Woodward, Inc.
Form 10-Q
April 24, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from ______ to ______

Commission file number 0-8408

WOODWARD, INC.

(Exact name of registrant as specified in its charter)

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

Registrant s telephone number, including area code:

(970) 482-5811

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

As of April 19, 2012**,** 69,146,674 shares of the common stock with a par value of $0.001455 per share were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share amounts)

(Unaudited)

	Three-Months Ending March 31, 2012	Three-Months Ending March 31, 2011	Six-Months Ending March 31, 2012	Six-Months Ending March 31, 2011
Net sales	$ 468,793	$ 418,866	$ 876,689	$ 783,941
Costs and expenses:				
Cost of goods sold	322,492	292,520	606,902	553,697
Selling, general and administrative expenses	40,788	38,445	79,358	71,111
Research and development costs	37,445	27,050	68,239	50,788
Amortization of intangible assets	8,294	8,542	16,552	17,085
Interest expense	6,552	6,299	12,860	12,800
Interest income	(84)	(85)	(210)	(208)
Other (income) expense, net	(732)	(392)	(1,226)	706
Total costs and expenses	414,755	372,379	782,475	705,979
Earnings before income taxes	54,038	46,487	94,214	77,962
Income tax expense	15,287	14,397	27,046	23,473
Net earnings	**$ 38,751**	**$ 32,090**	**$ 67,168**	**$ 54,489**
Earnings per share (Note 3):				
Basic earnings per share	$ 0.56	$ 0.47	$ 0.97	$ 0.79
Diluted earnings per share	$ 0.55	$ 0.46	$ 0.95	$ 0.78
Weighted Average Common Shares Outstanding (Note 3):				
Basic	69,077	68,752	68,998	68,782
Diluted	70,624	70,107	70,504	70,140
Cash dividends per share paid to Woodward common stockholders	$ 0.08	$ 0.07	$ 0.15	$ 0.13

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

	$000,000,000.	$000,000,000.	$000,000,000.	$000,000,000.
	Three-Months Ending March 31,		**Six-Months Ending March 31,**	
	2012	**2011**	**2012**	**2011**
Net earnings	$ 38,751	$ 32,090	$ 67,168	$ 54,489
Other comprehensive earnings:				
Foreign currency translation adjustments	7,928	11,009	(453)	8,629
Taxes on changes on foreign currency translation adjustments	2,348	(1,054)	3,293	(916)
	10,276	9,955	2,840	7,713
Reclassification of realized losses on derivatives to earnings	43	56	88	115
Taxes on changes on derivative transactions	(17)	(21)	(34)	(43)
	26	35	54	72
Minimum retirement benefit liability foreign currency exchange rate changes	51	(150)	82	(178)
Total comprehensive earnings	$ 49,104	$ 41,930	$ 70,144	$ 62,096

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	March 31, 2012	September 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 56,329	$ 74,539
Accounts receivable, less allowance for losses of $3,772 and $2,322, respectively	308,395	297,614
Inventories	416,622	381,555
Income taxes receivable	6,123	2,456
Deferred income tax assets	40,762	38,270
Other current assets	34,726	23,359
Total current assets	862,957	817,793
Property, plant and equipment, net	214,497	206,725
Goodwill	462,659	462,282
Intangible assets, net	252,370	268,897
Deferred income tax assets	7,915	10,466
Other assets	15,942	15,271
Total assets	$ 1,816,340	$ 1,781,434
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 32,500	$
Current portion of long-term debt	7,603	18,374
Accounts payable	118,815	123,453
Income taxes payable	3,251	5,440
Deferred income tax liability	800	74
Accrued liabilities	92,901	133,516
Total current liabilities	255,870	280,857
Long-term debt, less current portion	403,125	406,875
Deferred income tax liabilities	80,374	85,911
Other liabilities	88,961	88,694
Total liabilities	828,330	862,337
Commitments and contingencies (Note 19)		
Stockholders equity:		
Preferred stock, par value $0.003 per share, 10,000 shares authorized, no shares issued		
Common stock, par value $0.001455 per share, 150,000 shares authorized, 72,960 shares issued	106	106
Additional paid-in capital	94,397	81,453
Accumulated other comprehensive earnings	6,602	3,626
Deferred compensation	4,467	4,581
Retained earnings	1,006,398	949,573

	1,111,970	1,039,339
Treasury stock at cost, 3,813 shares and 4,070 shares, respectively	(119,493)	(115,661)
Treasury stock held for deferred compensation, at cost, 293 shares and 315 shares, respectively	(4,467)	(4,581)
Total stockholders equity	988,010	919,097
Total liabilities and stockholders equity	$ 1,816,340	$ 1,781,434

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six-Months Ending March 31, 2012	2011
Cash flows from operating activities:		
Net earnings	$ 67,168	$ 54,489
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	36,234	37,409
Net (gain) loss on sales of assets	(72)	1
Stock-based compensation	5,291	4,113
Excess tax benefits from stock-based compensation	(3,680)	(2,236)
Deferred income taxes	(1,691)	3,690
Loss on derivatives reclassified from accumulated comprehensive earnings into earnings	88	115
Changes in operating assets and liabilities:		
Accounts receivable	(11,252)	(7,712)
Inventories	(35,221)	(59,883)
Accounts payable and accrued liabilities	(32,696)	(7,279)
Current income taxes	(2,202)	5,789
Retirement benefit obligations	(1,164)	(1,980)
Other	(8,577)	(6,340)
Net cash provided by operating activities	12,226	20,176
Cash flows from investing activities:		
Payments for purchase of property, plant, and equipment	(30,523)	(20,124)
Proceeds from sale of assets	215	20
Net cash used in investing activities	(30,308)	(20,104)
Cash flows from financing activities:		
Cash dividends paid	(10,343)	(8,948)
Proceeds from sales of treasury stock	5,118	1,308
Payments for repurchases of common stock	(14,312)	(6,837)
Excess tax benefits from stock compensation	3,680	2,236
Borrowings on revolving lines of credit and short-term borrowings	141,375	28,207
Payments on revolving lines of credit and short-term borrowings	(108,935)	(46,278)
Payments of long-term debt	(14,515)	(14,569)
Payment of debt financing costs	(2,185)	
Net cash used in financing activities	(117)	(44,881)
Effect of exchange rate changes on cash and cash equivalents	(11)	49
Net change in cash and cash equivalents	(18,210)	(44,760)
Cash and cash equivalents at beginning of period	74,539	105,579

Cash and cash equivalents at end of period	$ 56,329	$ 60,819

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands)

(Unaudited)

	Number of shares				Stockholders equity										
							Accumulated other comprehensive earnings								
	Preferred stock	Common stock	Treasury stock	Treasury stock held for deferred compensation	Common stock	Additional paid-in capital	Foreign currency translation adjustments	Unrealized derivative gains (losses)	Minimum retirement benefit liability adjustments	Total accumulated other compre-hensive (loss) earnings	Deferred compen-sation	Retained earnings	Treasury stock at cost	Treasury stock held for deferred compen-sation	Total stockholders equity
Balances as of October 1, 2010		72,960	(4,223)	(356)	$ 106	$ 73,915	$ 23,152	$ (627)	$ (16,183)	$ 6,342	$ 4,888	$ 835,919	$ (113,088)	$ (4,888)	$ 803,194
Net earnings												54,489			54,489
Cash dividends paid												(8,948)			(8,948)
Purchases of treasury stock			(242)										(7,961)		(7,961)
Sales of treasury stock			261			(1,763)							4,187		2,424
Tax benefit attributable to exercise of stock options						2,236									2,236
Stock-based compensation						4,113									4,113
Purchases of stock by deferred compensation plan			2	(2)		33					107			(107)	33
Distribution of stock from deferred compensation plan				24							(274)			274	
Foreign currency translation adjustments							8,629			8,629					8,629
Reclassification of unrecognized derivative losses to earnings								115		115					115
Minimum retirement benefits liability adjustments									(274)	(274)					(274)

