

WOODWARD GOVERNOR CO

Form 10-Q

April 23, 2010

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**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 March 31, 2010  
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 GOVERNOR COMPANY**

**(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**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of each class:**

**Name of each exchange on which registered:**

Common stock, par value \$0.001455 per share

The NASDAQ Global Select Market

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark 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

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

As of April 20, 2010, 68,474,778 shares of the common stock with a par value of \$0.001455 per share were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****WOODWARD GOVERNOR COMPANY  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS***(In thousands, except per share amounts)**(Unaudited)*

|  | <b>Three Months Ended</b> |                                | <b>Six Months Ended</b> |                                |
|--|---------------------------|--------------------------------|-------------------------|--------------------------------|
|  | <b>March 31,</b>          |                                | <b>March 31,</b>        |                                |
|  | <b>2010</b>               | <b>2009</b>                    | <b>2010</b>             | <b>2009</b>                    |
|  |                           | <b>(as recast,<br/>Note 2)</b> |                         | <b>(as recast,<br/>Note 2)</b> |
| Net sales  | \$ 349,352                | \$ 334,661                     | \$ 688,660              | \$ 679,405                     |
| Costs and expenses:  |                           |                                |                         |                                |
| Cost of goods sold   | 244,316                   | 235,539                        | 483,868                 | 479,825                        |
| Selling, general and administrative expenses                             | 34,130                    | 29,093                         | 66,965                  | 61,553                         |
| Research and development costs   | 19,698                    | 18,796                         | 38,012                  | 37,880                         |
| Amortization of intangible assets  | 8,655                     | 5,055                          | 17,836                  | 9,883                          |
| Restructuring and other charges  |                           | 15,159                         |                         | 15,159                         |
| Interest expense   | 7,324                     | 6,707                          | 15,575                  | 13,244                         |
| Interest income  | (120)                     | (221)                          | (230)                   | (883)                          |
| Other income   | (473)                     | (338)                          | (827)                   | (369)                          |
| Other expense  | 4                         | 16                             | 153                     | 100                            |
| Total costs and expenses   | 313,534                   | 309,806                        | 621,352                 | 616,392                        |
| Earnings before income taxes   | 35,818                    | 24,855                         | 67,308                  | 63,013                         |
| Income taxes   | (11,642)                  | (6,333)                        | (20,686)                | (17,388)                       |
| <b>Net earnings</b>  | <b>24,176</b>             | <b>18,522</b>                  | <b>46,622</b>           | <b>45,625</b>                  |
| <b>Net earnings attributable to noncontrolling interests</b>             | <b>(108)</b>              | <b>(48)</b>                    | <b>(198)</b>            | <b>(87)</b>                    |
| <b>Net earnings attributable to Woodward</b>                             | <b>\$ 24,068</b>          | <b>\$ 18,474</b>               | <b>\$ 46,424</b>        | <b>\$ 45,538</b>               |
| <b>Comprehensive Earnings (Note 19):</b>                                 |                           |                                |                         |                                |
| Comprehensive earnings attributable to Woodward                          | \$ 14,005                 | \$ 7,895                       | \$ 33,788               | \$ 27,818                      |
| Comprehensive earnings (losses) attributable to noncontrolling interests | 149                       | (33)                           | 281                     | (44)                           |
| Comprehensive earnings   | \$ 14,154                 | \$ 7,862                       | \$ 34,069               | \$ 27,774                      |
| <b>Earnings per share (Note 6):</b>                                      |                           |                                |                         |                                |
| Basic earnings per share attributable to Woodward                        | \$ 0.35                   | \$ 0.27                        | \$ 0.68                 | \$ 0.67                        |
| Diluted earnings per share attributable to Woodward                      | \$ 0.34                   | \$ 0.27                        | \$ 0.66                 | \$ 0.66                        |

**Weighted Average Common Shares**

**Outstanding (Note 6):**

|                          |          |          |          |          |
|--------------------------|----------|----------|----------|----------|
| Basic                    | 68,436   | 67,824   | 68,398   | 67,810   |
| Diluted                  | 69,876   | 68,832   | 69,830   | 69,067   |
| Cash dividends per share | \$ 0.060 | \$ 0.060 | \$ 0.120 | \$ 0.120 |

*See accompanying Notes to Consolidated Financial Statements.*

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**WOODWARD GOVERNOR COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

*(In thousands, except per share amounts)*

*(Unaudited)*

|  | <b>March 31, 2010</b> | <b>September 30,<br/>2009</b><br><i>(as recast, Note 2)</i> |
|--|-----------------------|---|
| <b>ASSETS</b>  |                       |   |
| Current assets:  |                       |   |
| Cash and cash equivalents  | \$ 72,560             | \$ 100,863  |
| Accounts receivable, less allowance for losses of \$2,283 and \$2,660, respectively                          | 195,837               | 209,626   |
| Inventories  | 291,600               | 302,339   |
| Income taxes receivable  | 13,196                | 16,302  |
| Deferred income tax assets   | 38,054                | 45,413  |
| Other current assets   | 22,612                | 21,701  |
| <b>Total current assets</b>  | <b>633,859</b>        | <b>696,244</b>  |
| Property, plant and equipment, net   | 196,899               | 208,885   |
| Goodwill   | 437,928               | 442,802   |
| Intangible assets, net   | 309,322               | 327,773   |
| Deferred income tax assets   | 7,248                 | 8,200   |
| Other assets   | 13,082                | 12,518  |
| <b>Total assets</b>  | <b>\$ 1,598,338</b>   | <b>\$ 1,696,422</b>   |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                       |   |
| Current liabilities:   |                       |   |
| Short-term borrowings  | \$                    | \$  |
| Current portion of long-term debt  | 18,522                | 45,569  |
| Accounts payable   | 91,446                | 81,108  |
| Income taxes payable   | 6,055                 | 8,084   |
| Accrued liabilities  | 103,950               | 127,317   |
| <b>Total current liabilities</b>   | <b>219,973</b>        | <b>262,078</b>  |
| Long-term debt, less current portion   | 445,137               | 526,771   |
| Deferred income tax liabilities  | 83,130                | 86,048  |
| Other liabilities  | 106,641               | 110,010   |
| <b>Total liabilities</b>   | <b>854,881</b>        | <b>984,907</b>  |
| Commitments and contingencies (Note 20)  |                       |   |
| Stockholders' equity:  |                       |   |
| Preferred stock, par value \$0.003 per share, 10,000 shares authorized, no shares issued                     |                       |   |
| Common stock, par value \$0.001455 per share, 150,000 share authorized, 72,960 shares issued and outstanding | 106                   | 106   |



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|   |              |              |
|---|--------------|--------------|
| Additional paid-in capital  | 77,428       | 73,197       |
| Accumulated other comprehensive earnings (losses)   | (2,507)      | 10,129       |
| Deferred compensation   | 4,715        | 4,904        |
| Retained earnings   | 779,722      | 741,505      |
|   | 859,464      | 829,841      |
| Treasury stock at cost, 4,487 shares and 4,621 shares, respectively                             | (113,629)    | (115,478)    |
| Treasury stock held for deferred compensation, at cost, 365 shares and 389 shares, respectively | (4,715)      | (4,904)      |
| <b>Total Woodward stockholders equity</b>   | 741,120      | 709,459      |
| Noncontrolling interest in consolidated subsidiary (Note 2)                                     | 2,337        | 2,056        |
| <b>Total stockholders equity</b>  | 743,457      | 711,515      |
| <b>Total liabilities and stockholders equity</b>  | \$ 1,598,338 | \$ 1,696,422 |

*See accompanying Notes to Consolidated Financial Statements.*

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**WOODWARD GOVERNOR COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(In thousands)*

*(Unaudited)*

|   | <b>Six Months Ended March 31,</b> |                                |
|---|-----------------------------------|--------------------------------|
|   | <b>2010</b>                       | <b>2009</b>                    |
|   |                                   | <b>(as recast,<br/>Note 2)</b> |
| <b>Cash flows from operating activities</b>   |                                   |                                |
| Net earnings  | \$ 46,622                         | \$ 45,625                      |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                   |                                |
| Depreciation and amortization   | 37,994                            | 28,358                         |
| Net loss on sales of assets   | 57                                | 634                            |
| Stock-based compensation  | 3,883                             | 3,145                          |
| Excess tax benefits from stock-based compensation                                   | (541)                             | (211)                          |
| Deferred income taxes   | 7,528                             | 6,810                          |
| Reclassification of unrealized losses on derivatives to earnings                    | 141                               | 72                             |
| Changes in operating assets and liabilities, net of business acquisitions:          |                                   |                                |
| Accounts receivable   | 10,517                            | 9,376                          |
| Inventories   | 8,330                             | (12,999)                       |
| Accounts payable and accrued liabilities  | 15,933                            | (28,318)                       |
| Current income taxes  | 2,027                             | 6,821                          |
| Other   | (6,510)                           | (7,487)                        |
| Net cash provided by operating activities   | 125,981                           | 51,826                         |
| <b>Cash flows from investing activities:</b>  |                                   |                                |
| Payments for purchases of property, plant and equipment                             | (14,136)                          | (15,354)                       |
| Proceeds from sales of property, plant and equipment                                | 246                               | 188                            |
| Business acquisitions, net of cash acquired   | (25,000)                          | (369,065)                      |
| Proceeds from working capital adjustment on disposal of F&P product line            | 660                               |                                |
| Net cash used in investing activities   | (38,230)                          | (384,231)                      |
| <b>Cash flows from financing activities:</b>  |                                   |                                |
| Cash dividends paid   | (8,207)                           | (8,136)                        |
| Proceeds from sales of treasury stock   | 1,655                             | 888                            |
| Excess tax benefits from stock compensation   | 541                               | 211                            |
| Proceeds from issuance of long-term debt  |                                   | 400,000                        |
| Borrowings on revolving lines of credit and short-term borrowings                   | 32,715                            | 31,853                         |
| Payments on revolving lines of credit and short-term borrowings                     | (32,715)                          | (35,884)                       |
| Payments of long-term debt  | (108,569)                         | (12,850)                       |
| Payments of long-term debt assumed in MPC acquisition                               |                                   | (18,610)                       |
| Payment for cash flow hedge   |                                   | (1,308)                        |
| Debt issuance costs   |                                   | (3,081)                        |

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|  |           |            |
|--|-----------|------------|
| Net cash provided by (used in) financing activities          | (114,580) | 353,083    |
| Effect of exchange rate changes on cash and cash equivalents | (1,474)   | (3,638)    |
| Net change in cash and cash equivalents                      | (28,303)  | 17,040     |
| Cash and cash equivalents at beginning of period             | 100,863   | 109,833    |
| Cash and cash equivalents at end of period                   | \$ 72,560 | \$ 126,873 |

*See accompanying Notes to Consolidated Financial Statements.*



**Balances as of  
September 30, 2008**

|  |          |         |     |       |       |          |
|--|----------|---------|-----|-------|-------|----------|
| Net earnings   |          | 45,538  |     |       | 87    | 45,625   |
| Cash dividends   |          | (8,136) |     |       |       | (8,136)  |
| Sale of Treasury<br>Stock  | (489)    |         | 703 |       |       | 214      |
| Tax benefit<br>attributable to<br>exercise of stock<br>options                   | 211      |         |     |       |       | 211      |
| Stock-based<br>compensation  | 3,145    |         |     |       |       | 3,145    |
| Purchase of stock by<br>deferred<br>compensation plan                            | 304      | 708     | 369 | (708) |       | 673      |
| Distribution of stock<br>from deferred<br>compensation plan                      |          | (862)   |     | 862   |       |          |
| Foreign currency<br>translation<br>adjustments, net                              | (17,162) |         |     |       | (131) | (17,293) |
| Reclassification of<br>unrecognized losses<br>on derivatives to<br>earnings, net |          | 44      |     |       |       | 44       |
| Payments for cash<br>flow hedge, net of<br>deferred tax                          | (811)    |         |     |       |       | (811)    |
| Minimum<br>post-retirement<br>benefits liability<br>adjustments, net             |          | 209     |     |       |       | 209      |

**Balances as of  
March 31, 2009**

|        |           |          |          |            |              |            |          |            |
|--------|-----------|----------|----------|------------|--------------|------------|----------|------------|
| \$ 106 | \$ 71,691 | \$ 2,765 | \$ 5,129 | \$ 700,844 | \$ (121,687) | \$ (5,129) | \$ 2,578 | \$ 656,297 |
|--------|-----------|----------|----------|------------|--------------|------------|----------|------------|

*See accompanying Notes to Consolidated Financial Statements.*

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**Woodward Governor Company**  
**Note to Condensed Consolidated Financial Statements (Unaudited)**  
**(Amounts in thousands, except per share amounts)**

**Note 1. Basis of presentation and nature of operations**

**Basis of presentation**

The Condensed Consolidated Financial Statements of Woodward Governor Company ( Woodward or the Company ) as of March 31, 2010 and for the three and six months ended March 31, 2010 and 2009, 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 March 31, 2010, and the results of operations and cash flows for the periods presented herein. The Condensed Consolidated Balance Sheet as of September 30, 2009 was derived from Woodward s Annual Report on Form 10-K for the fiscal year ended September 30, 2009, adjusted to reflect the October 1, 2009 adoption of authoritative guidance relative to accounting and reporting standards for the noncontrolling interest in a subsidiary and authoritative guidance relative to inclusion of participating securities in the calculation of earnings per share, as discussed in Note 2, *New accounting standards*. The results of operations for the three and six month periods ended March 31, 2010 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 ). 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 Annual Report on Form 10-K for the fiscal year ended September 30, 2009 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 and 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, percent 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.

**Nature of operations**

Woodward is an independent designer, manufacturer, and service provider of energy control and optimization solutions for commercial and military aircraft and ground vehicles, turbines, reciprocating engines, and electrical power system equipment. Woodward s innovative fluid energy, combustion control, electrical energy and motion control systems help customers offer cleaner, more reliable and more cost-effective equipment. Leading original equipment manufacturers use Woodward s products and services in the aerospace, power generation and distribution and transportation markets.

Woodward has four operating business segments Turbine Systems, Airframe Systems, Electrical Power Systems and Engine Systems:

**Turbine Systems** develops and manufactures systems and components that provide energy control and optimization solutions for aircraft propulsion applications, including fuel and combustion systems for turbine engines, as well as industrial gas and steam turbine markets.

**Airframe Systems** develops and manufactures high-performance cockpit, electromechanical and hydraulic motion control systems, and mission-critical actuation systems and controls for weapons, aircraft, turbine

engines and combat vehicles, primarily for aerospace and military applications.

**Electrical Power Systems** develops and manufactures systems and components that provide power sensing and energy control systems that improve the security, quality, reliability and availability of electrical power networks for industrial markets, which include the power generation, power distribution and power conversion industries.

**Engine Systems** develops and manufactures systems and components that provide energy control and optimization solutions for the industrial engine markets, which include the power generation, transportation and process industries.

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**Woodward Governor Company**  
**Notes to Condensed Consolidated Financial**  
**Statements (Continued)**

On April 3, 2009, Woodward acquired all of the outstanding capital stock of HR Textron Inc. from Textron Inc., its parent company, and the United Kingdom assets and certain liabilities related to HR Textron Inc.'s business (collectively "HRT"). HR Textron Inc. became a wholly owned subsidiary of Woodward and was renamed Woodward HRT, Inc. following the consummation of the acquisition. HRT has been integrated into Woodward within its Airframe Systems business segment.

On August 10, 2009, Woodward HRT sold the Fuel and Pneumatics product line (the "F&P product line") originally acquired by Woodward in April 2009 as part of the HRT acquisition.

Additional information about the acquisition of HRT and the sale of the F&P product line is included in Note 4, *Business acquisitions and dispositions*.

To provide better focus and alignment of its business segment operations, Woodward moved the development and manufacture of systems and components for steam turbine markets from Engine Systems to Turbine Systems in the fourth quarter of fiscal 2009. All segment information for the three and six month periods ended March 31, 2009 has been recast to reflect the realigned segment structure.

**Note 2. New accounting standards****Accounting changes and recently adopted accounting standards**

In September 2006, the Financial Accounting Standards Board ("FASB") issued authoritative guidance which defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about a company's financial and nonfinancial assets and liabilities that are measured at fair value. In February 2008, the FASB issued authoritative guidance which delayed the effective date of this guidance for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. On October 1, 2008, Woodward adopted the measurement and disclosure impact of this guidance with respect to financial assets and liabilities. On October 1, 2009, Woodward adopted the measurement and disclosure of fair value with respect to non-financial assets and liabilities. This guidance did not change existing guidance on whether or not an instrument is carried at fair value. The adoption had no impact on Woodward's financial position and results of operations and required no additional disclosures in these Condensed Consolidated Financial Statements.

In November 2007, the FASB issued authoritative guidance to address accounting for collaborative arrangement activities that are conducted without the creation of a separate legal entity for the arrangement. Revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators pursuant to pre-existing accounting standards. Payments to or from collaborators should be presented in the income statement based on the nature of the arrangement, the nature of the company's business and whether the payments are within the scope of other accounting literature. Other detailed information related to the collaborative arrangement is also required to be disclosed. The requirements under this guidance must be applied to collaborative arrangements in existence at the beginning of Woodward's fiscal 2010 using a modified version of retrospective application. Woodward is currently not a party to significant collaborative arrangement activities, as defined by this guidance, and therefore, the adoption of this guidance had no impact on its Condensed Consolidated Financial Statements.

In December 2007, the FASB issued authoritative guidance to affirm that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This guidance defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. Among other requirements, this guidance requires the acquiring entity in a business combination to recognize the identifiable assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at their acquisition-date fair values, and with limited exceptions, acquisition-related costs will generally be expensed as incurred. This guidance requires certain financial statement disclosures to enable users to evaluate and understand the nature and financial effects of the business combination. This guidance must be applied prospectively to business



combinations that are consummated on or after October 1, 2009. Accordingly, Woodward will record and disclose business combinations under the revised standard for any transactions consummated on or after October 1, 2009. In addition, adjustments of certain income tax balances related to acquired deferred assets, including those acquired prior to the adoption of this new authoritative guidance, will be reported as an increase or decrease to income tax expense. Accordingly, Woodward has recorded adjustments of certain income tax balances under the revised authoritative guidance beginning October 1, 2009.

