

Woodward, Inc.
Form 10-Q
January 25, 2017
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2016

or

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

For the transition period from _____ to _____

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

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

1081 Woodward Way, Fort Collins, Colorado 80524
(Address of principal executive offices) (Zip Code)
(970) 482-5811

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

Yes No

As of January 23, 2017, 61,439,846 shares of the registrant’s common stock with a par value of \$0.001455 per share were outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share amounts)

(Unaudited)

| | Three-Months Ended December 31, | |
|--|------------------------------------|------------|
| | 2016 | 2015 |
| Net sales | \$ 442,894 | \$ 445,110 |
| Costs and expenses: | | |
| Cost of goods sold | 327,194 | 333,377 |
| Selling, general and administrative expenses | 33,796 | 40,782 |
| Research and development costs | 26,540 | 31,597 |
| Amortization of intangible assets | 6,458 | 6,946 |
| Interest expense | 6,840 | 6,908 |
| Interest income | (405) | (447) |
| Other (income) expense, net (Note 15) | (4,588) | (2,009) |
| Total costs and expenses | 395,835 | 417,154 |
| Earnings before income taxes | 47,059 | 27,956 |
| Income tax expense | 511 | 2,136 |
| Net earnings | \$ 46,548 | \$ 25,820 |
| Earnings per share (Note 3): | | |
| Basic earnings per share | \$ 0.76 | \$ 0.41 |
| Diluted earnings per share | \$ 0.73 | \$ 0.40 |
| Weighted Average Common Shares Outstanding (Note 3): | | |
| Basic | 61,559 | 63,054 |
| Diluted | 63,671 | 64,452 |

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Cash dividends per share paid to Woodward common stockholders \$ 0.11 \$ 0.10

See accompanying Notes to Condensed Consolidated Financial Statements

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

| | Three-Months Ended December 31, | |
|-------------------------------|------------------------------------|-----------|
| | 2016 | 2015 |
| Net earnings | \$ 46,548 | \$ 25,820 |
| Other comprehensive earnings: | | |

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| | | |
|--|-----------|-----------|
| Foreign currency translation adjustments | (18,635) | (10,254) |
| Gain on foreign currency transactions designated as hedges of net investments in foreign subsidiaries (Note 6) | 3,830 | 862 |
| Taxes on changes in foreign currency translation adjustments | (306) | 306 |
| Foreign currency translation and transactions adjustments, net of tax | (15,111) | (9,086) |
| Reclassification of net realized (gains) losses on derivatives to earnings (Note 6) | (18) | 29 |
| Taxes on changes in derivative transactions | 7 | (11) |
| Derivative adjustments, net of tax | (11) | 18 |
| Amortization of: | | |
| Net prior service cost | 56 | 56 |
| Net loss | 641 | 427 |
| Foreign currency exchange rate changes on minimum retirement benefit liabilities | 1,255 | 284 |
| Taxes on changes in minimum retirement liability adjustments, net of foreign currency exchange rate changes | (693) | (286) |
| Pension and other postretirement benefit plan adjustments, net of tax | 1,259 | 481 |
| Total comprehensive earnings | \$ 32,685 | \$ 17,233 |

See accompanying Notes to Condensed Consolidated Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

| | December 31, 2016 | September 30, 2016 |
|--|-------------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 80,885 | \$ 81,090 |
| Accounts receivable, less allowance for uncollectible amounts of \$2,641 and \$2,540, respectively | 252,761 | 343,768 |
| Inventories | 493,764 | 461,683 |
| Income taxes receivable | 23,129 | 20,358 |
| Other current assets | 34,257 | 37,525 |
| Total current assets | 884,796 | 944,424 |
| Property, plant and equipment, net | 877,077 | 876,350 |
| Goodwill | 553,300 | 555,684 |
| Intangible assets, net | 190,933 | 197,650 |
| Deferred income tax assets | 18,963 | 20,194 |
| Other assets | 51,146 | 48,060 |
| Total assets | \$ 2,576,215 | \$ 2,642,362 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings and current portion of long-term debt | \$ 150,000 | \$ 150,000 |
| Accounts payable | 149,280 | 169,439 |
| Income taxes payable | 1,374 | 4,547 |
| Accrued liabilities | 115,823 | 156,627 |
| Total current liabilities | 416,477 | 480,613 |
| Long-term debt, less current portion | 569,878 | 577,153 |
| Deferred income tax liabilities | 9,063 | 3,777 |
| Other liabilities | 358,429 | 368,224 |
| Total liabilities | 1,353,847 | 1,429,767 |
| Commitments and contingencies (Note 19) | | |
| Stockholders' equity: | | |

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| | | |
|---|--------------|--------------|
| 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 | 142,664 | 141,570 |
| Accumulated other comprehensive losses | (79,568) | (65,705) |
| Deferred compensation | 6,889 | 5,089 |
| Retained earnings | 1,689,275 | 1,649,506 |
| | 1,759,366 | 1,730,566 |
| Treasury stock at cost, 11,559 shares and 11,374 shares, respectively | (530,109) | (512,882) |
| Treasury stock held for deferred compensation, at cost, 183 shares and 157 shares, respectively | (6,889) | (5,089) |
| Total stockholders' equity | 1,222,368 | 1,212,595 |
| Total liabilities and stockholders' equity | \$ 2,576,215 | \$ 2,642,362 |

See accompanying Notes to Condensed Consolidated Financial Statements.

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Three-Months Ended December 31, | |
|---|------------------------------------|-----------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 46,548 | \$ 25,820 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,913 | 17,062 |
| Net gain on sales of assets | (3,699) | (1,602) |
| Stock-based compensation | 1,261 | 8,451 |
| Deferred income taxes | 4,777 | 9,768 |
| (Gain) loss on derivatives reclassified from accumulated comprehensive earnings into earnings | (18) | 29 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 87,615 | 74,717 |
| Inventories | (37,632) | (25,091) |
| Accounts payable and accrued liabilities | (54,563) | (56,816) |
| Current income taxes | (5,731) | (10,517) |
| Retirement benefit obligations | (897) | (874) |
| Other | (4,223) | (3,587) |
| Net cash provided by operating activities | 52,351 | 37,360 |
| Cash flows from investing activities: | | |
| Payments for purchase of property, plant, and equipment | (21,058) | (33,131) |
| Net proceeds from sale of assets | 3,682 | 1,852 |
| Proceeds from sales of short-term investments | 758 | - |
| Net cash used in investing activities | (16,618) | (31,279) |
| Cash flows from financing activities: | | |
| Cash dividends paid | (6,779) | (6,321) |
| Proceeds from sales of treasury stock | 4,843 | 1,252 |
| Payments for repurchases of common stock | (24,004) | (30,712) |

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| | | |
|---|-----------|-----------|
| Borrowings on revolving lines of credit and short-term borrowings | 316,650 | 220,000 |
| Payments on revolving lines of credit and short-term borrowings | (312,800) | (135,598) |
| Payments of long-term debt and capital lease obligations | (102) | (50,000) |
| Net cash used in financing activities | (22,192) | (1,379) |
| Effect of exchange rate changes on cash and cash equivalents | (13,746) | (2,482) |
| Net change in cash and cash equivalents | (205) | 2,220 |
| Cash and cash equivalents at beginning of year | 81,090 | 82,202 |
| Cash and cash equivalents at end of period | \$ 80,885 | \$ 84,422 |

See accompanying No

See accompanying Notes to Condensed Consolidated Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

(Unaudited)

| | Number of shares | | | Stockholders' equity | | | | | | Total accumulated other comprehensive (loss) earnings |
|---|------------------|--------------|----------------|---|--------------|----------------------------|--|--------------------------------------|--|---|
| | Preferred stock | Common stock | Treasury stock | Treasury stock held for deferred compensation | Common stock | Additional paid-in capital | Foreign currency translation adjustments | Unrealized derivative gains (losses) | Minimum retirement benefit liability adjustments | |
| Balances as of October 1, 2015 | - | 72,960 | (9,763) | (173) | \$ 106 | \$ 131,231 | \$ (21,610) | \$ 166 | \$ (30,014) | \$ (51,164) |
| Net earnings | - | - | - | - | - | - | - | - | - | - |
| Other comprehensive income (loss), net of tax | - | - | - | - | - | - | (9,086) | 18 | 481 | (8,587) |
| Cash dividends paid (\$0.10 per share) | - | - | - | - | - | - | - | - | - | - |
| Purchases of treasury stock | - | - | (624) | - | - | - | - | - | - | - |
| Sales of treasury stock | - | - | 49 | - | - | (406) | - | - | - | - |
| Stock-based compensation | - | - | - | - | - | 8,451 | - | - | - | - |
| Purchases of stock by deferred compensation plan | - | - | - | (21) | - | - | - | - | - | - |
| Distribution of stock from deferred compensation plan | - | - | - | (1) | - | - | - | - | - | - |

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| | | | | | | | | | | |
|---|---|--------|----------|-------|--------|------------|-------------|--------|-------------|---------|
| Balances as of December 31, 2015 | - | 72,960 | (10,338) | (195) | \$ 106 | \$ 139,276 | \$ (30,696) | \$ 184 | \$ (29,533) | \$ (60, |
| Balances as of October 1, 2016 | - | 72,960 | (11,374) | (157) | \$ 106 | \$ 141,570 | \$ (25,971) | \$ 179 | \$ (39,913) | \$ (65, |
| Net earnings | - | - | - | - | - | - | - | - | - | - |
| Other comprehensive income (loss), net of tax | - | - | - | - | - | - | (15,111) | (11) | 1,259 | (13, |
| Cash dividends paid (\$0.11 per share) | - | - | - | - | - | - | - | - | - | - |
| Purchases of treasury stock | - | - | (350) | - | - | - | - | - | - | - |
| Sales of treasury stock | - | - | 139 | - | - | (907) | - | - | - | - |
| Common shares issued from treasury stock to settle employee liabilities | - | - | 26 | (26) | - | 740 | - | - | - | - |
| Stock-based compensation | - | - | - | - | - | 1,261 | - | - | - | - |
| Purchases and transfers of stock by/to deferred compensation plan | - | - | - | - | - | - | - | - | - | - |
| Distribution of stock from deferred compensation plan | - | - | - | - | - | - | - | - | - | - |
| Balances as of December 31, 2016 | - | 72,960 | (11,559) | (183) | \$ 106 | \$ 142,664 | \$ (41,082) | \$ 168 | \$ (38,654) | \$ (79, |

See accompanying Notes to Condensed Consolidated Financial Statements

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 December 31, 2016 and for the three-months ended December 31, 2016 and December 31, 2015, 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 December 31, 2016, and the statements of earnings, comprehensive earnings, cash flows, and changes in stockholders’ equity for the periods presented herein. The results of operations for the three-months ended December 31, 2016 are not necessarily indicative of the operating results to be expected for other interim periods or for the full fiscal year. Dollar and share 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 amounts of assets and liabilities at the date of the financial statements, the reported revenues and expenses recognized during the reporting period, and certain financial statement disclosures, in the preparation of the Condensed Consolidated Financial Statements included herein. Significant estimates in these Condensed Consolidated Financial Statements include allowances for uncollectible amounts, net realizable value of inventories, customer rebates earned and payable, warranty reserves, useful lives of property and identifiable intangible assets, the evaluation of impairments of property, the provision for income tax and related valuation reserves, assumptions used in the determination of the funded status and annual expense of pension and postretirement employee benefit plans, the valuation of stock compensation instruments granted to employees and board members, and contingencies. Actual results could vary from Woodward’s estimates.