Taxes on changes in accumulated other comprehensive earnings						(916)	(43)	96	(863)					(863)
Balances as of March 31, 2011	72,960	(4,202)	(334)	$ 106	$ 78,534	$ 30,865	$ (555)	$ (16,361)	$ 13,949	$ 4,721	$ 881,460	$ (116,862)	$ (4,721)	$ 857,187
Balances as of October 1, 2011	72,960	(4,070)	(315)	$ 106	$ 81,453	$ 22,103	$ (484)	$ (17,993)	$ 3,626	$ 4,581	$ 949,573	$ (115,661)	$ (4,581)	$ 919,097
Net earnings											67,168			67,168
Cash dividends paid											(10,343)			(10,343)
Purchases of treasury stock		(345)										(14,312)		(14,312)
Sales of treasury stock		390			(1,324)							6,334		5,010
Common shares issued from treasury stock for benefit plans		209			5,238							4,097		9,335
Tax benefit attributable to exercise of stock options					3,680									3,680
Stock-based compensation					5,291									5,291
Purchases of stock by deferred compensation plan		3	(4)		59					157		49	(157)	108
Distribution of stock from deferred compensation plan			26							(271)			271	
Foreign currency translation adjustments						(453)			(453)					(453)
Reclassification of unrecognized derivative losses to earnings							88		88					88
Minimum retirement benefits liability adjustments								127	127					127
Taxes on changes in accumulated other comprehensive earnings						3,293	(34)	(45)	3,214					3,214
Balances as of March 31, 2012	72,960	(3,813)	(293)	$ 106	$ 94,397	$ 24,943	$ (430)	$ (17,911)	$ 6,602	$ 4,467	$ 1,006,398	$ (119,493)	$ (4,467)	$ 988,010

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 1. Basis of presentation

The Condensed Consolidated Financial Statements of Woodward, Inc. (Woodward or the Company) as of March 31, 2012 and for the three and six-months ending March 31, 2012 and March 31, 2011, included herein, have not been audited by an independent registered public accounting firm. These Condensed Consolidated Financial Statements reflect all normal recurring adjustments that, in the opinion of management, are necessary to present fairly Woodward s financial position as of March 31, 2012, and the results of operations, cash flows, and changes in stockholders equity for the periods presented herein. The Condensed Consolidated Balance Sheet as of September 30, 2011 was derived from Woodward s Annual Report on Form 10-K for the fiscal year then ended. The results of operations for the three and six-months ending March 31, 2012 are not necessarily indicative of the operating results to be expected for other interim periods or for the full fiscal year. Dollar amounts contained in these Condensed Consolidated Financial Statements are in thousands, except per share amounts.

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

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

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

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

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

Note 2. Recent accounting pronouncements

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

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

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 3. Earnings per share

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

Diluted earnings per share reflects the weighted-average number of shares outstanding after the assumed conversion of all dilutive securities.

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Numerator:				
Net earnings	$ 38,751	$ 32,090	$ 67,168	$ 54,489
Denominator:				
Basic shares outstanding	69,077	68,752	68,998	68,782
Dilutive effect of stock options	1,547	1,355	1,506	1,358
Diluted shares outstanding	70,624	70,107	70,504	70,140
Income per common share:				
Basic earnings per share	$ 0.56	$ 0.47	$ 0.97	$ 0.79
Diluted earnings per share	$ 0.55	$ 0.46	$ 0.95	$ 0.78

The following stock option grants were outstanding during the three and six-months ending March 31, 2012 and 2011, but were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Options	6	680	39	678
Weighted-average option price	$ 40.60	$ 32.03	$ 34.63	$ 32.02

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Weighted-average treasury stock shares held for deferred compensation obligations	304	345	307	348

Note 4. Business acquisitions

IDS Acquisition

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

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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

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

As of March 31, 2012, an amount of $7,987 paid in connection with the IDS Acquisition was deposited into escrow accounts to secure Woodward s ability to recover any amounts owed to Woodward by the sellers as a result of customary indemnities related to representations and warranties made by the sellers. Funds held in escrow will only be released to the sellers as specified in the related purchase agreements.

The purchase price of the IDS Acquisition is as follows:

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

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

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

Current assets	$ 14,627
Investments in marketable securities	8,463
Property, plant, and equipment	1,954
Goodwill	24,188
Intangible assets	11,882
Total assets acquired	61,114

Other current liabilities	5,505
Warranty accrual	2,250
Postretirement benefits	434
Deferred tax liabilities	2,472
Other tax noncurrent	3,292
Total liabilities assumed	13,953
Net assets acquired	$ 47,161

There were no changes to the values of assets acquired and liabilities assumed during the three and six-months ending March 31, 2012. The fair value of warranty liabilities assumed represents the estimated costs to provide service for contractual warranty obligations on products sold by IDS and IDS s business in China prior to the IDS Acquisition. The fair value of Other tax noncurrent represents the estimated value of gross unrecognized tax benefits assumed.

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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

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

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

	Amount	Weighted-Average Useful Life	Amortization Method
Customer relationships	$ 3,452	9 years	Straight-line
Process technology	7,752	8.5 years	Straight-line
Other	678	2.5 years	Straight-line
Total	$ 11,882	8 years	

The operating results of the IDS Acquisition are included in Woodward s Consolidated Statements of Earnings and Comprehensive Earnings beginning April 15, 2011. Pro forma financial disclosures have not been presented, as the IDS Acquisition was not significant to Woodward s financial position or results of operations. The Company incurred transaction costs of $2,396 during the year ending September 30, 2011, which were included in Selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings. No additional transactions costs were incurred in the six-months ending March 31, 2012.

Note 5. Financial instruments and fair value measurements

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

	At March 31, 2012		At September 30, 2011	
	Estimated Fair Value	Carrying Cost	Estimated Fair Value	Carrying Cost
Cash and cash equivalents	$ 56,329	$ 56,329	$ 74,539	$ 74,539
Investments in deferred compensation program	7,221	7,221	5,855	5,855
Short-term borrowings	(32,500)	(32,500)		
Long-term debt, including current portion	(464,137)	(410,728)	(482,776)	(425,246)

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

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

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

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

The fair value of long-term debt was estimated based on a model that discounted future principal and interest payments at interest rates available to the Company at the end of the period for similar debt of the same maturity, which is a Level 2 input as defined below. The weighted-average interest rates used to estimate the fair value of long-term debt were as follows:

	March 31, 2012	September 30, 2011
Weighted-average interest rate used to estimate fair value	2.5%	2.6%

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

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

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

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

The table below presents information about Woodward s financial assets that are measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques Woodward utilized to determine such fair value. Woodward had no financial liabilities required to be measured at fair value on a recurring basis as of March 31, 2012 or September 30, 2011.