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**Woodward Governor Company**  
**Notes to Condensed Consolidated Financial**  
**Statements (Continued)**

In December 2007, the FASB issued authoritative guidance to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Among other requirements, this guidance clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is to be reported in the Condensed Consolidated Balance Sheets within stockholders' equity, but separate from the parent's stockholders' equity. This guidance also requires consolidated net earnings and comprehensive earnings to include the amounts attributable to both the parent and the noncontrolling interest. Woodward adopted this guidance effective October 1, 2009. This guidance must be applied prospectively for fiscal years, and interim periods within those fiscal years, beginning in fiscal 2010, except for the presentation and disclosure requirements, which have been applied retrospectively for all periods presented. Accordingly, the following have been retrospectively adjusted: the Condensed Consolidated Statement of Earnings for the three and six months ended March 31, 2009, the Condensed Consolidated Balance Sheet as of September 30, 2009, the Condensed Consolidated Statement of Cash Flows for the six months ended March 31, 2009, the Condensed Consolidated Statement of Stockholders' Equity for the six months ended March 31, 2009, accumulated other comprehensive earnings for the six months ended March 31, 2009 as presented in Note 18, *Accumulated other comprehensive earnings*, and total comprehensive earnings for the three and six months ended March 31, 2009 as presented in Note 19, *Total comprehensive earnings*. In accordance with the authoritative guidance, Woodward's Consolidated Financial Statements have been recast from amounts previously reported as follows:

|   | 2009                         |              | As of September 30,<br>2008  |            | 2007                         |            |
|---|------------------------------|--------------|------------------------------|------------|------------------------------|------------|
|   | As<br>previously<br>reported | As recast    | As<br>previously<br>reported | As recast  | As<br>previously<br>reported | As recast  |
| <b>Balance Sheet:</b>                                 |                              |              |                              |            |                              |            |
| Total assets  | \$ 1,696,422                 | \$ 1,696,422 | \$ 927,017                   | \$ 927,017 | \$ 829,767                   | \$ 829,767 |
| Total liabilities                                     | \$ 987,184                   | \$ 984,907   | \$ 297,389                   | \$ 294,601 | \$ 285,336                   | \$ 282,554 |
| Total stockholders' equity                            | 709,238                      | 711,515      | 629,628                      | 632,416    | 544,431                      | 547,213    |
| Total liabilities and stockholders<br>equity          | \$ 1,696,422                 | \$ 1,696,422 | \$ 927,017                   | \$ 927,017 | \$ 829,767                   | \$ 829,767 |
| <b>Statements of stockholders' equity:</b>            |                              |              |                              |            |                              |            |
| Preferred stock                                       | \$                           | \$           | \$                           | \$         | \$                           | \$         |
| Common stock  | 106                          | 106          | 106                          | 106        | 106                          | 106        |
| Additional paid-in capital                            | 73,197                       | 73,197       | 68,520                       | 68,520     | 48,641                       | 48,641     |
| Accumulated other comprehensive<br>earnings           | 9,908                        | 10,129       | 20,319                       | 20,485     | 23,010                       | 22,892     |
| Deferred compensation                                 | 4,904                        | 4,904        | 5,283                        | 5,283      | 4,752                        | 4,752      |
| Retained earnings                                     | 741,505                      | 741,505      | 663,442                      | 663,442    | 565,136                      | 565,136    |
| Treasury Stock  | (120,382)                    | (120,382)    | (128,042)                    | (128,042)  | (97,214)                     | (97,214)   |
| Total Woodward stockholders' equity                   | 709,238                      | 709,459      | 629,628                      | 629,794    | 544,431                      | 544,313    |
| Noncontrolling interest in<br>consolidated subsidiary |                              | 2,056        |                              | 2,622      |                              | 2,900      |

|                           |            |            |            |            |            |            |
|---------------------------|------------|------------|------------|------------|------------|------------|
| Total stockholders equity | \$ 709,238 | \$ 711,515 | \$ 629,628 | \$ 632,416 | \$ 544,431 | \$ 547,213 |
|---------------------------|------------|------------|------------|------------|------------|------------|

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|   | For the year ended September 30, |              |                              |              |                              |              |
|---|----------------------------------|--------------|------------------------------|--------------|------------------------------|--------------|
|   | 2009                             |              | 2008                         |              | 2007                         |              |
|   | As<br>previously<br>reported     | As recast    | As<br>previously<br>reported | As recast    | As<br>previously<br>reported | As recast    |
| <b>Statements of Earnings:</b>                          |                                  |              |                              |              |                              |              |
| Net sales   | \$ 1,430,125                     | \$ 1,430,125 | \$ 1,258,204                 | \$ 1,258,204 | \$ 1,042,337                 | \$ 1,042,337 |
| Total costs and expenses                                | 1,307,713                        | 1,307,649    | 1,076,294                    | 1,075,619    | 910,349                      | 909,657      |
| Earnings before income taxes                            | 122,412                          | 122,476      | 181,910                      | 182,585      | 131,988                      | 132,680      |
| Income taxes  | (28,060)                         | (28,060)     | (60,030)                     | (60,030)     | (33,831)                     | (33,831)     |
| Net earnings  | 94,352                           | 94,416       | 121,880                      | 122,555      | 98,157                       | 98,849       |
| Net earnings attributable to noncontrolling interests   |                                  | (64)         |                              | (675)        |                              | (692)        |
| Net earnings attributable to Woodward                   | \$ 94,352                        | \$ 94,352    | \$ 121,880                   | \$ 121,880   | \$ 98,157                    | \$ 98,157    |
| Comprehensive earnings attributable to Woodward         | \$ 83,941                        | \$ 83,996    | \$ 119,189                   | \$ 119,473   | \$ 109,528                   | \$ 109,319   |
| Comp. earnings attributable to noncontrolling interests |                                  | 9            |                              | 391          |                              | 901          |
| Comprehensive earnings                                  | \$ 83,941                        | \$ 84,005    | \$ 119,189                   | \$ 119,864   | \$ 109,528                   | \$ 110,220   |
| Earnings per share attributable to Woodward:            |                                  |              |                              |              |                              |              |
| Basic   | \$ 1.39                          | \$ 1.39      | \$ 1.80                      | \$ 1.80      | \$ 1.43                      | \$ 1.43      |
| Diluted   | \$ 1.37                          | \$ 1.37      | \$ 1.75                      | \$ 1.75      | \$ 1.39                      | \$ 1.39      |
| <b>Statements of cash flows:</b>                        |                                  |              |                              |              |                              |              |
| Cash flows provided by operating activities             | \$ 218,652                       | \$ 218,652   | \$ 125,354                   | \$ 125,354   | \$ 117,718                   | \$ 117,718   |
| Cash used in investing activities                       | (714,130)                        | (714,130)    | (35,909)                     | (35,909)     | (67,048)                     | (67,048)     |
| Cash provided by (used in) financing activities         | 487,940                          | 487,940      | (48,904)                     | (48,904)     | (66,496)                     | (66,496)     |
| Effect of exchange rate changes on cash and cash        | (1,432)                          | (1,432)      | (2,343)                      | (2,343)      | 3,743                        | 3,743        |

equivalents

|   |    |         |    |         |    |        |    |        |    |          |    |          |
|---|----|---------|----|---------|----|--------|----|--------|----|----------|----|----------|
| Net change in cash and cash equivalents | \$ | (8,970) | \$ | (8,970) | \$ | 38,198 | \$ | 38,198 | \$ | (12,083) | \$ | (12,083) |
|---|----|---------|----|---------|----|--------|----|--------|----|----------|----|----------|

In April 2008, the FASB issued authoritative guidance to amend the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset and to require additional disclosures. The guidance for determining useful lives must be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements must be applied prospectively to all intangible assets recognized as of the effective date. Woodward adopted this guidance as of October 1, 2009. The adoption of this guidance had no impact on its Condensed Consolidated Financial Statements.

In November 2008, the FASB issued authoritative guidance regarding the accounting for defensive intangible assets. Defensive intangible assets are assets acquired in a business combination that the acquirer (a) does not intend to use or (b) intends to use in a way other than the assets' highest and best use as determined by an evaluation of market participant assumptions. While defensive intangible assets are not being actively used, they are likely contributing to an increase in the value of other assets owned by the acquiring entity. This guidance requires defensive intangible assets to be accounted for as separate units of accounting at the time of acquisition and the useful life of such assets to be based on the period over which the assets will directly or indirectly affect the entity's cash flows. Woodward will record and disclose defensive intangible assets under the revised standard for transactions consummated, if any, on or after October 1, 2009.

In November 2008, the FASB issued authoritative guidance addressing whether securities granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two class method. This guidance became effective for Woodward on October 1, 2009. Upon the adoption of this guidance, all outstanding restricted stock, which are participating securities, are considered in the calculation of both the basic and fully diluted earnings per share calculations in these Condensed Consolidated Financial Statements. The effects of this change are required to be applied retrospectively. Accordingly, the historical earnings per share presented in the Condensed Consolidated Statements of Earnings and in Note 6, *Earnings per share* have been recast to reflect the retrospective application of this guidance.

In April 2009, the FASB issued authoritative guidance to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably determined. If the fair value of such assets or liabilities cannot be reasonably determined, then they would generally be recognized in accordance with certain other pre-existing accounting standards. This guidance also amends the subsequent accounting for assets and liabilities arising from contingencies in a business combination and certain other disclosure requirements. This guidance became effective for assets or liabilities arising from contingencies in business combinations that are consummated on or after October 1, 2009. Accordingly, Woodward will record and disclose assets acquired and liabilities assumed in business combinations that arise from contingencies under the revised standard for any transactions consummated on or after October 1, 2009.

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**Issued but not yet effective accounting standards:**

In December 2008, the FASB issued authoritative guidance to require employers to provide additional disclosures about plan assets of a defined benefit pension or other postretirement plan. These disclosures should principally include information detailing investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets and an understanding of significant concentrations of risk within plan assets. The required disclosures must be provided for fiscal years ending after December 15, 2009 (Woodward's fiscal 2010, the anticipated period of adoption). These disclosures will be presented in Woodward's Consolidated Financial Statements for the year ended September 30, 2010. Upon initial application, this guidance is not required to be applied to earlier periods that are presented for comparative purposes. Woodward does not expect this guidance to have a significant impact on its September 30, 2010 Consolidated Financial Statements.

In June 2009, the FASB issued authoritative guidance to eliminate the exception to consolidate a qualifying special-purpose entity, change the approach to determining the primary beneficiary of a variable interest entity and require companies to more frequently re-assess whether they must consolidate variable interest entities. Under the new guidance, the primary beneficiary of a variable interest entity is identified qualitatively as the enterprise that has both (a) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. This guidance becomes effective for Woodward's fiscal year 2011 and interim reporting periods thereafter. Woodward does not expect this guidance to have a material impact on its Condensed Consolidated Financial Statements.

In June 2009, the FASB issued authoritative guidance to require an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. This guidance requires an ongoing reassessment and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This guidance will be effective for fiscal years beginning after November 15, 2009 (fiscal year 2011 for Woodward). Woodward is currently assessing the impact that this guidance may have on its Condensed Consolidated Financial Statements.

In October 2009, the FASB issued authoritative guidance that enables vendors to account for products or services sold to customers (deliverables) separately rather than as a combined unit, as was generally required by past guidance. The revised guidance provides for two significant changes to the existing multiple element revenue arrangements guidance. The first change, which will likely result in the requirement to separate more deliverables within an arrangement, relates to the determination of when the individual deliverables included in a multiple element arrangement may be treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. Together, these changes are likely to result in earlier recognition of revenue and related costs for multiple-element arrangements than under previous guidance. This guidance also significantly expands the disclosures required for multiple-element revenue arrangements. This guidance is required to be adopted in fiscal years beginning on or after June 15, 2010 (fiscal year 2011 for Woodward). Woodward expects to adopt the guidance as of October 1, 2010. Woodward is currently assessing the impact this guidance may have on its Condensed Consolidated Financial Statements.

In October 2009, the FASB issued authoritative guidance that changes the accounting model for revenue arrangements that include both tangible products and software elements. The revised guidance provides that tangible products containing software components and nonsoftware components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software revenue guidance in Accounting Standards Codification (ASC) Subtopic 985-605. In addition, the guidance requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. This guidance also significantly expands the disclosures required for multiple-element revenue arrangements. This guidance is required to be adopted in fiscal years beginning on or after June 15, 2010 (fiscal year 2011 for Woodward). Woodward is

currently assessing the impact this guidance may have on its Condensed Consolidated Financial Statements.

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**Note 3. Supplemental statements of cash flows information**

Supplemental cash flow information follows:

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>March 31,</b>        |             |
|   | <b>2010</b>             | <b>2009</b> |
| Interest expense paid                                 | \$ 15,609               | \$ 5,699    |
| Income taxes paid                                     | 17,285                  | 8,887       |
| Income tax refunds received                           | 8,691                   | 2,788       |
| <b>Non-cash investing activities:</b>                 |                         |             |
| Long-term debt assumed in business acquisition        |                         | 18,610      |
| Purchases of property, plant and equipment on account | 629                     | 899         |
| Sales of assets on account                            |                         | 410         |

MPC Products Corporation ( 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 fiscal 2010, MPC Products settled the criminal and civil claims related to the DOJ s investigation and paid approximately \$22,500 in compensation and a fine of \$2,500. The purchase price Woodward paid in connection with the acquisition of MPC Products was reduced by \$25,000 at the time of the acquisition, which represents the amounts discussed above. Payment of this amount during the six months ended March 31, 2010 is reflected as an investing activity in the Condensed Consolidated Statement of Cash Flows.

**Note 4. Business acquisitions and dispositions**

Woodward has recorded the HRT acquisition described below using the purchase method of accounting and, accordingly, has included the results of operations of the acquired business in its consolidated results as of the date of the acquisition. In accordance with authoritative accounting guidance for business combinations in effect during its fiscal year 2009, the purchase price for this acquisition is allocated to the tangible assets, liabilities, and intangible assets acquired based on their estimated fair values. The excess purchase price over the respective fair values of assets is recorded as goodwill. Goodwill is not amortized under U.S. GAAP but is tested for impairment at least annually (see Note 9, *Goodwill*). The goodwill resulting from the HRT acquisition is tax deductible.

**HRT acquisition**

On April 3, 2009, Woodward acquired all of the outstanding stock of HR Textron Inc. from Textron Inc., its parent company, and the United Kingdom assets and certain liabilities related to HR Textron Inc. s business, for approximately \$380,749.

HRT provides advanced technology, engineering development, and manufacturing of mission-critical actuation systems and controls for aircraft, turbine engines, weapons and combat vehicles. It is recognized for hydraulic and electric primary flight control actuation products, including electro-mechanical actuation systems for unmanned combat air vehicles and weapons, such as the Joint Direct Attack Munitions ( JDAM ) and the AIM-9X Sidewinder; hydraulic and electric flight controls for fixed and rotor wing aircraft; servovalves for global aerospace; and turret controls and stabilization systems for the U.S. M1 Abrams Main Battle Tank and other armored vehicles worldwide. HRT has been integrated into Woodward within its Airframe Systems business segment.



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The purchase price for the HRT acquisition is as follows:

|                          |                |
|--------------------------|----------------|
| Cash paid to owners      | \$ 377,660     |
| Cash acquired            | (11)           |
| Direct transaction costs | 3,100          |
| <br>Total purchase price | <br>\$ 380,749 |

During the first six months of fiscal 2010, the estimated fair values of the acquired current assets were increased by \$1,234, the accrued restructuring charges were increased by \$1,834, and other the current liabilities were decreased by \$2,660 to reflect updated estimates of fair values of assets acquired and liabilities assumed as of April 3, 2009.

The allocation of the purchase price to the assets acquired and liabilities assumed was finalized as of March 31, 2010. The following table summarizes estimated fair values of the assets acquired and liabilities assumed on April 3, 2009, the date of the HRT acquisition, including accrued restructuring charges:

|                                |                |
|--------------------------------|----------------|
| Current assets                 | \$ 115,707     |
| Property, plant, and equipment | 41,926         |
| Goodwill                       | 142,699        |
| Intangible assets              | 128,400        |
| Other assets                   | 13             |
| <br>Total assets acquired      | <br>428,745    |
| <br>Other current liabilities  | <br>19,515     |
| Accrued restructuring charges  | 9,334          |
| Postretirement benefits        | 13,077         |
| Other noncurrent liabilities   | 6,070          |
| <br>Total liabilities assumed  | <br>47,996     |
| <br>Net assets acquired        | <br>\$ 380,749 |

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

|                           | <b>Amount</b>  | <b>Weighted<br/>Average<br/>Useful<br/>Life</b> | <b>Amortization<br/>Method</b> |
|---------------------------|----------------|---|--------------------------------|
| Customer relationships    | \$ 70,900      | 15 years  | Accelerated                    |
| Process technology        | 29,000         | 15 years  | Accelerated                    |
| Product software          | 4,200          | 20 years  | Accelerated                    |
| Backlog                   | 21,900         | 5 years   | Accelerated                    |
| Favorable lease contracts | 1,400          | 7 years   | Straight Line                  |
| Non-compete agreements    | 1,000          | 3 years   | Straight Line                  |
| <br>Total                 | <br>\$ 128,400 | <br>13 years                                    |                                |

Accelerated amortization is calculated based on the pattern of estimated future economic benefits of the related intangible assets.

HRT's favorable lease contracts relate to a facility that Woodward has determined will be vacated in late calendar year 2010, when the unamortized cost of the asset is expected to be \$1,050. This amount is included in the accrued restructuring charges assumed in connection with the HRT acquisition.

Woodward made a 338(h)(10) election with the U.S. Internal Revenue Service, which allows the HRT acquisition to be treated as an asset purchase for income tax purposes. Accordingly, any deferred tax assets and liabilities recorded by Textron Inc. at the acquisition date are not available to Woodward because the election causes the HRT acquisition to be treated, for income tax purposes, as though Woodward did not purchase an ongoing business.

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In connection with the HRT acquisition, Woodward assumed certain defined benefit pension obligations contingent upon transfer of related pension plan assets. In September 2009, the trustee of the related Textron-sponsored defined benefit plan transferred \$46,788 to the Woodward HRT Plan. An additional \$1,019 was transferred by the Textron sponsored defined benefit plan to the Woodward HRT Plan in October 2009 and was recorded as a Woodward HRT Plan receivable as of September 30, 2009.

The results of HRT's operations are included in Woodward's Consolidated Statements of Earnings as of April 3, 2009. On August 10, 2009, Woodward HRT sold the F&P product line for \$48,000. During the quarter ended March 31, 2010, Woodward received an additional \$660 related to working capital adjustments typical in such transactions. The F&P product line provided a variety of off-turbine fuel management and pneumatic actuation components to producers of military and commercial aircraft and helicopters, as well as their suppliers.

**Pro forma results for Woodward giving effect to the HRT acquisition, excluding the F&P product line**

The following unaudited pro forma financial information presents the combined results of operations of Woodward and HRT as if the acquisition had occurred as of the beginning of fiscal year 2009. The pro forma financial information is presented for informational purposes and is not indicative of the results of operations that would have been achieved if the acquisition and related borrowings had taken place at the beginning of fiscal year 2009. The unaudited pro forma financial information combines the historical results of Woodward with the historical results of HRT for that period but excludes the historical results of the F&P product line.

Prior to the HRT acquisition by Woodward, HRT was a wholly owned subsidiary of Textron Inc., and as such was not a stand-alone entity, for financial reporting purposes. Accordingly, the historical operating results of HRT may not be indicative of the results that might have been achieved, historically or in the future, if HRT had been a stand-alone entity. The unaudited pro forma results for the three and six month periods ended March 31, 2009 include amortization charges for acquired intangible assets, eliminations of intercompany transactions, adjustments for stock options issued, adjustments for depreciation expense for property, plant, and equipment, adjustments to interest expense, adjustments for estimated general and administrative costs for HRT's historical management and administrative structure and functions, disposal of the F&P product line, and related tax effects.

The unaudited pro forma results for the three and six months ended March 31, 2009 compared to the actual results reported in these Condensed Consolidated Financial Statements follow:

|                     | <b>Three Months Ended</b> |                  | <b>Six Months Ended</b> |                  |
|---------------------|---------------------------|------------------|-------------------------|------------------|
|                     | <b>March 31, 2009</b>     |                  | <b>March 31, 2009</b>   |                  |
|                     | <b>As</b>                 | <b>Pro forma</b> | <b>As</b>               | <b>Pro forma</b> |
|                     | <b>reported</b>           | <b>Pro forma</b> | <b>reported</b>         | <b>Pro forma</b> |
| Revenue             | \$ 334,661                | \$ 385,260       | \$ 679,405              | \$ 791,269       |
| Net earnings        | 18,522                    | 16,850           | 45,625                  | 44,924           |
| Earnings per share: |                           |                  |                         |                  |
| Basic               | \$ 0.27                   | \$ 0.25          | \$ 0.67                 | \$ 0.66          |
| Diluted             | 0.27                      | 0.25             | 0.66                    | 0.65             |

**Note 5. Income taxes**

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

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

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

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

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The determination of the annual effective tax rate is based upon a number of significant estimates and judgments, including the estimated annual pretax income of Woodward in each tax jurisdiction in which it operates and the development of tax planning strategies during the year. In addition, as a global commercial enterprise, Woodward's tax expense can be impacted by changes in tax rates or laws, the finalization of tax audits and reviews, as well as other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions. The following table sets out the tax expense and the effective tax rate for Woodward's income from operations:

|                              | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|------------------------------|---------------------------|-------------|-------------------------|-------------|
|                              | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                              | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Earnings before income taxes | \$ 35,818                 | \$ 24,855   | \$ 67,308               | \$ 63,013   |
| Income tax expense           | 11,642                    | 6,333       | 20,686                  | 17,388      |
| Effective tax rate           | 32.5%                     | 25.5%       | 30.7%                   | 27.6%       |

The effective tax rates in both the six months ended March 31, 2010 and the six months ended March 31, 2009 benefited from favorable resolutions of tax matters of \$1,760 and \$3,422, respectively.

The total amount of the gross liability for worldwide unrecognized tax benefits was \$19,141 at March 31, 2010 and \$19,783 at September 30, 2009.

The amounts of unrecognized tax benefits that would impact Woodward's effective tax rate if recognized, net of expected offsetting benefits, were \$15,461 at March 31, 2010 and \$15,550 at September 30, 2009. At this time, Woodward estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as \$3,460 in the next twelve months through completion of reviews by various worldwide tax authorities and completion of internal revaluation assessments.

Woodward recognizes interest and penalties related to unrecognized tax benefits in tax expense. Woodward had accrued interest and penalties of \$4,475 as of March 31, 2010 and \$3,804 as of September 30, 2009.

Woodward's tax returns are audited by U.S., state, and foreign tax authorities and these audits are at various stages of completion at any given time. Fiscal years remaining open to examination in significant foreign jurisdictions include 2003 and forward. Woodward is subject to U.S. Federal income tax examinations for fiscal years 2006 and forward and is subject to U.S. state income tax examinations for fiscal years 2005 and forward.

The U.S. research tax credit expired as of December 31, 2009. The U.S. Congress is considering legislation to provide a one-year, retroactive extension, however as of March 31, 2010, the expired tax credit has not been reinstated.

Accounting guidance requires Woodward to use the tax law in effect at the balance sheet date. Accordingly, the calculation of its fiscal 2010 income tax provision does not reflect any assumed benefit from the research tax credit for the nine months ended September 30, 2010. In the event that the research tax credit is enacted in some form in future periods, Woodward will account for that change in the tax law at that time.

Woodward does not expect the Patient Protection and Affordable Care Act to impact its income tax expense in fiscal 2010 or thereafter.

**Note 6. 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 consideration of the dilutive effect of stock options.

In November 2008, the FASB issued authoritative guidance addressing whether securities granted in share-based payment transactions are participating securities prior to vesting and, thus, need to be included in the earnings allocation in computing earnings per share under the two class method. This guidance became effective for Woodward on October 1, 2009 and is required to be applied retrospectively. Upon the adoption of this guidance shares of restricted stock, which are participating securities, are considered in the calculation of both the basic and fully diluted

earnings per share calculations. The March 31, 2009 historical earnings per share amounts presented below have been recast to reflect the retrospective application of this guidance for 70 shares of restricted stock outstanding as of March 31, 2009. The inclusion of this participating security did not impact previously reported basic and diluted earnings per share for the three and six month periods ended March 31, 2009, and there is no impact for the previously reported quarter ended June 30, 2009, nor for the fiscal years ended September 30, 2009, 2008 and 2007.

