

Woodward, Inc.
Form 10-Q
February 08, 2019

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, 2018

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 every Interactive Data File required to be submitted 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 such files).

Yes No

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

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 February 5, 2019, 62,082,576 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,	
	2018	2017
Net sales	\$ 652,811	\$ 470,148
Costs and expenses:		
Cost of goods sold	492,174	347,627
Selling, general and administrative expenses	51,927	46,459
Research and development costs	38,867	34,786
Interest expense	11,878	8,872
Interest income	(371)	(363)
Other expense (income), net (Note 17)	(3,179)	(4,720)
Total costs and expenses	591,296	432,661
Earnings before income taxes	61,515	37,487
Income tax expense	12,395	19,227
Net earnings	\$ 49,120	\$ 18,260
Earnings per share (Note 4):		
Basic earnings per share	\$ 0.79	\$ 0.30
Diluted earnings per share	\$ 0.77	\$ 0.29
Weighted Average Common Shares Outstanding (Note 4):		
Basic	61,818	61,246
Diluted	64,059	63,709

See accompanying Notes to Condensed Consolidated Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands)

(Unaudited)

Three-Months Ended
December 31,
2018 2017

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Net earnings	\$ 49,120	\$ 18,260
Other comprehensive earnings:		
Foreign currency translation adjustments	(1,734)	5,103
Net gain (loss) on foreign currency transactions designated as hedges of net investments in foreign subsidiaries (Note 8)	649	(743)
Taxes on changes in foreign currency translation adjustments	383	187
Foreign currency translation and transactions adjustments, net of tax	(702)	4,547
Unrealized gain (loss) on fair value adjustment of derivative instruments (Note 8)	18,563	-
Reclassification of net realized (gains) losses on derivatives to earnings (Note 8)	(7,826)	(18)
Taxes on changes in derivative transactions	(208)	7
Derivative adjustments, net of tax	10,529	(11)
Curtailment of postretirement benefit plan arising during the period	-	59
Amortization of pension and other postretirement plan:		
Net prior service cost	176	137
Net loss	239	246
Foreign currency exchange rate changes on pension and other postretirement benefit plan liabilities	303	(99)
Taxes on changes in pension and other postretirement benefit plan liability adjustments, net of foreign currency exchange rate changes	(209)	(132)
Pension and other postretirement benefit plan adjustments, net of tax	509	211
Total comprehensive earnings	\$ 59,456	\$ 23,007

See accompanying Notes to Condensed Consolidated Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	December 31, 2018	September 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents, including restricted cash of \$0 and \$3,635, respectively	\$ 71,634	\$ 83,594
Accounts receivable, less allowance for uncollectible amounts of \$3,995 and \$3,938, respectively	489,529	432,003
Inventories	524,500	549,596
Income taxes receivable	3,769	6,397
Other current assets	37,004	43,207
Total current assets	1,126,436	1,114,797
Property, plant and equipment, net	1,060,556	1,060,005
Goodwill	809,480	813,250
Intangible assets, net	673,286	700,883
Deferred income tax assets	15,172	16,570
Other assets	175,606	85,144
Total assets	\$ 3,860,536	\$ 3,790,649
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term borrowings	\$ 160,000	\$ 153,635
Accounts payable	224,890	226,285
Income taxes payable	19,899	16,745
Accrued liabilities	171,137	194,513
Total current liabilities	575,926	591,178
Long-term debt, less current portion	1,024,872	1,092,397
Deferred income tax liabilities	168,409	170,915
Other liabilities	460,462	398,055
Total liabilities	2,229,669	2,252,545
Commitments and contingencies (Note 21)		
Stockholders' equity:		
Preferred stock, par value \$0.003 per share, 10,000 shares authorized, no shares issued	-	-
Common stock, par value \$0.001455 per share, 150,000 shares authorized, 72,960 shares issued	106	106
Additional paid-in capital	195,894	185,705
Accumulated other comprehensive losses	(64,648)	(74,942)
Deferred compensation	9,015	8,431

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Retained earnings	2,034,877	1,966,643
	2,175,244	2,085,943
Treasury stock at cost, 11,096 shares and 11,203 shares, respectively	(535,362)	(539,408)
Treasury stock held for deferred compensation, at cost, 209 shares and 202 shares, respectively	(9,015)	(8,431)
Total stockholders' equity	1,630,867	1,538,104
Total liabilities and stockholders' equity	\$ 3,860,536	\$ 3,790,649

See accompanying Notes to Condensed Consolidated Financial Statements.