Note 2. New accounting standards

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

In October 2016, the FASB issued ASU 2016-16, “Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory.” ASU 2016-16 eliminates the current U.S. GAAP exception deferring the tax effects of intercompany asset transfers (other than inventory) until the transferred asset is sold to a third party or otherwise recovered through use. After adoption of ASU 2016-16, Woodward will recognize the tax consequences of intercompany asset transfers in the buyer’s and seller’s tax jurisdictions when the transfer occurs, even though the pre-tax effects of these transactions are eliminated in consolidation. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017 (fiscal year 2019 for Woodward), including interim periods within the year of adoption. Early adoption is allowed only in the first quarter of fiscal year 2017 or the first quarter of fiscal year 2018. Modified retrospective adoption is required with any cumulative-effect adjustment recorded to retained earnings as of the beginning of the period of adoption. Woodward is currently assessing the impact this guidance may have on its Condensed Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, “Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 adds a current expected credit loss (“CECL”) impairment model to U.S. GAAP that is based on expected losses rather than incurred losses. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019 (fiscal year 2021 for Woodward), including interim periods within the year of adoption. Early adoption is permitted for fiscal years beginning after December 15, 2018 (fiscal year 2020 for Woodward), including interim periods within those fiscal years. Woodward has not determined in which period it will adopt the new guidance but does not expect the application of the CECL impairment model to have a significant impact on Woodward’s allowance for uncollectible amounts for accounts receivable and notes receivable from municipalities.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The purpose of ASU 2016-02 is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (fiscal year 2020 for Woodward), including interim periods within the year of adoption. In transition, Woodward will be required to recognize and measure leases beginning in the earliest period presented using a modified retrospective approach; therefore, Woodward anticipates restating its Consolidated Financial Statements for the two fiscal years prior to the year of adoption. Early adoption is permitted. Woodward has not determined in which period it will adopt the new guidance and is currently assessing the impact this guidance may have on its Consolidated Financial Statements, including which of its existing operating leases will be impacted by the new guidance. Rent expense for all operating leases in fiscal year 2016, none of which was recognized on the balance sheet, was \$7,359. As of September 30, 2016, future minimum rental payments required under operating leases, none of which were recognized on the balance sheet, were \$15,612.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" and has subsequently issued several supplemental and/or clarifying ASUs (collectively "ASC 606"). ASC 606 prescribes a single common revenue standard that replaces most existing U.S. GAAP revenue recognition guidance. ASC 606 outlines a five-step model, under which Woodward will recognize revenue as performance obligations within a customer contract are satisfied. ASC 606 is intended to provide more consistent interpretation and application of the principles outlined in the standard across filers in multiple industries and within the same industries compared to current practices, which should improve comparability. Adoption of ASC 606 is required for annual reporting periods beginning after December 15, 2017 (fiscal year 2019 for Woodward), including interim periods within the reporting period. Woodward may elect to adopt ASC 606 in fiscal year 2018, but does not expect to do so. Upon adoption, Woodward must elect to adopt either retrospectively to each prior reporting period presented or using the cumulative effect transition method with the cumulative effect of initial adoption recognized at the date of initial application. Woodward has not determined what transition method it will use.

Woodward is currently assessing the impact that the future adoption of ASC 606 may have on its Consolidated Financial Statements by analyzing its current portfolio of customer contracts, including a review of historical accounting policies and practices to identify potential differences in applying the guidance of ASC 606. Based on Woodward's preliminary review of its customer contracts, Woodward expects that revenue on the majority of its customer contracts will continue to be recognized at a point in time, generally upon shipment of products, consistent with Woodward's current revenue recognition model. Upon adoption of ASC 606, however, Woodward also believes some of its revenues from sales of products and services to customers will be recognized over time, rather than at a point in time, due to the terms of certain customer contracts. Related to recognizing some revenue over time, inventory levels and accounts receivable balances will be impacted. As such, Woodward believes the adoption of ASC 606 may have an impact on both the timing of revenue recognition and various line items within the Consolidated Balance Sheet.

Note 3. Earnings per share

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

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

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

| | Three-Months Ended December 31, | |
|---|------------------------------------|-----------|
| | 2016 | 2015 |
| Numerator: | | |
| Net earnings | \$ 46,548 | \$ 25,820 |
| Denominator: | | |
| Basic shares outstanding | 61,559 | 63,054 |
| Dilutive effect of stock options and restricted stock | 2,112 | 1,398 |
| Diluted shares outstanding | 63,671 | 64,452 |
| Income per common share: | | |
| Basic earnings per share | \$ 0.76 | \$ 0.41 |
| Diluted earnings per share | \$ 0.73 | \$ 0.40 |

There were no stock option grants outstanding during the three-months ended December 31, 2016 or 2015 that were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive.

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

| | Three-Months Ended December 31, | |
|---|---------------------------------------|------|
| | 2016 | 2015 |
| Weighted-average treasury stock shares held for deferred compensation obligations | 170 | 184 |

Note 4. Joint venture

On January 4, 2016, Woodward and General Electric Company (“GE”), acting through its GE Aviation business unit, consummated the formation of a strategic joint venture between Woodward and GE (the “JV”). The JV designs, develops and sources the fuel system for specified existing and all future GE commercial aircraft engines that produce thrust in excess of fifty thousand pounds.

As part of the JV formation, Woodward contributed to the JV certain contractual rights and intellectual property applicable to the existing GE commercial aircraft engine programs within the scope of the JV. Woodward has no initial cost basis in the JV because Woodward had no cost basis in the contractual rights and intellectual property contributed to the JV. GE purchased from Woodward a 50% ownership interest in the JV for a \$250,000 cash payment to Woodward. In addition, GE will pay contingent consideration to Woodward consisting of fifteen annual payments of \$4,894 per year beginning January 4, 2017 subject to certain claw-back conditions. Neither Woodward nor GE contributed any tangible assets to the JV.

Woodward determined that the JV formation was not the culmination of an earnings event because Woodward has significant performance obligations to support the future operations of the JV. Therefore, Woodward recorded the \$250,000 consideration received from GE, in January of 2016, for its purchase of a 50% equity interest in the JV as deferred income. The \$250,000 deferred income will be recognized as an increase to net sales in proportion to revenue realized on sales of applicable fuel systems within the scope of the JV in a particular period as a percentage of total revenue expected to be realized by Woodward over the estimated remaining lives of the underlying commercial aircraft engine programs assigned to the JV. Unamortized deferred income realized upon the JV formation included accrued liabilities of \$6,452 as of December 31, 2016 and \$6,552 as of September 30, 2016, and other liabilities of \$236,791 as of December 31, 2016 and \$238,187 as of September 30, 2016. Amortization of the deferred income recognized as an increase to sales was \$1,496 for the three-months ended December 31, 2016.

Woodward and GE jointly manage the JV and any significant decisions and/or actions of the JV require the mutual consent of both parties. Neither Woodward nor GE has a controlling financial interest in the JV, but both Woodward and GE do have the ability to significantly influence the operating and financial decisions of the JV. Therefore, Woodward is accounting for its 50% ownership interest in the JV using the equity method of accounting. The JV is a related party to

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Woodward. Other income includes \$684 for the three-months ended December 31, 2016 related to Woodward's equity interest in the earnings of the JV. During the three-months ended December 31, 2016, Woodward received no cash distributions from the JV. Woodward's net investment in the JV, which is included in other assets, was \$6,888 as of December 31, 2016.

During the three-months ended December 31, 2016, Woodward's net sales include \$15,302 of sales to the JV and a reduction to sales of \$5,403 related to royalties paid to the JV by Woodward on sales by Woodward directly to third party aftermarket customers. The Condensed Consolidated Balance Sheets, included "Accounts receivable" of \$5,145 at December 31, 2016 and \$5,326 at September 30, 2016 related to amounts the JV owed Woodward, and included "Accounts payable" of \$5,012 at December 31, 2016 and \$3,926 at September 30, 2016 related to amounts Woodward owed the JV.

Note 5. Financial instruments and fair value measurements

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

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

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

Level 3: Inputs that 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 December 31, 2016 or September 30, 2016.

| | At December 31, 2016 | | | | At September 30, 2016 | | | |
|---|----------------------|---------|---------|-----------|-----------------------|---------|---------|-----------|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Financial assets: | | | | | | | | |
| Cash | \$ 71,894 | \$ - | \$ - | \$ 71,894 | \$ 80,959 | \$ - | \$ - | \$ 80,959 |
| Investments in money market funds | - | - | - | - | 48 | - | - | 48 |
| Investments in reverse repurchase agreements | 313 | - | - | 313 | 83 | - | - | 83 |
| Investments in term deposits with foreign banks | 8,678 | - | - | 8,678 | 7,136 | - | - | 7,136 |
| Equity securities | 14,603 | - | - | 14,603 | 12,491 | - | - | 12,491 |

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Total financial assets \$ 95,488 \$ - \$ - \$ 95,488 \$ 100,717 \$ - \$ - \$ 100,717

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

Investments in reverse repurchase agreements: Woodward sometimes invests excess cash in reverse repurchase agreements. Under the terms of Woodward’s reverse repurchase agreements, Woodward purchases an interest in a pool of securities and is granted a security interest in those securities by the counterparty to the reverse repurchase agreement. At an agreed upon date, generally the next business day, the counterparty repurchases Woodward’s interest in the pool of securities at a price equal to what Woodward paid to the counterparty plus a rate of return determined daily per the terms of the reverse repurchase agreement. Woodward believes that the investments in these reverse repurchase agreements are with creditworthy financial institutions and that the funds invested are highly liquid. The investments in reverse repurchase agreements are reported at fair value, with realized gains from interest income recognized in earnings, and are included in “Cash and cash equivalents.” Since the investments are generally overnight, the carrying value is considered to be equal to the fair value as the amount is deemed to be a cash deposit with no risk of change in value as of the end of each fiscal quarter.

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Investments in term deposits with foreign banks: Woodward's foreign subsidiaries sometimes invest excess cash in various highly liquid financial instruments that Woodward believes are with creditworthy financial institutions. Such investments are reported in "Cash and cash equivalents" at fair value, with realized gains from interest income recognized in earnings. The carrying value of Woodward's investments in term deposits with foreign banks are considered equal to the fair value given the highly liquid nature of the investments.

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

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

| | Fair Value Hierarchy Level | At December 31, 2016 | | At September 30, 2016 | |
|---|----------------------------|----------------------|---------------|-----------------------|---------------|
| | | Estimated Fair Value | Carrying Cost | Estimated Fair Value | Carrying Cost |
| Assets: | | | | | |
| Notes receivable from municipalities | 2 | \$ 16,201 | \$ 15,229 | \$ 17,501 | \$ 15,849 |
| Investments in short-term time deposits | 2 | 4,065 | 4,084 | 4,882 | 4,918 |
| Liabilities: | | | | | |
| Short-term borrowings | 2 | (150,000) | (150,000) | (150,000) | (150,000) |
| Long-term debt, excluding current portion | 2 | \$ (590,556) | \$ (571,852) | \$ (617,857) | \$ (579,244) |

In fiscal years 2014 and 2013, Woodward received long-term notes from municipalities within the states of Illinois and Colorado in connection with certain economic incentives related to Woodward's development of a second campus in the greater-Rockford, Illinois area for its Aerospace segment and Woodward's development of a new campus at its corporate headquarters in Fort Collins, Colorado. The fair value of the long-term notes was estimated based on a model that discounted future principal and interest payments received at an interest rate available to the Company at the end of the period for similarly rated municipal notes of similar maturity, which is a level 2 input as defined by the U.S. GAAP fair value hierarchy. The interest rates used to estimate the fair value of the long-term notes were 2.9% at December 31, 2016 and 2.2% at September 30, 2016.

From time to time, certain of Woodward's foreign subsidiaries will invest excess cash in short-term time deposits with a fixed maturity date of longer than three months but less than one year from the date of the deposit. Woodward believes that the investments are with creditworthy financial institutions. The fair value of the investments in short-term time deposits was estimated based on a model that discounted future principal and interest payments to be received at an interest rate available to the foreign subsidiary entering into the investment for similar short-term time

deposits of similar maturity. This is determined to be a level 2 input as defined by the U.S. GAAP fair value hierarchy. The interest rate used to estimate the fair value of the short-term time deposits was 6.6% at December 31, 2016 and 6.9% at September 30, 2016.

The fair value of long-term debt was estimated based on a model that discounted future principal and interest payments at interest rates available to the Company at the end of the period for similar debt of the same maturity, which is a level 2 input as defined by the U.S. GAAP fair value hierarchy. The weighted-average interest rates used to estimate the fair value of long-term debt were 2.4% at December 31, 2016 and 1.9% at September 30, 2016.

