion of management, are necessary to present fairly Woodward s financial position as of June 30, 2011, and the results of operations, cash flows, and changes in stockholders equity for the periods presented herein. The Condensed Consolidated Balance Sheet as of September 30, 2010 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, 2011 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 doubtful accounts, net realizable value of inventories, warranty reserves, 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 contingencies. Actual results could vary materially from Woodward s estimates.

The Condensed Consolidated Statement of Cash Flows for the nine-months ending June 30, 2010 has been adjusted to conform to the nine-months ending June 30, 2011 presentation. The change in Retirement benefit obligations presented in Cash flows from operating activities has been reclassified from Other.

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 October 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements and ASU 2009-14, Certain Revenue Arrangements That Include Software Elements. ASU 2009-13 and ASU 2009-14 are required to be adopted concurrently in fiscal years beginning on or after June 15, 2010 (fiscal year 2011 for Woodward).

ASU 2009-13 changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable based on the relative selling price. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, or estimated selling price (ESP) if neither VSOE nor TPE is available.

ASU 2009-14 excludes software that is contained on a tangible product from the scope of software revenue guidance if the software is essential to the tangible product s functionality.

ASU 2009-13 and ASU 2009-14 were adopted by Woodward on October 1, 2010. The adoption did not impact the identification of or the accounting for separate units of accounting, including the pattern and timing of revenue recognition, and is not expected to have a significant impact on Woodward s financial position, results of operations or cash flows in future periods. Woodward does not generally sell its products and services through arrangements that include multiple-deliverable arrangements, and the Company had no significant multiple-deliverable arrangements as of June 30, 2011.

WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts)
(Unaudited)

In April 2010, the FASB issued ASU 2010-17, Milestone Method of Revenue Recognition. ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research and development transactions, and requires certain disclosures regarding the use of the milestone method.

ASU 2010-17 was adopted by Woodward on October 1, 2010. The adoption did not impact the pattern or timing of revenue recognition and is not expected to have a significant impact on Woodward s financial position, results of operations or cash flows in future periods. For certain development services provided to customers pursuant to funded long and short-term development contracts, Woodward recognizes revenue based on completion of substantive milestones determined based on the individual facts and circumstances of each arrangement. Total revenues recognized by Woodward based upon completion of substantive milestones as proscribed by ASU 2010-17 was $596 and $1,926 for the three and nine-months ending June 30, 2011, respectively.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income. ASU 2011-05 amends ASC Topic 220, Comprehensive Income, to require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, and it eliminates the option to present components of other comprehensive income as a part of the statement of changes in stockholders equity. In addition, ASU 2011-05 requires an entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. These amendments are to be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 (fiscal 2013 for Woodward), early adoption is permitted. Woodward does not expect this guidance will have a significant impact on its Condensed Consolidated Financial Statements.

Note 3. Earnings per share

Basic earnings per share attributable to Woodward 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 attributable to Woodward 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 net earnings per share basic and net earnings per share diluted:

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2011	**2010**	**2011**	**2010**
Numerator:				
Net earnings attributable to Woodward	$ 36,056	$ 31,745	$ 90,545	$ 78,169
Denominator:				
Basic shares outstanding	68,793	68,489	68,785	68,428
Dilutive effect of employee stock options	1,373	1,498	1,370	1,443
Diluted shares outstanding	70,166	69,987	70,155	69,871
Income per common share:				
Basic earnings per share attribuable to Woodward	$ 0.52	$ 0.46	$ 1.32	$ 1.14
Diluted earnings per share attributable to Woodward	$ 0.51	$ 0.45	$ 1.29	$ 1.12

The following stock option grants were outstanding during the three and nine-months ending June 30, 2011 and 2010, 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,	
	2011	**2010**	**2011**	**2010**
Options	678	430	679	447
Weighted-average option price	$ 32.06	$ 32.58	$ 32.03	$ 32.49

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WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts)
(Unaudited)

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,	
	2011	**2010**	**2011**	**2010**
Weighted average treasury stock shares held for deferred compensation obligation	324	361	340	375

Note 4. Business acquisitions

IDS Acquisition

During the third quarter of fiscal year 2011, Woodward acquired of 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 business in China (together the IDS Acquisition) for an aggregate purchase price of approximately $48,412. The purchase price remains subject to certain customary post-closing adjustments. The estimated purchase price is included in Cash flows from investing activities in the Condensed Consolidated Statement of Cash Flows.