	At March 31, 2012				At September 30, 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets:								
Investments in money market funds	$ 19,390	$	$	$ 19,390	$ 10,823	$	$	$ 10,823
Equity securities	7,221			7,221	5,855			5,855
Total financial assets	$ 26,611	$	$	$ 26,611	$ 16,678	$	$	$ 16,678

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

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

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Note 6. Derivative instruments and hedging activities

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

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

Derivatives in foreign currency relationships

Woodward did not enter into any hedging transactions during the three or six-months ending March 31, 2012 and was not a party to any derivative instruments as of March 31, 2012 or September 30, 2011.

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

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

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

	March 31, 2012	September 30, 2011
Derivatives designated as hedging instruments	**Unrecognized Gain (Loss)**	
Classified in accumulated other comprehensive earnings	$ (693)	$ (781)
Classified in current and long-term debt		3
	$ (693)	$ (778)

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

Derivatives in:	Location of (Gain) Loss Recognized in Earnings	Three-Months Ending March 31, 2012			Three-Months Ending March 31, 2011		
		Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings	Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings
Fair value hedging relationships	Interest expense	$	$	$	$ (15)	$	$
Cash flow hedging relationships	Interest expense	43		43	56		56
		$ 43	$	$ 43	$ 41	$	$ 56

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Derivatives in:	Location of (Gain) Loss Recognized in Earnings	Six-Months Ending March 31, 2012 Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings	Six-Months Ending March 31, 2011 Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings
Fair value hedging relationships	Interest expense	$ (3)	$	$	$ (34)	$	$
Cash flow hedging relationships	Interest expense	88		88	115		115
Foreign currency relationships	Other (income) expense				1,612		
		$ 85	$	$ 88	$ 1,693	$	$ 115

Based on the carrying value of the unrecognized gains and losses on terminated derivative instruments designated as cash flow hedges as of March 31, 2012, Woodward expects to reclassify $171 of net unrecognized losses on terminated derivative instruments from accumulated other comprehensive earnings to earnings during the next twelve months.

Note 7. Supplemental statements of cash flows information

	Six-Months Ending March 31, 2012	2011
Interest paid, net of amounts capitalized	$ 13,021	$ 13,156
Income taxes paid	31,343	17,731
Income tax refunds received	1,711	5,920
Non-cash activities:		
Purchases of property, plant and equipment on account	3,294	1,942
Common shares issued from treasury stock for benefit plans (Note 17)	9,335	
Cashless exercise of stock options		1,124
Reduction of accounts receivable and short-term borrowing due to the settlement of accounts receivable previously sold with recourse		3,228
Reduction of accounts payable due to the assignment of accounts receivable with recourse		570
Reduction to goodwill due to favorable resolution of lease termination recorded in restructuring reserve		103
Payment of director fees through issuance of treasury stock		24

Note 8. Inventories

	March 31, 2012	September 30, 2011
Raw materials	$ 29,239	$ 43,172
Work in progress	96,686	108,718
Component parts and finished goods	290,697	229,665
	$ 416,622	$ 381,555

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Note 9. Property, plant, and equipment, net

	March 31, 2012	September 30, 2011
Land	$ 14,553	$ 14,823
Buildings and improvements	192,736	177,637
Leasehold improvements	20,424	18,765
Machinery and production equipment	267,334	265,898
Computer equipment and software	82,315	66,149
Other	24,525	25,191
Construction in progress	33,847	44,975
	635,734	613,438
Less accumulated depreciation	(421,237)	(406,713)
Property, plant and equipment, net	$ 214,497	$ 206,725

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Depreciation expense	$ 9,513	$ 9,970	$ 19,682	$ 20,324

During fiscal year 2010, Woodward began construction of a new forty-eight thousand square foot system test facility in Rockford, Illinois. In the first half of fiscal year 2012, Woodward placed into service assets totaling $16,738 associated with the new system test facility, the majority of which is included in Buildings and improvements. As of March 31, 2012, $5,247 of assets related to the system test facility remained as construction in progress and are expected to be placed into service by the end of fiscal year 2012. The facility, which houses numerous environmental system test cells and a vibration lab, will support, among other development projects, Woodward s Aerospace segment development efforts of next generation fuel systems for aircraft turbines.

The increase in Computer equipment and software of $16,166 was primarily related to assets that were placed into service during the second quarter of fiscal year 2012 associated with a new enterprise resource planning (ERP) system for a group within Woodward s Aerospace segment.

For the three and six-months ending March 31, 2012 and March 31, 2011, Woodward had capitalized interest that would have otherwise been included in interest expense as follows:

Three-Months Ending March 31,		Six-Months Ending March 31,	
2012	2011	2012	2011

Capitalized interest	$ 124	$ 315	$ 428	$ 513

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Note 10. Goodwill

	September 30, 2011	Effects of Foreign Currency Translation	March 31, 2012
Aerospace	$ 356,525	$ 176	$ 356,701
Energy	105,757	201	105,958
Consolidated	$ 462,282	$ 377	$ 462,659

Woodward tests goodwill for impairment at the reporting unit level on an annual basis and more often if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment tests consist of comparing the implied fair value of each identified reporting unit with its carrying amount including goodwill. If the carrying amount of the reporting unit exceeds its implied fair value, Woodward compares the implied fair value of goodwill with the recorded carrying amount of goodwill. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss would be recognized to reduce the carrying amount to its implied fair value.

Woodward completed its annual goodwill impairment test as of July 31, 2011 during the quarter ended September 30, 2011. As a part of that test, the fair value of each of Woodward s reporting units was determined using a discounted cash flow method. This method represents a Level 3 input and incorporates various estimates and assumptions, the most significant being projected revenue growth rates, operating earnings margins, and forecasted cash flows based on the discount rate and terminal growth rate. Management projects revenue growth rates, operating earnings margins and cash flows based on each reporting unit s current operational results, expected performance and operational strategies over a five or ten-year period. These projections are adjusted to reflect economic conditions and the demand for certain products and require considerable management judgment.

Forecasted cash flows used in the July 31, 2011 impairment test were discounted using weighted-average cost of capital assumptions from 10.0% to 10.2%. The terminal values of the forecasted cash flows were calculated using the Gordon Growth Model and assumed an annual compound growth rate after five or ten years of 4.3%. These inputs, which are unobservable in the market, represent management s best estimate of what market participants would use in determining the present value of the Company s forecasted cash flows. Changes in these estimates and assumptions can have a significant impact on the fair value of forecasted cash flows. Woodward evaluated the reasonableness of the reporting units resulting fair values utilizing a market multiple method.

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

As part of the Company s ongoing monitoring efforts, Woodward will continue to consider the global economic environment and its potential impact on Woodward s business at a reporting unit level in assessing goodwill recoverability. There can be no assurance that Woodward s estimates and assumptions regarding forecasted cash flows of certain reporting units, the period or strength of the current economic recovery, or the other inputs used in forecasting the present value of forecasted cash flows will prove to be accurate projections of future performance.