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WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three-Months Ended December 31,	
	2018	2017
Net cash provided by (used in) operating activities	\$ 84,712	\$ (2,533)
Cash flows from investing activities:		
Payments for purchase of property, plant, and equipment	(31,346)	(28,450)
Proceeds from sale of assets	249	132
Proceeds from sales of short-term investments	27	-
Payments for purchases of short-term investments	(947)	(791)
Net cash used in investing activities	(32,017)	(29,109)
Cash flows from financing activities:		
Cash dividends paid	(8,808)	(7,656)
Proceeds from sales of treasury stock	3,384	1,389
Borrowings on revolving lines of credit and short-term borrowings	542,847	458,950
Payments on revolving lines of credit and short-term borrowings	(501,218)	(425,250)
Payments of long-term debt and capital lease obligations	(100,132)	(106)
Net cash (used in) provided by financing activities	(63,927)	27,327
Effect of exchange rate changes on cash and cash equivalents	(728)	2,542
Net change in cash and cash equivalents	(11,960)	(1,773)
Cash and cash equivalents at beginning of year	83,594	87,552
Cash and cash equivalents, including restricted cash, at end of period	\$ 71,634	\$ 85,779

See accompanying Notes to Condensed Consolidated Financial Statements

WOODWARD, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

(Unaudited)

		Stockholders' equity									
						Accumulated other comprehensive (loss) earnings					
		Treasury stock held for deferred compensation	Common stock	Additional paid-in capital	Foreign currency translation adjustments	Unrealized derivative gains (losses)	Minimum retirement benefit liability adjustments	Total accumulated other comprehensive earnings (loss)	Deferred compensation	Retained earnings	Treasury stock cost
50	(11,739)	(186)	\$ 106	\$ 163,836	\$ (27,280)	\$ 135	\$ (26,041)	\$ (53,186)	\$ 7,135	\$ 1,820,268	\$ (5,182,268)
	-	-	-	-	-	-	-	-	-	18,260	-
	-	-	-	-	4,547	(11)	211	4,747	-	-	-
	-	-	-	-	-	-	-	-	-	(7,656)	-
33	-	-	-	214	-	-	-	-	-	-	1,041
	-	-	-	12,423	-	-	-	-	-	-	-
	-	(14)	-	-	-	-	-	-	1,041	-	-
	-	-	-	-	-	-	-	-	(3)	-	-

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50	(11,706)	(200)	\$ 106	\$ 176,473	\$ (22,733)	\$ 124	\$ (25,830)	\$ (48,439)	\$ 8,173	\$ 1,830,872	\$ (5
50	(11,203)	(202)	\$ 106	\$ 185,705	\$ (39,794)	\$ (20,942)	\$ (14,206)	\$ (74,942)	\$ 8,431	\$ 1,966,643	\$ (5
-	-	-	-	-	(42)	-	-	(42)	-	28,927	-
-	-	-	-	-	-	-	-	-	-	(1,005)	-
-	-	-	-	-	-	-	-	-	-	49,120	-
-	-	-	-	-	(702)	10,529	509	10,336	-	-	-
-	-	-	-	-	-	-	-	-	-	(8,808)	-
107	-	-	-	(662)	-	-	-	-	-	-	4
-	-	-	-	10,851	-	-	-	-	-	-	-
-	(8)	-	-	-	-	-	-	-	591	-	-
-	1	-	-	-	-	-	-	-	(7)	-	-
50	(11,096)	(209)	\$ 106	\$ 195,894	\$ (40,538)	\$ (10,413)	\$ (13,697)	\$ (64,648)	\$ 9,015	\$ 2,034,877	\$ (5

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, 2018 and for the three-months ended December 31, 2018 and December 31, 2017, 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, 2018, 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, 2018 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, variable consideration including customer rebates earned and payable and early payment discounts, 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, the valuation of assets and liabilities acquired in business combinations, the valuation of derivative instruments, 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, board members and any other eligible recipients, estimates of total lifetime sales used in the recognition of revenue of deferred material rights and balance sheet classification of the related contract liability, estimates of total sales contract costs when recognizing revenue under the cost-to-cost method and contingencies. Actual results could vary from Woodward’s estimates.