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

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Numerator:</b>                                   |                           |             |                         |             |
| Net earnings attributable to Woodward               | \$ 24,068                 | \$ 18,474   | \$ 46,424               | \$ 45,538   |
| <b>Denominator:</b>                                 |                           |             |                         |             |
| Basic   | 68,436                    | 67,824      | 68,398                  | 67,810      |
| Assumed exercise of dilutive stock options          | 1,440                     | 1,008       | 1,432                   | 1,257       |
| Diluted   | 69,876                    | 68,832      | 69,830                  | 69,067      |
| <b>Income per common share:</b>                     |                           |             |                         |             |
| Basic earnings per share attributable to Woodward   | \$ 0.35                   | \$ 0.27     | \$ 0.68                 | \$ 0.67     |
| Diluted earnings per share attributable to Woodward | \$ 0.34                   | \$ 0.27     | \$ 0.66                 | \$ 0.66     |

The following stock option grants were outstanding during the three and six month periods ended March 31, 2010 and 2009, but were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

|                               | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|-------------------------------|---------------------------|-------------|-------------------------|-------------|
|                               | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                               | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Options                       | 1,102,367                 | 1,443,346   | 447,207                 | 696,494     |
| Weighted-average option price | \$ 26.92                  | \$ 23.05    | \$ 32.52                | \$ 27.59    |

**Note 7. Inventories**

|                                    | <b>March 31,</b> | <b>September 30,</b> |
|------------------------------------|------------------|----------------------|
|                                    | <b>2010</b>      | <b>2009</b>          |
| Raw materials                      | \$ 41,595        | \$ 44,608            |
| Work in progress                   | 69,841           | 71,270               |
| Component parts and finished goods | 180,164          | 186,461              |
|                                    | \$ 291,600       | \$ 302,339           |

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**Note 8. Property, plant, and equipment net**

|                                    | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|------------------------------------|---------------------------|-------------------------------|
| Land                               | \$ 10,899                 | \$ 11,231                     |
| Buildings and equipment            | 176,343                   | 178,410                       |
| Machinery and equipment            | 326,696                   | 336,903                       |
| Construction in progress           | 22,175                    | 16,333                        |
|                                    | 536,113                   | 542,877                       |
| Less accumulated depreciation      | (339,214)                 | (333,992)                     |
| Property, plant and equipment, net | \$ 196,899                | \$ 208,885                    |

|                      | <b>Three months ended<br/>March 31,</b> |             | <b>Six months ended<br/>March 31,</b> |             |
|----------------------|---|-------------|---------------------------------------|-------------|
|                      | <b>2010</b>                             | <b>2009</b> | <b>2010</b>                           | <b>2009</b> |
| Depreciation expense | \$ 10,403                               | \$ 9,298    | \$ 20,158                             | \$ 18,475   |

**Note 9. Goodwill**

|                          | <b>September<br/>30,<br/>2009</b> | <b>Additions /<br/>Adjustments</b> | <b>Translation<br/>Adjustments</b> | <b>March 31,<br/>2010</b> |
|--------------------------|-----------------------------------|------------------------------------|------------------------------------|---------------------------|
| Turbine Systems          | \$ 86,565                         | \$                                 | \$                                 | \$ 86,565                 |
| Airframe Systems         | 297,412                           | (2,722)                            | (400)                              | 294,290                   |
| Electrical Power Systems | 17,733                            |                                    | (1,285)                            | 16,448                    |
| Engine Systems           | 41,092                            |                                    | (467)                              | 40,625                    |
| Consolidated             | \$ 442,802                        | \$ (2,722)                         | \$ (2,152)                         | \$ 437,928                |

Additions and adjustments recorded during the year represent changes in the estimated values of assets acquired and liabilities assumed in purchase accounting, as described in Note 4, *Business acquisitions and dispositions*. In addition on August 10, 2009, Woodward HRT sold the F&P product line for \$48,000. During the quarter ended March 31, 2010, Woodward received an additional \$660 related to working capital adjustments typical in such transactions, which reduced goodwill.

Woodward tests goodwill for impairment on 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 reporting units, determined using discounted cash flows, 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. There was no impairment charge recorded in fiscal 2009 or in the first six months of fiscal 2010.





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Statements (Continued)**

Woodward completed its annual goodwill impairment test during the quarter ended March 31, 2010. Woodward considered the Turbine Systems, Airframe Systems and Engine Systems operating segments to be reporting units. Woodward evaluated goodwill for the Electrical Power Systems operating segment through three identified reporting units within the operating segment. The fair value of Woodward's six reporting units was based on cash flow forecasts which have been updated to reflect current global economic conditions, including anticipated weakening of global demand for certain products and forecasts of demand increases anticipated as a result of the economic recovery. 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 4.5% and was calculated using the Gordon Growth Model.

The results of Woodward's fiscal 2010 annual goodwill impairment test performed as of March 31, 2010 indicated that no goodwill impairment existed. The estimated fair value of each reporting unit was in excess of its carrying value. At March 31, 2010 the reporting unit with the closest ratio of estimated fair value to carrying value was Woodward's recently acquired Airframe Systems reporting unit, which has a significant concentration of business in the presently depressed business jet and regional jet market segments. Our analysis indicates a premium of over 30% compared to this reporting unit's carrying value.

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, or the duration of the current economic downturn, or the period or strength of the recovery, made for purposes of the annual goodwill impairment test performed during the second fiscal quarter of 2010, will prove to be accurate predictions of the future. If Woodward's assumptions are not realized, it is possible that an impairment charge may need to be recorded in future periods.

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**Note 10. Other intangibles net**

|                                | March 31, 2010    |                             |                    | September 30, 2009 |                             |                    |
|--------------------------------|-------------------|-----------------------------|--------------------|--------------------|-----------------------------|--------------------|
|                                | Gross             |                             | Net                | Gross              |                             | Net                |
|                                | Carrying<br>Value | Accumulated<br>Amortization | Carrying<br>Amount | Carrying<br>Value  | Accumulated<br>Amortization | Carrying<br>Amount |
| <b>Customer relationships:</b> |                   |                             |                    |                    |                             |                    |
| Turbine Systems                | \$ 44,327         | \$ (17,485)                 | \$ 26,842          | \$ 44,327          | \$ (16,746)                 | \$ 27,581          |
| Airframe Systems               | 176,581           | (7,739)                     | 168,842            | 176,661            | (2,068)                     | 174,593            |
| Electrical Power Systems       | 2,144             | (732)                       | 1,412              | 2,319              | (676)                       | 1,643              |
| Engine Systems                 | 20,675            | (12,647)                    | 8,028              | 20,675             | (11,718)                    | 8,957              |
| Total                          | \$ 243,727        | \$ (38,603)                 | \$ 205,124         | \$ 243,982         | \$ (31,208)                 | \$ 212,774         |
| <b>Intellectual property:</b>  |                   |                             |                    |                    |                             |                    |
| Turbine Systems                | \$                | \$                          | \$                 | \$                 | \$                          | \$                 |
| Airframe Systems               |                   |                             |                    |                    |                             |                    |
| Electrical Power Systems       | 7,593             | (3,275)                     | 4,318              | 7,941              | (3,073)                     | 4,868              |
| Engine Systems                 | 12,571            | (6,564)                     | 6,007              | 12,613             | (6,180)                     | 6,433              |
| Total                          | \$ 20,164         | \$ (9,839)                  | \$ 10,325          | \$ 20,554          | \$ (9,253)                  | \$ 11,301          |
| <b>Process technology:</b>     |                   |                             |                    |                    |                             |                    |
| Turbine Systems                | \$ 11,941         | \$ (4,710)                  | \$ 7,231           | \$ 11,941          | \$ (4,511)                  | \$ 7,430           |
| Airframe Systems               | 62,941            | (4,703)                     | 58,238             | 62,981             | (2,590)                     | 60,391             |
| Electrical Power Systems       |                   |                             |                    | 1,390              | (1,346)                     | 44                 |
| Engine Systems                 | 12,593            | (4,292)                     | 8,301              | 12,593             | (3,797)                     | 8,796              |
| Total                          | \$ 87,475         | \$ (13,705)                 | \$ 73,770          | \$ 88,905          | \$ (12,244)                 | \$ 76,661          |
| <b>Other intangibles:</b>      |                   |                             |                    |                    |                             |                    |
| Turbine Systems                | \$                | \$                          | \$                 | \$                 | \$                          | \$                 |
| Airframe Systems               | 39,623            | (21,051)                    | 18,572             | 39,646             | (14,325)                    | 25,321             |
| Electrical Power Systems       | 1,501             | (338)                       | 1,163              | 1,623              | (316)                       | 1,307              |
| Engine Systems                 | 460               | (92)                        | 368                | 460                | (51)                        | 409                |
| Total                          | \$ 41,584         | \$ (21,481)                 | \$ 20,103          | \$ 41,729          | \$ (14,692)                 | \$ 27,037          |
| Consolidated                   | \$ 392,950        | \$ (83,628)                 | \$ 309,322         | \$ 395,170         | \$ (67,397)                 | \$ 327,773         |

|                      | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|----------------------|---------------------------|-------------|-------------------------|-------------|
|                      | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                      | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Amortization expense | \$ 8,655                  | \$ 5,055    | \$ 17,836               | \$ 9,883    |

Future amortization expense associated with intangibles is expected to be:

Year Ending September 30:

|                  |            |
|------------------|------------|
| 2010 (remaining) | \$ 25,943  |
| 2011             | 34,140     |
| 2012             | 31,335     |
| 2013             | 29,093     |
| 2014             | 25,996     |
| Thereafter       | 162,815    |
|                  | \$ 309,322 |

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**Note 11. Long-term debt**

Long-term debt consisted of the following:

|  | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|--|---------------------------|-------------------------------|
| 2008 Term loan Variable rate of 2.01% at March 31, 2010, matures October 2013; unsecured | \$ 91,625                 | \$ 144,375                    |
| 2009 Term loan   |                           | 45,000                        |
| Series B Notes 5.63%, due October 2013; unsecured  | 100,000                   | 100,000                       |
| Series C Notes 5.92%, due October 2015; unsecured  | 50,000                    | 50,000                        |
| Series D Notes 6.39%, due October 2018; unsecured  | 100,000                   | 100,000                       |
| Series E Notes 7.81%, due April 2016; unsecured  | 57,000                    | 57,000                        |
| Series F Notes 8.24%, due April 2019; unsecured  | 43,000                    | 43,000                        |
| Senior notes 6.39%, due October 2011; unsecured  | 21,429                    | 32,143                        |
| Term notes 5.95%, due June 2012; secured by land and buildings                           | 472                       | 624                           |
| Fair value hedge adjustment for unrecognized discontinued hedge gains                    | 133                       | 198                           |
|  | 463,659                   | 572,340                       |
| Less: current portion  | (18,522)                  | (45,569)                      |
| Long-term debt, less current portion   | \$ 445,137                | \$ 526,771                    |

Under certain circumstances, the interest rate on each series of the Series B, C and D Notes is subject to increase if Woodward's leverage ratio of consolidated net debt to consolidated earnings before interest, taxes, depreciation and amortization, plus any unusual non-cash charges to the extent deducted in computing net income minus any unusual non-cash gains to the extent added in computing net income ( Debt Covenant EBITDA ) increases beyond a ratio of 3.5 to 1.0.

During the first half of fiscal 2010, Woodward prepaid \$33,000 against the 2009 term loan and \$49,000 against the 2008 term loan. Required future principal payments of outstanding long-term debt as of March 31, 2010, after giving effect to this prepayment, are as follows:

**Year Ending September 30:**

|                  |            |
|------------------|------------|
| 2010 (remainder) | \$ 3,855   |
| 2011             | 18,424     |
| 2012             | 18,372     |
| 2013             | 7,500      |
| 2014             | 165,375    |
| Thereafter       | 250,000    |
|                  | \$ 463,526 |

The current portion of long-term debt includes \$98 at March 31, 2010 and \$128 at September 30, 2009 related to the fair value hedge adjustment for unrecognized discontinued hedge gains.

The 2008 term loan, the 2009 term loan, the Series B, C, D, E and F Notes (together, the Notes ) and the senior notes due October 2011 are held by multiple institutions. The term notes are held by banks in Germany.

Woodward's obligations under the 2008 term loan, the 2009 term loan, the Notes and the senior notes due October 2011 are guaranteed by Woodward FST, Inc., MPC Products Corporation and Woodward HRT, Inc., each of which is a wholly owned subsidiary of Woodward.

Management believes that Woodward was in compliance with its financial debt covenants at March 31, 2010.

**2008 and 2009 Term Loans**

In October 2008, Woodward entered into a term loan credit agreement (the 2008 Term Loan Credit Agreement), which provides for an initial \$150,000 unsecured term loan facility, and may, from time to time, be expanded by up to \$50,000 of additional indebtedness, subject to the Company's compliance with certain conditions and the lenders participation. The 2008 Term Loan Credit Agreement bears interest at LIBOR plus 1.00% to 2.25% and requires quarterly principal payments of \$1,875.

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In April 2009, Woodward entered into a term loan credit agreement (the 2009 Term Loan Credit Agreement and, together with the 2008 Term Loan Credit Agreement, the Term Loan Credit Agreements ), by and among Woodward, the institutions from time to time parties thereto, as lenders, and JPMorgan Chase Bank, National Association, as administrative agent. The 2009 Term Loan Credit Agreement provides for an initial \$120,000 unsecured term loan facility, and may be expanded by up to \$50,000 of additional indebtedness from time to time, subject to the Company's compliance with certain conditions and the lenders' participation. The outstanding indebtedness under the 2009 Term Loan Credit Agreement, which generally bore interest at LIBOR plus 2.50% to 3.50%, was paid-off in full during the quarter ended March 31, 2010. Woodward intends to terminate the 2009 Term Loan Credit Agreement during the quarter ending June 30, 2010.

The Term Loan Credit Agreements contain customary terms and conditions, including, among others, covenants that place limits on the Company's ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell the Company's assets, merge or consolidate with other persons, make certain investments, make certain restricted payments, and enter into material transactions with affiliates. The Term Loan Credit Agreements contain financial covenants requiring that (a) the Company's ratio of consolidated net debt to Debt Covenant EBITDA, not exceed a ratio of 3.5 to 1.0 and (b) the Company have a minimum consolidated net worth of \$400,000 with respect to the 2008 Term Loan Credit Agreement and \$510,000 with respect to the 2009 Term Loan Credit Agreement, plus 50% of net income for any fiscal year and 50% of the net proceeds of certain issuances of capital stock, in each case on a rolling four quarter basis. The Term Loan Credit Agreements also contain customary events of default, including certain cross default provisions related to Woodward's other outstanding debt arrangements in excess of \$15,000, the occurrence of which would permit the lenders to accelerate the amounts due thereunder.

The loans under the Term Loan Credit Agreements can be prepaid, or prepaid and terminated, without penalty.

**Series B, C, D, E and F Notes**

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

The Notes have not been registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. Holders of the Notes do not have any registration rights.

Woodward's obligations under the Notes rank equal in right of payment with all of Woodward's other unsecured unsubordinated debt, including its outstanding debt under the Term Loan Credit Agreements, revolving credit facility (see Note 12, *Line of credit facilities and short-term borrowing*) and note purchase agreement relating to the senior notes due October 2011.

The Note Purchase Agreements contain customary restrictive covenants, including, among other things, covenants that place limits on Woodward's ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell Woodward's assets, merge or consolidate with other persons, and enter into material transactions with affiliates. The Note Purchase Agreements also contain customary events of default, including certain cross default provisions related to Woodward's other outstanding debt arrangements in excess of \$25,000 with respect to the 2008 Note Purchase Agreement and \$30,000 with respect to the 2009 Note Purchase Agreement, the occurrence of which would permit the holders of the respective Notes to accelerate the amounts due. The 2008 Note Purchase Agreement contains financial covenants requiring that Woodward's (a) ratio of consolidated net debt to consolidated Debt Covenant EBITDA not exceed a ratio of 4.0 to 1.0 during any material acquisition period, or a ratio of 3.5 to 1.0 at any other time on a rolling four quarter basis, and (b) consolidated net worth at any time equal or exceed \$425,000 plus 50% of consolidated net earnings for each fiscal year beginning with the fiscal year ended September 30, 2008. Additionally, under the 2008 Note Purchase Agreement, Woodward may not permit

the aggregate amount of priority debt to at any time to exceed 20% of its consolidated net worth at the end of the then most recently ended fiscal quarter. Priority debt generally refers to certain unsecured debt of Woodward's subsidiaries and all debt of Woodward and its subsidiaries secured by liens other than certain permitted liens.



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The 2009 Note Purchase Agreement contains financial covenants requiring that Woodward's (a) ratio of consolidated net debt to consolidated Debt Covenant EBITDA not exceed a ratio of 3.5 to 1.0 at any time on a rolling four quarter basis, and (b) consolidated net worth at all times equal or exceed \$485,940 plus 50% of consolidated net earnings for each fiscal year beginning with the fiscal year ending September 30, 2009. Additionally, under the 2009 Note Purchase Agreement, Woodward may not permit the aggregate amount of priority debt to at any time exceed 20% of its consolidated net worth at the end of the then most recently ended fiscal quarter. Priority debt generally refers to certain unsecured debt of Woodward's subsidiaries and all debt of Woodward and its subsidiaries secured by liens other than certain permitted liens.

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

**Note 12. Line of credit facilities and short-term borrowings**

Woodward has a \$225,000 revolving credit facility related to unsecured financing arrangements with a syndicate of U.S. banks. The revolving credit facility agreement provides for an option to increase the amount to \$350,000, subject to the lenders' participation, and has an expiration date of October 2012. The interest rate on borrowings under the revolving credit facility agreement varies with LIBOR, the federal funds rate, or the prime rate. The revolving credit facility 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 \$15,000, the occurrence of which would permit the lenders to accelerate the amounts due thereunder.

Woodward also has various foreign lines of credit and foreign overdraft facilities. The foreign banking facilities are generally reviewed annually for renewal and are subject to the usual terms and conditions applied by the banks.

As of March 31, 2010, availability under Woodward's short-term credit facilities follows:

|  | Total      | Outstanding<br>letters of<br>credit | Outstanding<br>borrowings | Borrowing<br>availability |
|--|------------|-------------------------------------|---------------------------|---------------------------|
| Revolving credit facility                        | \$ 225,000 | \$ (3,144)                          | \$                        | \$ 221,856                |
| Foreign lines of credit and overdraft facilities | 6,675      |                                     |                           | 6,675                     |
|  | \$ 231,675 | \$ (3,144)                          | \$                        | \$ 228,531                |

Woodward also has a foreign letter of credit facility in place for the issuance of performance guarantees. Per the terms of the related facility agreement, this facility is limited in use to the issuance of performance guarantees. As of March 31, 2010, \$5,097 in performance guarantees was issued against the \$9,468 foreign letter of credit facility. The Company participates in a pooling arrangement whereby certain foreign bank accounts of Woodward or its subsidiaries may serve as collateral for borrowings by other Woodward subsidiaries up to the total amounts deposited in the pool.

No borrowings were outstanding under any of Woodward's line of credit or other short-term credit facilities as of March 31, 2010 or as of September 30, 2009.

**Note 13. 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 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 minimizes this credit risk by entering into transactions with only high quality 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 minimizes this market risk by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

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Woodward was not a party to any derivative instruments as of March 31, 2010. As of September 30, 2009, Woodward was a party to the forward foreign currency exchange contract described below. As of September 30, 2008, all previous derivative instruments into which Woodward had entered were terminated.

In 2001, Woodward entered into treasury lock agreements that were designated as cash flow hedges of its long-term debt. The discontinuance of these treasury lock agreements resulted in losses that are recognized as an increase of interest expense over the term of the associated debt (10 years) using the effective interest method. The unrecognized portion of the loss is recorded in accumulated other comprehensive earnings.

In 2002, Woodward entered into certain interest rate swaps that were designated as fair value hedges of its long-term debt. The discontinuance of these interest rate swaps resulted in gains that are recognized as a reduction of interest expense over the term of the associated debt (10 years) using the effective interest method. The unrecognized portion of the gain is presented as an adjustment to long-term debt based on the accounting guidance in effect at the time the interest rate swaps were terminated.

In September 2008, the Company entered into treasury lock agreements with a notional amount totaling \$100,000 that qualified as cash flow hedges under authoritative guidance for derivatives and hedging. The objective of this derivative instrument was to hedge the risk of variability in cash flows related to future interest payments of a portion of the anticipated future debt issuances attributable to changes in the designated benchmark interest rate associated with the expected issuance of long-term debt. The hedges were terminated prior to September 30, 2008 resulting in a realized gain of approximately \$108 and the gain was recorded in accumulated other comprehensive earnings as of September 30, 2008, net of tax. The realized gain on the termination of the treasury lock agreements is being recognized as a reduction of interest expense over a seven-year period on the hedged debt issued on October 1, 2008 using the effective interest method.

In March 2009, Woodward entered into LIBOR lock agreements with a total notional amount of \$50,000 that qualified as cash flow hedges under authoritative guidance for derivatives and hedging. The objective of this derivative instrument was to hedge the risk of variability in cash flows over a seven-year period related to future interest payments of a portion of anticipated future debt issuances attributable to changes in the designated benchmark interest rate associated with the then expected issuance of long-term debt to acquire HRT. The hedges were terminated in March 2009, resulting in a loss of \$1,308. The realized loss was recorded in accumulated other comprehensive earnings, net of tax. The realized loss on the terminated LIBOR lock agreements is being recognized as an increase of interest expense over a seven-year period on the hedged debt, which was issued on April 3, 2009, using the effective interest method.