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Note 11. Other intangibles, net

	March 31, 2012			September 30, 2011		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Customer relationships:						
Aerospace	$ 205,206	$ (50,475)	$ 154,731	$ 205,171	$ (41,652)	$ 163,519
Energy	41,981	(25,189)	16,792	41,991	(23,696)	18,295
Total	$ 247,187	$ (75,664)	$ 171,523	$ 247,162	$ (65,348)	$ 181,814
Intellectual property:						
Aerospace	$	$	$	$	$	$
Energy	20,145	(12,607)	7,538	20,162	(11,918)	8,244
Total	$ 20,145	$ (12,607)	$ 7,538	$ 20,162	$ (11,918)	$ 8,244
Process technology:						
Aerospace	$ 71,709	$ (18,002)	$ 53,707	$ 71,691	$ (15,380)	$ 56,311
Energy	23,470	(8,707)	14,763	23,451	(7,657)	15,794
Total	$ 95,179	$ (26,709)	$ 68,470	$ 95,142	$ (23,037)	$ 72,105
Other intangibles:						
Aerospace	$ 39,645	$ (36,272)	$ 3,373	$ 39,635	$ (34,655)	$ 4,980
Energy	2,610	(1,144)	1,466	2,621	(867)	1,754
Total	$ 42,255	$ (37,416)	$ 4,839	$ 42,256	$ (35,522)	$ 6,734
Total intangibles:						
Aerospace	$ 316,560	$ (104,749)	$ 211,811	$ 316,497	$ (91,687)	$ 224,810
Energy	88,206	(47,647)	40,559	88,225	(44,138)	44,087
Consolidated Total	$ 404,766	$ (152,396)	$ 252,370	$ 404,722	$ (135,825)	$ 268,897

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Amortization expense	$ 8,294	$ 8,542	$ 16,552	$ 17,085

Future amortization expense associated with intangibles is expected to be:

Year Ending September 30:	
2012 (remaining)	$ 16,309
2013	30,525
2014	27,374
2015	24,864
2016	23,496
Thereafter	129,802
	$ 252,370

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

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

On January 4, 2012, the $225,000 revolving credit facility was amended and restated by the Third Amended and Restated Credit Agreement (the Amended and Restated Revolver Agreement) entered into between Woodward and a syndicate of nine lenders led by JPMorgan Chase Bank, N.A., as administrative agent. The Amended and Restated Revolver Agreement extended the existing revolving credit facility s maturity to January 2017. The borrowing capacity increased from $225,000 to $400,000 and the option, subject to the lenders participation, to expand the commitment increased from $125,000 to $200,000, for a total borrowing capacity of up to $600,000. Borrowings under the Amended and Restated Revolver Agreement generally bear interest at LIBOR plus 0.95% to 1.525%. Outstanding borrowings under the revolving credit facility as of March 31, 2012 were $27,500, at an effective interest rate of 1.29%.

The Amended and Restated Revolver Agreement contains certain covenants customary with such agreements, which are generally consistent with the covenants applicable to Woodward s long-term debt agreements, and contains customary events of default, including certain cross default provisions related to Woodward s other outstanding debt arrangements in excess of $30,000, the occurrence of which would permit the lenders to accelerate the amounts due thereunder. In addition, the Amended and Restated Revolver Agreement increases the minimum required consolidated net worth of Woodward to a base of $725,000, plus 50% of Woodward s positive net income for the prior fiscal year and plus 50% of Woodward s net cash proceeds resulting from certain issuances of stock, subject to certain adjustments. Woodward also made amendments to its existing Term Loan Credit Agreement, dated as of October 1, 2008 (the Term Loan Agreement), that provided for certain changes to, among other things, the affirmative, negative and financial covenants of the Term Loan Agreement consistent with the covenant provisions in the Amended and Restated Revolver Agreement.

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

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

On January 5, 2012, a Chinese subsidiary of Woodward entered into a local credit facility with the Hong Kong and Shanghai Banking Company under which it has the ability to borrow up to either $5,000, or the local currency equivalent of $5,000. Any cash borrowings under the local Chinese credit facility are secured by a parent guarantee from Woodward. The Chinese subsidiary may utilize the local facility for cash borrowings to support its local operating cash needs. Local currency borrowings on the Chinese credit facility are charged interest at the prevailing interest rate offered by the People s Bank of China on the date of borrowing, plus a margin equal to 25% of that prevailing rate. U.S. dollar borrowings on the credit facility are charged interest at the lender s cost of borrowing rate at the date of borrowing, plus a margin of 3%.

At March 31, 2012, the Chinese subsidiary had outstanding cash borrowings of $5,000 which were fully secured by a $5,000 parent guarantee issued by Woodward. The U.S. dollar borrowings were made at an effective interest rate of 7.45%.

Woodward also has other foreign lines of credit and foreign overdraft facilities at various financial institutions, which are generally reviewed annually for renewal and are subject to the usual terms and conditions applied by the financial institutions. Pursuant to the terms of the related facility agreements, Woodward s foreign performance guarantee facilities are limited in use to providing performance guarantees to third parties.

As of March 31, 2012 and September 30, 2011, there were no outstanding borrowings from Woodward s other foreign lines of credit and foreign overdraft facilities.

At March 31, 2012, Woodward held $56,329 in cash and cash equivalents, and had total outstanding debt of $443,228 with additional borrowing availability of $365,728 under its revolving credit facility, net of outstanding letters of credit, and $15,351 under its other foreign lines of credit and foreign overdraft facilities.

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Management believes that Woodward was in compliance with all its debt covenants at March 31, 2012.

Note 13. Accrued liabilities

	March 31, 2012	September 30, 2011
Salaries and other member benefits	$ 30,710	$ 70,965
Current portion of restructuring and other charges	2,429	2,489
Warranties	13,783	14,083
Interest payable	11,357	11,611
Accrued retirement benefits	2,423	2,560
Deferred revenues	5,870	8,160
Taxes, other than income	7,377	5,097
Other	18,952	18,551
	$ 92,901	$ 133,516

Warranties

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

Warranties, September 30, 2011	$ 14,083
Increases to accruals related to warranties during the period	952
Settlements of amounts accrued	(1,194)
Foreign currency exchange rate changes	(58)
Warranties, March 31, 2012	$ 13,783

Restructuring and other charges

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

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The summary of the activity in accrued restructuring charges during the three and six-months ending March 31, 2012 is as follows:

	Three-Months Ending March 31, 2012		
	Restructuring Charges	Business Acquisitions	Total
Accrued restructuring charges, December 31, 2011	$ 261	$ 2,499	$ 2,760
Payments	(21)	(45)	(66)
Non-cash adjustments	6		6
Foreign currency exchange rates	1		1
Accrued restructuring charges, March 31, 2012	$ 247	$ 2,454	$ 2,701

	Six-Months Ending March 31, 2012		
	Restructuring Charges	Business Acquisitions	Total
Accrued restructuring charges, September 30, 2011	$ 365	$ 2,544	$ 2,909
Payments	(130)	(90)	(220)
Non-cash adjustments	12		12
Foreign currency exchange rates			
Accrued restructuring charges, March 31, 2012	$ 247	$ 2,454	$ 2,701

Other liabilities included the following amounts of accrued restructuring charges not expected to be settled within twelve months:

	000,000 March 31, 2012	000,000 September 30, 2011
Non-current accrued restructuring charges	$ 272	$ 420

Note 14. Other liabilities

	March 31, 2012	September 30, 2011
Net accrued retirement benefits, less amounts recognized within accrued liabilities	$ 62,127	$ 61,994
Uncertain tax positions, net of offsetting benefits (Note 16)	15,322	14,078

Other	11,512	12,622
	$ 88,961	$ 88,694

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Note 15. Other (income) expense, net

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	**2011**	**2012**	**2011**
Net (gain) loss on sale of assets	$ (80)	$ (11)	$ (72)	$ 1
Rent income	(128)	(126)	(256)	(307)
Net gain on investments in deferred compensation program	(527)	(233)	(896)	(568)
Net expense recognized in earnings on foreign currency derivatives (Note 6)				1,612
Other	3	(22)	(2)	(32)
	$ (732)	$ (392)	$ (1,226)	$ 706

For additional information regarding Net expense recognized in earnings on foreign currency derivatives refer to Note 6, *Derivative instruments and hedging activities*.