In the September 30, 2018 Balance Sheet, “Accounts receivable” has increased by \$183 and “Other current assets” has decreased by \$183, reflecting the reclassification of current unbilled receivables to “Accounts receivable” in order to conform to the current year presentation.

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 ASC are communicated through issuance of an Accounting Standards Update (“ASU”).

In August 2018, the FASB issued ASU 2018-14, “Compensation – Retirement Benefits – Defined Benefit Plans - General (Topic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plan.” ASU 2018-14 amends ASC 715 to add, remove, and modify disclosure requirements related to defined benefit pension and other postretirement plans. The ASU’s changes to disclosures aim to improve the effectiveness of ASC 715’s disclosure requirements under the FASB’s disclosure framework project. ASU 2018-14 is effective for public entities for fiscal years beginning after December 15, 2020 (fiscal year 2022 for Woodward). ASU 2018-14 does not impact the interim disclosure requirements of ASC 715. The amendments in ASU 2018-14 should be applied on a retrospective basis to all periods presented. Early adoption is permitted. Woodward expects to adopt the new and modified disclosures requirements of this new guidance in fiscal year 2022.

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In February 2018, the FASB issued ASU 2018-02, “Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the enactment of tax reform under H.R.1, “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (the “Tax Act”) (also known as “The Tax Cuts and Jobs Act”), and provides guidance on the disclosure requirements regarding the stranded tax effects. The amendments in ASU 2018-02 are effective for all entities for fiscal years beginning after December 15, 2018 (fiscal year 2020 for Woodward), and interim periods within those fiscal years. Early adoption is permitted. The amendments in ASU 2018-02 may be applied retrospectively in the period of adoption to all periods in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized or may be applied as of the beginning of the period of adoption. Woodward is currently assessing the impact of the adoption of the new guidance and has not yet elected the method of adoption it will apply. Woodward expects to adopt the new guidance under ASU 2018-02 in fiscal year 2020. Upon adoption, if Woodward elects to reclassify under ASU 2018-02, a portion of accumulated other comprehensive earnings would be reclassified to retained earnings.

In March 2017, the FASB issued ASU 2017-07, “Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” ASU 2017-07 requires that the service cost component of net periodic benefit costs from defined benefit and other postretirement benefit plans be included in the same statement of earnings captions as other compensation costs arising from services rendered by the covered employees during the period. The other components of net benefit cost are presented in the statement of earnings separately from service costs. ASU 2017-07 is effective for fiscal years beginning after December 31, 2017 (fiscal year 2019 for Woodward). Following adoption, only service costs will be eligible for capitalization into manufactured inventories, which should reduce diversity in practice. The amendments of ASU 2017-07 must be applied retrospectively for the presentation of the service cost component and the other components of net periodic benefit costs from defined benefit and other postretirement benefit plans in the statement of earnings and prospectively, on and after the effective date, for the capitalization of the service cost component into manufactured inventories. Woodward adopted the new guidance effective October 1, 2018 and concluded it had no impact on net earnings. As a result of the adoption of ASU 2017-07, only the service component of net periodic benefit costs from defined benefit and other postretirement benefit plans are included in cost of goods sold and selling, general and administrative expenses. All other net periodic benefit costs, other than interest cost, are included on other expense (income), net. The interest cost component of net periodic benefit costs is included in interest expense as Woodward believes it is more similar to the elements within interest expense than other expense (income), net, which combines several elements that are heterogeneous (see Note 17, Other (income) expense, net.), thus improving consistency for users of the financial statements.

The following table shows the impact of retrospectively applying this guidance to the Condensed Consolidated Statement of Earnings for the three-months ended December 31, 2017.

	Three-Months Ended December 31, 2017		
	As previously reported	Adjustment	As recast
Net sales	\$ 470,148	\$ -	\$ 470,148
Costs and expenses:			
Cost of goods sold	346,784	843	347,627
Selling, general, and administrative expenses	46,276	183	46,459
Research and development costs	34,786	-	34,786

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Interest expense	6,750	2,122	8,872
Interest income	(363)	-	(363)
Other expense (income), net	(1,572)	(3,148)	(4,720)
Total costs and expenses	432,661	-	432,661
Earnings before income taxes	37,487	-	37,487
Income tax expense	19,227	-	19,227
Net earnings	\$ 18,260	\$ -	\$ 18,260

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. Woodward adopted the new guidance on October 1,

2018. Modified retrospective adoption is required with any cumulative-effect adjustment recorded to retained earnings as of the beginning of the period of adoption. The cumulative impact of the adoption of ASU 2016-16 of \$1,005 was recognized at the date of adoption as a decrease to both retained earnings and other current assets at the Condensed Consolidated Balance Sheet.