In September 2009, Woodward entered into a foreign currency exchange rate contract to purchase 7,900 for approximately \$11,662 in early October 2009. The objective of this derivative instrument, which was not designated as an accounting hedge, was to limit the risk of foreign currency exchange rates on certain short-term intercompany loan balances. An unrealized loss of \$173 on the derivative instrument was carried at fair market value in Accrued liabilities as of September 30, 2009. A loss of \$71 was realized on the settlement of the forward contract in October 2009.

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

| <b>Derivatives designated as hedging instruments</b> | <b>Balance Sheet Location</b>            | <b>March<br/>31,<br/>2010</b>       | <b>September<br/>30,<br/>2009</b> |
|--|--|-------------------------------------|-----------------------------------|
|  |  | <b>Unrecognized Gain<br/>(Loss)</b> |                                   |
| 2001 Treasury lock                                   | Accumulated other comprehensive earnings | \$ (115)                            | \$ (171)                          |

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|                         |  |            |            |
|-------------------------|--|------------|------------|
| 2002 Interest rate swap | Long-term debt                           | 133        | 197        |
|                         | Accumulated other comprehensive earnings | 85         | 93         |
| 2008 Treasury lock      | Accumulated other comprehensive earnings | (1,121)    | (1,215)    |
| 2009 LIBOR lock         |  |            |            |
|                         |  | \$ (1,018) | \$ (1,096) |

**Derivative not designated as hedging instrument**

|                                   |                     |    |          |
|-----------------------------------|---------------------|----|----------|
| Foreign exchange forward contract | Accrued liabilities | \$ | \$ (173) |
|-----------------------------------|---------------------|----|----------|

**Recognized Gain (Loss)**

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

**Three months ended March 31, 2010**

|  | Location of Gain<br>(Loss) Recognized in<br>Earnings | Amount of<br>Income<br>(Expense)<br>Recognized<br>in<br>Earnings<br>on<br>Derivative | Amount of<br>Gain (Loss)<br>Recognized<br>in<br>OCI on<br>Derivative | Amount of<br>Gain<br>(Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Earnings |
|--|--|--|--|--|
| <b>Derivatives in fair value hedging relationships</b> |  |  |  |  |
| 2002 Interest rate swap                                | Interest expense                                     | \$ 31  | \$   | \$   |
| <b>Derivatives in cash flow hedging relationships</b>  |  |  |  |  |
| 2001 Treasury lock                                     | Interest expense                                     | (27)   |  | (27)   |
| 2008 Treasury lock                                     | Interest expense                                     | 4  |  | 4  |
| 2009 LIBOR lock  | Interest expense                                     | (47)   |  | (47)   |
|  |  | \$ (39)  | \$   | \$ (70)  |

**Three months ended March 31, 2009**

|  | Location of Gain<br>(Loss) Recognized in<br>Earnings | Amount of<br>Income<br>(Expense)<br>Recognized<br>in<br>Earnings<br>on<br>Derivative | Amount of<br>Gain (Loss)<br>Recognized<br>in<br>OCI on<br>Derivative | Amount of<br>Gain<br>(Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Earnings |
|--|--|--|--|--|
| <b>Derivatives in fair value hedging relationships</b> |  |  |  |  |
| 2002 Interest rate swap                                | Interest expense                                     | \$ 45  | \$   | \$   |
| <b>Derivatives in cash flow hedging relationships</b>  |  |  |  |  |
| 2001 Treasury lock                                     | Interest expense                                     | (39)   |  | (39)   |
| 2008 Treasury lock                                     | Interest expense                                     | 4  |  | 4  |

|                 |                  |    |    |         |         |         |
|-----------------|------------------|----|----|---------|---------|---------|
| 2009 LIBOR lock | Interest expense |    |    | (1,308) |         |         |
|                 |                  | \$ | 10 | \$      | (1,308) | \$ (35) |

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**Woodward Governor Company**  
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**Six months ended March 31, 2010**

|  | <b>Location of Gain<br/>(Loss) Recognized in<br/>Earnings</b> | <b>Amount of<br/>Income<br/>(Expense)<br/>Recognized<br/>in Earnings<br/>on<br/>Derivative</b> | <b>Amount of<br/>Gain<br/>(Loss)<br/>Recognized<br/>in<br/>Accumulated<br/>OCI on<br/>Derivative</b> | <b>Amount of<br/>Gain (Loss)<br/>Reclassified<br/>from<br/>Accumulated<br/>OCI into<br/>Earnings</b> |
|--|---|--|--|--|
| <b>Derivatives in fair value hedging relationships</b> |   |  |  |  |
| 2002 Interest rate swap                                | Interest expense  | \$ 64  | \$   | \$   |
| <b>Derivatives in cash flow hedging relationships</b>  |   |  |  |  |
| 2001 Treasury lock                                     | Interest expense  | (56)   |  | (56)   |
| 2008 Treasury lock                                     | Interest expense  | 8  |  | 8  |
| 2009 LIBOR lock  | Interest expense  | (94)   |  | (94)   |
| <b>Derivative in foreign currency relationships</b>    |   |  |  |  |
| Foreign exchange forward contract                      | Other income  | 102  |  |  |
|  |   | \$ 24  | \$   | \$ (142)   |

**Six months ended March 31, 2009**

|  | <b>Location of Gain<br/>(Loss) Recognized<br/>in Earnings</b> | <b>Amount of<br/>Income<br/>(Expense)<br/>Recognized<br/>in Earnings<br/>on<br/>Derivative</b> | <b>Amount of<br/>Gain (Loss)<br/>Recognized<br/>in<br/>Accumulated<br/>OCI on<br/>Derivative</b> | <b>Amount of<br/>Gain (Loss)<br/>Reclassified<br/>from<br/>Accumulated<br/>OCI into<br/>Earnings</b> |
|--|---|--|--|--|
| <b>Derivatives in fair value hedging relationships</b> |   |  |  |  |
| 2002 Interest rate swap                                | Interest expense  | \$ 92  | \$   | \$   |
| <b>Derivatives in cash flow hedging relationships</b>  |   |  |  |  |
| 2001 Treasury lock                                     | Interest expense  | (79)   |  | (79)   |
| 2008 Treasury lock                                     | Interest expense  | 8  |  | 8  |
| 2009 LIBOR lock  | Interest expense  |  | (1,308)  |  |

\$ 21    \$ (1,308)    \$ (71)

Based on the carrying value of the unrecognized gains and losses on terminated derivative instruments designated as cash flow hedges as of March 31, 2010, Woodward expects to reclassify \$256 of net unrecognized losses on terminated derivative instruments from accumulated other comprehensive earnings to earnings during the next twelve months.

**Note 14. Accrued liabilities**

Accrued liabilities consist of the following:

|  | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|--|---------------------------|-------------------------------|
| Salaries and other member benefits                 | \$ 26,217                 | \$ 32,135                     |
| Department of Justice matter (see Note 20)         |                           | 25,000                        |
| Current portion of restructuring and other charges | 6,477                     | 11,619                        |
| Warranties   | 9,460                     | 10,005                        |
| Interest payable                                   | 11,997                    | 12,376                        |
| Accrued retirement benefits                        | 2,727                     | 2,734                         |
| Deferred revenues                                  | 15,625                    | 1,314                         |
| Taxes, other than income                           | 5,812                     | 5,910                         |
| Other  | 25,635                    | 26,224                        |
|  | <b>\$ 103,950</b>         | <b>\$ 127,317</b>             |



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Deferred revenues increased at March 31, 2010 compared to September 30, 2009 due primarily to a customer prepayment which is expected to be fully earned within one year.

**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, 2009                                | \$     | 10,005    |
| Increases to accruals related to warranties during the period |        | 2,756     |
| Settlements of amounts accrued                                |        | (3,049)   |
| Foreign currency exchange rate changes                        |        | (252)     |
| <br>Warranties, March 31, 2010                                | <br>\$ | <br>9,460 |

**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 six months ended March 31, 2010, accrued restructuring charges were increased by \$1,834 to reflect updated estimates of anticipated costs in connection with the HRT acquisition. The business acquisition related accrued restructuring charges of \$6,074 as of March 31, 2010 relate primarily to the planned closing of the Pacoima, California facility as part of a decision to consolidate HRT's production facilities. The summary of the activity in accrued restructuring charges during the three and six months ended March 31, 2010 is as follows:

|  | <b>Restructuring<br/>Charges</b> | <b>Business<br/>Acquisitions</b> | <b>Total</b> |
|--|----------------------------------|----------------------------------|--------------|
| Accrued restructuring charges, September 30, 2009    | \$ 3,196                         | \$ 9,668                         | \$ 12,864    |
| Purchase accounting adjustments                      |                                  | 1,400                            | 1,400        |
| Payments   | (1,000)                          | (932)                            | (1,932)      |
| Foreign currency exchange rates                      | (9)                              |                                  | (9)          |
| <br>Accrued restructuring charges, December 31, 2009 | <br>2,187                        | <br>10,136                       | <br>12,323   |
| Purchase accounting adjustments                      |                                  | 434                              | 434          |
| Payments   | (495)                            | (4,896)                          | (5,391)      |
| Non-cash adjustments                                 | (266)                            | 400                              | 134          |
| Foreign currency exchange rates                      | (36)                             |                                  | (36)         |
| <br>Accrued restructuring charges, March 31, 2010    | <br>\$ 1,390                     | <br>\$ 6,074                     | <br>\$ 7,464 |

Other liabilities as of March 31, 2010 and September 30, 2009, respectively, include \$987 and \$1,245 of accrued restructuring charges not expected to be settled within twelve months.



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**Note 15. Other liabilities**

|   | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|---|---------------------------|-------------------------------|
| Net accrued retirement benefits, less amounts recognized with accrued liabilities                     | \$ 83,812                 | \$ 83,837                     |
| Uncertain tax positions, net of offsetting benefits, less amounts recognized with accrued liabilities | 15,461                    | 15,550                        |
| Other   | 7,368                     | 10,623                        |
|   | <b>\$ 106,641</b>         | <b>\$ 110,010</b>             |

**Note 16. Retirement benefits**

Woodward provides various benefits to certain current and former employees through defined benefit plans, retirement healthcare benefit plans and various defined contribution plans. Eligibility requirements and benefit levels vary depending on employee location. A September 30 measurement date is utilized to value plan assets and obligations for all of Woodward's defined benefit and retirement healthcare benefit plans.

U.S. GAAP requires that, for obligations outstanding as of September 30, 2009, the funded status reported in interim periods shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (a) subsequent accruals of net periodic benefit cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (b) contributions to a funded plan, or benefit payments.

In connection with the acquisition of HRT (see Note 4. *Business acquisitions and dispositions*), Woodward assumed pension benefit obligations and postretirement healthcare benefit obligation that contributed to increases in recognized expenses for the three and six months ended March 31, 2010 compared to the three and six months ended March 31, 2009.

Effective January 1, 2010, the HRT pension plan was amended so that non-bargained HRT employees hired after December 31, 2009 will not participate in the plan. Also, effective January 1, 2010, non-bargained HRT employees hired before January 1, 2010 will be ineligible for matching contributions for participation in defined contribution plans. Non-bargained HRT employees hired after December 31, 2009 will be eligible to fully participate in Woodward's defined contribution plans.

Effective April 19, 2010, the HRT pension plan was amended so that bargained HRT employees hired after April 19, 2010 will not participate in the plan. The amendment also included certain modifications to the calculation of postretirement plan benefit payments to bargained employees which Woodward expects to result in an increase to projected benefit obligations plan of approximately \$4,000 at the next remeasurement date. Also, effective January 1, 2010, bargained HRT employees hired before April 19, 2010 will be ineligible for matching contributions for participation in defined contribution plans. Bargained HRT employees hired after April 18, 2009 will be eligible to fully participate in Woodward's defined contribution plans.

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

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Retirement pension benefits United States:</b>   |                           |             |                         |             |
| Service cost  | \$ 912                    | \$          | \$ 1,824                | \$          |
| Interest cost                                       | 1,223                     | 287         | 2,445                   | 574         |
| Expected return on plan assets                      | (1,190)                   | (282)       | (2,380)                 | (564)       |
| Amortization of:                                    |                           |             |                         |             |
| Net actuarial loss                                  | 132                       | 84          | 264                     | 168         |
| Prior service cost                                  | (65)                      | (65)        | (130)                   | (130)       |
| Net periodic benefit                                | \$ 1,012                  | \$ 24       | \$ 2,023                | \$ 48       |
| Contributions                                       | \$                        | \$          | \$                      | \$          |
| <b>Retirement pension benefits other countries:</b> |                           |             |                         |             |
| Service cost  | \$ 194                    | \$ 175      | \$ 395                  | \$ 354      |
| Interest cost                                       | 565                       | 511         | 1,155                   | 1,060       |
| Expected return on plan assets                      | (590)                     | (511)       | (1,206)                 | (1,061)     |
| Amortization of:                                    |                           |             |                         |             |
| Transition obligation                               | 22                        | 20          | 43                      | 40          |
| Net actuarial loss                                  | 187                       | 34          | 382                     | 68          |
| Prior service cost                                  | (2)                       | (2)         | (4)                     | (4)         |
| Net periodic benefit                                | \$ 376                    | \$ 227      | \$ 765                  | \$ 457      |
| Contributions                                       | \$ 447                    | \$ 413      | \$ 1,839                | \$ 1,242    |

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

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Retirement healthcare benefits:</b> |                           |             |                         |             |
| Service cost                           | \$ 30                     | \$ 43       | \$ 60                   | \$ 85       |
| Interest cost                          | 521                       | 562         | 1,041                   | 1,125       |
| Amortization of:                       |                           |             |                         |             |
| Net actuarial loss                     | 47                        | 24          | 94                      | 48          |
| Prior service cost                     | (312)                     | (808)       | (624)                   | (1,616)     |
| Net periodic benefit (cost)            | \$ 286                    | \$ (179)    | \$ 571                  | \$ (358)    |
| Contributions                          | \$ 911                    | \$ 1,316    | \$ 1,466                | \$ 2,061    |



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The exact amount of cash contributions made to these plans in any year is dependent upon a number of factors, including minimum funding requirements in the jurisdictions in which Woodward operates and arrangements made with trustees of certain foreign plans. As a result, the actual funding in fiscal 2010 may differ from the current estimate. Woodward estimates its cash contributions in fiscal 2010 will be as follows:

Retirement pension benefits:

|                                |          |
|--------------------------------|----------|
| Other countries                | \$ 6,760 |
| United States                  | 2,750    |
| Retirement healthcare benefits | 2,769    |

**Note 17. Stock-based compensation****Stock options**

Stock option awards are granted with an exercise price equal to the market price of Woodward's stock at the date of grant, and generally with a four-year graded vesting schedule and a term of 10 years.

The fair value of options granted was estimated on the date of grant using the Black-Scholes-Merton option-pricing model using the following assumptions:

|                                  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|----------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                  | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                                  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Expected term                    | 6.5 years                 | n/a         | 6.5 years               | 7 years     |
| Estimated volatility             | 51.0%                     | n/a         | 51.0%                   | 43.0%       |
| Estimated dividend yield         | 1.4%                      | n/a         | 1.4%                    | 1.4%        |
| Risk-free interest rate          | 3.0%                      | n/a         | 3.4%                    | 3.1%        |
| Weighted-average forfeiture rate | 10.8%                     | n/a         | 8.1%                    | 8.2%        |

The following is a summary of the activity for stock option awards during the three and six months ended March 31, 2010:

|                               | <b>Number of</b> | <b>Weighted-</b>      |
|-------------------------------|------------------|-----------------------|
|                               | <b>options</b>   | <b>Average</b>        |
|                               |                  | <b>Exercise Price</b> |
| Balance at September 30, 2009 | 4,068            | \$ 14.48              |
| Options granted               | 662              | 23.18                 |
| Options exercised             | (69)             | 11.54                 |
| Options cancelled             |                  | n/a                   |
| Options forfeited             | (2)              | 32.73                 |
| Balance at December 31, 2009  | 4,659            | 15.75                 |
| Options granted               | 10               | 26.72                 |
| Options cancelled             | (2)              | 32.73                 |
| Options exercised             | (62)             | 12.53                 |
| Options forfeited             | (4)              | 24.38                 |
| Balance at March 31, 2010     | 4,601            | 15.80                 |



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**Restricted stock**

The following is a summary of the activity for restricted stock awards during the three and six months ended March 31, 2010:

|                               | <b>Number<br/>of<br/>Shares</b> | <b>Weighted-<br/>Average Grant<br/>Date Fair Value<br/>per Share</b> |
|-------------------------------|---------------------------------|--|
| Balance at September 30, 2009 | 70                              | \$ 33.49   |
| Shares granted                |                                 | n/a  |
| Shares vested                 |                                 | n/a  |
| Shares forfeited              |                                 | n/a  |
| Balance at December 31, 2009  | 70                              | 33.49  |
| Shares granted                |                                 | n/a  |
| Shares vested                 |                                 | n/a  |
| Shares forfeited              |                                 | n/a  |
| Balance at March 31, 2010     | 70                              | 33.49  |

Restricted stock shares participate in dividends during the vesting period.



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**Note 18. Accumulated other comprehensive earnings**

|   | <b>Six Months Ended March 31, 2010</b> |                                    |              |
|---|--|------------------------------------|--------------|
|   | <b>Woodward</b>                        | <b>Noncontrolling<br/>Interest</b> | <b>Total</b> |
| <b>Accumulated foreign currency translation adjustments:</b>              |  |                                    |              |
| Balance at September 30, 2009   | \$ 29,464                              | \$ (221)                           | \$ 29,243    |
| Translation adjustments, net of reclassification to earnings              | (13,820)                               | 128                                | (13,692)     |
| Taxes associated with translation adjustments                             | 849                                    | (45)                               | 804          |
| Balance at March 31, 2010   | 16,493                                 | (138)                              | 16,355       |
| <b>Accumulated unrealized derivative losses:</b>                          |  |                                    |              |
| Balance at September 30, 2009   | (801)                                  |                                    | (801)        |
| Reclassification to interest expense                                      | 141                                    |                                    | 141          |
| Taxes associated with interest reclassification                           | (54)                                   |                                    | (54)         |
| Balance at March 31, 2010   | (714)                                  |                                    | (714)        |
| <b>Accumulated minimum post-retirement benefit liability adjustments:</b> |  |                                    |              |
| Balance at September 30, 2009   | (18,534)                               |                                    | (18,534)     |
| Minimum benefit liability adjustment                                      | 480                                    |                                    | 480          |
| Taxes associated with benefit adjustments                                 | (232)                                  |                                    | (232)        |
| Balance at March 31, 2010   | (18,286)                               |                                    | (18,286)     |
| Total accumulated other comprehensive earnings                            | \$ (2,507)                             | \$ (138)                           | \$ (2,645)   |

|  | <b>Six Months Ended March 31, 2009</b> |                                    |              |
|--|--|------------------------------------|--------------|
|  | <b>Woodward</b>                        | <b>Noncontrolling<br/>Interest</b> | <b>Total</b> |
| <b>Accumulated foreign currency translation adjustments:</b> |  |                                    |              |
| Balance at September 30, 2008                                | \$ 23,709                              | \$ (166)                           | \$ 23,543    |
| Translation adjustments, net of reclassification to earnings | (15,633)                               | (206)                              | (15,839)     |
| Taxes associated with translation adjustments                | (1,529)                                | 75                                 | (1,454)      |
| Balance at March 31, 2009                                    | 6,547                                  | (297)                              | 6,250        |
| <b>Accumulated unrealized derivative losses:</b>             |  |                                    |              |
| Balance at September 30, 2008                                | (137)                                  |                                    | (137)        |
| Payments for cash flow hedge, net of deferred tax            | (811)                                  |                                    | (811)        |
| Reclassification to interest expense                         | 71                                     |                                    | 71           |
| Taxes associated with interest reclassification              | (27)                                   |                                    | (27)         |

|   |          |    |       |          |
|---|----------|----|-------|----------|
| Balance at March 31, 2009   | (904)    |    |       | (904)    |
| <b>Accumulated minimum post-retirement benefit liability adjustments:</b> |          |    |       |          |
| Balance at September 30, 2008   | (3,087)  |    |       | (3,087)  |
| Minimum benefit liability adjustment                                      | 209      |    |       | 209      |
| Taxes associated with benefit adjustments                                 |          |    |       |          |
| Balance at March 31, 2009   | (2,878)  |    |       | (2,878)  |
| Total accumulated other comprehensive earnings                            | \$ 2,765 | \$ | (297) | \$ 2,468 |

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**Note 19. Total comprehensive earnings**

|  | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                  |
|--|---------------------------|-----------------|-------------------------|------------------|
|  | <b>March 31,</b>          |                 | <b>March 31,</b>        |                  |
|  | <b>2010</b>               | <b>2009</b>     | <b>2010</b>             | <b>2009</b>      |
| <b>Comprehensive earnings:</b>   |                           |                 |                         |                  |
| Net earnings attributable to Woodward                                  | \$ 24,068                 | \$ 18,474       | \$ 46,424               | \$ 45,538        |
| Other comprehensive earnings:  |                           |                 |                         |                  |
| Foreign currency translation adjustments, net                          | (10,345)                  | (10,105)        | (12,971)                | (17,162)         |
| Reclassification of unrealized losses on derivatives to earnings       | 43                        | 21              | 87                      | 44               |
| Payments for cash flow hedge, net of deferred tax                      |                           | (811)           |                         | (811)            |
| Minimum pension liability adjustment                                   | 239                       | 316             | 248                     | 209              |
| Comprehensive earnings attributable to Woodward                        | \$ 14,005                 | \$ 7,895        | \$ 33,788               | \$ 27,818        |
| <b>Comprehensive earnings attributable to noncontrolling interest:</b> |                           |                 |                         |                  |
| Net earnings attributable to noncontrolling interests                  | \$ 108                    | \$ 48           | \$ 198                  | \$ 87            |
| Foreign currency translation adjustments, net                          | 41                        | (81)            | 83                      | (131)            |
| Comprehensive earnings attributable to noncontrolling interests        | \$ 149                    | \$ (33)         | \$ 281                  | \$ (44)          |
| <b>Comprehensive earnings</b>  | <b>\$ 14,154</b>          | <b>\$ 7,862</b> | <b>\$ 34,069</b>        | <b>\$ 27,774</b> |

**Note 20. Commitments and contingencies**

Woodward is currently involved in claims, pending or threatened litigation or other legal proceedings, or regulatory proceedings arising in the normal course of business, including, among others, those relating to product liability claims, employment matters, workers' compensation claims, contractual disputes, product warranty claims and alleged violations of various environmental laws. Woodward has accrued for individual matters that it believes are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss.