Note 16. Income taxes

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

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

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

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

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

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	**2011**	**2012**	**2011**
Earnings before income taxes	$ 54,038	$ 46,487	$ 94,214	$ 77,962
Income tax expense	15,287	14,397	27,046	23,473
Effective tax rate	28.3%	31.0%	28.7%	30.1%

Income taxes for the three and six-months ending March 31, 2012 included a tax benefit of $3,326 related to a reduction in the anticipated amount of undistributed earnings of certain of Woodward s foreign subsidiaries that were previously expected to be repatriated into the U.S. within the foreseeable future. Woodward now anticipates that a portion of those earnings will remain indefinitely invested outside the U.S. to support the growth of its foreign operations, and has accordingly reversed the deferred tax liability associated with repatriating those earnings.

Income taxes for the six-months ending March 31, 2011 included an expense reduction of $1,890 related to the retroactive extension of the U.S. research and experimentation tax credit.

Worldwide unrecognized tax benefits were as follows:

	March 31, 2012	September 30, 2011
Gross liability	$ 17,947	$ 16,931
Amount that would impact Woodward s effective tax rate, if recognized, net of expected offsetting adjustments	15,322	14,078

At this time, Woodward estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as $1,122 in the next twelve months due to the completion of reviews by tax authorities and the expiration of certain statutes of limitations.

Woodward recognizes interest and penalties related to unrecognized tax benefits in tax expense. Woodward had accrued interest and penalties of the following:

	March 31, 2012	September 30, 2011
Accrued interest and penalties	$ 2,383	$ 1,989

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 2004 and forward. Woodward has been subject to U.S. Federal income tax examinations for fiscal years through 2008. Woodward is subject to U.S. state income tax examinations for fiscal years 2007 and forward.

Note 17. Retirement benefits

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

Defined contribution plans

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

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Most U.S. employees with at least two years of service receive an annual contribution of Woodward stock, equal to 5% of their eligible prior year wages, to their personal Woodward Retirement Savings Plan accounts. In February 2012, Woodward fulfilled the annual Woodward stock contribution using shares held in treasury stock by issuing 209 shares of common stock for a total value of $9,335. In the second quarter of fiscal year 2011, the annual Woodward stock contribution totaling $9,107 was funded by way of a cash contribution to the Woodward Retirement Savings Plan, which then purchased shares of Woodward stock on the open market.

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Company costs	$ 4,350	$ 4,058	$ 8,982	$ 8,256

Woodward operates one multi-employer plan for certain employees in the Netherlands. The amounts of contributions associated with the multi-employer plan were as follows:

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Company contributions	$ 121	$ 114	$ 242	$ 233

Defined benefit plans

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

U.S. GAAP requires that, for obligations outstanding as of September 30, 2011, 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.

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

	Three-Months Ending March 31,					
	United States		Other Countries		Total	
	2012	2011	2012	2011	2012	2011
Service cost	$ 882	$ 859	$ 285	$ 224	$ 1,167	$ 1,083
Interest cost	1,454	1,411	569	562	2,023	1,973
Expected return on plan assets	(1,752)	(1,674)	(645)	(627)	(2,397)	(2,301)
Amortization of:						
Net actuarial (gain) loss	131	78	165	224	296	302
Prior service cost (benefit)	18	18	(2)	(2)	16	16
Net periodic retirement pension (benefit) cost	$ 733	$ 692	$ 372	$ 381	$ 1,105	$ 1,073
Contributions paid	$ 150	$	$ 451	$ 488	$ 601	$ 488

	Six-Months Ending March 31,					
	United States		Other Countries		Total	
	2012	2011	2012	2011	2012	2011
Service cost	$ 1,765	$ 1,717	$ 572	$ 446	$ 2,337	$ 2,163
Interest cost	2,908	2,823	1,138	1,117	4,046	3,940
Expected return on plan assets	(3,504)	(3,347)	(1,290)	(1,246)	(4,794)	(4,593)
Amortization of:						
Net actuarial (gain) loss	262	156	332	445	594	601
Prior service cost (benefit)	37	37	(4)	(4)	33	33
Net periodic retirement pension (benefit) cost	$ 1,468	$ 1,386	$ 748	$ 758	$ 2,216	$ 2,144
Contributions paid	$ 300	$	$ 2,332	$ 3,190	$ 2,632	$ 3,190

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Service cost	$ 18	$ 23	$ 35	$ 46
Interest cost	450	494	899	987
Amortization of:				

Net actuarial (gain) loss	23	32	46	64
Prior service cost (benefit)	(138)	(217)	(275)	(435)
Net periodic other postretirement (benefit) cost	$ 353	$ 332	$ 705	$ 662
Contributions paid	$ 792	$ 817	$ 1,293	$ 1,594

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

The amount of cash contributions made to these plans in any year is dependent upon a number of factors, including minimum funding requirements in the jurisdictions in which Woodward operates and arrangements made with trustees of certain foreign plans. As a result, the actual funding in fiscal year 2012 may differ from the current estimate. Woodward estimates its remaining cash contributions in fiscal year 2012 will be as follows:

Retirement pension benefits:	
United States	$ 300
United Kingdom	864
Japan	
Switzerland	191
Other postretirement benefits	3,417

Note 18. Stock-based compensation

Stock options

Woodward s 2006 Omnibus Incentive Plan (the 2006 Plan), which has been approved by Woodward s stockholders, provides for the grant of up to 7,410 stock options to its employees and directors. Woodward believes that these awards align the interest of its employees with those of its stockholders. Stock option awards are granted with an exercise price equal to the market price of Woodward s stock at the date of grant, and generally with a four-year vesting schedule at a vesting rate of 25% per year 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-valuation model using the assumptions in the following table. Woodward calculates the expected term based upon historical experience of plan participants and it represents the period of time that stock options granted are expected to be outstanding. Expected volatility is based on historical volatility using daily stock price observations. The estimated dividend yield is based upon Woodward s historical dividend practice and the market value of its common stock. The risk-free rate is based on the U.S. treasury yield curve, for periods within the contractual life of the stock option, at the time of grant.