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. Modified retrospective adoption is required with any cumulative-effect adjustment recorded to retained earnings as of the beginning of the period of adoption. 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 expects to adopt the new guidance in fiscal year 2021. Woodward 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. In addition, ASU 2016-02 modifies the definition of a lease to clarify that an arrangement contains a lease when such arrangement conveys the right to control the use of an identified asset. 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. Originally under ASU 2016-02, an organization was required upon adoption to recognize and measure leases beginning in the earliest period presented using a modified retrospective approach and restate the financial statements for all periods presented. In July 2018, the FASB issued ASU 2018-11, which amends ASU 2016-02 to provide organizations with an additional (and optional) transition method whereby it may elect to recognize and measure leases by applying the cumulative impact of adopting ASU 2016-02 to the opening retained earnings balance in the period of adoption, thereby removing the requirement that the financial statements of prior periods be restated. Although early adoption is permitted, Woodward expects to adopt the new guidance in fiscal year 2020. Woodward expects that it will elect to not restate fiscal years 2018 and 2019 and will recognize the cumulative impact of adopting the standard in Woodward’s opening retained earnings for fiscal year 2020. Woodward is currently assessing the impact this guidance may have on its Condensed Consolidated Financial Statements, including which of its existing lease arrangements will be impacted by the new guidance and whether other arrangements not currently classified as leases may become subject to the guidance of ASU 2016-02, and the possible impacts to embedded leases within existing service arrangements not classified as leases under the previous guidance. Rent expense for all operating leases in fiscal year 2018, none of which was recognized on the balance sheet, was \$8,348. As of September 30, 2018, future minimum rental payments required under operating leases, none of which were recognized on the balance sheet, were \$26,020. Woodward expects to recognize a higher level of lease commitments after the new guidance is adopted.

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. Woodward adopted ASC 606 on October 1, 2018 using the modified retrospective transition method with the cumulative effect of initial adoption recognized at the date of initial application. See Note 3, Revenue, for disclosures and financial statement impacts related to implementation and adoption of ASC 606.

Note 3. Revenue

Adoption of ASC 606

Woodward adopted ASC 606 on October 1, 2018 and elected the modified retrospective transition method. The results for periods prior to fiscal year 2019 were not adjusted for the new standard and the cumulative effect of the change in accounting of \$28,927 was recognized as a net increase to retained earnings at the date of adoption.

Woodward has elected to apply the modified retrospective method only to contracts that were not completed as of October 1, 2018. As a practical expedient under ASC 606, Woodward elected to reflect the aggregate effect of all modifications that occurred before the beginning of fiscal year 2019 to contracts for which Woodward had not recognized all revenue as of October 1, 2018 as part of the adjustment to retained earnings at the date of adoption.

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Revenue Recognition Policy

Revenue is recognized on contracts with Woodward's customers for arrangements in which quantities and pricing are fixed and/or determinable and are generally based on customer purchase orders, often within the framework of a long-term supply arrangement with the customer. Woodward has determined that it is the principal in its sales transactions, as Woodward is primarily responsible for fulfilling the promised performance obligations, has discretion to establish the selling price, and generally assumes the inventory risk. A performance obligation is a promise in a contract with a customer to transfer a distinct product or service to the customer. Woodward recognizes revenue for performance obligations within a customer contract when control of the associated product or service is transferred to the customer. Some of Woodward's contracts with customers contain a single performance obligation, while other contracts contain multiple performance obligations. Each product within a contract generally represents a separate performance obligation as Woodward does not provide significant installation and integration services, the products do not customize each other, and the products can function independently of each other.