Note 6. Derivative instruments and hedging activities

Woodward has exposures related 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.

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

Woodward did not enter into any derivatives or hedging transactions during the three-months ended December 31, 2016.

The remaining unrecognized gains and losses in Woodward's Condensed Consolidated Balance Sheets associated with derivative instruments that were previously entered into by Woodward, which are classified in accumulated other comprehensive (losses) earnings ("accumulated OCI"), were net gains of \$272 as of December 31, 2016 and \$290 as of September 30, 2016.

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

| | Three-Months Ended December 31, | |
|---|---------------------------------------|-------|
| | 2016 | 2015 |
| Amount of (income) expense recognized in earnings on derivative | \$ (18) | \$ 29 |
| Amount of (gain) loss recognized in accumulated OCI on derivative | - | - |
| Amount of (gain) loss reclassified from accumulated OCI into earnings | (18) | 29 |

Based on the carrying value of the realized but unrecognized gains on terminated derivative instruments designated as cash flow hedges as of December 31, 2016, Woodward expects to reclassify \$72 of net unrecognized gains on terminated derivative instruments from accumulated other comprehensive (losses) earnings to earnings during the next twelve months.

On September 23, 2016, Woodward and Woodward International Holding B.V., a wholly owned subsidiary of Woodward organized under the laws of The Netherlands (the "BV Subsidiary"), each entered into a note purchase agreement (the "2016 Note Purchase Agreements") relating to the sale by Woodward and the BV Subsidiary of an aggregate principal amount of €160,000 of senior unsecured notes in a series of private placement transactions. Woodward issued €40,000 aggregate principal amount of Woodward's Series M Senior Notes due September 23, 2026. Woodward designated the €40,000 Series M Notes as a hedge of a foreign currency exposure of Woodward's net investment in its Euro denominated functional currency subsidiaries. A foreign exchange gain on the Series M Notes of \$2,814 for the three-months ended December 31, 2016 is included in foreign currency translation adjustments within total comprehensive (losses) earnings.

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In June 2015, Woodward designated an intercompany loan of 160,000 Renminbi (“RMB”) between two wholly owned subsidiaries as a hedge of a foreign currency exposure of the net investment of the borrower in the lender. Unrealized foreign exchange gains on the loan of \$862 is included in foreign currency translation adjustments within total comprehensive earnings for the three-months ended December 31, 2015. In June 2016, the intercompany loan was repaid.

In July 2016, Woodward designated a new intercompany loan of 160,000 RMB between two wholly owned subsidiaries as a hedge of a foreign currency exposure of the net investment of the borrower in the lender. Unrealized foreign exchange gains on the loan of \$1,016 for the three-months ended December 31, 2016 are included in foreign currency translation adjustments within total comprehensive (losses) earnings.

Note 7. Supplemental statement of cash flows information

| | Three-Months Ended December 31, | |
|---|------------------------------------|-----------|
| | 2016 | 2015 |
| Interest paid, net of amounts capitalized | \$ 10,317 | \$ 14,878 |
| Income taxes paid | 6,047 | 3,667 |
| Income tax refunds received | 59 | 913 |
| Non-cash activities: | | |
| Purchases of property, plant and equipment on account | 6,130 | 26,666 |
| Common shares issued from treasury to settle employee liabilities | 1,767 | - |

Note 8. Inventories

| | December 31, 2016 | September 30, 2016 |
|---------------------|-------------------------|--------------------------|
| Raw materials | \$ 58,064 | \$ 54,246 |
| Work in progress | 111,908 | 109,756 |
| Component parts (1) | 269,456 | 249,307 |
| Finished goods | 54,336 | 48,374 |
| | \$ 493,764 | \$ 461,683 |

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

Note 9. Property, plant, and equipment

| | December 31, 2016 | September 30, 2016 |
|-------------------------------------|-------------------------|--------------------------|
| Land and land improvements | \$ 87,294 | \$ 87,696 |
| Buildings and building improvements | 525,710 | 527,704 |
| Leasehold improvements | 14,662 | 15,213 |
| Machinery and production equipment | 481,041 | 484,315 |
| Computer equipment and software | 122,418 | 117,984 |
| Office furniture and equipment | 29,133 | 29,344 |
| Other | 19,121 | 18,969 |
| Construction in progress | 92,516 | 88,909 |
| | 1,371,895 | 1,370,134 |
| Less accumulated depreciation | (494,818) | (493,784) |
| Property, plant, and equipment, net | \$ 877,077 | \$ 876,350 |

Included in "Office furniture and equipment" and "Other" is \$1,653 at December 31, 2016 and September 30, 2016, of gross assets acquired on capital leases, and accumulated depreciation included \$425 at December 31, 2016 and \$322 at September 30, 2016 of amortization associated with the capital lease assets.

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In fiscal year 2015, Woodward completed and placed into service a manufacturing and office building on a second campus in the greater-Rockford, Illinois area and has occupied the new facility in anticipation of beginning serial production of new narrow-body product lines beginning in fiscal year 2017 for its Aerospace segment. This campus is intended to support Woodward's expected growth in its Aerospace segment over the next ten years and beyond, required as a result of Woodward being awarded a substantial number of new system platforms, particularly on narrow-body aircraft. Included in "Construction in progress" are costs of \$34,207 at December 31, 2016 and \$26,741 at September 30, 2016 associated with new equipment purchases for the second campus.

For the three-months ended December 31, 2016 and 2015, Woodward had depreciation expense as follows:

| | Three-Months Ended | |
|----------------------|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Depreciation expense | \$ 12,455 | \$ 10,116 |

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For the three-months ended December 31, 2016 and 2015, Woodward capitalized interest that would have otherwise been included in interest expense of the following:

| | Three-Months Ended December 31, 2016 2015 | |
|----------------------|--|----------|
| Capitalized interest | \$ 472 | \$ 1,873 |

Note 10. Goodwill

| | September 30, 2016 | Effects of Foreign Currency Translation | December 31, 2016 |
|--------------|-----------------------|--|----------------------|
| Aerospace | \$ 455,423 | \$ - | \$ 455,423 |
| Industrial | 100,261 | (2,384) | 97,877 |
| Consolidated | \$ 555,684 | \$ (2,384) | \$ 553,300 |

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. Woodward completed its annual goodwill impairment test as of July 31, 2016 during the quarter ended September 30, 2016. Woodward determined it was appropriate to aggregate certain components of the same operating segment into a single reporting unit. The fair value of each of Woodward's reporting units was determined using a discounted cash flow method. This method represents a level 3 input and incorporates various estimates and assumptions, the most significant being projected revenue growth rates, earnings margins, future tax rates, and the present value, based on an estimated weighted-average cost of capital (or the discount rate) and terminal growth rate, of forecasted cash flows. Management projects revenue growth rates, earnings margins and cash flows based on each reporting unit's current operational results, expected performance and operational strategies over a ten-year period. These projections are adjusted to reflect current economic conditions and demand for certain products, and require considerable management judgment.

Forecasted cash flows used in the July 31, 2016 impairment test were discounted using weighted-average cost of capital assumptions ranging from 8.91% to 11.49%. The terminal values of the forecasted cash flows were calculated

using the Gordon Growth Model and assumed an annual compound growth rate after ten years of 3.71%. 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, 2016 did not indicate impairment of any of Woodward's reporting units.

Note 11. Intangible assets, net

| | December 31, 2016 | | | September 30, 2016 | | |
|---------------------------------------|----------------------|--------------------------|---------------------|----------------------|--------------------------|---------------------|
| | Gross Carrying Value | Accumulated Amortization | Net Carrying Amount | Gross Carrying Value | Accumulated Amortization | Net Carrying Amount |
| Customer relationships and contracts: | | | | | | |
| Aerospace | \$ 282,225 | \$ (138,408) | \$ 143,817 | \$ 282,225 | \$ (134,158) | \$ 148,067 |
| Industrial | 40,693 | (33,530) | 7,163 | 40,969 | (33,509) | 7,460 |
| Total | \$ 322,918 | \$ (171,938) | \$ 150,980 | \$ 323,194 | \$ (167,667) | \$ 155,527 |
| Intellectual property: | | | | | | |
| Aerospace | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Industrial | 19,156 | (17,734) | 1,422 | 19,435 | (17,876) | 1,559 |
| Total | \$ 19,156 | \$ (17,734) | \$ 1,422 | \$ 19,435 | \$ (17,876) | \$ 1,559 |
| Process technology: | | | | | | |
| Aerospace | \$ 76,605 | \$ (44,703) | \$ 31,902 | \$ 76,605 | \$ (43,229) | \$ 33,376 |
| Industrial | 22,596 | (16,344) | 6,252 | 22,965 | (16,200) | 6,765 |
| Total | \$ 99,201 | \$ (61,047) | \$ 38,154 | \$ 99,570 | \$ (59,429) | \$ 40,141 |
| Other intangibles: | | | | | | |
| Aerospace | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Industrial | 1,168 | (791) | 377 | 1,246 | (823) | 423 |
| Total | \$ 1,168 | \$ (791) | \$ 377 | \$ 1,246 | \$ (823) | \$ 423 |
| Total intangibles: | | | | | | |
| Aerospace | \$ 358,830 | \$ (183,111) | \$ 175,719 | \$ 358,830 | \$ (177,387) | \$ 181,443 |
| Industrial | 83,613 | (68,399) | 15,214 | 84,615 | (68,408) | 16,207 |
| Consolidated Total | \$ 442,443 | \$ (251,510) | \$ 190,933 | \$ 443,445 | \$ (245,795) | \$ 197,650 |

For the three-months ended December 31, 2016 and 2015, Woodward recorded amortization expense associated with intangibles of the following:

Three-Months
Ended
December 31,

| | 2016 | 2015 |
|----------------------|----------|----------|
| Amortization expense | \$ 6,458 | \$ 6,946 |

Future amortization expense associated with intangibles is expected to be:

| Year Ending September 30: | |
|---------------------------|------------|
| 2017 (remaining) | \$ 19,279 |
| 2018 | 24,907 |
| 2019 | 23,071 |
| 2020 | 20,332 |
| 2021 | 18,393 |
| Thereafter | 84,951 |
| | \$ 190,933 |

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

Revolving credit facility

Woodward maintains a \$1,000,000 revolving credit facility established under a revolving credit agreement among Woodward, a syndicate of lenders and Wells Fargo Bank, National Association, as administrative agent (the "Revolving Credit Agreement"). The Revolving Credit Agreement provides for the option to increase available borrowings to up to \$1,200,000, subject to lenders' participation. Borrowings under the Revolving Credit Agreement generally bear interest at LIBOR plus 0.85% to 1.65%. The Revolving Credit Agreement matures in April 2020. Under the Revolving Credit Agreement, there were \$160,550 in principal amount of borrowings outstanding as of December 31, 2016, at an effective interest rate of 1.66% and \$156,700 in principal amount of borrowings outstanding as of September 30, 2016, at an effective interest rate of 1.77%. As of December 31, 2016, \$150,000 of the borrowings under the Revolving Credit Agreement were classified as short-term based on Woodward's intent and ability to pay this amount in the next twelve months.

Short-term borrowings

As of December 31, 2016, a Chinese subsidiary of Woodward has a local uncommitted credit facility with the Hong Kong and Shanghai Banking Company under which it has the ability to borrow up to either \$22,700, or the local currency equivalent of \$22,700, up to the amount of a parent guarantee from Woodward. The Chinese subsidiary may utilize the local facility for cash borrowings to support its operating cash needs. Local currency borrowings on the Chinese credit facility are charged interest at the prevailing interest rate offered by the People's Bank of China on the date of borrowing, plus a margin equal to 15% of that prevailing rate. U.S. dollar borrowings on the credit facility are charged interest at the lender's cost of borrowing rate at the date of borrowing, plus 3%. The Chinese subsidiary had no outstanding cash borrowings against the local credit facility at December 31, 2016 and September 30, 2016.