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

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

In addition, MPC Products Corporation ( 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, and related administrative actions by the U.S. Department of Defense ( DOD ). In October 2009, MPC Products reached an agreement with the DOJ to resolve the criminal and civil claims related to the investigation. As part of the settlement of the civil claims, MPC Products paid approximately \$22,500 in

compensation. The civil settlement was approved by the United States District Court for the Northern District of Illinois (the District Court ) on October 7, 2009. In connection with the settlement of the criminal claims, on November 4, 2009, MPC Products pled guilty to one count of wire fraud related to its pre-June 2005 government contract pricing practices, and paid a fine of \$2,500. Pursuant to the plea agreement, MPC Products was also placed on probation for two years. The criminal case plea agreement and sentencing were approved by the District Court in November 2009, concluding the DOJ's investigation of these matters.

On October 7, 2009, Woodward and MPC Products entered into a three-year administrative agreement with the DOD. The administrative agreement lifted a suspension, which was in place from July 8, 2009 until October 7, 2009, of MPC Products from receiving new government contracts. Accordingly, MPC Products is again fully eligible to bid, receive and perform on U.S. government contracts. The administrative agreement requires, among other things, that Woodward and its affiliates, including MPC Products, implement certain enhancements to existing ethics and compliance programs and make periodic reports to the DOD. Woodward and its affiliates have been implementing these enhancements and furnishing reports as required by the administrative agreement.

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The purchase price Woodward paid in connection with the acquisition of MPC Products was reduced by \$25,000 at the time of the acquisition, which represents the amounts discussed above. Payment of this amount during the six months ended March 31, 2010 is reflected as an investing activity in the Condensed Consolidated Statement of Cash Flows.

In connection with the sale of the F&P product line during fiscal 2009, Woodward intends to assign to a subsidiary of the purchaser its rights and responsibilities related to certain contracts with the U.S. Government. As is customary and as requested by the U.S. Government, Woodward expects to guarantee to the U.S. Government the purchaser's subsidiary's obligations under the contracts. The purchaser has agreed to indemnify Woodward for any liability incurred with respect to the guarantee.

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

**Note 21. Financial instruments**

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

|  | <b>At March 31, 2010</b>        |                          | <b>At September 30, 2009</b>    |                          |
|--|---------------------------------|--------------------------|---------------------------------|--------------------------|
|  | <b>Estimated<br/>Fair Value</b> | <b>Carrying<br/>Cost</b> | <b>Estimated<br/>Fair Value</b> | <b>Carrying<br/>Cost</b> |
| Cash and cash equivalents                    | \$ 72,560                       | \$ 72,560                | \$ 100,863                      | \$ 100,863               |
| Investments in deferred compensation program | 5,916                           | 5,916                    | 5,331                           | 5,331                    |
| Long-term debt, including current portion    | (513,982)                       | (463,526)                | (588,229)                       | (572,142)                |

The fair values of cash and cash equivalents, which include investments in money market funds and short-term borrowings at variable interest rates, 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 and that the funds are highly liquid.

Investments related to the deferred compensation program used to provide deferred compensation benefits to certain employees are assumed to be equal to their carrying amounts because the assets are marked to market value each reporting period.

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 3.6% at March 31, 2010 and 4.8% at September 30, 2009.

**Note 22. Fair value measurements**

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.



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The following table presents information about Woodward's financial assets and liabilities 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:

|                                   | <b>At March 31, 2010</b> |                |                | <b>Total</b>    |
|-----------------------------------|--------------------------|----------------|----------------|-----------------|
|                                   | <b>Level 1</b>           | <b>Level 2</b> | <b>Level 3</b> |                 |
| Financial assets:                 |                          |                |                |                 |
| Investments in money market funds | \$ 2,690                 | \$             | \$             | \$ 2,690        |
| Trading securities                | 5,916                    |                |                | 5,916           |
| <b>Total financial assets</b>     | <b>\$ 8,606</b>          | <b>\$</b>      | <b>\$</b>      | <b>\$ 8,606</b> |

|                                   | <b>At September 30, 2009</b> |                |                | <b>Total</b>     |
|-----------------------------------|------------------------------|----------------|----------------|------------------|
|                                   | <b>Level 1</b>               | <b>Level 2</b> | <b>Level 3</b> |                  |
| Financial assets:                 |                              |                |                |                  |
| Investments in money market funds | \$ 20,130                    | \$             | \$             | \$ 20,130        |
| Trading securities                | 5,331                        |                |                | 5,331            |
| <b>Total financial assets</b>     | <b>\$ 25,461</b>             | <b>\$</b>      | <b>\$</b>      | <b>\$ 25,461</b> |

|                                    |           |               |           |               |
|------------------------------------|-----------|---------------|-----------|---------------|
| Financial liabilities:             |           |               |           |               |
| Foreign exchange forward contract  | \$        | \$ 173        | \$        | \$ 173        |
| <b>Total financial liabilities</b> | <b>\$</b> | <b>\$ 173</b> | <b>\$</b> | <b>\$ 173</b> |

*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 credit worthy financial institutions and that the funds are highly liquid. The investments in money market funds are reported at fair value, with realized gains from interest income realized in earnings and are included in Cash and cash equivalents. The fair values of Woodward's investments in money market funds are based on the quoted market prices for the net asset value of the various money market funds.

*Trading 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.

*Forward contract:* As of September 30, 2009, Woodward was a party to a forward contract. The value of the unrealized loss on the derivative instrument, which was classified as an accrued liability, was derived from published foreign currency exchange rates as of September 30, 2009.

**Note 23. Segment information**

Segment profit is determined based on internal performance measures used by the Chief Executive Officer to assess the performance of each business in a given period. In connection with that assessment, the Chief Executive Officer excludes matters such as charges for restructuring costs, interest income and expense, and certain gains and losses

from asset dispositions.

To provide better focus and alignment of its business segment operations, Woodward moved the development and manufacture of systems and components for steam turbine markets from Engine Systems to Turbine Systems in the fourth quarter of fiscal 2009. All segment information for the three and six months ended March 31, 2009, have been recast to reflect the realigned segment structure.



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**Woodward Governor Company**  
**Notes to Condensed Consolidated Financial**  
**Statements (Continued)**

A summary of consolidated net sales follows:

|                                 | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                 | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                                 | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Segment net sales:</b>       |                           |             |                         |             |
| <b>Turbine Systems</b>          |                           |             |                         |             |
| External net sales              | \$ 144,844                | \$ 164,571  | \$ 284,930              | \$ 316,853  |
| Intersegment sales              | 2,269                     | 3,472       | 4,599                   | 8,009       |
| Total segment net sales         | 147,113                   | 168,043     | 289,529                 | 324,862     |
| <b>Airframe Systems</b>         |                           |             |                         |             |
| External net sales              | 90,260                    | 50,909      | 181,309                 | 102,569     |
| Intersegment sales              | 613                       | 701         | 1,291                   | 1,359       |
| Total segment net sales         | 90,873                    | 51,610      | 182,600                 | 103,928     |
| <b>Electrical Power Systems</b> |                           |             |                         |             |
| External net sales              | 43,664                    | 45,221      | 92,545                  | 93,138      |
| Intersegment sales              | 10,863                    | 13,300      | 18,785                  | 27,225      |
| Total segment net sales         | 54,527                    | 58,521      | 111,330                 | 120,363     |
| <b>Engine Systems</b>           |                           |             |                         |             |
| External net sales              | 70,584                    | 73,960      | 129,876                 | 166,845     |
| Intersegment sales              | 7,639                     | 11,274      | 16,226                  | 23,683      |
| Total segment net sales         | 78,223                    | 85,234      | 146,102                 | 190,528     |
| <b>Consolidated</b>             |                           |             |                         |             |
| External net sales              | 349,352                   | 334,661     | 688,660                 | 679,405     |
| Intersegment sales              | 21,384                    | 28,747      | 40,901                  | 60,276      |
| Total segment net sales         | \$ 370,736                | \$ 363,408  | \$ 729,561              | \$ 739,681  |

A summary of consolidated earnings follows:

|                                  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|----------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                  | <b>March 31,</b>          |             | <b>March 31,</b>        |             |
|                                  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Segment earnings:</b>         |                           |             |                         |             |
| Turbine Systems                  | \$ 32,355                 | \$ 37,635   | \$ 64,429               | \$ 70,879   |
| Airframe Systems                 | 4,976                     | 3,233       | 7,385                   | 5,034       |
| Electrical Power Systems         | 4,859                     | 9,137       | 12,182                  | 18,303      |
| Engine Systems                   | 6,147                     | 4,882       | 9,382                   | 12,468      |
| Total segment earnings           | 48,337                    | 54,887      | 93,378                  | 106,684     |
| Nonsegment expenses              | (5,315)                   | (23,546)    | (10,725)                | (31,310)    |
| Interest expense and income, net | (7,204)                   | (6,486)     | (15,345)                | (12,361)    |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Consolidated earnings before income taxes | \$ 35,818 | \$ 24,855 | \$ 67,308 | \$ 63,013 |
|---|-----------|-----------|-----------|-----------|

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**Woodward Governor Company**  
**Notes to Condensed Consolidated Financial**  
**Statements (Continued)**

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

|   | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|---|---------------------------|-------------------------------|
| <b>Segment assets:</b>                                    |                           |                               |
| Turbine Systems   | \$ 338,437                | \$ 344,789                    |
| Airframe Systems  | 759,789                   | 801,300                       |
| Electrical Power Systems                                  | 134,603                   | 135,808                       |
| Engine Systems  | 189,532                   | 200,226                       |
| <br>  |                           |                               |
| Total segment assets                                      | 1,422,361                 | 1,482,123                     |
| Unallocated corporate property, plant, and equipment, net | 7,141                     | 6,857                         |
| Other unallocated assets                                  | 168,836                   | 207,442                       |
| <br>  |                           |                               |
| Consolidated total assets                                 | \$ 1,598,338              | \$ 1,696,422                  |

**Note 24. Subsequent events**

On April 21, 2010, Woodward's Board of Directors approved the purchase by Woodward of the 26% noncontrolling interest in Woodward Governor India Limited, a Woodward consolidated subsidiary, for approximately \$8,000. Upon completion of the transaction, Woodward will own 100% of Woodward Governor India Limited. The transaction is expected to be completed during the fiscal quarter ending June 30, 2010.

On April 21, 2010, Woodward's Board of Directors also approved a quarterly cash dividend of \$0.06 per share, payable on June 1, 2010 to shareholders of record as of May 18, 2010.

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

**Forward Looking Statements**

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

*future sales, earnings, cash flow, uses of cash, and other measures of financial performance;*

*description of our plans and expectations for future operations;*

*the effect of economic downturns or growth in particular regions;*

*the effect of changes in the level of activity in particular industries or markets;*

*the availability and cost of materials, components, services, and supplies;*

*the scope, nature, or impact of acquisition activity and integration into our businesses;*

*the development, production, and support of advanced technologies and new products and services;*

*new business opportunities;*

*restructuring costs and savings;*

*our plans, objectives, expectations and intentions with respect to recent acquisitions and expected business opportunities that may be available to us;*

*the outcome of contingencies;*

*future repurchases of common stock;*

*future levels of indebtedness and capital spending; and*

*pension plan assumptions and future contributions.*

*Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including:*

*a decline in business with, or financial distress of, our significant customers;*

*the continued instability in the financial markets and prolonged unfavorable economic and other industry conditions;*

*our ability to obtain financing, on acceptable terms or at all, to implement our business plans, complete acquisitions, or otherwise take advantage of business opportunities or respond to business pressures;*

*the long sales cycle, customer evaluation process, and implementation period of some of our products and services;*

*our ability to implement, and realize the intended effects of, our restructuring efforts;*

*any failure to fully comply, to the U.S. Government's satisfaction, with any of the terms of the civil and criminal settlements related to the U.S. Department of Justice ( DOJ ) investigation of the pre-June 2005 government contract pricing practices of MPC Products Corporation ( MPC Products ) and the related administrative agreement with the U.S. Department of Defense ( DOD );*

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*our ability to successfully manage competitive factors, including prices, promotional incentives, industry consolidation, and commodity and other input cost increases;*

*our ability to reduce our expenses in proportion to any sales shortfalls;*

*the ability of our subcontractors to perform contractual obligations and our suppliers to provide us with materials of sufficient quality or quantity required to meet our production needs at favorable prices or at all;*

*the success of, or expenses associated with, our product development activities;*

*our ability to integrate acquisitions and manage costs related thereto;*

*our substantial debt obligations, our debt service requirements, and our ability to operate our business, pursue business strategies and incur additional debt in the light of covenants contained in our outstanding debt agreements;*

*future impairment charges resulting from changes in the estimates of fair value of reporting units or of long-lived assets;*

*changes in domestic or international tax statutes;*

*changes in future subsidiary results;*

*environmental liabilities related to manufacturing activities;*

*our continued access to a stable workforce and favorable labor relations with our employees;*

*the geographical location of a significant portion of the Woodward HRT business in California, which historically has been susceptible to natural disasters;*

*our ability to successfully manage regulatory, tax, and legal matters (including government contracting, product liability, patent, and intellectual property matters);*

*risks from operating internationally, including the impact on reported earnings from fluctuations in foreign currency exchange rates, and changes in the legal and regulatory environments of countries in which we operate; and*

*certain provisions of our charter documents and Delaware law that could discourage or prevent others from acquiring our company.*

*These factors are representative of the risks, uncertainties, and assumptions that could cause actual outcomes and results to differ materially from what is expressed or forecast in our forward-looking statements. Other factors are discussed under **Risk Factors** in our Securities and Exchange Commission ( SEC ) filings and are incorporated by reference.*

*Therefore, actual results could differ materially and adversely from those expressed in any forward-looking statements. For additional information regarding factors that may affect our actual financial condition and results of operations, see the information under the caption **Risk Factors** in Item 1A in our Annual Report on Form 10-K for the year ended September 30, 2009. We undertake no obligation to revise or update any forward-looking statements for any reason.*

*Unless we have indicated otherwise or the context otherwise requires, references in this Quarterly Report on Form 10-Q to Woodward, the Company, we, us, and our refer to Woodward Governor Company and its consolidated subsidiaries.*

*Amounts presented in this Quarterly Report on Form 10-Q are in thousands except per share amounts.*

**OVERVIEW**

We are an independent designer, manufacturer, and service provider of energy control and optimization solutions for commercial and military aircraft and ground vehicles, turbines, reciprocating engines, and electrical power system equipment. Our innovative fluid energy, combustion control, electrical energy, and motion control systems help customers offer cleaner, more reliable and more cost-effective equipment. Leading original equipment manufacturers ( OEMs ) use our products and services in the aerospace, power generation and distribution, and transportation markets. Our strategic focus is energy control and optimization solutions. The control of energy, including fluid and electrical energy, combustion, and motion, is a growing requirement in the markets we serve. Our customers look to us to optimize the efficiency, emissions, and operation of power equipment in both commercial and military operations. Our core technologies leverage well across our markets and customer applications, enabling us to develop and integrate cost-effective and state-of- the-art fuel, combustion, fluid, actuation and electronic systems. We focus primarily on OEMs and equipment packagers, partnering with them to bring superior component and system solutions to their demanding applications.

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We have four operating business segments – Turbine Systems, Airframe Systems, Electrical Power Systems and Engine Systems:

**Turbine Systems** develops and manufactures systems and components that provide energy control and optimization solutions for aircraft propulsion applications, including fuel and combustion systems for turbine engines, as well as industrial gas and steam turbine markets.

**Airframe Systems** develops and manufactures high-performance cockpit, electromechanical and hydraulic motion control systems, and mission-critical actuation systems and controls for weapons, aircraft, turbine engines, and combat vehicles, primarily for aerospace and military applications.

**Electrical Power Systems** develops and manufactures systems and components that provide power sensing and energy control systems that improve the security, quality, reliability and availability of electrical power networks for industrial markets, which include the power generation, power distribution, and power conversion industries.

**Engine Systems** develops and manufactures systems and components that provide energy control and optimization solutions for the industrial engine markets, which include the power generation, transportation and process industries.

To provide better focus and alignment of our business segment operations, we moved the development and manufacture of systems and components for steam turbine markets from Engine Systems to Turbine Systems in the fourth quarter of fiscal 2009. All segment information for the three and six months ended March 31, 2009 have been recast to reflect the realigned segment structure.

We use segment information internally to assess the performance of each segment and to make decisions on the allocation of resources.

This discussion should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended September 30, 2009, and the Condensed Consolidated Financial Statements and Notes included in this report. Financial information for the acquired HRT business is reflected in our financial statements from the April 3, 2009 acquisition date. As a result of this acquisition, a comparison of results for the three and six months ended March 31, 2010 to the three and six months ended March 31, 2009 may not be particularly meaningful.

References to organic net sales, segment earnings or EBIT refer to financial information of Woodward businesses excluding the business acquired in the HRT acquisition, which has been integrated into Woodward within the Airframe Systems business segment.

References to net earnings represent net earnings attributable to Woodward Governor Company.

### **Non-U.S. GAAP Financial Measures**

Earnings before interest and taxes ( EBIT ), earnings before interest, taxes, depreciation and amortization ( EBITDA ) and free cash flow are financial measures not prepared and presented in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). Management uses EBIT to evaluate Woodward's performance without financing and tax related considerations, as these elements may not fluctuate with operating results. Management uses EBITDA in evaluating Woodward's operating performance, making business decisions, including developing budgets, managing expenditures, and forecasting future periods, and evaluating capital structure impacts of various strategic scenarios. Management uses free cash flow, which is derived from cash flows provided by operating activities, in reviewing the financial performance of Woodward's various business segments and evaluating cash levels. Securities analysts, investors, and others frequently use EBIT, EBITDA and free cash flow in their evaluation of companies, particularly those with significant property, plant, and equipment, and intangible assets that are subject to amortization. The use of these non-U.S. GAAP financial measures is not intended to be considered in isolation of, or as a substitute for, the financial information prepared and presented in accordance with U.S. GAAP. As EBIT and EBITDA exclude certain financial information compared with net earnings, the most comparable U.S. GAAP financial measure, users of this financial information should consider the information that is excluded. Free



cash flow does not necessarily represent funds available for discretionary use and is not necessarily a measure of our ability to fund our cash needs. Our calculations of EBIT, EBITDA and free cash flow may differ from similarly titled measures used by other companies, limiting their usefulness as comparative measures.

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EBIT and EBITDA for the three and six months ended March 31, 2010 and March 31, 2009 were as follows:

|                                   | <b>Three Months Ended</b> |                  | <b>Six Months Ended</b> |                   |
|-----------------------------------|---------------------------|------------------|-------------------------|-------------------|
|                                   | <b>March 31,</b>          |                  | <b>March 31,</b>        |                   |
|                                   | 2010                      | 2009             | 2010                    | 2009              |
| Net earnings                      | \$ 24,176                 | \$ 18,522        | \$ 46,622               | \$ 45,625         |
| Income taxes                      | 11,642                    | 6,333            | 20,686                  | 17,388            |
| Interest expense                  | 7,324                     | 6,707            | 15,575                  | 13,244            |
| Interest income                   | (120)                     | (221)            | (230)                   | (883)             |
| <b>EBIT</b>                       | <b>43,022</b>             | <b>31,341</b>    | <b>82,653</b>           | <b>75,374</b>     |
| Amortization of intangible assets | 8,655                     | 5,055            | 17,836                  | 9,883             |
| Depreciation expense              | 10,403                    | 9,298            | 20,158                  | 18,475            |
| <b>EBITDA</b>                     | <b>\$ 62,080</b>          | <b>\$ 45,694</b> | <b>\$ 120,647</b>       | <b>\$ 103,732</b> |

Organic EBIT for the three and six months ended March 31, 2010 and March 31, 2009 was as follows:

|                            | <b>Three Months Ended</b> |                  | <b>Six Months Ended</b> |                  |
|----------------------------|---------------------------|------------------|-------------------------|------------------|
|                            | <b>March 31,</b>          |                  | <b>March 31,</b>        |                  |
|                            | 2010                      | 2009             | 2010                    | 2009             |
| EBIT                       | \$ 43,022                 | \$ 31,341        | \$ 82,653               | \$ 75,374        |
| Less: HRT operating income | (8,297)                   |                  | (14,397)                |                  |
| <b>Organic EBIT</b>        | <b>\$ 34,725</b>          | <b>\$ 31,341</b> | <b>\$ 68,256</b>        | <b>\$ 75,374</b> |

Free cash flow for the six months ended March 31, 2010 and March 31, 2009 was as follows:

|   | <b>Six Months Ended</b> |                  |
|---|-------------------------|------------------|
|   | <b>March 31,</b>        |                  |
|   | 2010                    | 2009             |
| Net cash provided by operating activities | \$ 125,981              | \$ 51,826        |
| Capital expenditures                      | (14,136)                | (15,354)         |
| <b>Free cash flow</b>                     | <b>\$ 111,845</b>       | <b>\$ 36,472</b> |

**Quarterly Highlights**

Net sales for the second quarter of fiscal 2010 were \$349,352, which was an increase of 4.4% from \$334,661 for the second quarter of the prior year. Without the effects of foreign currency exchange rates, net sales for the current quarter would have been approximately \$5,300 lower compared to the second quarter of fiscal 2009.