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Expected term	5.9 years	5.8 years	5.9 8.5 years	5.8 8.7 years
Estimated volatility	55.5% 55.6%	54.0%	48.9% 55.6%	48.0% 54.0%
Estimated dividend yield	0.7%	1.1%	0.7% 1.1%	1.1% 1.3%
Risk-free interest rate	1.0% 1.3%	2.6%	1.0% 1.6%	1.9% 2.6%

The following is a summary of the activity for stock option awards during the three and six-months ending March 31, 2012:

	Three-Months Ending March 31, 2012	Six-Months Ending March 31, 2012

	Number of options	Weighted-Average Exercise Price per Share	Number of options	Weighted-Average Exercise Price per Share
Options, beginning balance	4,858	$ 21.34	4,228	$ 20.12
Options granted	20	43.27	845	26.00
Options exercised	(205)	13.90	(390)	12.86
Options forfeited		n/a	(10)	26.83
Options, ending balance	4,673	$ 21.76	4,673	$ 21.76

WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Changes in nonvested stock options during the three and six-months ending March 31, 2012 were as follows:

	Three-Months Ending March 31, 2012		Six-Months Ending March 31, 2012	
	Number of options	Weighted-Average Exercise Price per Share	Number of options	Weighted-Average Exercise Price per Share
Options, beginning balance	1,713	$ 26.80	1,368	$ 27.71
Options granted	20	43.27	845	26.00
Options vested	(4)	29.00	(476)	27.41
Options forfeited		n/a	(8)	26.83
Options, ending balance	1,729	$ 26.99	1,729	$ 26.99

As of March 31, 2012, there was approximately $13,000 of total unrecognized compensation cost, which assumes a weighted-average forfeiture rate of 6.4%, related to non-vested stock-based compensation arrangements granted under the 2002 Stock Option Plan (for which no further grants will be made) and the 2006 Plan. The remaining unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 2.8 years.

Information about stock options that have vested, or are expected to vest, and are exercisable at March 31, 2012 were as follows:

	Number	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years	Aggregate Intrinsic Value
Options outstanding	4,673	$ 21.76	6.1	$ 98,471
Options vested and exercisable	2,944	18.69	4.5	71,059
Options vested and expected to vest	4,505	21.55	5.9	95,871

Note 19. Commitments and contingencies

Woodward is currently involved in claims, pending or threatened litigation, other legal proceedings, investigations and/or regulatory proceedings arising in the normal course of business, including, among others, those relating to product liability claims, employment matters, workman s compensation claims, contractual disputes, product warranty claims and alleged violations of various laws and regulations. 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. Legal costs are expensed as incurred and are classified in Selling, general and administrative expenses on the Condensed Consolidated Statements of Earnings.

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

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

In connection with the sale of the Fuel & Pneumatic product line during fiscal year 2009, Woodward assigned to a subsidiary of the purchaser its rights and responsibilities related to certain contracts with the U.S. Government. Woodward provided to the U.S. Government a customary guarantee of the purchaser s subsidiary s obligations under the contracts. The purchaser and its affiliates have agreed to indemnify Woodward for any liability incurred with respect to the guarantee.

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WOODWARD, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

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 20. Segment information

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

Woodward uses reportable segment information internally to manage its business, including the assessment of business segment performance and decisions for the allocation of resources between segments.

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

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

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Segment external net sales:				
Aerospace	$ 224,337	$ 204,945	$ 417,563	$ 386,089
Energy	244,456	213,921	459,126	397,852
Total consolidated net sales	$ 468,793	$ 418,866	$ 876,689	$ 783,941
Segment earnings:				
Aerospace	$ 33,681	$ 33,241	$ 60,741	$ 53,155
Energy	34,334	26,941	61,059	51,444
Total segment earnings	68,015	60,182	121,800	104,599
Nonsegment expenses	(7,509)	(7,481)	(14,936)	(14,045)
Interest expense, net	(6,468)	(6,214)	(12,650)	(12,592)
Consolidated earnings before income taxes	$ 54,038	$ 46,487	$ 94,214	$ 77,962

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WOODWARD, INC.

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(In thousands, except per share amounts)

(Unaudited)

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

	March 31, 2012	September 30, 2011
Segment assets:		
Aerospace	$ 1,035,470	$ 1,036,797
Energy	604,689	569,929
Total segment assets	1,640,159	1,606,726
Unallocated corporate property, plant and equipment, net	12,137	8,556
Other unallocated assets	164,044	166,152
Consolidated total assets	$ 1,816,340	$ 1,781,434

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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, forecast, intend, continue, outlook, plan, project, target, strive, can, could, may, should, will, would, variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characteristics of future events or circumstances are forward-looking statements. Forward-looking statements may include, among others, statements relating to:

- *future sales, earnings, cash flow, uses of cash, and other measures of financial performance;*
- *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 instability in the financial markets, sovereign credit rating downgrades and uncertainty surrounding European sovereign and other debt defaults, 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;*

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

- *our ability to manage our expenses and product mix while responding to sales increases or decreases;*

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

risks related to our U. S. Government contracting activities;

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

future subsidiary results or changes in domestic or international tax statutes;

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 our Aerospace business in California, which historically has been susceptible to natural disasters;

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

liabilities resulting from legal and regulatory proceedings, inquiries, or investigations by private or U.S. Government persons or entities;

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;

fair value of defined benefit plan assets and assumptions used in determining our retirement pension and other postretirement benefit obligations and related expenses including, among others, discount rates and investment return on pension assets; 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 herein 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 Part I, Item 1A in our most recent Annual Report on Form 10-K filed with the SEC (our Form 10-K). 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, Inc. and its consolidated subsidiaries.

Except where we have otherwise indicated or the context otherwise requires, amounts presented in this Quarterly Report on Form 10-Q are in thousands except per share amounts.

This discussion should be read together with Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our most recent Form 10-K and the Condensed Consolidated Financial Statements and Notes included therein and in this report.

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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 defined as net cash flows provided by operating activities less payments for property, plant and equipment, in reviewing the financial performance of Woodward s various business groups 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.

EBIT and EBITDA for the three and six-months ending March 31, 2012 and March 31, 2011 were as follows:

	Three-Months Ending March 31,		Six-Months Ending March 31,	
	2012	2011	2012	2011
Net earnings	$ 38,751	$ 32,090	$ 67,168	$ 54,489
Income taxes	15,287	14,397	27,046	23,473
Interest expense	6,552	6,299	12,860	12,800
Interest income	(84)	(85)	(210)	(208)
EBIT	60,506	52,701	106,864	90,554
Amortization of intangible assets	8,294	8,542	16,552	17,085
Depreciation expense	9,513	9,970	19,682	20,324
EBITDA	$ 78,313	$ 71,213	$ 143,098	$ 127,963

Free cash flow for the six-months ending March 31, 2012 and March 31, 2011 was as follows:

	Six-Months Ending March 31,	
	2012	2011
Net cash provided by operating activities	$ 12,226	$ 20,176
Payments for property, plant and equipment	(30,523)	(20,124)
Free cash flow	$ (18,297)	$ 52

OVERVIEW

Operational Highlights

Quarterly Highlights

Net sales for the second quarter of fiscal 2012 were $468,793, an increase of 11.9% from $418,866 for the second quarter of the prior fiscal year. Net sales growth as compared to the second quarter of fiscal 2011 was across both of our segments reflecting continued market share gains and consistent growth in most of the markets we serve.