As of December 31, 2016, the Brazilian subsidiary of Woodward had a local uncommitted credit facility with the Banco J.P. Morgan S.A. under which it had the ability to borrow up to 52,000 Brazilian Real. Any cash borrowings under the local Brazilian credit facility are secured by a parent guarantee from Woodward. The Brazilian subsidiary may utilize the local facility to support its operating cash needs. Local currency borrowings on the Brazilian credit facility are charged interest at the lender's cost of borrowing rate at the date of borrowing, plus 1.75%. On January 5, 2017, the Brazilian subsidiary of Woodward entered into an amendment to the original credit facility to extend the maturity date until July 14, 2017 and decrease the maximum borrowing capacity to 1,000 Brazilian Real. The Brazilian subsidiary had no outstanding cash borrowings against the local credit facility at December 31, 2016 and September 30, 2016.

Woodward also has other foreign lines of credit and foreign overdraft facilities at various financial institutions, which are generally reviewed annually for renewal and are subject to the usual terms and conditions applied by the financial institutions. Pursuant to the terms of the related facility agreements, Woodward's foreign performance guarantee facilities are limited in use to providing performance guarantees to third parties. There were no borrowings outstanding as of December 31, 2016 and September 30, 2016 on Woodward's other foreign lines of credit and foreign overdraft facilities.

Long-term debt

| | December 31, 2016 | September 30, 2016 |
|---|-------------------------|--------------------------|
| Revolving credit facility - Floating rate (LIBOR plus 0.85% - 1.65%), due April 2020, unsecured | \$ 160,550 | \$ 156,700 |
| Series D notes – 6.39%, due October 2018; unsecured | 100,000 | 100,000 |
| Series F notes – 8.24%, due April 2019; unsecured | 43,000 | 43,000 |
| Series G notes – 3.42%, due November 2020; unsecured | 50,000 | 50,000 |
| Series H notes – 4.03%, due November 2023; unsecured | 25,000 | 25,000 |
| Series I notes – 4.18%, due November 2025; unsecured | 25,000 | 25,000 |
| Series J notes – Floating rate (LIBOR plus 1.25%), due November 2020; unsecured | 50,000 | 50,000 |
| Series K notes – 4.03%, due November 2023; unsecured | 50,000 | 50,000 |
| Series L notes – 4.18%, due November 2025; unsecured | 50,000 | 50,000 |
| Series M notes – 1.12% due September 2026; unsecured | 42,076 | 44,886 |
| Series N notes – 1.31% due September 2028; unsecured | 80,995 | 86,406 |
| Series O notes – 1.57% due September 2031; unsecured | 45,231 | 48,252 |
| Total debt | 721,852 | 729,244 |
| Less: Current portion of long-term debt | (150,000) | (150,000) |
| Unamortized debt issuance costs | (1,974) | (2,091) |
| Long-term debt, less current portion | \$ 569,878 | \$ 577,153 |
| The Notes | | |

In October 2008, Woodward entered into a note purchase agreement relating to the Series D Notes (the “2008 Notes”). In April 2009, Woodward entered into a note purchase agreement relating to the Series F Notes (the “2009 Notes”).

On October 1, 2013, Woodward entered into a note purchase agreement relating to the sale by Woodward of an aggregate principal amount of \$250,000 of its senior unsecured notes in a series of private placement transactions. Woodward issued the Series G, H and I Notes (the “First Closing Notes”) on October 1, 2013. Woodward issued the Series J, K and L Notes (the “Second Closing Notes”, and together with the 2008 Notes, 2009 Notes and the First Closing Notes, the “USD Notes”) on November 15, 2013.

On September 23, 2016, Woodward and the BV Subsidiary each entered into note purchase agreements relating to the sale by Woodward and the BV Subsidiary of an aggregate principal amount of €160,000 of senior unsecured notes in a series of private placement transactions. Woodward issued €40,000 aggregate principal amount of Woodward’s Series M Senior Notes (the “Series M Notes”). The BV Subsidiary issued (a) €77,000 aggregate principal amount of the BV Subsidiary’s Series N Senior Notes (the “Series N Notes”) and (b) €43,000 aggregate principal amount of the BV Subsidiary’s Series O Senior Notes (the “Series O Notes” and together with the Series M Notes and the Series N Notes, the “2016 Notes”, and together with the USD Notes, collectively, the “Notes”).

Interest on the 2008 Notes, the First Closing Notes, and the Series K and L Notes is payable semi-annually on April 1 and October 1 of each year until all principal is paid. Interest on the 2009 Notes is payable semi-annually on April 15 and October 15 of each year until all principal is paid. Interest on the 2016 Notes will be payable semi-annually on March 23 and September 23 of each year, commencing on March 23, 2017, until all principal is paid. Interest on the Series J Notes is payable quarterly on January 1, April 1, July 1 and October 1 of each year until all principal is paid. As of December 31, 2016, the Series J Notes bore interest at an effective rate of 2.16%.

Debt Issuance Costs

Unamortized debt issuance costs associated with the Notes of \$1,974 as of December 31, 2016 and \$2,091 as of September 30, 2016 were recorded as a reduction in “Long-term debt, less current portion” in the Condensed Consolidated Balance Sheets. Unamortized debt issuance costs of \$2,915 associated with the Revolving Credit Agreement as of December 31, 2016 and \$3,134 as of September 30, 2016 were recorded as “Other assets” in the Condensed Consolidated Balance Sheets. Amortization of debt issuance costs is included in operating activities in the Condensed Consolidated Statements of Cash Flows.

Note 13. Accrued liabilities

| | December 31, 2016 | September 30, 2016 |
|---|-------------------------|--------------------------|
| Salaries and other member benefits | \$ 47,677 | \$ 87,197 |
| Warranties | 15,528 | 15,993 |
| Interest payable | 5,789 | 9,071 |
| Current portion of acquired performance obligations and unfavorable contracts (1) | 2,910 | 2,910 |
| Accrued retirement benefits | 2,503 | 2,505 |
| Current portion of loss reserve on contractual lease commitments | 1,840 | 1,840 |
| Current portion of deferred income from JV formation (Note 4) | 6,452 | 6,552 |
| Deferred revenues | 7,577 | 5,779 |
| Taxes, other than income | 9,289 | 14,580 |
| Other | 16,258 | 10,200 |
| | \$ 115,823 | \$ 156,627 |

(1) In connection with Woodward's acquisition of GE Aviation Systems LLC's (the "Seller") thrust reverser actuation systems business located in Duarte, California (the "Duarte Acquisition") in fiscal year 2013, Woodward assumed current and long-term performance obligations for contractual commitments that are expected to result in future economic losses. In addition, Woodward assumed current and long-term performance obligations for services to be provided to the Seller and others, partially offset by current and long-term assets related to contractual payments due from the Seller. The current portion of both obligations is included in Accrued liabilities.

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:

| | Three-Months Ended | |
|--|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Warranties, beginning of period | \$ 15,993 | \$ 13,741 |
| Expense, net of recoveries | 1,923 | 3,236 |
| Reductions for settling warranties | (2,032) | (3,469) |
| Foreign currency exchange rate changes | (356) | (138) |
| Warranties, end of period | \$ 15,528 | \$ 13,370 |

Loss reserve on contractual lease commitments

In connection with the construction of a new production facility in Niles, Illinois, Woodward vacated a leased facility in Skokie, Illinois. During the first quarter of fiscal year 2016 Woodward fully vacated the Skokie facility and therefore recorded a charge of \$8,165 to recognize a loss reserve against the estimated remaining contractual lease commitments, less anticipated sublease income.

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The summary for the activity in the loss reserve during the three-months ended December 31, 2016 is as follows:

| | Three-Months Ended December 31, | |
|--|---------------------------------------|-----------|
| | 2016 | 2015 |
| Loss reserve on contractual lease commitments, beginning of period | \$ 9,242 | \$ 2,464 |
| Additions | - | 8,165 |
| Payments | (402) | - |
| Loss reserve on contractual lease commitments, end of period | \$ 8,840 | \$ 10,629 |

Other liabilities included \$7,000 of accrued loss reserve on contractual lease commitments that are not expected to be settled or paid within twelve months as of December 31, 2016.

Note 14. Other liabilities

| | December 31, 2016 | September 30, 2016 |
|---|----------------------|-----------------------|
| Net accrued retirement benefits, less amounts recognized within accrued liabilities | \$ 70,549 | \$ 70,479 |
| Noncurrent portion of deferred income from JV formation (1) | 236,791 | 238,187 |
| Total unrecognized tax benefits, net of offsetting adjustments (Note 16) | 12,541 | 17,239 |
| Acquired unfavorable contracts (2) | 2,859 | 3,148 |
| Deferred economic incentives (3) | 15,685 | 16,196 |
| Loss reserve on contractual lease commitments (4) | 7,000 | 7,402 |

| | | |
|-------|------------|------------|
| Other | 13,004 | 15,573 |
| | \$ 358,429 | \$ 368,224 |

- (1) See Note 4, Joint venture for more information on the deferred income from JV formation.
- (2) In connection with the Duarte business acquisition in fiscal year 2013, Woodward assumed current and long-term performance obligations for contractual commitments that are expected to result in future economic losses. The long-term portion of the acquired unfavorable contracts is included in Other liabilities.
- (3) Woodward receives certain economic incentives from various state and local authorities related to capital expansion projects. Such amounts are initially recorded as deferred credits and are being recognized as a reduction to pre-tax expense over the economic lives of the related capital expansion projects.
- (4) See Note 13, Accrued liabilities for more information on the loss reserve on contractual lease commitments.

Note 15. Other (income) expense, net

| | Three-Months Ended December 31, | |
|---|---------------------------------------|------------|
| | 2016 | 2015 |
| Equity interest in the earnings of the JV (Note 4) | \$ (684) | \$ - |
| Net gain on sales of assets | (3,699) | (1,602) |
| Rent income | (73) | (101) |
| Net gains on investments in deferred compensation program | (24) | (304) |
| Other | (108) | (2) |
| | \$ (4,588) | \$ (2,009) |

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, and other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

On December 7, 2016, the U.S. Treasury issued regulations under Internal Revenue Code Section 987 (“Section 987 Regulations”) which clarify how companies calculate foreign currency translation gains and losses for income tax purposes for branches whose accounting records are kept in a currency other than the currency of the company. The issuance of these Section 987 Regulations had no significant impact on Woodward’s Condensed Consolidated Financial Statements for the three months ended December 31, 2016.

The following table sets forth the tax expense and the effective tax rate for Woodward’s earnings before income taxes:

| | Three-Months Ended | |
|------------------------------|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Earnings before income taxes | \$ 47,059 | \$ 27,956 |
| Income tax expense | 511 | 2,136 |
| Effective tax rate | 1.1% | 7.6% |

The decrease in the year-over-year effective tax rate for the three-months ended December 31, 2016 is primarily attributable to the impact in the quarter of the repatriation to the U.S. of certain net foreign profits and losses. The U.S. foreign tax credits available as a result of the repatriation of the foreign net earnings is greater than the U.S. taxes payable on these net foreign earnings. The excess U.S. foreign tax credits are expected to be used to offset U.S. taxes on other foreign source income.

The decrease in the year-over-year effective tax rate caused by the repatriated earnings was partially offset by the retroactive benefit of the U.S. research and experimentation credit (“R&E credit”) pursuant to the December 18, 2015 enactment of the Protecting Americans from Tax Hikes (PATH) Act of 2015, which was included in the effective tax rate for the first quarter of fiscal year 2016 but did not repeat in the first quarter of fiscal year 2017.

Gross unrecognized tax benefits were \$18,579 as of December 31, 2016, and \$23,526 as of September 30, 2016. Included in the balance of unrecognized tax benefits were \$11,460 as of December 31, 2016 and \$11,426 as of September 30, 2016 of tax benefits that, if recognized, would affect the effective tax rate. At this time, Woodward estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as \$3,373 in the next twelve months due to the completion of reviews by tax authorities, lapses of statutes, and the settlement of tax positions. Woodward accrues for potential interest and penalties related to unrecognized tax benefits and all other interest and penalties related to tax payments in tax expense. Woodward had accrued gross interest and penalties of \$1,460 as of December 31, 2016 and \$1,273 as of September 30, 2016.