Organic net sales were down \$44,438, or 13.3%, for the three months ended March 31, 2010, compared to the three months ended March 31, 2009.

EBIT for the three months ended March 31, 2010 was \$43,022, up 37.3% from \$31,341 in the same period of fiscal 2009. EBIT was significantly impacted by organic sales volume declines across all our business segments, partially offset by savings resulting from cost reduction actions primarily taken in fiscal 2009 and the impact of the acquisition of HRT.

Organic EBIT increased \$3,384 or 10.8% to \$34,725 for the three months ended March 31, 2010 from \$31,341 in the same period in fiscal 2009. Organic EBIT in the second quarter of 2009 included pretax special charges of \$16,605.

Net earnings for the second quarter of fiscal 2010 were \$24,068, or \$0.34 per diluted share, compared to \$18,474, or \$0.27 per diluted share, for the second quarter of fiscal 2009. The results of operations in the second quarter of 2009 included pretax special charges to expense of \$16,605, or \$0.16 per share.

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**Year To Date Highlights**

Net sales for the six months ended March 31, 2010 were \$688,660, an increase of 1.4% from \$679,405 for the same period of the prior year. Without the effects of foreign currency exchange rates, net sales for the six month period would have been approximately \$14,200 lower compared to the same period in fiscal 2009.

Organic net sales were down \$108,074, or 15.9%, for the six months ended March 31, 2010, compared to the six months ended March 31, 2009.

EBIT for the six months ended March 31, 2010 was \$82,653, up 9.7% from \$75,374 in the same period of fiscal 2009. EBIT was significantly impacted by organic sales volume declines across all our business segments, partially offset by savings resulting from cost reduction actions primarily taken in fiscal 2009 and the impact of the acquisition of HRT. Organic EBIT for the six months ended March 31, 2010 decreased to \$68,256 for the six months ended March 31, 2010 from \$75,374 in the same period in fiscal 2009.

Year to date net earnings for the six months ended March 31, 2010 were \$46,424, or \$0.66 per diluted share, compared to \$45,538, or \$0.66 per diluted share, in the same period in fiscal 2009. Excluding the impact of special charges recorded during the three months ended March 31, 2009, year to date earnings per share for the six months ended March 31, 2009 were \$0.82.

At March 31, 2010, our total assets were \$1,598,338, including \$72,560 in cash and cash equivalents, and our total debt was \$463,659. During the six months ended March 31, 2010, we paid \$108,569 of long-term debt through scheduled and unscheduled repayments. As of March 31, 2010, we had borrowing availability of \$221,856 under our \$225,000 revolving credit facility, net of outstanding letters of credit.

The results for the six months ended March 31, 2010 reflect our continued focus on generating cash from operations, which allowed us to prepay \$82,000 in long-term debt during the period. Net cash provided by operating activities for the six month period was \$125,981 compared to \$51,826 for the same period in fiscal 2009, reflecting lower levels of inventories and receivables, and lower payments for liabilities, including variable compensation payments, compared to the prior year period.

Free cash flows for the six months ended March 31, 2010 were \$111,845, up 206.7% from the same period in fiscal 2009. EBITDA increased by \$16,915, or 16.3% during the six months ended March 31, 2010 compared to the same period in fiscal 2009, from \$103,732 to \$120,647.

We believe liquidity and cash generation are important to our strategy of self-funding our ongoing operating needs. We also believe that the restructuring actions we implemented in fiscal 2009 have generated, and will continue to generate, improved cash flows from operations and that this level of cash generation, together with our existing cash and available borrowings, will adequately support our ongoing operations.

**Table of Contents****Results of Operations****Net Sales**

The following table presents the breakdown of consolidated net sales by segment:

|  | Three Months Ended March 31, |             |                   |             | Six Months Ended March 31, |             |                   |             |
|--|------------------------------|-------------|-------------------|-------------|----------------------------|-------------|-------------------|-------------|
|  | 2010                         |             | 2009              |             | 2010                       |             | 2009              |             |
| <b>Segment net sales:</b>              |                              |             |                   |             |                            |             |                   |             |
| Turbine Systems                        | \$ 147,113                   | 42%         | \$ 168,043        | 50%         | \$ 289,529                 | 42%         | \$ 324,862        | 48%         |
| Airframe Systems                       | 90,873                       | 26          | 51,610            | 15          | 182,600                    | 27          | 103,928           | 15          |
| Electrical Power Systems               | 54,527                       | 16          | 58,521            | 17          | 111,330                    | 16          | 120,363           | 18          |
| Engine Systems                         | 78,223                       | 22          | 85,234            | 25          | 146,102                    | 21          | 190,528           | 28          |
| Total segment net sales                | 370,736                      | 106         | 363,408           | 109         | 729,561                    | 106         | 739,681           | 109         |
| <b>Less intersegment net sales:</b>    |                              |             |                   |             |                            |             |                   |             |
| Turbine Systems                        | (2,269)                      | (1)         | (3,472)           | (1)         | (4,599)                    | (1)         | (8,009)           | (1)         |
| Airframe Systems                       | (613)                        | (0)         | (701)             | (0)         | (1,291)                    | (0)         | (1,359)           | (0)         |
| Electrical Power Systems               | (10,863)                     | (3)         | (13,300)          | (4)         | (18,785)                   | (3)         | (27,225)          | (4)         |
| Engine Systems                         | (7,639)                      | (2)         | (11,274)          | (3)         | (16,226)                   | (2)         | (23,683)          | (3)         |
| <b>Consolidated net external sales</b> | <b>\$ 349,352</b>            | <b>100%</b> | <b>\$ 334,661</b> | <b>100%</b> | <b>\$ 688,660</b>          | <b>100%</b> | <b>\$ 679,405</b> | <b>100%</b> |

Consolidated net external sales for the three and six months ended March 31, 2010 increased by \$14,691, or 4.4%, and \$9,255, or 1.4%, respectively, compared to the same periods in fiscal 2009. Details of the changes in consolidated net external sales are as follows:

|   | Three Month Period | Six Month Period |
|---|--------------------|------------------|
| Consolidated net external sales at March 31, 2009 | \$ 334,661         | \$ 679,405       |
| Acquisition of HRT                                | 59,129             | 117,329          |
| Turbine Systems volume changes                    | (22,391)           | (36,945)         |
| Airframe Systems volume changes                   | (19,778)           | (38,589)         |
| Electrical Power Systems volume changes           | (4,148)            | (7,624)          |
| Engine Systems volume changes                     | (5,293)            | (41,327)         |
| Price changes and sales mix                       | 1,843              | 2,190            |
| Effects of changes in foreign currency            | 5,329              | 14,221           |
| Consolidated net external sales at March 31, 2010 | \$ 349,352         | \$ 688,660       |

Sales increases associated with the acquisition of HRT in April 2009 partially offset organic sales volume decreases. Total organic net sales decreased \$44,438, or 13.3%, and \$108,074, or 15.9%, for the three and six month periods ended March 31, 2010 compared to the three and six month periods ended March 31, 2009. Organic net sales declined primarily due to volume changes across all of our segments of \$51,610 and \$124,485 for the three and six month periods ended March 31, 2010 compared to the same periods in 2009.

As part of their component and system offerings, Turbine Systems and Engine Systems sell electronic controls manufactured by Electrical Power Systems. Engine Systems also manufactures certain components of larger systems ultimately sold by Turbine Systems. These intersegment activities have historically increased growth in our Turbine Systems and Engine Systems segments. Further integration of our Airframe Systems segment is also expected to result in the manufacture of additional electronic controls by Electrical Power Systems.

***Turbine Systems segment net sales*** (including intersegment sales) were \$147,113 and \$289,529 for the three and six months ended March 31, 2010 compared to \$168,043 and \$324,862 in the same periods of fiscal 2009. While we believe our experience is largely consistent with underlying economic market trends, we also believe the fleet dynamics of platforms on which we have content, such as Airbus A320 and Boeing 777, have allowed us to be somewhat less negatively impacted by the effects of the current economic down-cycle than some of our competitors. Primary impacts of the down-cycle have included slowing deliveries of business and regional jets, industrial aeroderivative gas turbines and industrial heavy frame gas turbines. Commercial aircraft deliveries of narrow-body and large-body aircraft and military sales have remained relatively stable, although order patterns have fluctuated.

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Year-over-year declines were experienced in both the aerospace and industrial markets. The continuing impact of the global recession has resulted in excess temporary supplies of electricity in certain markets, which has contributed to reduced sales volumes of industrial gas and steam turbines. Also, uncertainty caused by the delay in issuance of new emissions standards in the U.S. continues to dampen customer demand.

**Airframe Systems segment net sales** (including intersegment sales) were \$90,873 and \$182,600 for the three and six month periods ended March 31, 2010 compared to \$51,610 and \$103,928 in the same periods of fiscal 2009.

On April 3, 2009, we acquired HRT and we have integrated this business into Woodward, and more specifically into our Airframe Systems segment. HRT net sales of \$59,129 and \$117,329 in the three and six month periods ended March 31, 2010 were down slightly compared to the same pre-acquisition periods in fiscal 2009 due to modest declines in our rotorcraft, military aircraft, military ground, and certain other markets.

Airframe Systems organic net sales for the three and six months ended March 31, 2010 were down 38.8% and 37.6% compared to the three and six months ended March 31, 2009. The sales decline in the organic business was primarily due to continued production softness in the overall regional and business jet OEM and aftermarket markets, coupled with reduced utilization of various platforms supplied by Airframe Systems to airframers. The sales decline was also impacted by reduced demand on various electro-optical programs to which we have significant exposure. Aftermarket net sales continued to experience slight declines due to passenger and cargo carriers removing planes from service.

**Electrical Power Systems segment net sales** (including intersegment sales) were \$54,527 and \$111,330 for the three and six month periods ended March 31, 2010, compared to \$58,521 and \$120,363 in the same periods a year ago.

Without the effects of foreign currency exchange rates, net sales for the current three and six month periods would have been approximately \$2,800 and \$8,600 lower compared to the same periods ended March 31, 2009. Decreased sales of wind turbine converters were partially offset by increases in non-wind related power generation and distribution equipment.

Intersegment sales declined \$2,437 and \$8,440 during the three and six month periods ended March 31, 2010 to \$10,863 and \$18,785, respectively, compared to the three and six month periods ended March 31, 2009. The intersegment sales declines reflect weakness in demand for industrial gas turbine and reciprocating engines used in power generation applications.

Wind converter sales declined in the three and six months ended March 31, 2010 as compared to the same periods of fiscal 2009. During the first three quarters of fiscal 2009, Electrical Power Systems experienced growth in demand for wind converters, but saw a significant decrease in demand during the second half of fiscal 2009, which has continued during the first six months of fiscal 2010. Wind converter demand continues to be impacted by tighter lender requirements for project financing as well as delays in finalizing government subsidy programs in the U.S. and elsewhere.

During the second half of fiscal 2009 demand for our non-wind power generation and distribution equipment and services declined. Demand for these products was up slightly in the three months ended March 31, 2010 compared to the same period of fiscal 2009.

**Engine Systems segment net sales** (including intersegment sales) were \$78,223 and \$146,102 for the three and six months ended March 31, 2010 compared to \$85,234 and \$190,528 in the same periods of fiscal 2009. However, sales for the three months ended March 31, 2010 were up \$10,344 from \$67,879 in the three months ended December 31, 2009.

Although sales of short-cycle engine control products supporting the construction and alternative-fuel vehicle markets have shown improvements, the lower year-over-year sales levels were primarily attributable to continued declines in large engine applications which serve the marine and power generation markets.

**Price changes and sales mix:** Selling price increases across several products in Turbine Systems and Engine Systems were in response to prevailing market conditions, partially offset by price decreases and changes in sales mix by customer in Electrical Power Systems.

**Foreign currency exchange rates:** Our worldwide sales activities are primarily denominated in U.S. dollars ( USD ), European Monetary Units (the Euro ), Great Britain pounds ( GBP ) and Chinese Yuan ( CNY ). As the USD, Euro and GBP fluctuate against each other and other currencies, we are exposed to gains or losses on sales transactions. If CNY, which has not fluctuated against other currencies in 2009 or 2010, is allowed to fluctuate against other currencies in

the future, we would be exposed to gains or losses on sales transactions denominated in CNY.

During the first three and six months of fiscal 2010, our organic net sales were positively impacted by approximately \$5,300 and \$14,200 due to changes in foreign currency exchange rates, compared to the same periods of fiscal 2009.



**Table of Contents****Costs and Expenses**

The following table presents costs and expenses in relation to net sales:

|   | Three Months Ended March 31,<br>2010 |                      |            | Six Months Ended March 31,<br>2010 |            |                      | 2009       |                      |  |
|---|--------------------------------------|----------------------|------------|------------------------------------|------------|----------------------|------------|----------------------|--|
|   |                                      | % of<br>Net<br>Sales |            | % of<br>Net<br>Sales               |            | % of<br>Net<br>Sales |            | % of<br>Net<br>Sales |  |
| Net sales                                     | \$ 349,352                           | 100.0%               | \$ 334,661 | 100.0%                             | \$ 688,660 | 100.0%               | \$ 679,405 | 100.0%               |  |
| Cost of goods sold                            | \$ 244,316                           | 69.9%                | \$ 235,539 | 70.4%                              | \$ 483,868 | 70.3%                | \$ 479,825 | 70.6%                |  |
| Selling, general, and administrative expenses | 34,130                               | 9.8                  | 29,093     | 8.7                                | 66,965     | 9.7                  | 61,553     | 9.1                  |  |
| Research and development costs                | 19,698                               | 5.6                  | 18,796     | 5.6                                | 38,012     | 5.5                  | 37,880     | 5.6                  |  |
| Amortization of intangible assets             | 8,655                                | 2.5                  | 5,055      | 1.5                                | 17,836     | 2.6                  | 9,883      | 1.5                  |  |
| Restructuring and other charges               |                                      |                      | 15,159     | 4.5                                |            | 0.0                  | 15,159     | 2.2                  |  |
| Interest and other income                     | (593)                                | (0.2)                | (559)      | (0.2)                              | (1,057)    | (0.2)                | (1,252)    | (0.2)                |  |
| Interest and other expenses                   | 7,328                                | 2.1                  | 6,723      | 2.0                                | 15,728     | 2.3                  | 13,344     | 2.0                  |  |
| Consolidated costs and expenses               | \$ 313,534                           | 89.7%                | \$ 309,806 | 92.6%                              | \$ 621,352 | 90.2%                | \$ 616,392 | 90.7%                |  |

**Cost of goods sold** decreased to \$244,316, or 69.9% of sales, in the three months ended March 31, 2010 from \$235,539, or 70.4% of sales, in the three months ended March 31, 2009. Cost of goods sold decreased to \$483,868, or 70.3% of sales, in the six months ended March 31, 2010 from \$479,825, or 70.6% of sales, for the six months ended March 31, 2009.

Correspondingly, gross margins (as measured by net sales less cost of goods sold divided by net sales) increased to 30.1% and 29.7% for the three and six months ended March 31, 2010, compared to 29.6% and 29.4% for the same periods last year, largely as a result of our focus on cost control.

During the three and six month periods ending March 31, 2010, cost of goods sold increased by approximately \$3,700 and \$9,800 due to changes in foreign currency exchange rates, compared to the same period of fiscal 2009.

**Selling, general, and administrative expenses** increased as a percent of sales to 9.8% and 9.7% for the three and six months ended March 31, 2010 as compared to 8.7% and 9.1% in the same periods of fiscal 2009. Selling, general, and administrative expenses for the three and six months ended March 31, 2010 increased \$5,037 and \$5,412 compared with the same periods of fiscal 2009, reflecting the addition of the related expenses of the HRT business and higher variable compensation accruals compared to amounts recorded in the same periods in the prior year, partially offset by the impact of cost reduction efforts taken during fiscal 2009.

**Research and development costs** as a percent of sales were 5.6% and 5.5% for the three and six month periods ended March 31, 2010 compared to 5.6% for both periods in fiscal 2009. Research and development costs increased \$902

and \$132 for the three and six months ended March 31, 2010 compared to the same periods in the prior year. Results for the three and six month periods ended March 31, 2010 reflect the impact of the acquisition of HRT offset by reduced workforce resulting from fiscal 2009 restructuring activities, when compared to the three and six month periods in fiscal 2009. Our research and development activities extend across virtually our entire customer base, and our current level of spending is consistent with our strategy of continuing to invest in future platforms and technologies.

**Amortization of intangible assets** as a percent of sales was 2.5% and 2.6% for the three and six months ended March 31, 2010 compared to 1.5% for both periods of fiscal 2009, primarily reflecting increased amortization expense related to \$128,400 of intangible assets acquired in the HRT acquisition in April 2009.

**Restructuring and other charges** of \$15,159 were recognized during the three months ended March 31, 2009. No restructuring charges were incurred in the three or six month periods ended March 31, 2010 or in the three month period ended December 31, 2008. The non-acquisition related restructuring and other charges recognized in the three months ended March 31, 2009 resulted from a number of projects we implemented which were intended to maintain our margins through cost reduction and efficiency improvements. The program savings were primarily related to indirect expenses, selling, general, and administrative expenses, material productivity, and facility rationalization.

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**Interest and other expenses** as a percent of sales was 2.1% and 2.3% for the three and six months ended March 31, 2010 compared to 2.0% for both periods of fiscal 2009. Interest expense increased in the three and six month periods ended March 31, 2010 because of interest on \$220,000 of long-term debt issued in April 2009, which was used primarily to finance the HRT acquisition, partially offset by interest savings due to debt reductions.

Since the acquisition of HRT in April 2009, we have made unscheduled prepayments of \$151,000 on our outstanding long-term debt. Since the HRT acquisition, total current and long-term debt has declined from \$651,859 to \$463,659.

**Earnings**

The following table presents earnings by segment:

|   | Three Months Ended March |           | Six Months Ended March |           |
|---|--------------------------|-----------|------------------------|-----------|
|   | 31,                      |           | 31,                    |           |
|   | 2010                     | 2009      | 2010                   | 2009      |
| Turbine Systems                           | \$ 32,355                | \$ 37,635 | \$ 64,429              | \$ 70,879 |
| Airframe Systems                          | 4,976                    | 3,233     | 7,385                  | 5,034     |
| Electrical Power Systems                  | 4,859                    | 9,137     | 12,182                 | 18,303    |
| Engine Systems                            | 6,147                    | 4,882     | 9,382                  | 12,468    |
| Total segment earnings                    | 48,337                   | 54,887    | 93,378                 | 106,684   |
| Nonsegment expenses                       | (5,315)                  | (23,546)  | (10,725)               | (31,310)  |
| Interest expense and income, net          | (7,204)                  | (6,486)   | (15,345)               | (12,361)  |
| Consolidated earnings before income taxes | 35,818                   | 24,855    | 67,308                 | 63,013    |
| Income tax expense                        | (11,642)                 | (6,333)   | (20,686)               | (17,388)  |
| Consolidated net earnings                 | \$ 24,176                | \$ 18,522 | \$ 46,622              | \$ 45,625 |

The following table presents earnings by segment as a percent of segment net sales, including intersegment sales:

|                          | Three Months Ended March |       | Six Months Ended March |       |
|--------------------------|--------------------------|-------|------------------------|-------|
|                          | 31,                      |       | 31,                    |       |
|                          | 2010                     | 2009  | 2010                   | 2009  |
| Turbine Systems          | 22.0%                    | 22.4% | 22.3%                  | 21.8% |
| Airframe Systems         | 5.5                      | 6.3   | 4.0                    | 4.8   |
| Electrical Power Systems | 8.9                      | 15.6  | 10.9                   | 15.2  |
| Engine Systems           | 7.9                      | 5.7   | 6.4                    | 6.5   |

Total segment earnings decreased by \$6,550 and \$13,306 for the three and six months ended March 31, 2010 as compared to the same periods of fiscal 2009. Organic segment earnings decreased \$14,847 and \$27,703 for the three and six month periods in fiscal 2010 primarily due to organic sales volume declines of \$44,438 and \$108,074, and were partially offset by savings from workforce management and other cost savings initiatives.