A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the customer obtains control of the associated product or service. When there are multiple performance obligations within a contract, Woodward generally uses the observable standalone sales price for each distinct product or service within the contract to allocate the transaction price to the distinct products or services. In instances when a standalone sales price for each product or service is not observable within the contract, Woodward allocates the transaction price to each performance obligation using an estimate of the standalone selling price for each product or service, which is generally based on incurred costs plus a reasonable margin, for each distinct product or service in the contract.

When determining the transaction price of each contract, Woodward considers contractual consideration payable by the customer and variable consideration that may affect the total transaction price. Variable consideration, consisting of early payment discounts, rebates and other sources of price variability, are included in the estimated transaction price based on both customer-specific information as well as historical experience. Woodward's contracts with customers generally do not include a financing component. Woodward regularly reviews its estimates of variable consideration on the transaction price and recognizes changes in estimates on a cumulative catch-up basis as if the most current estimate of the transaction price adjusted for variable consideration had been known as of the inception of the contract. In the three-months ended December 31, 2018, Woodward did not recognize a significant amount of revenue due to changes in transaction price from performance obligations that were satisfied, or partially satisfied, in prior periods.

Customers sometimes trade in used products in exchange for new or refurbished products. In addition, Woodward's customers sometimes provide inventory to Woodward which will be integrated into final products sold to those customers. Woodward obtains control of these exchanged products and customer provided inventory, and therefore, both are forms of noncash consideration. Noncash consideration paid by customers on overall sales transactions is additive to the transaction price. Woodward's net sales and cost of goods sold include the value of such noncash consideration for the same amount, with no resulting impact to earnings before income taxes. Upon receipt of such inventory, Woodward recognizes an inventory asset and a contract liability. For the three-months ended December 31, 2018, Woodward recognized revenue of \$17,057 related to noncash consideration received from customers, of which \$16,706 was recognized in the Aerospace segment and \$351 was recognized in the Industrial segment.

Sales of Products

Woodward primarily generates revenue through the manufacture and sale of engineered aerospace and industrial products, including revenue derived from maintenance, repair and overhaul ("MRO") performance obligations performed on products originally manufactured by Woodward and subsequently returned by original equipment manufacturer ("OEM") or other end-user customers. The majority of Woodward's costs incurred to satisfy MRO performance obligations are related to replacing and/or refurbishing component parts of the returned products to restore the units back to a condition generally comparable to that of the unit upon its initial sale to an OEM

customer. Therefore, Woodward considers almost all of its revenue to be derived from product sales, including those related to MRO.

Revenue from manufactured and MRO products represented 87% and 11%, respectively, of Woodward's net sales for the three-months ended December 31, 2018.

Many Woodward products include embedded software or firmware that is critical to the performance of the product as designed. As the embedded software or firmware is essential to the functioning of the products sold it does not represent a distinct performance obligation separate from the related tangible product in which the software or firmware is embedded. Woodward does not generally sell or license software or firmware on a standalone basis. Software or firmware upgrades, if any, are generally paid for by the customer and treated as separate performance obligations.

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The products Woodward sells generally are not subject to risk of return, refund or other similar obligations. Woodward's sales include product warranty arrangements with customers which are generally assurance-type warranties, rather than service-type warranties. Accordingly, Woodward accounts for warranty related promises to its customers as a guarantee for which a warranty liability is recorded when the related product or service is sold, rather than as a distinct performance obligation accounted for separately from the sale of the underlying product or service. Warranty liabilities are accrued for based on specifically identified warranty issues that are probable to result in future costs, or on a non-specific basis whenever past experience indicates that a normal and predictable pattern exists.

Revenue from shipping and handling activities charged to customers are included in net sales when invoiced to the customer and the related costs are included in cost of goods sold. As a practical expedient under ASC 606, Woodward has elected to account for the costs of shipping and handling activities as a cost to fulfill a contract and not a promised product or service. Shipping and handling costs relating to the sale of products recognized at a point in time are recognized as incurred. Shipping and handling costs relating to the sale of products or services recognized over time are accrued and recognized during the earnings process.

Material Rights and Costs to Fulfill a Contract

Customers sometimes pay consideration to Woodward for product engineering and development activities that do not result in the immediate transfer of distinct products or services to the customer. There is an implicit assumption that without the customer making such advance payments to Woodward, Woodward's future sales of products or services to the customer would be at a higher selling price; therefore, such payments create a "material right" to the customer that effectively gives the customer an option to acquire future products or services, at a discount, that are dependent upon the product engineering and development. Material rights are recorded as contract liabilities and will be recognized when control of the related products or services are transferred to the customer.