Woodward's tax returns are subject to audits by U.S. federal, state, and foreign tax authorities, and these audits are at various stages of completion at any given time. Reviews of tax matters by authorities and lapses of the applicable statutes of limitations may result in changes to tax expense. Fiscal years remaining open to examination in significant foreign jurisdictions include 2008 and thereafter. Woodward's fiscal years remaining open to examination in the United States include fiscal years 2013 and thereafter. Woodward is currently under examination by the Internal Revenue Service for fiscal year 2014. Woodward has concluded U.S. federal income tax examinations through fiscal year 2012. Woodward is generally subject to U.S. state income tax examinations for fiscal years 2012 and the periods thereafter.

Note 17. Retirement benefits

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

Defined contribution plans

Most of the Company's U.S. employees are eligible to participate in the U.S. defined contribution plan. The U.S. defined contribution plan allows employees to defer part of their annual income for income tax purposes into their personal 401(k) accounts. The Company makes matching 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.

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

| | Three-Months Ended December 31, | |
|---------------|---------------------------------------|----------|
| | 2016 | 2015 |
| Company costs | \$ 7,249 | \$ 8,004 |

Defined benefit plans

Woodward has defined benefit plans that provide pension benefits for certain retired employees in the United States, the United Kingdom, and Japan. Woodward also provides other postretirement benefits to its employees including

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

U.S. GAAP requires that, for obligations outstanding as of September 30, 2016, 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.

During the third quarter of fiscal year 2016, Woodward opened a lump-sum buy-out window for certain former U.S. employees and/or their dependents eligible to receive postretirement defined benefit pension payments for past employment services to the Company. Eligible pension plan participants may elect to receive a one-time lump-sum payment or an immediate annuity in lieu of future pension benefit payments. Pension benefit payments paid from available pension plan assets under the lump-sum buy-out options were \$670 during the first quarter of fiscal year 2017. Woodward expects to make no further pension benefit payments under the lump-sum buy-out options.

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

| | Three-Months Ended December 31, | | | | | |
|---|---------------------------------|----------|-----------------|---------|----------|----------|
| | United States | | Other Countries | | Total | |
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Service cost | \$ 419 | \$ 674 | \$ 192 | \$ 186 | \$ 611 | \$ 860 |
| Interest cost | 1,439 | 1,317 | 296 | 435 | 1,735 | 1,752 |
| Expected return on plan assets | (2,632) | (2,542) | (641) | (697) | (3,273) | (3,239) |
| Amortization of: | | | | | | |
| Net actuarial loss | 464 | 323 | 127 | 65 | 591 | 388 |
| Prior service cost | 96 | 96 | - | - | 96 | 96 |
| Net periodic retirement pension benefit | \$ (214) | \$ (132) | \$ (26) | \$ (11) | \$ (240) | \$ (143) |
| Contributions paid | \$ - | \$ - | \$ 365 | \$ 389 | \$ 365 | \$ 389 |

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

| | Three-Months Ended December 31, | |
|--|---------------------------------------|--------|
| | 2016 | 2015 |
| | Service cost | \$ 4 |
| Interest cost | 311 | 262 |
| Amortization of: | | |
| Net actuarial loss | 50 | 39 |
| Prior service benefit | (40) | (40) |
| Net periodic other postretirement cost | \$ 325 | \$ 266 |
| Contributions paid | \$ 615 | \$ 381 |

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 2017 may differ from the current estimate. Woodward estimates its remaining cash contributions in fiscal year 2017 will be as follows:

| | |
|-------------------------------|-------|
| Retirement pension benefits: | |
| United States | \$ - |
| United Kingdom | 323 |
| Japan | - |
| Other postretirement benefits | 3,424 |

Multiemployer defined benefit plans

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

| | Three-Months Ended December 31, 2016 2015 | |
|-----------------------|--|--------|
| Company contributions | \$ 68 | \$ 130 |

Note 18. Stockholders' equity

Stock repurchase program

In the first quarter of fiscal year 2017, Woodward's Board of Directors terminated the Company's prior stock repurchase program and replaced it with a new program for the repurchase of up to \$500,000 of Woodward's outstanding shares of

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common stock on the open market or in privately negotiated transactions over a three-year period that will end in 2019 (the “2016 Authorization”). Under the 2016 Authorization, in the first quarter of fiscal year 2017, Woodward purchased 350 shares of its common stock for \$24,004 pursuant to a 10b5-1 plan.

In the first quarter of fiscal year 2016, Woodward executed a 10b5-1 plan to repurchase up to \$125,000 of its common stock for a period that ended on April 20, 2016. During the first quarter of fiscal year 2016, Woodward purchased 624 shares of its common stock for \$30,712 pursuant to the 10b5-1 plan under the prior stock repurchase program, which was terminated in November 2016.

Stock-based compensation

Provisions governing outstanding stock option awards are included in the 2006 Omnibus Incentive Plan (the “2006 Plan”) and the 2002 Stock Option Plan (the “2002 Plan”). The 2002 Plan provided that no further grants would be made after December 31, 2006. The 2006 Plan, which was approved by Woodward’s stockholders and became effective January 25, 2006, expired in fiscal year 2016. No further grants will be made under either the 2002 Plan or the 2006 Plan.

Woodward’s stockholders approved a successor plan to the 2006 Plan (the “2017 Plan”) at the January 25, 2017 Annual Stockholder Meeting. As of September 14, 2016, the effective date of the 2017 Plan, Board of Directors delegated authority to administer the 2017 Plan to the compensation committee of the board (the “Committee”), including, but not limited to, the power to determine the recipients of awards and the terms of those awards. The Committee approved issuance of options under the 2017 Plan, with an award date of October 3, 2016 conditional and subject to approval of the 2017 Plan by the stockholders. The stock options conditionally awarded under the 2017 Plan were not granted or outstanding for accounting purposes prior to stockholder approval of the 2017 Plan, and as such no stock based compensation expense was recognized on these stock options during the three months ended December 31, 2016. As of December 31, 2016, 773 stock options awards were approved but not granted.

Stock options

Woodward granted no stock options in the first quarter of fiscal year 2017. Previous stock options granted under the 2006 Plan were granted with an exercise price equal to the market price of Woodward’s stock at the date of grant, a ten-year term, and generally a four-year vesting schedule at a rate of 25% per year.

The following is a summary of the activity for stock option awards during the three-months ended December 31, 2016:

| | Three-Months Ended December 31, 2016 | |
|----------------------------|---|---|
| | Number of options | Weighted-Average Exercise Price per Share |
| Options, beginning balance | 4,944 | \$ 35.35 |
| Options granted | - | n/a |
| Options exercised | (139) | 34.83 |
| Options forfeited | (13) | 42.19 |
| Options, ending balance | 4,792 | 35.35 |

Changes in non-vested stock options during the three-months ended December 31, 2016 were as follows:

| | Three-Months Ended December 31, 2016 | |
|--|---|--|
| | Number of options | Weighted-Average Grant Date Fair Value Per Share |
| Options outstanding, beginning balance | 2,075 | \$ 14.90 |
| Options granted | - | n/a |
| Options vested | (758) | 15.24 |
| Options forfeited | (13) | 14.47 |
| Options outstanding, ending balance | 1,304 | 14.70 |

Information about stock options that have vested, or are expected to vest, and are exercisable at December 31, 2016 was as follows:

| | Number | Weighted- Average Exercise Price | Weighted- Average Remaining Life in Years | Aggregate Intrinsic Value |
|-------------------------------------|--------|---|---|---------------------------------|
| Options outstanding | 4,792 | \$ 35.35 | 5.9 | \$ 161,511 |
| Options vested and exercisable | 3,488 | 32.83 | 5.0 | 126,348 |
| Options vested and expected to vest | 4,719 | 35.25 | 5.8 | 159,525 |
| Restricted Stock | | | | |

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

A summary of the activity for restricted stock awards in the three-months ended December 31, 2016 follows:

| | Three-Months Ended December 31, 2016 | |
|-------------------|---|----------------------|
| | Number | Fair Value per Share |
| Beginning balance | 24 | \$ 39.43 |

| | | |
|-------------------------------|----|-------|
| Shares granted | - | n/a |
| Shares vested | - | n/a |
| Shares forfeited | - | n/a |
| Ending balance | 24 | 39.43 |
| Stock-based compensation cost | | |

Woodward recognizes stock compensation expense on a straight-line basis over the requisite service period. Pursuant to form stock option agreements used by the Company, the requisite service period can be less than the four-year vesting period based on grantee's retirement eligibility. As such, the recognition of stock-based compensation expense associated with some stock option grants can be accelerated to a period of less than four years, including immediate recognition of stock-based compensation on the date of grant.

At December 31, 2016, there was approximately \$6,820 of total unrecognized compensation cost related to non-vested stock-based compensation arrangements, both stock options and restricted stock awards, granted under the 2002 Plan and the 2006 Plan (for which no further grants will be made under either plan). The pre-vesting forfeiture rates for purposes of determining stock-based compensation cost recognized were estimated to be 0% for members of Woodward's board of directors and 9% for all others. The remaining unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 2.1 years.

Note 19. Commitments and contingencies

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

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

Woodward is partially self-insured in the United States for healthcare and worker's compensation up to predetermined amounts, above which third party insurance applies. Management regularly reviews the probable outcome of these claims

and proceedings, the expenses expected to be incurred, the availability and limits of the insurance coverage, and the established accruals for liabilities.

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

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

Note 20. Segment information

Woodward serves the aerospace, industrial and energy markets through its two reportable segments - Aerospace and Industrial. When appropriate, Woodward's reportable segments are aggregations of Woodward's operating segments. Woodward uses operating segment information internally to manage its business, including the assessment of operating segment performance and decisions for the allocation of resources between operating 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 generally excludes matters such as certain charges for restructuring costs, interest income and expense, certain gains and losses from asset dispositions, or other non-recurring and/or non-operationally related expenses.

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

| | Three-Months Ended December 31, | |
|---|------------------------------------|------------|
| | 2016 | 2015 |
| Segment external net sales: | | |
| Aerospace | \$ 266,680 | \$ 268,599 |
| Industrial | 176,214 | 176,511 |
| Total consolidated net sales | \$ 442,894 | \$ 445,110 |
| Segment earnings: | | |
| Aerospace | \$ 46,877 | \$ 43,486 |
| Industrial | 17,998 | 21,551 |
| Total segment earnings | 64,875 | 65,037 |
| Nonsegment expenses | (11,381) | (30,620) |
| Interest expense, net | (6,435) | (6,461) |
| Consolidated earnings before income taxes | \$ 47,059 | \$ 27,956 |

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:

| | December 31, 2016 | September 30, 2016 |
|--|----------------------|-----------------------|
| Segment assets: | | |
| Aerospace | \$ 1,611,306 | \$ 1,637,522 |
| Industrial | 663,886 | 705,169 |
| Total segment assets | 2,275,192 | 2,342,691 |
| Unallocated corporate property, plant and equipment, net | 89,990 | 89,988 |
| Other unallocated assets | 211,033 | 209,683 |
| Consolidated total assets | \$ 2,576,215 | \$ 2,642,362 |

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

Forward Looking Statements

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

- future sales, earnings, cash flow, uses of cash, and other measures of financial performance;
- our expected expenses in future periods and trends in such expenses over time;
- descriptions of our plans and expectations for future operations;
- plans and expectations relating to the performance of our joint venture with General Electric Company;
- investments in new campuses, business sites and related business developments;
- the effect of economic trends or growth;
- the expected level of activity in particular industries or markets and the effects of changes in those levels;
- the scope, nature, or impact of acquisition activity and integration of such acquisition into our business;
- the research, development, production, and support of new products and services;
- new business opportunities;
- restructuring and alignment costs and savings;
- our plans, objectives, expectations and intentions with respect to business opportunities that may be available to us;
- our liquidity, including our ability to meet capital spending requirements and operations;
- future repurchases of common stock;
- future levels of indebtedness and capital spending;
- the stability of financial institutions, including those lending to us; and
- pension and other postretirement 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;
- global economic uncertainty and instability in the financial markets;
- our ability to manage product liability claims, product recalls or other liabilities associated with the products and services that we provide;
 - 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 any restructuring and alignment efforts;