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*Turbine Systems segment earnings* decreased \$5,280, or 14.0%, and \$6,450, or 9.1%, in the three and six month periods ended March 31, 2010, as compared to the same periods of fiscal 2009 due to the following:

|   | <b>Three Month<br/>Period</b> | <b>Six Month<br/>Period</b> |
|---|-------------------------------|-----------------------------|
| Earnings at March 31, 2009              | \$ 37,635                     | \$ 70,879                   |
| Sales volume changes                    | (9,272)                       | (14,587)                    |
| Selling price changes                   | 1,569                         | 2,711                       |
| Sales mix                               | 3,482                         | 4,470                       |
| Changes in variable compensation        | (996)                         | (1,449)                     |
| Effects of changes in foreign currency  | (90)                          | (238)                       |
| Savings related to workforce management | 2,300                         | 4,600                       |
| Other, net                              | (2,273)                       | (1,957)                     |
| Earnings at March 31, 2010              | \$ 32,355                     | \$ 64,429                   |

Turbine Systems segment earnings decreased in the three and six months ended March 31, 2010 compared to the same periods in fiscal 2009 primarily as a result of the decrease in sales volume. Earnings as a percent of sales decreased to 22.0% in the three months ended March 31, 2010 compared to 22.4% in the same period of fiscal 2009. Earnings as a percent of sales improved in the six month period ending March 31, 2010 to 22.3% from 21.8% in the same period of fiscal 2009. The sales volume impact was partially offset by the impacts of workforce management and other cost control initiatives, a more favorable sales mix, and changes in our selling prices that were made in response to prevailing market conditions.

*Airframe Systems segment earnings* increased \$1,743, or 53.9%, and \$2,351, or 46.7%, in the three and six month periods ended March 31, 2010 as compared to the same periods of fiscal 2009 due to the following:

|   | <b>Three Month<br/>Period</b> | <b>Six Month<br/>Period</b> |
|---|-------------------------------|-----------------------------|
| Earnings at March 31, 2009              | \$ 3,233                      | \$ 5,034                    |
| Acquisition of HRT                      | 8,297                         | 14,397                      |
| Organic sales volume changes            | (8,770)                       | (19,423)                    |
| Sales mix                               | (405)                         | (405)                       |
| Intangible amortization                 | (673)                         | (2,091)                     |
| Changes in variable compensation        | (426)                         | (809)                       |
| Change in customer funded R&D           | (879)                         | (1,639)                     |
| Savings related to workforce management | 5,471                         | 12,792                      |
| Other, net                              | (872)                         | (471)                       |
| Earnings at March 31, 2010              | \$ 4,976                      | \$ 7,385                    |

The HRT acquisition contributed \$8,297 and \$14,397 to Airframe Systems segment earnings for the three and six months ended March 31, 2010. Our Airframe Systems integration is expected to contribute to improved profitability, broader control system content, and better aftermarket presence and support. Airframe Systems has begun to realize previously anticipated benefits from cost reduction efforts taken at both MPC and HRT, and the operational integration of the MPC and HRT businesses is proceeding consistent with our expectations. Additional expense control initiatives, the costs of which were included in accrued restructuring costs recorded in connection with the HRT acquisition and related primarily to the planned closing of the Pacoima, California facility as part of a decision to consolidate HRT's production facilities, are expected to occur during the remainder of calendar year 2010.

Segment earnings increased for the three and six month periods ended March 31, 2010 compared to the same periods of fiscal 2009, primarily due to the HRT acquisition and restructuring savings, partially offset by the impact of the organic sales volume declines, changes in customer funded R&D, higher levels of intangible amortization, and higher levels of variable compensation.

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Organic segment earnings resulted in a loss of \$3,321 during the three months ended March 31, 2010 compared to earnings of \$3,233 in the same period of fiscal 2009. For the six month period ended March 31, 2010, organic segment earnings resulted in a loss of \$7,012 compared to earnings of \$5,034 in the prior year period. The decrease in organic earnings in both periods was driven primarily by the decrease in sales volumes, increased amortization expense, lower levels of customer funding for research and development, and increased costs associated with initiatives to secure new business and develop new platforms, partially offset by the impacts of workforce management actions taken during fiscal year 2009 in response to declining sales.

Non-cash intangible amortization expense in the three months ended March 31, 2010 of \$7,023 and for the six month period ended March 31, 2010 of \$14,522 were related to the MPC and HRT acquisitions.

**Electrical Power Systems segment earnings** decreased \$4,278, or 46.8%, and \$6,121, or 33.4%, in the three and six month periods ended March 31, 2010 as compared to the same periods of fiscal 2009 due to the following:

|  | <b>Three Month<br/>Period</b> | <b>Six Month<br/>Period</b> |
|--|-------------------------------|-----------------------------|
| Earnings at March 31, 2009                               | \$ 9,137                      | \$ 18,303                   |
| Sales volume changes                                     | (2,285)                       | (5,832)                     |
| Selling price changes                                    | (207)                         | (270)                       |
| Sales mix  | 48                            | (270)                       |
| Changes in variable compensation                         | (724)                         | (940)                       |
| Effects of changes in foreign currency                   | 486                           | 1,094                       |
| Expansion of wind converter production in U.S. and China | (893)                         | (1,294)                     |
| Savings related to workforce management                  | 553                           | 1,270                       |
| Other, net   | (1,256)                       | 121                         |
| Earnings at March 31, 2010                               | \$ 4,859                      | \$ 12,182                   |

The decrease in earnings in both the three and six month periods ended March 31, 2010 compared to the same periods in fiscal 2009 was driven mainly by the decrease in sales volumes, which was primarily due to reduced current market demand for wind turbines, and sales mix. Earnings were also negatively impacted by increased costs associated with expansion of wind converter production into the U.S. and China and higher variable compensation costs. These negative factors were partially offset by increased sales of power generation and distribution equipment, foreign currency exchange rates and savings realized as a result of workforce management actions taken during fiscal 2009 in response to declining sales.

Segment earnings as a percent of segment net sales were 8.9% and 10.9% for the three and six month periods ended March 31, 2010 compared to 15.6% and 15.2% in the same periods of fiscal 2009.

**Engine Systems segment earnings** increased \$1,265, or 25.9%, and decreased \$3,086, or 24.8%, in the three and six month periods ended March 31, 2010 as compared to the same periods of fiscal 2009 due to the following:

|  | <b>Three Month<br/>Period</b> | <b>Six Month<br/>Period</b> |
|--|-------------------------------|-----------------------------|
| Earnings at March 31, 2009                             | \$ 4,882                      | \$ 12,468                   |
| Sales volume changes                                   | (3,279)                       | (19,301)                    |
| Selling price changes                                  | 481                           | 1,074                       |
| Sales mix  | (771)                         | 1,906                       |
| Changes in variable compensation                       | (650)                         | (981)                       |
| Effects of changes in foreign currency                 | 614                           | 1,719                       |
| Decreased infrastructure and overhead related expenses | 1,455                         | 1,781                       |
| Savings related to workforce management                | 2,400                         | 8,546                       |
| Other, net   | 1,015                         | 2,170                       |

|                            |    |       |    |       |
|----------------------------|----|-------|----|-------|
| Earnings at March 31, 2010 | \$ | 6,147 | \$ | 9,382 |
|----------------------------|----|-------|----|-------|

In the three month period ended March 31, 2010, lower sales volumes, unfavorable sales mix and increases in variable compensation costs were more than offset by the benefits of cost savings related to workforce management activities in 2009, reduced infrastructure and overhead spending, and other factors, resulting in increased segment earnings.

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Segment earnings decreased in the six month period ended March 31, 2010. Lower sales volumes and increases in variable compensation costs negatively impacted earnings, but were partially offset by price increases, favorable sales mix, cost savings related to workforce management activities, and reduced infrastructure and overhead spending.

**Nonsegment expenses** for the three and six month periods ended March 31, 2010 decreased to \$5,315, or 1.5%, of sales and \$10,725, or 1.6% of sales, from \$23,546 and \$31,310 in the same periods of fiscal 2009.

During the three months ended March 31, 2009, we recorded \$16,605 in special charges to properly size our business for the economic environment related to the global recession. The special charges were composed of \$14,254 in workforce management costs, \$905 related to the impairment of a vacated facility, \$1,255 in inventory write-downs related specifically to order cancellations and \$191 in other charges. Without these special charges, nonsegment expenses for the three and six months ended March 31, 2009 were \$6,941, or 2.1%, and \$14,705, or 2.2% of net sales. Excluding the impact of the special charges, the year-over-year decline in nonsegment expenses in the three and six months ended March 31, 2010 compared to the same periods in fiscal 2009 resulted mainly from reductions in variable compensation, cost reduction efforts and lower intercompany profit eliminations. We anticipate that our ongoing rate of spend will be slightly above the spend rate experienced during the six months ended March 31, 2010.

**Income taxes** were provided at an effective rate on earnings before income taxes of 32.5% and 30.7% for the three and six month periods ended March 31, 2010 compared to 25.5% and 27.6% for the same periods of fiscal 2009. The change in the effective tax rate (as a percent of earnings before income taxes) was attributable to the following:

|   | <b>Three Month<br/>Period</b> | <b>Six Month<br/>Period</b> |
|---|-------------------------------|-----------------------------|
| Effective tax rate at March 31, 2009                                    | 25.5%                         | 27.6%                       |
| Retroactive extension of research credit recorded in fiscal 2009        |                               | 3.2                         |
| Research credit in fiscal 2010 as compared to fiscal 2009               | 1.5                           | 0.7                         |
| Resolution of tax issue recorded in the six months ended March 31, 2009 | 8.4                           | 5.4                         |
| Resolution of tax issue recorded in the six months ended March 31, 2010 | (1.1)                         | (2.6)                       |
| Foreign earnings mix  | (2.0)                         | (3.8)                       |
| Other changes, net  | 0.2                           | 0.2                         |
| Effective tax rate at March 31, 2010                                    | 32.5%                         | 30.7%                       |

The total amount of the gross liability for worldwide unrecognized tax benefits reported in other liabilities in the Condensed Consolidated Balance Sheet was \$19,141 at March 31, 2010, and \$19,783 at September 30, 2009. At March 31, 2010, the amount of unrecognized tax benefits that would impact Woodward's effective tax rate, if recognized, was \$15,461. At this time, we estimate that it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as \$3,460 in the next twelve months through completion of reviews by various worldwide tax authorities.

We recognize interest and penalties related to unrecognized tax benefits in tax expense. Woodward had accrued interest and penalties of \$4,475 as of March 31, 2010 and \$3,804 as of September 30, 2009.

Woodward's tax returns are audited by U.S., state, and foreign tax authorities, and these audits are at various stages of completion at any given time. Fiscal years remaining open to examination in significant foreign jurisdictions include 2003 and forward. Woodward is subject to U.S. Federal income tax examinations for fiscal years 2006 and forward, and is subject to U.S. state income tax examinations for fiscal years 2005 and forward.

The U.S. research tax credit expired as of December 31, 2009. The U.S. Congress is considering legislation to provide a retroactive extension; however as of March 31, 2010, the expired tax credit has not been reinstated. Accounting guidance requires us to use the tax law in effect at the balance sheet date. Accordingly, the calculation of our 2010 income tax provision does not reflect any assumed benefit from the research tax credit for the nine months ended September 30, 2010. In the event the research tax credit is enacted in some form in future periods, we will account for that change in the tax law at that time.



We do not expect the Patient Protection and Affordable Care Act to impact our income tax expenses in 2010 or thereafter.

**Financial Condition, Liquidity, and Capital Resources**

We believe liquidity and cash generation are important to our strategy of self-funding our ongoing operating needs. We also believe that the restructuring actions we implemented in fiscal 2009 have generated, and will continue to generate, improved cash flows from operations and that this level of cash generation, together with our existing cash and available borrowings, will adequately support our on-going operations.

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Our ability to service our long-term debt, to remain in compliance with the various restrictions and covenants contained in our debt agreements and to fund working capital, capital expenditures and product development efforts will depend on our ability to generate cash from operating activities which in turn is subject to, among other things, future operating performance as well as general economic, financial, competitive, legislative, regulatory, and other conditions, some of which may be beyond our control.

Historically, we have been able to finance our ongoing businesses, including capital expenditures and product development, with cash flows provided by operating activities. We expect that cash generated from our operating activities will continue to fund our operating needs. In the event we are unable to generate sufficient cash flows from operating activities, we have a revolving credit facility comprised of unsecured financing arrangements with a syndicate of U.S. banks totaling \$225,000, with an option to increase the amount to \$350,000, subject to the lenders participation. In addition, we have various foreign lines of credit tied to net amounts on deposit at certain foreign financial institutions, which are generally reviewed annually for renewal. Historically, we have used borrowings under these foreign lines of credit to finance certain local operations.

During fiscal 2009 we incurred \$620,000 of long-term debt in connection with our 2009 acquisitions. Since April 2009, we have made non-scheduled principal prepayments of \$151,000, including \$82,000 during the first six months of fiscal year 2010. Year to date, we have made principal payments on our outstanding debt of \$108,569. At March 31, 2010, we were in compliance with the financial covenants under our existing long-term debt agreements and revolving credit facility.

We believe liquidity and cash generation are important to fund our ongoing operating needs. We also believe that the restructuring and other cost reduction actions we have been taking will continue to generate cash flow from operations and that this level of cash generation, together with our existing cash and available borrowings, will adequately support our operations.

We believe we have adequate access to several sources of contractually committed borrowings and other available credit facilities. However, we could be adversely affected if banks supplying our short-term borrowing requirements refuse to honor their contract commitments, cease lending, or declare bankruptcy. While we believe the lending institutions participating in our credit arrangements are financially capable, events in the global credit markets during fiscal year 2009 and the first half of fiscal 2010, including the failure, takeover or rescue by various government entities of major financial institutions, have created uncertainty of credit availability.

**Assets**

Segment assets consist of accounts receivable, inventories, property, plant, and equipment - net, goodwill, and other intangibles net. The following table presents assets by segment:

|                           | <b>March 31,<br/>2010</b> | <b>September 30,<br/>2009</b> |
|---------------------------|---------------------------|-------------------------------|
| Turbine Systems           | \$ 338,437                | \$ 344,789                    |
| Airframe Systems          | 759,789                   | 801,300                       |
| Electrical Power Systems  | 134,603                   | 135,808                       |
| Engine Systems            | 189,532                   | 200,226                       |
| Total segment assets      | 1,422,361                 | 1,482,123                     |
| Nonsegment assets         | 175,977                   | 214,299                       |
| Consolidated total assets | \$ 1,598,338              | \$ 1,696,422                  |

*Turbine Systems segment assets* decreased \$6,352 during the six months ended March 31, 2010, reflecting lower net carrying cost of property, plant and equipment, accounts receivable and inventories. The decrease in property, plant and equipment was due to depreciation expense outpacing capital expenditures. Both accounts receivables and inventories were down slightly.

*Airframe Systems segment assets* decreased \$41,511 during the six months ended March 31, 2010 as a result of lower accounts receivable, inventories, intangible assets, and property, plant and equipment. The decrease in accounts receivable and inventories is primarily due to lower sales volume and management's focus on rationalizing inventory levels relative to anticipated sales activity. The decrease in intangible assets was due to amortization expense. The decrease in property, plant and equipment was due to depreciation expense outpacing capital expenditures.

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**Electrical Power Systems segment assets** decreased \$1,205 during the six months ended March 31, 2010 primarily due to lower inventory and intangible assets, partially offset by increased accounts receivable. The decrease in inventories is primarily due to lower sales volume compared to prior fiscal years and management's focus on rationalizing inventory levels relative to anticipated sales activity. The decrease in intangible assets was due to amortization expense. Accounts receivable increased primarily due to longer terms granted to certain customers. Excluding the effects of foreign currency exchange rates, Electrical Power Systems segment assets increased by approximately \$6,100, due primarily to increases of accounts receivable and property, plant and equipment. The property, plant and equipment increases related mainly to capital expenditures associated with the expansion of our plant in Poland.

**Engine Systems segment assets** decreased by \$10,694 during the six months ended March 31, 2010 due primarily to lower levels of property, plant and equipment and intangible assets. Property, plant and equipment decreased due to depreciation expense exceeding capital expenditures. Intangible assets decreased due to amortization expense recognized during six months ended March 31, 2010. Accounts receivable and inventories also decreased. The effects of foreign currency fluctuations decreased Engine Systems segment assets by approximately \$3,700 during the six months ended March 31, 2010.

**Nonsegment assets** decreased \$38,322 during the six months ended March 31, 2010 primarily because of decreases in cash and cash equivalents and deferred income tax assets. The changes in cash and cash equivalents related to payments of long-term debt and the payment of \$25,000 in connection with MPC Products settlement with the DOJ, partially offset by cash provided by operating activities. Changes in cash are discussed more fully in a separate section of this Management's Discussion and Analysis.

**Other Balance Sheet Measures**

|                                      | March 31,<br>2010 | September 30,<br>2009 |
|--------------------------------------|-------------------|-----------------------|
| Working capital                      | \$ 413,886        | \$ 434,166            |
| Short-term borrowings                |                   |                       |
| Long-term debt, less current portion | 445,137           | 526,771               |
| Other liabilities                    | 106,641           | 110,010               |
| Total Stockholders' equity           | 743,457           | 711,515               |

**Working capital** (current assets less current liabilities) decreased to \$413,886 at March 31, 2010 from \$434,166 at September 30, 2009. Lower levels of cash, accounts receivable, inventories, and deferred income tax assets and higher accounts payable were partially offset by reductions in accrued liabilities and the current portion of long-term debt.

**Short-term borrowings:** We have a \$225,000 revolving credit facility, with an option to increase the amount to \$350,000, subject to the lenders' participation. In addition, we have further short-term borrowing capabilities under various foreign lines of credit tied to net amounts on deposit at certain foreign financial institutions, which are generally reviewed annually for renewal. We use these facilities to meet short-term funding requirements. As of March 31, 2010 and September 30, 2009, no short-term borrowings were outstanding. As of March 31, 2010, we had borrowing availability of \$221,856 under our \$225,000 revolving credit facility, net of outstanding letters of credit, and borrowing availability of \$6,675 under our foreign lines of credit, net of outstanding letters of credit.

Provisions of our short-term and long-term debt agreements include covenants customary to such agreements, including certain cross default provisions, which require us to maintain specified minimum or maximum financial measures and place limitations on various investing and financing activities. The agreements also permit the lenders to accelerate repayment requirements in the event of a material adverse event. Our most restrictive covenants require us to maintain a minimum consolidated net worth, a maximum consolidated debt to consolidated operating cash flow ratio, and a maximum ratio of consolidated debt to consolidated earnings before interest, taxes, depreciation and amortization, plus any unusual non-cash charges to the extent deducted in computing net income, minus any unusual non-cash gains to the extent added in computing net income (Debt Covenant EBITDA). See additional discussion in Notes 11, *Long-term debt*, and 12, *Line of credit facilities and short-term borrowings*, to the Condensed Consolidated

Financial Statements in Item 1 Financial Statements.

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**Long-term debt, less current portion** decreased in the six months ended March 31, 2010 due primarily to unscheduled debt prepayments made during the period and scheduled reclassifications of long-term debt to current portion of long-term debt. \$82,000 of long-term debt was prepaid during the six months ended March 31, 2010, including \$53,000 in the three months ended March 31, 2010.

**Other liabilities** include \$83,812 of accrued retirement benefits, primarily related to postretirement employee benefit plans, which are not expected to significantly impact our cash flows during fiscal year 2010.

**Stockholders' equity** increased by \$31,942 in the six month period ended March 31, 2010, primarily due to net earnings during the period, which were partially offset by cash dividend payments to stockholders.

In 2007, the Board of Directors authorized the repurchase of up to \$200,000 of our outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period that will end in October 2010. No shares have been purchased under the authorization since fiscal 2008. As of March 31, 2010 and \$168,075 remains available for stock repurchase.

**Commitments, contingencies and guarantees** at March 31, 2010 include claims, pending or threatened litigation or other legal proceedings, or regulatory proceedings arising in the normal course of business, including, among others, those relating to product liability claims, employment matters, workers' compensation claims, contractual disputes, product warranty claims and alleged violations of various environmental laws. We have accrued for individual matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss. Woodward is partially self-insured in the U.S. for healthcare and workers' compensation up to predetermined amounts, above which third party insurance applies. Management regularly reviews the probable outcome of these claims and proceedings, the expenses expected to be incurred, the availability and limits of the insurance coverage, and the established accruals for liabilities.

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

In the event of a change in control of Woodward, as defined in change-in-control agreements with our current corporate officers, we may be required to pay termination benefits to such officers. We believe the change-in-control agreements are appropriate to enable our executives to remain focused on running the business, and to protect the value of the Company by retaining key talent, in the event of a change in control. We further believe that change in control agreements are necessary to help ensure actions and behaviors that are aligned with and in the best interests of the Company's stockholders in the event of a change of control and to facilitate a smooth transition.

**Contractual Obligations**

We have various contractual obligations, including obligations related to long-term debt, operating leases, purchases, retirement pensions and retirement healthcare. These contractual obligations are summarized and discussed more fully in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended September 30, 2009. We prepaid \$82,000 of long-term debt during the six months ended March 31, 2010.