Sequentially, net sales for the second quarter of fiscal 2012 increased by $60,897, or 14.9%, to $468,793 from $407,896 for the first quarter of 2012. Historically, net sales in the first quarter have generally been lower than the remaining three quarters of the fiscal year due to customer buying patterns and the observance of various holidays.

EBIT for the second quarter of fiscal 2012 was $60,506, up 14.8% from $52,701 in the same period of fiscal 2011. The current quarter EBIT was positively impacted by increased sales volumes, partially offset by increased research and development costs of $10,395, or 38.4%, compared to the same quarter for fiscal 2011, reflecting increased investment in awarded customer programs. In addition, variable compensation expense for the second quarter of fiscal 2012 was $7,659 lower than the second quarter of fiscal 2011.

Net earnings for the second quarter of fiscal 2012 were $38,751, or $0.55 per diluted share, compared to $32,090, or $0.46 per diluted share, for the second quarter of fiscal 2011. The effective tax rate in the second quarter of fiscal 2012 was 28.3% compared to 31.0% for the second quarter of the prior year.

Year to Date Highlights

Net sales for the first half of fiscal 2012 were $876,689, an increase of 11.8% from $783,941 for the first half of the prior fiscal year. The sales increase was across both of our segments and reflected continued market share gains and consistent growth in most of the markets we serve.

EBIT for the first half of fiscal 2012 was $106,864, up 18.0% from $90,554 in the same period of fiscal 2011. Current year EBIT was positively affected by increased sales volumes and favorable price and sales mix, partially offset by increased investment in research and development. In addition, variable compensation expense for the first half of fiscal 2012 was $4,985 lower than the first half of fiscal 2011.

Net earnings for the first half of fiscal 2012 were $67,168, or $0.95 per diluted share, compared to $54,489, or $0.78 per diluted share, for the first half of fiscal 2011. The effective tax rate in the first half of fiscal 2012 was 28.7% compared to 30.1% for the first half of the prior year.

Liquidity Highlights

Net cash provided by operating activities for the first half of fiscal 2012 was $12,226 compared to $20,176 for the same period of fiscal 2011, primarily reflecting increased payments of variable compensation in the current year, partially offset by less of an increase in accounts receivable and inventory.

Negative free cash flow for the first half of fiscal 2012 was $18,297 compared to positive free cash flow of $52 for the same period of fiscal 2011, due mainly to increased payments of variable compensation in the current year as compared to the prior year and our continuing investment in capital expenditures. EBITDA increased $15,135 to $143,098 for the first half of fiscal 2012 from $127,963 for the same period of fiscal 2011, primarily due to increased net earnings.

On January 4, 2012, we amended and restated our revolving credit facility, which had an expiration date of October 2012, by entering into a Third Amended and Restated Credit Agreement (the Amended and Restated Revolver Agreement) with a syndicate of lenders led by JPMorgan Chase Bank, N.A., as administrative agent. The Amended and Restated Revolver Agreement extended the prior revolving credit facility s maturity to January 2017. The borrowing capacity increased from $225,000 to $400,000 and the option, subject to the lenders participation, to expand the commitment increased from $125,000 to $200,000, for a total borrowing capacity of up to $600,000.

At March 31, 2012, we held $56,329 in cash and cash equivalents, and had total outstanding debt of $443,228 with additional borrowing availability of $365,728 under our revolving credit facility, net of outstanding letters of credit, and $15,351 under various foreign credit facilities.

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RESULTS OF OPERATIONS

The following table sets forth selected consolidated statements of earnings data as a percentage of net sales for each period indicated:

	Three-Months Ending				Six-Months Ending			
	March 31, 2012	% of Net Sales	March 31, 2011	% of Net Sales	March 31, 2012	% of Net Sales	March 31, 2011	% of Net Sales
Net sales	$ 468,793	100%	$ 418,866	100%	$ 876,689	100%	$ 783,941	100%
Costs and expenses:								
Cost of goods sold	322,492	68.8	292,520	69.8	606,902	69.2	553,697	70.6
Selling, general, and administrative expenses	40,788	8.7	38,445	9.2	79,358	9.1	71,111	9.1
Research and development costs	37,445	8.0	27,050	6.5	68,239	7.8	50,788	6.5
Amortization of intangible assets	8,294	1.8	8,542	2.0	16,552	1.9	17,085	2.2
Interest expense	6,552	1.4	6,299	1.5	12,860	1.5	12,800	1.6
Interest income	(84)	0.0	(85)	0.0	(210)	0.0	(208)	0.0
Other (income) expense, net	(732)	(0.2)	(392)	(0.1)	(1,226)	(0.1)	706	0.1
Total costs and expenses	414,755	88.5	372,379	88.9	782,475	89.3	705,979	90.1
Earnings before income taxes	54,038	11.5	46,487	11.1	94,214	10.7	77,962	9.9
Income tax expense	15,287	3.3	14,397	3.4	27,046	3.1	23,473	3.0
Net earnings	$ 38,751	8.3	$ 32,090	7.7	$ 67,168	7.7	$ 54,489	7.0

Other select financial data:

	March 31, 2012	September 30, 2011
Working capital	$ 607,087	$ 536,936
Short-term borrowings	32,500	
Total debt	443,228	425,249
Total stockholders equity	988,010	919,097

Net Sales

Consolidated net sales for the second quarter and first half of fiscal 2012 increased by $49,927, or 11.9%, and $92,748, or 11.8%, respectively, compared to the same periods of fiscal 2011. Details of the changes in consolidated net sales are as follows:

	Three-Month Period	Six-Month Period
Consolidated net sales for the period ending March 31, 2011	$ 418,866	$ 783,941
Aerospace volume changes	14,607	22,309
Energy volume changes	33,217	63,066
Price changes	4,963	9,888
Effects of changes in foreign currency rates	(2,860)	(2,515)
Consolidated net sales for the period ending March 31, 2012	$ 468,793	$ 876,689

The increase in net sales for the second quarter and first half of fiscal 2012 was primarily attributable to sales volume increases across both of our segments. Net sales increases in our Aerospace segment were primarily attributable to commercial and military aftermarket and commercial original equipment manufacturer (OEM) sales. Control systems for wind turbines and industrial gas turbines were leading contributors to increased sales in our Energy segment.

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Price changes: Increases in selling prices were driven primarily by price increases related to both OEM and aftermarket sales within our Aerospace segment. Selling prices in the Energy segment were relatively unchanged from the prior year, consistent with prevailing market conditions.

Foreign currency exchange rates: During the second quarter and first half of fiscal 2012, our net sales were negatively impacted by $2,860 and $2,515, respectively, due to changes in foreign currency exchange rates compared to the same periods of fiscal 2011.

Our worldwide sales activities are primarily denominated in U.S. Dollars (USD), European Monetary Units (the Euro), Great Britain Pounds (GBP), Japanese Yen (JPY), Chinese Yuan (CNY), and Swiss Francs (CHF). As the USD, Euro, GBP, JPY, CNY, and CHF fluctuate against each other and other currencies, we are exposed to gains or losses on sales transactions. If the CNY, which the Chinese government has not historically allowed to fluctuate significantly against USD, is allowed to fluctuate against USD in the future, we would be exposed to gains or losses on sales transactions denominated in CNY. For additional information on foreign currency exchange rate risk please refer to the risks summarized under the caption Risk Factors in Part I, Item 1A of our most recent Form 10-K.