- our ability to successfully manage competitive factors, including prices, promotional incentives, competitor product development, 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;
 - 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;
 - our ability to monitor our technological expertise and the success of, and/or costs associated with, our product development activities;
 - consolidation in the aerospace market and our participation in a strategic joint venture with General Electric Company may make it more difficult to secure long-term sales in certain aerospace markets;
 - 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;
 - our ability to manage additional tax expense and exposures;

- risks related to our U.S. Government contracting activities, including liabilities resulting from legal and regulatory proceedings, inquiries, or investigations related to such activities;
- the potential of a significant reduction in defense sales due to decreases in the amount of U.S. Federal defense spending or other specific budget cuts impacting defense programs in which we participate;
- changes in government spending patterns, priorities, subsidy programs and/or regulatory requirements;
- future impairment charges resulting from changes in the estimates of fair value of reporting units or of long-lived assets;
- future results of our subsidiaries;
- environmental liabilities related to manufacturing activities and/or real estate acquisitions;
- our continued access to a stable workforce and favorable labor relations with our employees;
- physical and other risks related to our operations and suppliers, including natural disasters, which could disrupt production;
- our ability to successfully manage regulatory, tax, and legal matters (including the adequacy of amounts accrued for contingencies, the U.S. Foreign Corrupt Practices Act, and product liability, patent, and intellectual property matters);
- risks related to our common stock, including changes in prices and trading volumes;
- risks from operating internationally, including the impact on reported earnings from fluctuations in foreign currency exchange rates, and compliance with and changes in the legal and regulatory environments of the United States and the countries in which we operate;
- risks associated with global political and economic uncertainty in the European Union and elsewhere;
- 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;
- industry risks, including changes in commodity prices for oil, natural gas, and other minerals, unforeseen events that may reduce commercial aviation, and changing emissions standards;
- our operations may be adversely affected by information systems interruptions or intrusions; 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 the caption “Risk Factors” in Part I, Item 1A in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) (our “Form 10-K”), as updated from time to time in our subsequent SEC filings. 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 (this “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 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.

OVERVIEW

Operational Highlights

Net sales for the first quarter of fiscal year 2017 were \$442,894, a decrease of 0.5% from \$445,110 for the prior year first quarter. Aerospace segment sales for the first quarter of fiscal year 2017 were down 0.7% to \$266,680, compared to \$268,599 for the first quarter of the prior fiscal year. Industrial segment sales for the first quarter of fiscal year 2017 were down 0.2% to \$176,214, compared to \$176,511 for the first quarter of the prior fiscal year.

Net earnings for the first quarter of fiscal year 2017 were \$46,548, or \$0.73 per diluted share, compared to \$25,820, or \$0.40 per diluted share, for the first quarter of fiscal year 2016. Net earnings for the first quarter of fiscal year 2016 included approximately \$16,100 of special charges related to our efforts to consolidate facilities, reduce costs and address current market conditions, which was equal to approximately \$9,900 net of tax. The effective tax rate in the first quarter of fiscal year 2017 was 1.1% compared to 7.6% for the first quarter of the prior fiscal year.

Earnings before interest and taxes (“EBIT”) for the first quarter of fiscal year 2017 was \$53,494, up 55.4% from \$34,417 in the first quarter of fiscal year 2016. Earnings before interest, taxes, depreciation and amortization (“EBITDA”) for the first quarter of fiscal year 2017 was \$72,407, up 40.7% from \$51,479 for the first quarter of fiscal year 2016. EBIT and EBITDA for the first quarter of fiscal year 2016 included the special charges of approximately \$16,100 discussed above.

Aerospace segment earnings as a percent of segment net sales increased to 17.6% in the first quarter of fiscal year 2017 from 16.2% in the first quarter of the prior fiscal year. Industrial segment earnings as a percent of segment net sales decreased to 10.2% in the first quarter of fiscal year 2017 from 12.2% in the first quarter of the prior fiscal year.

Liquidity Highlights

Net cash provided by operating activities for the first quarter of fiscal year 2017 was \$52,351, compared to \$37,360 for the first quarter of fiscal year 2016. The increase in net cash provided by operating activities is primarily attributable to higher earnings.

For the first quarter of fiscal year 2017, free cash flow, which we define as net cash flows provided by operating activities less payments for property, plant and equipment, was \$31,293, compared to \$4,229 for the first quarter of fiscal year 2016. The increase is primarily attributable to higher earnings and lower payments for property, plant and equipment in the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016.

At December 31, 2016, we held \$80,885 in cash and cash equivalents, and had total outstanding debt of \$721,852 with additional borrowing availability of \$830,589, net of outstanding letters of credit, under our revolving credit agreement. At December 31, 2016, we had additional borrowing capacity of \$43,505 under various foreign lines of credit and foreign overdraft facilities.

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 Ended | | | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 31, 2016 | % of Net Sales | December 31, 2015 | % of Net Sales |
| Net sales | \$ 442,894 | 100 % | \$ 445,110 | 100 % |
| Costs and expenses: | | | | |
| Cost of goods sold | 327,194 | 73.9 | 333,377 | 74.9 |
| Selling, general, and administrative expenses | 33,796 | 7.6 | 40,782 | 9.2 |
| Research and development costs | 26,540 | 6.0 | 31,597 | 7.1 |
| Amortization of intangible assets | 6,458 | 1.5 | 6,946 | 1.6 |
| Interest expense | 6,840 | 1.5 | 6,908 | 1.6 |
| Interest income | (405) | (0.1) | (447) | (0.1) |
| Other (income) expense, net | (4,588) | (1.0) | (2,009) | (0.5) |
| Total costs and expenses | 395,835 | 89.4 | 417,154 | 93.7 |
| Earnings before income taxes | 47,059 | 10.6 | 27,956 | 6.3 |
| Income tax expense | 511 | 0.1 | 2,136 | 0.5 |
| Net earnings | \$ 46,548 | 10.5 | \$ 25,820 | 5.8 |
| Other select financial data: | | | | |

| | December 31, 2016 | September 30, 2016 |
|---|-------------------------|--------------------------|
| Working capital | \$ 468,319 | \$ 463,811 |
| Short-term borrowings and current portion of long-term debt | 150,000 | 150,000 |
| Total debt, net of unamortized debt issuance costs | 719,878 | 727,153 |
| Total stockholders' equity | 1,222,368 | 1,212,595 |

Net Sales

Consolidated net sales for the first quarter of fiscal year 2017 decreased by \$2,216, or 0.5%, compared to the same period of fiscal year 2016. Details of the changes in consolidated net sales are as follows:

| | |
|---|------------|
| Consolidated net sales for the period ended December 31, 2015 | \$ 445,110 |
| Aerospace volume | (4,337) |
| Industrial volume | 2,183 |
| Effects of changes in price and sales mix | 109 |
| Effects of changes in foreign currency rates | (171) |
| Consolidated net sales for the period ended December 31, 2016 | \$ 442,894 |

The decrease in net sales for the first quarter of fiscal year 2017 was primarily attributable to commercial aftermarket being down relative to strong comparable commercial aftermarket sales in the prior year's first quarter in the Aerospace segment, which was partially offset by increased heavy frame gas turbine aftermarket sales in the Industrial segment during the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016.

Costs and Expenses

Costs and expenses for the first quarter of fiscal year 2016 included special charges totaling approximately \$16,100 (\$13,300 included in cost of goods sold, \$1,700 included in selling, general and administrative expenses, and \$1,100 included

in research and development costs) related to our efforts to consolidate facilities, reduce costs and address current market conditions in fiscal year 2016. There were no comparable costs and expenses recorded in the first quarter of fiscal year 2017.

Cost of goods sold decreased by \$6,183 to \$327,194, or 73.9% of net sales, for the first quarter of fiscal year 2017 from \$333,377, or 74.9% of net sales, for the first quarter of fiscal year 2016. The decrease in cost of goods sold is primarily attributable to the inclusion in the first quarter of fiscal year 2016 of approximately \$13,300 of special charges, as described above. This decrease was partially offset by increased cost of goods sold due to planned facility ramp-up costs in our Aerospace segment and planned new facility expenses for our new Colorado facilities.

Gross margin (as measured by net sales less cost of goods sold, divided by net sales) was 26.1% for the first quarter of fiscal year 2017, compared to 25.1% for the first quarter of fiscal year 2016. Gross margin for the first quarter of fiscal year 2017 was higher compared to the first quarter of fiscal year 2016, primarily related to the inclusion in cost of goods sold of approximately \$13,300 of special charges in the first quarter of fiscal year 2016, partially offset by planned facility ramp-up costs in both our Aerospace and Industrial segments.

Selling, general, and administrative expenses decreased by \$6,986, or 17.1%, to \$33,796 for the first quarter of fiscal year 2017 as compared to \$40,782 for the first quarter of fiscal year 2016. Selling, general, and administrative expenses as a percentage of net sales was 7.6% for the first quarter of fiscal year 2017 as compared to 9.2% for the first quarter of fiscal year 2016. The decrease in selling, general and administrative expenses for the first quarter of fiscal year 2017 was primarily due to the timing of certain expenses. In addition, the first quarter of fiscal year 2016 included special charges of approximately \$1,700 described above.

Research and development costs decreased by \$5,057, or 16.0%, to \$26,540 for the first quarter of fiscal year 2017, as compared to \$31,597 for the first quarter of fiscal year 2016. Research and development costs decreased as a percentage of net sales to 6.0% for the first quarter of fiscal year 2017 as compared to 7.1% for the first quarter of fiscal year 2016. Research and development costs in the first quarter of fiscal year 2017 were lower due to less spent on Aerospace programs as well as variability in the timing of projects and expenses. In addition, the first quarter of fiscal year 2016 included the special charges of approximately \$1,100 described above. Our research and development activities extend across almost all of our customer base, and we anticipate ongoing variability in research and development due to the timing of customer business needs on current and future programs

Amortization of intangible assets decreased to \$6,458 for the first quarter of fiscal year 2017, compared to \$6,946 for the first quarter of fiscal year 2016. As a percentage of net sales, amortization of intangible assets were 1.5% for the first quarter of fiscal year 2017 as compared to 1.6% for the first quarter of fiscal year 2016. The decrease in amortization expense was primarily related to certain intangible assets becoming fully amortized during fiscal year 2016.

Interest expense was \$6,840, or 1.5% of net sales, for the first quarter of fiscal year 2017, comparable to \$6,908, or 1.6% of net sales, for the first quarter of fiscal year 2016. Interest expense was down slightly primarily attributable to a decrease in higher interest debt due to the retirement of \$57,000 of 7.81% Series E notes in fiscal year 2016, partially offset by lower amounts of capitalized interest in the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016, as capital projects have been completed.

Income taxes were provided at an effective rate on earnings before income taxes of 1.1% for the first quarter of fiscal year 2017, compared to 7.6% for the first quarter of fiscal year 2016. The changes in components of our effective tax rate (as a percentage of earnings before income taxes) were attributable to the following:

| | Three-Month Period | |
|---|-----------------------|---|
| Effective tax rate for the period ended December 31, 2015 | 7.6 | % |
| Retroactive benefit of research and experimentation credit | 20.7 | |
| State and local taxes | (0.1) | |
| Adjustment of prior period tax items | 0.2 | |
| Taxes on international activities | (26.5) | |
| Net excess income tax benefit from stock-based compensation | (1.1) | |
| Other | 0.3 | |
| Effective tax rate for the period ended December 31, 2016 | 1.1 | % |

The decrease in the year-over-year effective tax rate for the three-months ended December 31, 2016 is primarily attributable to the impact in the quarter of the repatriation to the U.S. of certain net foreign profits and losses. The U.S. foreign tax credits available as a result of the repatriation of the foreign net earnings is greater than the U.S. taxes payable on

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these net foreign earnings. The excess U.S. foreign tax credits are expected to be used to offset U.S. taxes on other foreign source income.