In connection with the sale of the F&P product line during fiscal 2009, we intend to assign to a subsidiary of the purchaser our rights and responsibilities related to certain contracts with the U.S. Government. As is customary and as requested by the U.S. Government, we expect to guarantee to the U.S. Government the purchaser's subsidiary's obligations under the contracts. The purchaser has agreed to indemnify us for any liability incurred with respect to the guarantee.

**Table of Contents****Cash Flows**

Cash flows were as follows:

|  | <b>Six Months Ended</b> |             |
|--|-------------------------|-------------|
|  | <b>March 31,</b>        |             |
|  | <b>2010</b>             | <b>2009</b> |
| Net cash provided by operating activities                    | \$ 125,981              | \$ 51,826   |
| Net cash used in investing activities                        | (38,230)                | (384,231)   |
| Net cash provided by (used in) financing activities          | (114,580)               | 353,083     |
| Effect of exchange rate changes on cash and cash equivalents | (1,474)                 | (3,638)     |
| Net change in cash and cash equivalents                      | (28,303)                | 17,040      |
| Cash and cash equivalents at beginning of period             | 100,863                 | 109,833     |
| Cash and cash equivalents at end of period                   | \$ 72,560               | \$ 126,873  |

**Net cash flows provided by operating activities** increased by \$74,155 for the six month period compared to the same period of fiscal 2009. The increase was driven mainly by decreases in inventories as a result of lower sales levels and by management's focus on rationalizing inventory levels relative to anticipated sales activity and lower cash payments for accounts payable and variable compensation programs compared to the first six months of fiscal 2009.

As credit has remained tight during the first half of fiscal 2010 due to the global economy, we continue to believe that adequate liquidity and cash generation will be important to the execution of our strategic initiatives. We believe the restructuring and other cost reduction actions we have taken during fiscal year 2009 and the first half of fiscal 2010 will permit us to continue to generate adequate cash flow from operations. We also believe that this level of cash generation, together with our existing cash and available borrowings, will adequately support our operations.

**Net cash flows used in investing activities** decreased by \$346,001 compared to the same period last year. During the six months ended March 31, 2009, we completed acquisitions which used \$369,065 of cash. During the six months ended March 31, 2010 we paid \$25,000 to the DOJ to settle a liability assumed in the MPC acquisition. The purchase price we paid in connection with the acquisition of MPC Products was reduced by \$25,000 at the time of the acquisition to account for this contingent liability, and therefore the \$25,000 payment is classified as cash used for business acquisitions.

Cash paid for capital expenditures was \$14,136 during the six months ended March 31, 2010, compared to \$15,354 during the same period last year. We intend to remain focused on our low cost strategy, continuing our expansion in Poland, which came online during the three months ended March 31, 2010, and maximizing efficient use of existing resources. Future capital expenditures are expected to be funded through cash flows from operations, borrowings under our revolving credit facility and available foreign lines of credit.

On April 21, 2010, Woodward's Board of Directors approved the purchase by Woodward of the 26% noncontrolling interest in Woodward Governor India Limited, a Woodward consolidated subsidiary, for approximately \$8,000. Upon completion of the transaction, Woodward will own 100% of Woodward Governor India Limited. The transaction is expected to be completed during the fiscal quarter ending June 30, 2010.

**Net cash flows provided by (used in) financing activities** decreased by \$467,663 during the six months ended March 31, 2010 compared to the same period last year. During the six months ended March 31, 2009, we issued \$400,000 of long-term debt, which was used primarily to finance business acquisitions. During the six months ended March 31, 2010, we repaid \$108,569 of outstanding debt, including unscheduled debt prepayments of \$82,000.

As a result of the decreases in outstanding current and long-term debt during the six months ended March 31, 2010, our debt to total capitalization ratio decreased to 38.4% as of March 31, 2010 compared to 44.6% as of September 30, 2009.

**Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Note 1, *Basis of presentation and nature of operations*, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended September 30, 2009 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. Our critical accounting estimates, discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended September 30, 2009, include estimates for revenue recognition, purchase accounting, inventory valuation, postretirement benefit obligations, reviews for impairment of goodwill, and our provision for income taxes. Such accounting policies and estimates require significant judgments and assumptions to be used in the preparation of the Condensed Consolidated Financial Statements, and actual results could differ materially from the amounts reported based on variability in factors affecting these estimates.



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Our management discusses the development and selection of our critical accounting policies and estimates with the Audit Committee of our Board of Directors at least annually.

**Goodwill** is tested for impairment on 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 reporting units, determined using discounted cash flows, with its carrying amount including goodwill. If the carrying amount of the reporting unit exceeds its fair value, we compare 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. There was no impairment charge recorded in fiscal 2009 or in the first six months of fiscal 2010.

We completed our annual goodwill impairment test during the quarter ended March 31, 2010. The fair value of the reporting units was based on reporting unit level cash flow forecasts which have been updated to reflect current global economic conditions, including anticipated weakening of global demand for certain products. 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 of 4.5% after five years and was calculated using the Gordon Growth Model.

The results of our fiscal 2010 annual goodwill impairment test performed as of March 31, 2010 indicated that no goodwill impairment existed. The estimated fair value of each of our reporting units was in excess of its carrying value. At March 31, 2010 the reporting unit with the closest ratio of estimated fair value to carrying value was our recently acquired Airframe Systems reporting unit, which has a significant concentration of business in the presently depressed business jet and regional jet market segments. Our analysis indicates a premium of over 30% compared to this reporting unit's carrying value.

As part of our ongoing monitoring efforts, we will continue to consider the global economic environment and its potential impact on our businesses in assessing goodwill recoverability. There can be no assurance that our estimates and assumptions regarding forecasted cash flows of certain reporting units as well as the duration of the current economic downturn, or the period or strength of the recovery, made for purposes of the annual goodwill impairment test performed during the second fiscal quarter of 2010, will prove to be accurate predictions of the future. If our assumptions are not realized it is possible that an impairment charge may need to be recorded in future periods.

**Market Risks**

In the normal course of business, we have exposures to interest rate risk from our long-term debt and foreign currency exchange rate risk related to our foreign operations and foreign currency transactions. We are also exposed to various market risks that arise from transactions entered into in the normal course of business related to items such as the cost of raw materials and changes in inflation. Certain contractual relationships with customers and vendors mitigate risks from changes in raw material costs and foreign currency exchange rate changes that arise from normal purchasing and normal sales activities.

Our market risks are discussed more fully in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended September 30, 2009.

**New Accounting Standards*****Accounting changes and recently adopted accounting standards***

In September 2006, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance which defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about a company's financial and nonfinancial assets and liabilities that are measured at fair value. In February 2008, the FASB issued authoritative guidance which delayed the effective date of this guidance for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. On October 1, 2008, we adopted the measurement and disclosure impact of this guidance with respect to financial assets and liabilities. On October 1, 2009, we adopted the measurement and disclosure of fair value with respect to non-financial assets and liabilities. This guidance did not change existing guidance on whether or not an instrument is carried at fair value. The adoption had no impact on our financial position and results of operations and required no additional disclosures in our Condensed Consolidated Financial Statements.



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In November 2007, the FASB issued authoritative guidance to address accounting for collaborative arrangement activities that are conducted without the creation of a separate legal entity for the arrangement. Revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators pursuant to pre-existing accounting standards. Payments to or from collaborators should be presented in the income statement based on the nature of the arrangement, the nature of the company's business and whether the payments are within the scope of other accounting literature. Other detailed information related to the collaborative arrangement is also required to be disclosed. The requirements under this guidance must be applied to collaborative arrangements in existence at the beginning of our fiscal 2010 using a modified version of retrospective application.

We are currently not a party to significant collaborative arrangement activities, as defined by this guidance, and therefore, the adoption of this guidance had no impact on our Condensed Consolidated Financial statements.

In December 2007, the FASB issued authoritative guidance to affirm that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This guidance defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. Among other requirements, this guidance requires the acquiring entity in a business combination to recognize the identifiable assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at their acquisition-date fair values, and with limited exceptions, acquisition-related costs will generally be expensed as incurred. This guidance requires certain financial statement disclosures to enable users to evaluate and understand the nature and financial effects of the business combination. This guidance must be applied prospectively to business combinations that are consummated on or after October 1, 2009. Accordingly, we will record and disclose business combinations under the revised standard for any transactions consummated on or after October 1, 2009. In addition, adjustments of certain income tax balances related to acquired deferred assets, including those acquired prior to the adoption of this new authoritative guidance, will be reported as an increase or decrease to income tax expense.

Accordingly, we have recorded adjustments of certain income tax balances under the revised authoritative guidance beginning October 1, 2009.

In December 2007, the FASB issued authoritative guidance to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Among other requirements, this guidance clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is to be reported in the Condensed Consolidated Balance Sheets within stockholders' equity, but separate from the parent's stockholders' equity. This guidance also requires consolidated net earnings and comprehensive earnings to include the amounts attributable to both the parent and the noncontrolling interest. We adopted this guidance effective October 1, 2009. This guidance must be applied prospectively for fiscal years, and interim periods within those fiscal years, beginning in fiscal 2010, except for the presentation and disclosure requirements, which has been applied retrospectively for all periods presented. Accordingly, the following have been retrospectively adjusted: our Condensed Consolidated Statement of Earnings for the three and six months ended March 31, 2009, our Condensed Consolidated Balance Sheet as of September 30, 2009, our Condensed Consolidated Statement of Cash Flows for the six months ended March 31, 2009, our Condensed Consolidated Statement of Stockholders' Equity for the six months ended March 31, 2009, accumulated other comprehensive earnings for the six months ended March 31, 2009 as presented in Note 18, *Accumulated other comprehensive earnings*, and total comprehensive earnings for the three and six months ended March 31, 2009 as presented in Note 19, *Total comprehensive earnings*, in the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

In April 2008, the FASB issued authoritative guidance to amend the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset and to require additional disclosures. The guidance for determining useful lives must be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements must be applied prospectively to all intangible assets recognized as of the effective date. We adopted this guidance as of October 1, 2009. The adoption of this guidance had no impact on our Condensed Consolidated Financial Statements.

In November 2008, the FASB issued authoritative guidance regarding the accounting for defensive intangible assets. Defensive intangible assets are assets acquired in a business combination that the acquirer (a) does not intend to use or

(b) intends to use in a way other than the assets' highest and best use as determined by an evaluation of market participant assumptions. While defensive intangible assets are not being actively used, they are likely contributing to an increase in the value of other assets owned by the acquiring entity. This guidance requires defensive intangible assets to be accounted for as separate units of accounting at the time of acquisition and the useful life of such assets to be based on the period over which the assets will directly or indirectly affect the entity's cash flows. We will record and disclose defensive intangible assets under the revised standard for transactions consummated, if any, on or after October 1, 2009.

In November 2008, the FASB issued authoritative guidance addressing whether securities granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two class method. This guidance became effective for us on October 1, 2009. Upon the adoption of this guidance all outstanding restricted stock, which are participating securities, are considered in the calculation of both the basic and fully diluted earnings per share calculations in our Condensed Consolidated Financial Statements. The effects of this change are required to be applied retrospectively. Accordingly, the historical earnings per share presented have been recast to reflect the retrospective application of this guidance.

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In April 2009, the FASB issued authoritative guidance to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably determined. If the fair value of such assets or liabilities cannot be reasonably determined, then they would generally be recognized in accordance with certain other pre-existing accounting standards. This guidance also amends the subsequent accounting for assets and liabilities arising from contingencies in a business combination and certain other disclosure requirements. This guidance became effective for assets or liabilities arising from contingencies in business combinations that are consummated on or after October 1, 2009. Accordingly, we will record and disclose assets acquired and liabilities assumed in business combinations that arise from contingencies under the revised standard for any transactions consummated on or after October 1, 2009.

***Issued but not yet effective accounting standards:***

In December 2008, the FASB issued authoritative guidance to require employers to provide additional disclosures about plan assets of a defined benefit pension or other postretirement plan. These disclosures should principally include information detailing investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets and an understanding of significant concentrations of risk within plan assets. The required disclosures must be provided for fiscal years ending after December 15, 2009 (our fiscal 2010 year-end). These disclosures will be presented in our Consolidated Financial Statements for the year ended September 30, 2010. Upon initial application, this guidance is not required to be applied to earlier periods that are presented for comparative purposes. We do not expect this guidance to have a significant impact on our September 30, 2010 Consolidated Financial Statements.

In June 2009, the FASB issued authoritative guidance to eliminate the exception to consolidate a qualifying special-purpose entity, change the approach to determining the primary beneficiary of a variable interest entity and require companies to more frequently re-assess whether they must consolidate variable interest entities. Under the new guidance, the primary beneficiary of a variable interest entity is identified qualitatively as the enterprise that has both (a) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. This guidance becomes effective for our fiscal year 2011 and interim reporting periods thereafter. We do not expect this guidance to have a material impact on our Condensed Consolidated Financial Statements.

In June 2009, the FASB issued authoritative guidance to require an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. This guidance requires an ongoing reassessment and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This guidance will be effective for fiscal years beginning after November 15, 2009 (our fiscal year 2011). We are currently assessing the impact that this guidance may have on our Condensed Consolidated Financial Statements.

In October 2009, the FASB issued authoritative guidance that enables vendors to account for products or services sold to customers (deliverables) separately rather than as a combined unit, as was generally required by past guidance. The revised guidance provides for two significant changes to the existing multiple element revenue arrangements guidance. The first change, which will likely result in the requirement to separate more deliverables within an arrangement, relates to the determination of when the individual deliverables included in a multiple element arrangement may be treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. Together, these changes are likely to result in earlier recognition of revenue and related costs for multiple-element arrangements than under previous guidance. This guidance also significantly expands the disclosures required for multiple-element revenue arrangements. This guidance is required to be adopted in fiscal years beginning on or after June 15, 2010 (our fiscal year 2011). We expect to adopt the guidance as of October 1, 2010. We are currently assessing the impact this guidance may have on our Condensed Consolidated Financial Statements.

In October 2009, the FASB issued authoritative guidance that changes the accounting model for revenue arrangements that include both tangible products and software elements. The revised guidance provides that tangible products containing software components and nonsoftware components that function together to deliver the tangible product's

essential functionality are no longer within the scope of the software revenue guidance in Accounting Standards Codification ( ASC ) Subtopic 985-605. In addition, the guidance requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. This guidance is required to be adopted in fiscal years beginning on or after June 15, 2010 (our fiscal year 2011). We expect to adopt the guidance as of October 1, 2010. We are currently assessing the impact this guidance may have on our Condensed Consolidated Financial Statements.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

In the normal course of business, we have exposures to interest rate risk from our long-term debt, and foreign currency exchange rate risk related to our foreign operations and foreign currency transactions. We are also exposed to various market risks that arise from transactions entered into in the normal course of business related to items such as the cost of raw materials and changes in inflation. Certain contractual relationships with customers and vendors mitigate risks from changes in raw material costs and foreign currency exchange rate changes that arise from normal purchasing and normal sales activities.

These market risks are discussed more fully in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended September 30, 2009.

**Item 4. Controls and Procedures**

We have established disclosure controls and procedures, which are designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Act is accumulated and communicated to management, including our Principal Executive Officer (Thomas A. Gendron, Chief Executive Officer and President) and Principal Financial Officer (Robert F. Weber, Jr., Chief Financial Officer and Treasurer), as appropriate, to allow timely decisions regarding required disclosures.

Thomas A. Gendron and Robert F. Weber, Jr., evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-Q. Based on their evaluations; they concluded that our disclosure controls and procedures were effective as of March 31, 2010.

Furthermore, there have been no changes in our internal control over financial reporting, except as discussed below, during the fiscal quarter covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management included the internal controls of MPC in its assessment of the effectiveness of Woodward's internal controls over financial reporting, beginning in the first quarter of fiscal year 2010. Beginning in the third quarter of fiscal year 2010, management will include the internal controls of HRT in its assessment of the effectiveness of Woodward's internal controls over financial reporting. MPC and HRT were acquired in the prior fiscal year and were excluded from management's annual report on internal control over financial reporting for the fiscal year ended September 30, 2009, in accordance with the general guidance issued by the SEC regarding exclusion of certain acquired businesses. MPC and HRT will be included in management's annual report on internal control over financial reporting for the fiscal year ending September 30, 2010.

We considered the results of our pre-acquisition due diligence activities, the continuation by HRT of its established internal control over financial reporting, and our implementation of additional internal control over financial reporting activities as part of our overall evaluation of disclosure controls and procedures as of March 31, 2010. The objectives of HRT's established internal control over financial reporting are consistent, in all material respects, with Woodward's objectives. However, we believe the design of HRT's established internal control over financial reporting is sufficiently different from Woodward's overall design to conclude that Woodward's internal control over financial reporting materially changed during the quarter in which we completed our acquisition of HRT, which was the quarter ended June 30, 2009. We are in the process of completing a more complete review of HRT's internal control over financial reporting and will be implementing changes to better align its reporting and controls with the rest of Woodward. HRT constituted 21.5% of the total assets in Woodward's Condensed Consolidated Financial Statements as of March 31, 2010. HRT constituted 17.0% of the total net sales in Woodward's Condensed Consolidated Financial Statements for the six months ended March 31, 2010.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Woodward is currently involved in claims, pending or threatened litigation or other legal proceedings, or regulatory proceedings arising in the normal course of business, including, among others, those relating to product liability claims, employment matters, workers' compensation claims, contractual disputes, product warranty claims and alleged violations of various environmental laws. We have accrued for individual matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss.

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

**Item 1A. Risk Factors**

Investment in our securities involves risk. An investor or potential investor should consider the risks summarized in Item 1A. Risk Factors in Part I, Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2009, when making investment decisions regarding our securities. The risk factors that were disclosed in our Form 10-K have not materially changed since the date our Form 10-K was filed.



**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****(a) Recent Sales of Unregistered Securities**

Sales of common stock issued from treasury to one of our directors during the second quarter of fiscal 2010 consisted of the following:

|  | Total Shares<br>Sold | Consideration<br>Received<br>(in thousands) |
|--|----------------------|---|
| January 1, 2010 through January 31, 2010   | 224                  | \$ 6  |
| February 1, 2010 through February 28, 2010 |                      |   |
| March 1, 2010 through March 31, 2010       |                      |   |

The securities were sold in reliance upon the exemption contained in Section 4(2) of the Securities Act of 1933.

**(b) Issuer Purchases of Equity Securities**

|  | Total<br>Number<br>of Shares<br>Purchased | Average Price<br>Paid Per<br>Share | Total<br>Number<br>of Shares<br>Purchased<br>as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number (or<br>Approximate<br>Dollar Value)<br>of Shares that<br>may yet be<br>Purchased<br>under the<br>Plans or<br>Programs (1)<br>(in<br>thousands) |
|--|---|------------------------------------|---|--|
| January 1, 2010 through January 31, 2010   |   | \$                                 |   | \$ 168,075   |
| February 1, 2010 through February 28, 2010 |   |                                    |   | 168,075  |
| March 1, 2010 through March 31, 2010 (2)   | 674                                       | 31.98                              |   | 168,075  |

(1) During September 2007, the Board of Directors authorized a stock repurchase program of up to \$200,000 of our outstanding shares of common stock on the open market or privately

negotiated transactions over a three-year period that will end in October 2010.

- (2) The Woodward Governor Company Executive Benefit Plan, which is a separate legal entity, acquired shares of common stock on the open market related to the reinvestment of dividends for treasury stock shares under our deferred compensation plan.

**Table of Contents****Item 4. Other Information**

Three matters were submitted to a vote of stockholders at the January 22, 2010 Annual Meeting of Stockholders. The results of the voting were as follows:

|   |            |                 |                |
|---|------------|-----------------|----------------|
|   | <b>For</b> | <b>Withheld</b> |                |
| 1. Election of Directors for a three year term:                                       |            |                 |                |
| John D. Cohn  | 53,145,165 | 1,359,190       |                |
| Michael H. Joyce  | 53,086,800 | 1,417,555       |                |
| James R. Rulseh   | 53,126,324 | 1,378,031       |                |
|   | <b>For</b> | <b>Against</b>  | <b>Abstain</b> |
| 2. Ratification of the Appointment of Independent Registered Public Accounting Firm   | 61,470,942 | 585,253         | 148,223        |
|   | <b>For</b> | <b>Against</b>  | <b>Abstain</b> |
| 3. Shareholder proposal to eliminate the classification of the terms of the Directors | 36,676,465 | 16,963,517      | 864,363        |

**Item 6. Exhibits**

(a) Exhibits filed as Part of this Report are listed in the Exhibit Index.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**WOODWARD GOVERNOR COMPANY**

Date: April 22, 2010

/s/ Thomas A. Gendron  
Thomas A. Gendron  
*Chief Executive Officer and President*  
*(Principal Executive Officer)*

Date: April 22, 2010

/s/ Robert F. Weber, Jr.  
Robert F. Weber, Jr.  
*Chief Financial Officer and Treasurer*  
*(Principal Financial and Accounting Officer)*

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**WOODWARD GOVERNOR COMPANY  
EXHIBIT INDEX**

| Exhibit<br>Number | Description:   |
|-------------------|--|
| 31.1              | Rule 13a-14(a)/15d-14(a) certification of Thomas A. Gendron, filed as an exhibit.    |
| 31.2              | Rule 13a-14(a)/15d-14(a) certification of Robert F. Weber, Jr., filed as an exhibit. |
| 32.1              | Section 1350 certifications, filed as an exhibit.                                    |