IDS is a developer and manufacturer of innovative power electronic systems predominantly in utility scale wind turbines and photovoltaic power plants. Additionally, IDS offers key products in 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 is being integrated into Woodward s Electrical Power Systems business 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 and 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 Electrical Power Systems business segment.

Woodward is in the process of finalizing valuations of current assets, property, plant and equipment (including estimated useful lives), intangible assets (including estimated useful lives), other current liabilities, postretirement benefits obligations, deferred tax liabilities, and other noncurrent liabilities.

The preliminary purchase price of the IDS Acquisition is as follows:

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

As of June 30, 2011, $8,478 paid in connection with the IDS purchase was deposited into escrow accounts as surety against standard representations and warranties made by the seller. Funds held in escrow will be released upon the payment of certain tax and as otherwise specified in the related purchase agreements.

The preliminary allocation of the purchase price for the IDS Acquisition 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 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. As Woodward is still in the process of finalizing valuations, as mentioned above, the final purchase accounting has not yet been completed.

WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts)
(Unaudited)

The following table summarizes the preliminary 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 three-months ending June 30, 2011. The fair value of warranty liabilities assumed represents the estimated costs to provide service for contractual warranty obligations on products sold by IDS prior to April 15, 2011. 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.

Also, in connection with the IDS Acquisition, Woodward assumed the net postretirement benefit obligations of several 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 as of April 15, 2011. Pro forma financial disclosures have not been presented as the IDS Acquisition was not material to Woodward s results of operations or financial position. The Company incurred transaction costs of $219 and $1,964 for the three and nine-months ending June 30, 2011, which are included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

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WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts 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, 2011 Estimated Fair Value	At June 30, 2011 Carrying Cost	At September 30, 2010 Estimated Fair Value	At September 30, 2010 Carrying Cost
Cash and cash equivalents	$ 72,598	$ 72,598	$ 105,579	$ 105,579
Investments in deferred compensation program	6,486	6,486	5,633	5,633
Short-term borrowings	(41,577)	(41,577)	(22,099)	(22,099)
Long-term debt, including current portion	(482,374)	(427,190)	(506,120)	(443,673)

The fair values of cash and cash equivalents, which include investments in money market funds, 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 are expected to be repaid or settled for their carrying amounts within a short period of time.

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

	June 30, 2011	September 30, 2010
Weighted-average interest rate used to estimate fair value	2.7%	2.9%

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.

WOODWARD, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts 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, 2011 or September 30, 2010.

	At June 30, 2011				At September 30, 2010			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets:								
Investments in money market funds	$ 8,444	$	$	$ 8,444	$ 50,360	$	$	$ 50,360
Equity securities	6,486			6,486	5,633			5,633
Foreign exchange forward contract						579		579
Total financial assets	$ 14,930	$	$	$ 14,930	$ 55,993	$ 579	$	$ 56,572

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 and are included in Woodward s Condensed Consolidated Balance Sheet under the caption Cash and cash equivalents. Realized gains from interest income are recognized in earnings. 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 included in Woodward s Condensed Consolidated Balance Sheet under the caption Other current assets. The trading securities are reported at fair value, with gains and losses recognized in earnings. 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.

Forward contracts: As of September 30, 2010, Woodward was a party to a forward contract. The fair value of the derivative instrument was derived from published foreign currency exchange rates as of September 30, 2010. The forward contract was settled in December 2010, resulting in a realized loss of $1,033.

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.

Woodward did not enter into any hedging transactions during the three or nine-months ending June 30, 2011 and was not a party to any derivative instruments as of June 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. 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 a short-term intercompany loan balance. At September 30, 2010, an unrealized gain of $579 was recorded in Woodward s Condensed Consolidated Balance Sheet under the caption Other current assets reflecting an adjustment to fair market value for the related foreign currency exchange rate contract. 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 resulting correlated foreign currency gain realized on the repayment of the short-term intercompany loan balance was recorded in Woodward s Condensed Consolidated Statement of Earnings in Selling, general and administrative expenses.