The decrease in the year-over-year effective tax rate caused by the repatriated earnings was partially offset by the retroactive benefit of the U.S. research and experimentation credit (“R&E credit”) pursuant to the December 18, 2015 enactment of the Protecting Americans from Tax Hikes (PATH) Act of 2015, which was included in the effective tax rate for the first quarter of fiscal year 2016 but did not repeat in the first quarter of fiscal year 2017.

Segment Results

The following table presents sales by segment:

| | Three-Months Ended December 31, | | | | | |
|------------------------|---------------------------------|---------|------------|---------|--|--|
| | 2016 | | 2015 | | | |
| Net sales: | | | | | | |
| Aerospace | \$ 266,680 | 60.2 % | \$ 268,599 | 60.3 % | | |
| Industrial | 176,214 | 39.8 | 176,511 | 39.7 | | |
| Consolidated net sales | \$ 442,894 | 100.0 % | \$ 445,110 | 100.0 % | | |

The following table presents earnings by segment:

| | Three-Months Ended | |
|---|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Aerospace | \$ 46,877 | \$ 43,486 |
| Industrial | 17,998 | 21,551 |
| Total segment earnings | 64,875 | 65,037 |
| Nonsegment expenses | (11,381) | (30,620) |
| Interest expense, net | (6,435) | (6,461) |
| Consolidated earnings before income taxes | 47,059 | 27,956 |
| Income tax expense | (511) | (2,136) |
| Consolidated net earnings | \$ 46,548 | \$ 25,820 |

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

| | Three-Months | |
|------------|----------------|-------|
| | Ended December | |
| | 31, | |
| | 2016 | 2015 |
| Aerospace | 17.6% | 16.2% |
| Industrial | 10.2% | 12.2% |

Aerospace

Aerospace segment net sales were \$266,680 for the first quarter of fiscal year 2017, down 0.7% compared to \$268,599 for the first quarter of fiscal year 2016. The decrease in segment net sales for the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016 was driven primarily by decreased commercial aftermarket sales in the first quarter of fiscal year 2017 relative to strong commercial aftermarket sales in the prior fiscal year first quarter, partially offset by increased defense sales for aftermarket and original equipment manufacturer (“OEM”), and slightly increased commercial OEM sales in the current period. However, commercial aftermarket sales in the first quarter of fiscal year 2017 did benefit from both the initial provisioning for new platforms and increased utilization of existing fleets.

U.S. government funds continue to be prioritized for defense platforms on which we have content. Defense sales, for both aftermarket and OEM, continued to increase in the first quarter of fiscal year 2017. Sales of smart weapons remain strong on increased customer demand in the first quarter of fiscal year 2017.

Commercial OEM sales were up slightly for the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016 due to next generation aircraft programs driving strong commercial OEM sales, partially offset by continuing weakness in business jets and rotorcraft.

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Aerospace segment earnings increased by \$3,391, or 7.8%, to \$46,877 for the first quarter of fiscal year 2017, compared to \$43,486 for the first quarter of fiscal year 2016. The net increase in Aerospace segment earnings for the first quarter of fiscal year 2017 was due to the following:

| | Three-Month Period |
|---|-----------------------|
| Earnings for the period ended December 31, 2015 | \$ 43,486 |
| Sales volume | (2,128) |
| Price, sales mix and productivity | 793 |
| Decrease in research and development expenses | 3,496 |
| Other, net | 1,230 |
| Earnings for the period ended December 31, 2016 | \$ 46,877 |

Aerospace segment earnings as a percentage of sales were 17.6% for the first quarter of fiscal year 2017, compared to 16.2% for the first quarter of fiscal year 2016. The increase was primarily attributable to decreased research and development expenses.

Industrial

Industrial segment net sales decreased by 0.2% to \$176,214 for the first quarter of fiscal year 2017, compared to \$176,511 for the first quarter of fiscal year 2016. Industrial sales continued to stabilize in the quarter. Increased heavy frame gas turbine sales for aftermarket programs were offset predominantly by lower wind turbine converter sales.

Industrial segment earnings decreased by \$3,553, or 16.5%, to \$17,998 for the first quarter of fiscal year 2017, compared to \$21,551 for the first quarter of fiscal year 2016. The net decrease in Industrial segment earnings for the first quarter of fiscal year 2017 was due to the following:

| | Three-Month Period |
|---|-----------------------|
| Earnings for the period ended December 31, 2015 | \$ 21,551 |
| Sales volume | 631 |
| Price, sales mix and productivity | (3,981) |
| Savings from fiscal year 2016 reorganization | 2,862 |
| New facility costs | (2,395) |
| Other, net | (670) |
| Earnings for the period ended December 31, 2016 | \$ 17,998 |

Industrial segment earnings as a percentage of sales were 10.2% for the first quarter of fiscal year 2017, compared to 12.2% for the first quarter of fiscal year 2016. The decrease in segment earnings for the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016 was driven by the impact of unfavorable product mix. Savings from prior year cost reductions initiatives were offset by costs associated with our new facility in Colorado.

Nonsegment expenses

Nonsegment expenses decreased to \$11,381 for the first quarter of fiscal year 2017, compared to \$30,620 for the first quarter of fiscal year 2016. As a percent of sales, nonsegment expenses decreased to 2.6% of net sales for the first quarter of fiscal year 2017, compared to 6.9% of net sales for the first quarter of fiscal year 2016. The decrease in nonsegment expenses in the first quarter of fiscal year 2017 as compared to the first quarter of fiscal year 2016 is due to special charges taken in the first quarter of fiscal year 2016 totaling approximately \$16,100 related to our efforts to consolidate facilities, reduce costs and address market conditions, which did not recur in the first quarter of fiscal year 2017, and timing differences in the recognition of certain expenses.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have satisfied our working capital needs, as well as capital expenditures, product development and other liquidity requirements associated with our operations, with cash flow provided by operating activities and borrowings under our credit facilities. Historically, we have also issued debt to supplement our cash needs or repay our other indebtedness.

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We expect that cash generated from our operating activities, together with borrowings under our revolving credit facility, will be sufficient to fund our continuing operating needs, including capital expansion funding for the foreseeable future.

Our aggregate cash and cash equivalents were \$80,885 at December 31, 2016 and \$81,090 at September 30, 2016, and our working capital was \$468,319 at December 31, 2016 and \$463,811 at September 30, 2016. Of the \$80,885 of cash and cash equivalents held at December 31, 2016, \$80,671 was held by our foreign locations. We are not presently aware of any significant restrictions on the repatriation of these funds, although a portion is considered indefinitely reinvested in these foreign subsidiaries. If these funds were needed to fund our operations or satisfy obligations in the United States, then they could be repatriated and their repatriation into the United States may cause us to incur additional U.S. income taxes or foreign withholding taxes. Any additional U.S. taxes could be offset, in part or in whole, by foreign tax credits. The amount of such taxes and application of tax credits would be dependent on the income tax laws and other circumstances at the time these amounts are repatriated. Based on these variables, it is impractical to determine the income tax liability that might be incurred if these funds were to be repatriated.

Our revolving credit facility matures in April 2020 and provides a borrowing capacity of up to \$1,000,000 with the option to increase total available borrowings to up to \$1,200,000, subject to lenders' participation. We can borrow against our \$1,000,000 revolving credit facility as long as we are in compliance with all of our debt covenants. Historically, we have used borrowings under our revolving credit facilities to meet certain short-term working capital needs, as well as for strategic uses, including repurchases of our common stock, payments of dividends, acquisitions, and facilities expansions. In addition, we have various foreign credit facilities, some of which are tied to net amounts on deposit at certain foreign financial institutions. These foreign credit facilities are reviewed annually for renewal. We use borrowings under these foreign credit facilities to finance certain local operations on a periodic basis. For further discussion of our \$1,000,000 revolving credit facility and our other credit facilities, see Note 12, Credit facilities, short-term borrowings and long-term debt in the Notes to the Condensed Consolidated Financial Statements in Part I, Item I of this Form 10-Q.

At December 31, 2016, we had total outstanding debt of \$721,852 consisting of amounts borrowed under our revolving credit facility and various series of unsecured notes due between 2018 and 2031, with additional borrowing availability of \$830,589 under our revolving credit facility, net of outstanding letters of credit, and additional borrowing availability of \$43,505 under various foreign credit facilities. During January 2016, we amended a foreign credit facility to align with current business needs, which reduced our foreign borrowing capacity by approximately \$16,000. For further discussion of our notes, see Note 12, Credit facilities, short-term borrowings and long-term debt in the Notes to the Condensed Consolidated Financial Statements in Part I, Item I of this Form 10-Q.

At December 31, 2016, we had \$160,550 of borrowings outstanding under our revolving credit facility, of which \$150,000 was classified as short-term and the remainder was classified as long-term. Revolving credit facility and short-term borrowing activity during the three-months ended December 31, 2016 were as follows:

| | |
|---|------------|
| Maximum daily balance during the period | \$ 317,700 |
| Average daily balance during the period | \$ 270,098 |
| Weighted average interest rate on average daily balance | 1.73% |

We believe we were in compliance with all our debt covenants as of December 31, 2016. See Note 12, Credit facilities, short-term borrowings and long-term debt in the Notes to the Consolidated Financial Statements in Part II, Item 8 of our most recent 10-K, for more information about our covenants.

In addition to utilizing our cash resources to fund the working capital needs of our business, we evaluate additional strategic uses of our funds, including the repurchase of our common stock, payment of dividends, significant capital expenditures, consideration of strategic acquisitions and other potential uses of cash.

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

In the first quarter of fiscal year 2017, Woodward's Board of Directors terminated the Company's prior stock repurchase program and replaced it with a new program for the repurchase of up to \$500,000 of Woodward's outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period that will end in 2019 (the "2016 Authorization"). In the first quarter of fiscal year 2017, Woodward purchased 350 shares of its common stock for \$24,004 under the 2016 Authorization, including \$23,997 under a 10b5-1 plan.

For our Aerospace segment, in fiscal year 2015 we completed construction of a manufacturing and office building on a second campus in the greater-Rockford, Illinois area. This campus is intended to support the expected growth in our

Aerospace segment over the next ten years and beyond, as a result of our being awarded a substantial number of new system platforms, particularly on narrow-body aircraft. We have been purchasing production equipment for the second campus and anticipate continuing such purchases as new aircraft platforms ramp up to full production volumes.

We believe that cash flows from operations, along with our contractually committed borrowings and other borrowing capability, will continue to be sufficient to fund anticipated capital spending requirements and our operations for the foreseeable future. However, we could be adversely affected if the financial institutions providing our capital requirements refuse to honor their contractual commitments, cease lending, or declare bankruptcy. We believe the lending institutions participating in our credit arrangements are financially stable.

Cash Flows

| | Three-Months Ended | |
|--|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Net cash provided by operating activities | \$ 52,351 | \$ 37,360 |
| Net cash used in investing activities | (16,618) | (31,279) |
| Net cash used in financing activities | (22,192) | (1,379) |
| Effect of exchange rate changes on cash and cash equivalents | (13,746) | (2,482) |
| Net change in cash and cash equivalents | (205) | 2,220 |
| Cash and cash equivalents at beginning of year | 81,090 | 82,202 |
| Cash and cash equivalents at end of period | \$ 80,885 | \$ 84,422 |

Net cash flows provided by operating activities for the first quarter of fiscal year 2017 was \$52,351, compared to \$37,360 in the first quarter of fiscal year 2016. The increase in net cash provided by operating activities is primarily attributable to increased net earnings.

Net cash flows used in investing activities for the first quarter of fiscal year 2017 was \$16,618, compared to \$31,279 in the first quarter of fiscal year 2016. The decrease in cash used in investing activities compared to the same period of the prior fiscal year is due to decreased payments for capital expenditures. Payments for property, plant and equipment decreased by \$12,073 to \$21,058 in the first quarter of fiscal year 2017 as compared to \$33,131 in the first quarter of fiscal year 2016 related mainly to lower equipment purchases associated with the facilitization of our aerospace segment facility in the greater-Rockford, Illinois area and completion of our industrial segment facility in Fort Collins, Colorado.