Costs and Expenses

Cost of goods sold increased by $29,972 to $322,492 for the second quarter of fiscal 2012 from $292,520 for the second quarter of fiscal 2011. Cost of goods sold increased to $606,902 for the first half of fiscal 2012 from $553,697 for the first half of 2011. Gross margins (as measured by net sales less cost of goods sold, divided by net sales) increased to 31.2% and 30.8% for the second quarter and first half of fiscal 2012, respectively, compared to 30.2% and 29.4%, respectively, for the same periods of the prior year. The increase in gross margins is due primarily to favorable prices and sales mix realized by our Aerospace segment.

Selling, general, and administrative expenses increased by $2,343, or 6.1%, to $40,788 for the second quarter of fiscal 2012 as compared to $38,445 for the same period of fiscal 2011. Selling, general and administrative expenses decreased as a percentage of net sales to 8.7% for the second quarter of fiscal 2012 as compared to 9.2% for the same period of fiscal 2011. Selling, general, and administrative expenses increased by $8,247, or 11.6%, to $79,358 for the first half of fiscal 2012 as compared to $71,111 for the same period of fiscal 2011. Selling, general, and administrative expenses as a percentage of net sales remained flat at 9.1% for both the first half of fiscal 2012 and fiscal 2011. The increase in selling, general and administrative expenses in both comparable periods is due to increases in employee related costs and other costs to support our sales growth.

Research and development costs increased by $10,395, or 38.4%, to $37,445 for the second quarter of fiscal 2012 as compared to $27,050, for the same period of fiscal 2011. Research and development costs increased by $17,451, or 34.4%, to $68,239 for the first half of fiscal 2012 as compared to $50,788 for the same period of fiscal 2011. Research and development costs increased as a percentage of sales to 8.0% and 7.8% for the second quarter and first half of fiscal 2012, respectively, as compared to 6.5% for both the second quarter and the first half of fiscal 2011. The increase in research and development costs is primarily due to increased investment related to our pursuit of new and awarded customer programs and market share gains in most of our markets, particularly those within our Aerospace segment. Our research and development activities extend across almost all of our customer base. We anticipate that our research and development costs as a percent of net sales in each of the third and fourth quarters of fiscal 2012 will be slightly lower than the second quarter of fiscal 2012.

Amortization of intangible assets decreased slightly to $8,294 and $16,552 for the second quarter and first half of fiscal 2012, respectively, compared to $8,542 and $17,085 for the same periods in fiscal 2011. As a percentage of net sales, amortization of intangible assets decreased to 1.8% and 1.9% for the second quarter and first half of fiscal 2012, respectively, as compared to 2.0% and 2.2% for the same periods of the prior year.

Interest expense increased slightly to $6,552 and $12,860 for the second quarter and first half of fiscal 2012, respectively, compared to $6,299 and $12,800 for the same periods in fiscal 2011. As a percentage of net sales, interest expense decreased to 1.4% and 1.5% for the second quarter and first half of fiscal 2012, respectively, from 1.5% and 1.6% for the same periods of the prior year.

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Income taxes were provided at an effective rate on earnings before income taxes of 28.3% and 28.7% for the second quarter and first half of fiscal 2012, respectively, compared to 31.0% and 30.1% for the same periods of fiscal 2011. The reductions in the effective tax rates for the second quarter and first half of fiscal 2012 each contributed $0.02 to earnings per diluted share when compared to the same periods of the prior fiscal year. The change in the effective tax rate (as a percentage of earnings before income taxes) was attributable to the following:

	Three-Month Period	Six-Month Period
Effective tax rate for the period ending March 31, 2011	31.0%	30.1%
Repatriation reserve change	(6.2)	(3.5)
Research credit in fiscal 2011 as compared to fiscal 2012	1.6	2.5
Adjustment of tax issues recorded in the period ending March 31, 2011	1.6	0.2
Adjustment of tax issues recorded in the period ending March 31, 2012	(0.1)	(0.9)
Domestic production activities deduction	(0.6)	(0.6)
Foreign tax rate differences	1.0	1.0
Other changes, net		(0.1)
Effective tax rate for the period ending March 31, 2012	28.3%	28.7%

During the second quarter of fiscal 2012, we reevaluated our strategic alternatives in various international markets and determined that a portion of the undistributed earnings of certain of our foreign subsidiaries that were previously expected to be repatriated into the U.S. within the foreseeable future will remain indefinitely invested outside the U.S. to support the growth of our foreign operations. We accordingly reversed the deferred tax liability associated with repatriating those earnings, resulting in a tax benefit of $3,326, or 6.2% and 3.5% of earnings before income taxes, respectively, for the three and six-months ending March 31, 2012.

On December 17, 2010, legislation was enacted that retroactively extended the U.S. research tax credit, which had expired as of December 31, 2009. As a result of this extension, we recognized a net tax benefit of $1,890 in the first quarter of fiscal 2011 related to the prior year impact. The credit expired again as of December 31, 2011.

Segment Results

In September 2011, we reorganized our reportable segments to better align with our markets. We now have two reportable segments Aerospace and Energy. Both of our reportable segments are comprised of multiple business groups, which focus on particular applications within the aerospace and energy markets. Our Aerospace segment combines the aircraft propulsion portion of the former Turbine Systems business group, now referred to as the Aircraft Turbine Systems business group, with our Airframe Systems business group. Our Energy segment combines the industrial turbine portion of the former Turbine Systems business group, now referred to as the Industrial Turbomachinery Systems business group, with our Engine Systems and Electrical Power Systems business groups.

Prior period segment information has been retrospectively revised to be consistent with our current reportable segment structure, which is based on how we managed our business as of September 30, 2011 and during the first half of fiscal 2012.

The following table presents sales by segment:

	Three-Months Ending March 31,				Six-Months Ending March 31,			
	2012		2011		2012		2011	
External net sales:								
Aerospace	$ 224,337	47.9%	$ 204,945	48.9%	$ 417,563	47.6%	$ 386,089	49.2%
Energy	244,456	52.1	213,921	51.1	459,126	52.4	397,852	50.8
Consolidated net sales	$ 468,793	100.0%	$ 418,866	100.0%	$ 876,689	100.0%	$ 783,941	100.0%

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The following table presents earnings by segment:

	Three-Months Ending March 31, 2012	Three-Months Ending March 31, 2011	Six-Months Ending March 31, 2012	Six-Months Ending March 31, 2011
Aerospace	$ 33,681	$ 33,241	$ 60,741	$ 53,155
Energy	34,334	26,941	61,059	51,444
Total segment earnings	68,015	60,182	121,800	104,599
Nonsegment expenses	(7,509)	(7,481)	(14,936)	(14,045)
Interest expense, net	(6,468)	(6,214)	(12,650)	(12,592)
Consolidated earnings before income taxes	54,038	46,487	94,214	77,962
Income tax expense	(15,287)	(14,397)	(27,046)	(23,473)
Consolidated net earnings	$ 38,751	$ 32,090	$ 67,168	$ 54,489

The following table presents earnings by segment as a percentage of segment net sales:

	Three-Months Ending March 31, 2012	Three-Months Ending March 31, 2011	Six-Months Ending March 31, 2012	Six-Months Ending March 31, 2011