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The following table discloses the remaining unrecognized gains and losses and recognized gains associated with derivative instruments in Woodward s Condensed Consolidated Balance Sheets:

	June 30, 2011	September 30, 2010
Derivatives designated as hedging instruments	**Unrecognized Gain (Loss)**	
Classified in accumulated other comprehensive earnings	$ (839)	$ (1,011)
Classified in current and long-term debt	19	70
	$ (820)	$ (941)
Derivatives not designated as hedging instruments	**Recognized Gain**	
Classified in other current assets	$	$ 579

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

		Three-Months Ending June 30, 2011			Three-Months Ending June 30, 2010		
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)	$	$	$ (31)	$	$
Cash flow hedging relationships	Interest expense	57		57	70		70
Foreign currency relationships	Other (income) expense						
		$ 40	$	$ 57	$ 39	$	$ 70

		Nine-Months Ending June 30, 2011			Nine-Months Ending June 30, 2010		
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	$ (51)	$	$	$ (95)	$	$
Cash flow hedging relationships	Interest expense	172		172	211		211
Foreign currency relationships	Other (income) expense	1,612			(102)		
		$ 1,733	$	$ 172	$ 14	$	$ 211

Based on the carrying value of the unrecognized gains and losses on terminated derivative instruments designated as cash flow hedges as of June 30, 2011, Woodward expects to reclassify $188 of net unrecognized losses on terminated derivative instruments from accumulated other comprehensive earnings to earnings during the next twelve months.

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Note 7. Supplemental statements of cash flows information

	Nine-Months Ending June 30,	
	2011	**2010**
Interest paid	$ 25,596	$ 27,627
Income taxes paid	33,549	27,104
Income tax refunds received	9,269	9,008
Non-cash activities:		
Purchases of property, plant and equipment on account	1,881	751
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	

During the first quarter of fiscal 2011, Woodward negotiated a lease settlement that was favorable in comparison to the previously recorded restructuring accrual established in purchase accounting in connection with the fiscal year 2009 acquisition of MPC Products Corporation (MPC Products) and Techni-Core, Inc. (Techni-Core and together with MPC Products MPC). The resulting benefit of $103 was recorded as a reduction to goodwill.

MPC Products, one of Woodward s subsidiaries acquired in fiscal year 2009, was previously subject to an investigation by the Department of Justice (DOJ) regarding certain of its government contract pricing practices prior to June 2005. In the three-months ending December 31, 2009, MPC settled the criminal and civil claims related to the DOJ s investigation and paid $25,000 in compensation and fines. The purchase price Woodward paid in connection with the acquisition of MPC was reduced by $25,000 at the time of the acquisition, which represents the amounts discussed above. Payment of this amount during the nine-months ending June 30, 2010 is reflected as an investing activity in the accompanying Condensed Consolidated Statements of Cash Flows.

Note 8. Inventories

	June 30, 2011	September 30, 2010
Raw materials	$ 46,963	$ 19,457
Work in progress	91,971	86,438
Component parts and finished goods	248,834	189,139
	$ 387,768	$ 295,034

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Note 9. Property, plant, and equipment net

	June 30, 2011	September 30, 2010
Land	$ 14,596	$ 11,372
Buildings and improvements	179,787	171,257
Leasehold improvements	18,891	17,884
Machinery and production equipment	262,611	270,126
Computer equipment and software	62,791	57,518
Other	24,097	22,854
Construction in progress	39,265	13,125
	602,038	564,136
Less accumulated depreciation	(401,996)	(370,612)
Property, plant and equipment, net	$ 200,042	$ 193,524

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2011	2010	2011	2010
Depreciation expense	$ 10,955	$ 9,826	$ 31,279	$ 29,984

During fiscal 2010, Woodward began construction of a new 48,000 square foot system test facility in Rockford, Illinois. The facility, which will house numerous environmental system test cells and a vibration lab, will support, among other development projects, Turbine Systems development efforts of next generation fuel systems for aircraft turbines. The test facility is expected to be completed and placed into service in early fiscal year 2012. Included in construction in progress at June 30, 2011 and September 30, 2010 are $17,384 and $4,836, respectively, of costs associated with the construction of the test facility, including $805 and $165, respectively, of capitalized interest.

In addition at June 30, 2011 and September 30, 2010, Woodward recognized as construction in progress, $8,592 and $1,604, respectively, of costs associated with the development of a new Enterprise Resource Planning (ERP) system for its Airframe Systems segment, including capitalized interest of $239 and $24, respectively.