Net cash flows used in financing activities for the first quarter of fiscal year 2017 was \$22,192, compared to \$1,379 in the first quarter of fiscal year 2016. During the first quarter of fiscal year 2017, we had net debt borrowings of \$3,748 compared to net debt borrowings of \$34,402 in the first quarter of fiscal year 2016. We utilized \$24,004 to repurchase 350 shares of our common stock in the first quarter of fiscal year 2017 under the 2016 Authorization, compared to \$30,712 to repurchase 624 shares of our common stock, under the then existing stock repurchase program, in the first quarter of fiscal year 2016.

Contractual Obligations

We have various contractual obligations, including obligations related to long-term debt, operating and capital leases, purchases, retirement pension benefit plans, and other postretirement benefit plans. These contractual obligations are summarized and discussed more fully in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our most recent Form 10-K. There have been no material changes to our various

contractual obligations during the first quarter of fiscal year 2017.

NON-GAAP MEASURES

EBIT, 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"). However, we believe these non-U.S. GAAP financial measures provide additional information that enables readers to evaluate our business from the perspective of management.

Earnings based non-U.S. GAAP financial measures

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

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performance, making business decisions, including developing budgets, managing expenditures, forecasting future periods, and evaluating capital structure impacts of various strategic scenarios. Securities analysts, investors and others frequently use EBIT and EBITDA in their evaluation of companies, particularly those with significant property, plant, and equipment, and intangible assets subject to amortization.

EBIT and EBITDA for the three-months ended December 31, 2016 and December 31, 2015 were as follows:

| | Three-Months Ended | |
|-----------------------------------|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Net earnings (U.S. GAAP) | \$ 46,548 | \$ 25,820 |
| Income tax expense | 511 | 2,136 |
| Interest expense | 6,840 | 6,908 |
| Interest income | (405) | (447) |
| EBIT (Non-U.S. GAAP) | 53,494 | 34,417 |
| Amortization of intangible assets | 6,458 | 6,946 |
| Depreciation expense | 12,455 | 10,116 |
| EBITDA (Non-U.S. GAAP) | \$ 72,407 | \$ 51,479 |

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. Our calculations of EBIT and EBITDA may differ from similarly titled measures used by other companies, limiting their usefulness as comparative measures.

Cash flow-based non-U.S. GAAP financial measures

Management uses free cash flow, which is defined by the Company 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. In addition, securities analysts, investors, and others frequently use free cash flow in their evaluation of companies. The use of this non-U.S. GAAP financial measure is not intended to be considered in isolation of, or as substitutes for, the financial information prepared and presented in accordance with U.S. GAAP. 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 calculation of free cash flow may differ from similarly titled measures used by other companies, limiting its usefulness as a comparative measure.

Free cash flow for the three-months ended December 31, 2016 and December 31, 2015 were as follows:

| | Three-Months Ended | |
|---|--------------------|-----------|
| | December 31, | |
| | 2016 | 2015 |
| Net cash provided by operating activities (U.S. GAAP) | \$ 52,351 | \$ 37,360 |

| | | |
|--|-----------|----------|
| Payments for property, plant and equipment | (21,058) | (33,131) |
| Free cash flow (Non-U.S. GAAP) | \$ 31,293 | \$ 4,229 |

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Note 1, Operations and summary of significant accounting policies, to the Consolidated Financial Statements in our most recent Form 10-K, describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. Our critical accounting estimates, identified in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our most recent Form 10-K, include the discussion of estimates used for revenue recognition, inventory valuation, depreciation and amortization, reviews for impairment of goodwill, postretirement benefit obligations, and our provision for income taxes. Such accounting policies and estimates require significant judgments and assumptions to be used in the preparation of the Condensed Consolidated Financial Statements included in this Form 10-Q, and actual results could differ materially from the amounts reported.

New Accounting Standards

From time to time, the Financial Accounting Standards Board (“FASB”) or other standards-setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification are communicated through issuance of an Accounting Standards Update. Unless otherwise discussed, we believe that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to have a material impact on our Condensed Consolidated Financial Statements upon adoption.

To understand the impact of recently issued guidance, whether adopted or to be adopted, please review the information provided in Note 2, New accounting standards, in the Notes to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

Off-Balance Sheet Arrangements

As of December 31, 2016, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenues, or expenses, results of operations, liquidity, capital expenditures, or capital resources, that are material to investors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

These market risks are discussed more fully in “Quantitative and Qualitative Disclosures About Market Risk” in Part II, Item 7A of our most recent Form 10-K. These market risks have not materially changed since the date our most recent Form 10-K was filed with the SEC.

Item 4. Controls and Procedures

We have established disclosure controls and procedures, which are designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended (the “Act”) is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Act is accumulated and communicated to management, including our Principal Executive Officer (Thomas A. Gendron, Chairman of the Board, Chief Executive Officer and President) and Principal Financial and Accounting Officer (Robert F. Weber, Jr., Vice

Chairman, Chief Financial Officer and Treasurer), as appropriate, to allow timely decisions regarding required disclosures.

Thomas A. Gendron and Robert F. Weber, Jr., evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-Q. Based on their evaluations, they concluded that our disclosure controls and procedures were effective as of December 31, 2016.

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

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Item 1A.Risk Factors

Investment in our securities involves risk. An investor or potential investor should consider the risks summarized under the caption "Risk Factors" in Part I, Item 1A of our most recent Form 10-K when making investment decisions regarding our securities. The risk factors that were disclosed in our most recent Form 10-K have not materially changed since the date our most recent Form 10-K was filed with the SEC.

Item 2.Unregistered Sales of Equity Securities and Use of Proceeds

Sales of Unregistered Securities

None.

| Issuer Purchases of Equity Securities (In thousands, except for shares and per share amounts) | Total Number of Shares Purchased | Weighted Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased under the Plans or Programs at Period End (1) |
|--|----------------------------------|---------------------------------------|--|--|
| October 1, 2016 through October 31, 2016 (2) | 290 | \$ 69.05 | - | \$ 50,000 |
| November 1, 2016 through November 30, 2016 (2) | 127,862 | 68.07 | 109,000 | 492,599 |
| December 1, 2016 through December 31, 2016 (2) | 247,978 | 68.90 | 241,000 | 475,996 |

(1) In November 2017, our Board of Directors terminated the Company's prior stock repurchase program and replaced it with a new program for the repurchase of up to \$500,000 of Woodward's outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period that will end in 2019.

- (2) Under a trust established for the purposes of administering the Woodward Executive Benefit Plan, 290 shares of common stock were acquired in October 2016, 18,613 shares of common stock were acquired in November 2016 and 6,978 shares of common stock were acquired in December 2016, each on the open market related to the deferral of compensation by certain eligible members of Woodward's management who irrevocably elected to invest some or all of their deferred compensation in Woodward common stock. In addition, 249 shares of common stock were acquired on the open market related to the reinvestment of dividends for shares of treasury stock held for deferred compensation in November 2016. Shares owned by the trust, which is a separate legal entity, are included in "Treasury stock held for deferred compensation" in the Consolidated Balance Sheets

Item

Item 5. Other Information

Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers

As described below, on January 25, 2017, the stockholders of Woodward, Inc. (the "Company") approved the Company's 2017 Omnibus Incentive 2017 Plan (the "2017 Plan"), which replaced the 2006 Omnibus Incentive Plan. The 2017 Plan permits the Company to grant various types of incentive awards, including: (1) stock options, (2) stock appreciation rights, (3) restricted stock, (4) performance units, (5) performance shares, (6) restricted stock units, (7) other stock-based awards, (8) annual incentive awards, and (9) cash-based awards (collectively, "awards"). A total of 2,000,000 shares of common stock of the Company are reserved for issuance under the 2017 Plan, but only 200,000 shares may be issued as "full value awards" (for example, restricted stock, performance shares and restricted stock units). Under the 2017

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Plan, employees, non-employee directors and consultants are eligible to be selected to receive awards, as determined by a committee of the Company's board of directors.

As of September 14, 2016, the effective date of the 2017 Plan, the compensation committee of the board (the "Committee") was delegated authority to administer the 2017 Plan, including but not limited to, the power to determine the recipients of awards and the terms of those awards. The Committee approved grants of options under the 2017 Plan, with an award date of October 3, 2016, to the Company's officers, including but not limited to: Thomas A. Gendron, Chairman, Chief Executive Officer and President (who received 181,200 options); Robert F. Weber, Jr., Vice Chairman, Chief Financial Officer and Treasurer (37,700 options); Martin V. Glass, President, Airframe Systems (23,300 options); Sagar A. Patel, President, Aircraft Turbine Systems (25,400 options); and A. Christopher Fawzy, Corporate Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer (24,700 options). These same options also were described in the proxy statement for the Company's 2016 Annual Meeting of Stockholders (the "2016 Annual Meeting") held on January 25, 2017 and were subject to stockholder approval at the 2016 Annual Meeting. Had stockholders not approved the 2017 Plan, these options would have been cancelled. The options have an exercise price of \$62.57 (which was the closing price of the Company's shares on NASDAQ on the grant date) and a maximum term of 10 years, and are scheduled to vest over four years at the rate of 25% per year, subject to continued status as a service provider to the Company.

On November 15, 2016, the Committee granted cash-based target cash incentive opportunities under the 2017 Plan to these same officers as follows: Mr. Gendron (\$925,000 under the Company's Variable Incentive Plan ("WVIP") and \$462,500 under the Company's Long-Term Incentive Plan ("LTIP")); Mr. Weber (\$378,750 under the WVIP and \$202,000 under the LTIP); Mr. Glass (\$284,050 under the WVIP and \$152,950 under the LTIP); Mr. Patel (\$305,500 under the WVIP and \$164,500 under the LTIP); and Mr. Fawzy (\$266,500 under the WVIP and \$102,500 under the LTIP). These awards also were shown in the proxy statement for the 2016 Annual Meeting and would have been cancelled had the stockholders not approved the 2017 Plan. Payment of the WVIP and LTIP awards are not guaranteed, and the actual amount paid (if any) will depend on the achievement of performance goals previously set by the Committee. For the WVIP, the goals relate to net earnings of the Company, adjusted EPS, adjusted EBITDA margin, business group adjusted OEAB margin, and strategic performance measures. For the LTIP, the goals pertain to relative earnings per share and return on capital.

Item 6.Exhibits

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: January 25, 2017 WOODWARD, INC.
/s/ Thomas A. Gendron
Thomas A. Gendron
Chairman of the Board, Chief Executive Officer, and President

(Principal Executive Officer)

Date: January 25, 2017 /s/ Robert F. Weber, Jr.
Robert F. Weber, Jr.
Vice Chairman, Chief Financial Officer and Treasurer

(Principal Financial and Accounting Officer)

WOODWARD, INC.

EXHIBIT INDEX

| Exhibit | Description |
|-----------|---|
| * 2017 | 2017 Omnibus Incentive Plan |
| * Form | Form of Nonqualified Stock Option Agreement under the 2017 Omnibus Incentive Plan |
| * Rule | Rule 13a-14(a)/15d-14(a) certification of Thomas A. Gendron |
| * Rule | Rule 13a-14(a)/15d-14(a) certification of Robert F. Weber, Jr. |
| * Section | Section 1350 certifications |
| * XBRL | XBRL Instance Document |
| * XBRL | XBRL Taxonomy Extension Schema Document |
| * XBRL | XBRL Taxonomy Extension Calculation Linkbase Document |
| * XBRL | XBRL Taxonomy Extension Definition Linkbase Document |
| * XBRL | XBRL Taxonomy Extension Label Linkbase Document |
| * XBRL | XBRL Taxonomy Extension Presentation Linkbase Document |

Attached as Exhibit 101 to this report are the following materials from Woodward, Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 31, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Statements of Earnings, (ii) the Condensed Consolidated Statements of Comprehensive Earnings, (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, (v) the Condensed Consolidated Statements of Stockholders' Equity, and (vi) the Notes to the Condensed Consolidated Financial Statements.

* Filed as an exhibit to this Report