For the three and nine-months ending June 30, 2011 and June 30, 2010, Woodward had capitalized interest that would have otherwise been included in interest expense of the following:

	Three-Months Ending June 30,		Nine-Months Ending June 30,	
	2011	2010	2011	2010
Capitalized interest	$ 383	$ 36	$ 896	$ 61

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Note 10. Goodwill

	September 30, 2010	Additions	Adjustments	Effects of Currency Translation	June 30, 2011
Turbine Systems	$ 86,565	$	$	$	$ 86,565
Airframe Systems	294,557		(103)	165	294,619
Electrical Power Systems	16,534	24,188		2,715	43,437
Engine Systems	40,938			273	41,211
Consolidated	$ 438,594	$ 24,188	$ (103)	$ 3,153	$ 465,832

During the first quarter of fiscal 2011, Woodward negotiated a lease settlement that was favorable in comparison to the previously recorded restructuring accrual established in purchase accounting in connection with the fiscal year 2009 acquisition of MPC. The resulting benefit of $103 was recorded as a reduction to goodwill.

During the third quarter of fiscal 2011, Woodward completed the IDS Acquisition (Note 4, *Business acquisitions*), which resulted in the recognition of $24,188 in goodwill. The operations of the IDS Acquisition will be integrated into Woodward's Electrical Power Systems segment.

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. The impairment tests consist of comparing the fair value of each identified reporting unit with its carrying amount including goodwill. If the carrying amount of the reporting unit exceeds its fair value, Woodward compares the implied value of goodwill with its carrying amount. 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 during the quarter ended March 31, 2011. As a part of that test, Woodward determined its Turbine Systems, Airframe Systems and Engine Systems operating segments represented individual reporting units. Woodward determined its Electrical Power Systems operating segment was represented through three discrete identifiable reporting units. 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-year period. These projections are adjusted to reflect current economic conditions and demand for certain products and require considerable management judgment. Forecasted cash flows were discounted using an 11.3% weighted average cost of capital assumption. The terminal value of the forecasted cash flows assumed an annual compound growth rate after five years of 4.4% and was calculated using the Gordon Growth Model. These inputs, which are unobservable in the market, represent management s 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 resulting fair values of its reporting units by comparing the aggregate fair value to its market capitalization and assessing the reasonableness of any resulting premium.

The results of Woodward s fiscal year 2011 annual goodwill impairment test performed as of March 31, 2011 indicated the estimated fair value of each reporting unit was in excess of its carrying value, and accordingly, no impairment existed. At March 31, 2011 the goodwill impairment test for Woodward s Airframe Systems reporting unit, which has a significant concentration of business in the business jet and regional jet market segments that lagged in the economic recovery, indicated the closest premium, as compared to this reporting unit s carrying value. Each of Woodward s remaining reporting units had resulting fair values significantly in excess of their carrying values. Increasing the discount rate by 10%, decreasing the growth rate by 10%, or decreasing forecasted cash flow by 10%, as it relates to the Airframe Systems operating segment, would not have resulted in an impairment charge. However, an increase in the discount rate by approximately 11%, decreasing the growth rate by approximately 38%, or decreasing forecasted cash flow by approximately 15%, as it relates to the Airframe Systems operating segment would have resulted in an impairment charge.

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 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.

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Note 11. Other intangibles net

	June 30, 2011			September 30, 2010		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Customer relationships:						
Turbine Systems	$ 44,327	$ (19,331)	$ 24,996	$ 44,327	$ (18,223)	$ 26,104
Airframe Systems	176,667	(25,019)	151,648	176,634	(13,162)	163,472
Electrical Power Systems	5,993	(1,167)	4,826	2,156	(844)	1,312
Engine Systems	20,675	(14,990)	5,685	20,675	(13,577)	7,098
Total	$ 247,662	$ (60,507)	$ 187,155	$ 243,792	$ (45,806)	$ 197,986
Intellectual property:						
Turbine Systems	$	$	$	$	$	$
Airframe Systems						
Electrical Power Systems	7,908	(4,106)	3,802	7,616	(3,567)	4,049
Engine Systems	12,616	(7,611)	5,005	12,599	(6,988)	5,611
Total	$ 20,524	$ (11,717)	$ 8,807	$ 20,215	$ (10,555)	$ 9,660
Process technology:						
Turbine Systems	$ 11,941	$ (5,208)	$ 6,733	$ 11,941	$ (4,909)	$ 7,032
Airframe Systems	62,984	(10,327)	52,657	62,967	(6,797)	56,170
Electrical Power Systems	8,289	(212)	8,077			
Engine Systems	12,593	(5,560)	7,033	12,593	(4,787)	7,806
Total	$ 95,807	$ (21,307)	$ 74,500	$ 87,501	$ (16,493)	$ 71,008
Other intangibles:						
Turbine Systems	$	$	$	$	$	$
Airframe Systems	39,648	(32,900)	6,748	39,638	(27,595)	12,043
Electrical Power Systems	2,337	(583)	1,754	1,510	(389)	1,121
Engine Systems	460	(196)	264	460	(129)	331
Total	$ 42,445	$ (33,679)	$ 8,766	$ 41,608	$ (28,113)	$ 13,495

Total intangibles:						
Turbine Systems	$ 56,268	$ (24,539)	$ 31,729	$ 56,268	$ (23,132)	$ 33,136
Airframe Systems	279,299	(68,246)	211,053	279,239	(47,554)	231,685
Electrical Power Systems	24,527	(6,068)	18,459	11,282	(4,800)	6,482
Engine Systems	46,344	(28,357)	17,987	46,327	(25,481)	20,846
Consolidated Total	$ 406,438	$ (127,210)	$ 279,228	$ 393,116	$ (100,967)	$ 292,149

	Three-Months Ending June 30,		**Nine-Months Ending June 30,**	
	2011	**2010**	**2011**	**2010**
Amortization expense	$ 8,935	$ 8,635	$ 26,020	$ 26,471

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Future amortization expense associated with intangibles is expected to be:

Year Ending September 30:		
2011 (remaining)	$	8,973
2012		33,062
2013		30,701
2014		27,545
2015		25,029
Thereafter		153,918
	$	279,228

Note 12. Accrued liabilities

		June 30, 2011		September 30, 2010
Salaries and other member benefits	$	57,300	$	43,598
Current portion of restructuring and other charges		2,740		4,862
Warranties		14,522		10,851
Interest payable		5,689		11,925
Accrued retirement benefits		2,735		2,748
Deferred revenues		7,242		12,376
Taxes, other than income		1,956		4,618
Other		17,542		18,074
	$	109,726	$	109,052

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, 2010	$	10,851
Increases to accruals related to warranties during the period		4,070
Increases due to acquisition of IDS		2,250
Settlements of amounts accrued		(3,226)
Foreign currency exchange rate changes		577
Warranties, June 30, 2011	$	14,522

Restructuring and other charges

The main components of accrued non-acquisition related restructuring charges 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 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.

During the three-months ending December 31, 2010, Woodward negotiated a lease settlement that was favorable in comparison to the previously recorded restructuring accrual established in purchase accounting in connection with the fiscal year 2009 acquisition of MPC. The resulting benefit of $103 was recorded as a non-cash charge to restructuring and a reduction to goodwill previously established at the time of the acquisition of MPC. During the three-months ending December 31, 2010, Woodward also modified its exit plan related to its Pacoima, California location. As a result, the Company intends to occupy and continue operating from the Pacoima location for a longer period than originally anticipated. Accordingly, Woodward has reduced the anticipated exit costs by $1,513 for the Pacoima location.

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The summary of the activity in accrued restructuring charges during the three and nine-months ending June 30, 2011 is as follows:

	Three-Months Ending June 30, 2011		
	Restructuring Charges	Business Acquisitions	Total
Accrued restructuring charges, March 31, 2011	$ 497	$ 3,253	$ 3,750
Payments	(63)	(5)	(68)
Non-cash adjustments	3	(453)	(450)
Foreign currency exchange rates	3		3
Accrued restructuring charges, June 30, 2011	$ 440	$ 2,795	$ 3,235

	Nine-Months Ending June 30, 2011		
	Restructuring Charges	Business Acquisitions	Total
Accrued restructuring charges, September 30, 2010	$ 667	$ 5,446	$ 6,113
Payments	(208)	(705)	(913)
Non-cash adjustments	(28)	(1,946)	(1,974)
Foreign currency exchange rates			