Woodward capitalizes costs of product engineering and development identified as material rights up to the amount of customer funding as costs to fulfill a contract because the costs incurred up to the amount of the customer funding commitment are recoverable. Due to the uncertainty of the product success and/or demand, fulfillment costs in excess of the customer funding are expensed as incurred. Woodward recognizes the deferred material rights as revenue based on a percentage of actual sales to total estimated lifetime sales of the related developed products as the customers exercise their option to acquire additional products or services at a discount. Woodward amortizes the capitalized costs to fulfill a contract as cost of goods sold proportionally to the recognition of the associated deferred material rights. Estimated total lifetime sales are reviewed at least annually and more frequently when circumstances warrant a modification to the previous estimate. For the three-months ended December 31, 2018 Woodward recognized an increase in revenue of \$620 and cost of goods sold of \$182 related to changes in estimated total lifetime sales.

As of December 31, 2018, other assets included \$92,091 of capitalized costs to fulfill contracts with customers. Other than amounts related to changes in estimate, during the three-months ended December 31, 2018, Woodward amortized no capitalized costs to fulfill contracts with customers to cost of goods sold.

In 2016, Woodward contributed certain contractual rights and intellectual property to a joint venture with the General Electric Company ("GE"). In exchange for a 50% ownership interest in the joint venture and future rights to purchase products from the joint venture at favorable pricing, GE agreed to pay total consideration of \$323,410 to Woodward. Under previous accounting guidance, Woodward concluded that the formation of the joint venture was not the culmination of an earnings event and deferred recognition of the consideration paid until earned in the future. Under ASC 606, Woodward also concluded that the formation of the joint venture was not a culmination of an earnings event and has further concluded that the consideration paid or receivable from GE represents a material right. Accordingly, under both ASC 606 and the previous standard, Woodward concluded it was appropriate to defer the consideration received as a liability and recognized it as an increase to net sales in proportion to revenue realized on sales of applicable fuel systems within the scope of the joint venture. Recognition to net sales in a particular period

is determined 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 joint venture. As of the adoption of ASC 606, Woodward has classified this as a contract liability with both a current and noncurrent portion. For further discussion of Woodward's joint venture, see Note 6, Joint venture.

Woodward does not record incremental costs of obtaining a contract, as Woodward does not pay sales commissions or incur other incremental costs related to contracts with Woodward's customers for arrangements in which quantities and pricing are fixed and/or determinable.

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Point in time and over time revenue recognition

Approximately one-half of Woodward's customer contracts are recognized at the point in time when control of the products transfers to the customer, generally upon shipment of products, consistent with Woodward's historical revenue recognition model. The remaining portion of Woodward's revenues from sales of products and services to customers are recognized over time, rather than at a point in time, due primarily to the terms of certain customer contracts and/or the type of performance obligation being satisfied, as described below.

The following table reflects the amount of revenue recognized as point in time or over time for the three-months ended December 31, 2018:

	Three-Months Ended December 31, 2018		
	Aerospace	Industrial	Consolidated
Point in time	\$ 164,014	\$ 172,162	\$ 336,176
Over time	228,873	87,762	316,635
Total net sales	\$ 392,887	\$ 259,924	\$ 652,811
Point in time			

Control of the products generally transfers to the customer at a point in time, as the customer does not control the products as they are produced. Woodward exercises judgment and considers the timing of right of payment, transfer of the risk and rewards, transfers of title, transfer of physical possession, and customer acceptance when determining when control of the product transfers to the customer, generally upon shipment of products, consistent with Woodward's historical revenue recognition model.

Over time

Performance obligations are satisfied and revenue is recognized over time if: (i) the customer receives the benefits as Woodward performs work, if the customer controls the asset as it is being enhanced, or if the product being produced for the customer has no alternative use to Woodward; and (ii) Woodward has an enforceable right to payment with a profit. For products being produced for the customer that have no alternative use to Woodward and Woodward has an enforceable right to payment with a profit, and where the products are substantially the same and have the same pattern of transfer to the customer, revenue is recognized as a series of distinct products. As Woodward satisfies MRO performance obligations, revenue is recognized over time, as the customer, rather than Woodward, controls the asset being enhanced. When services are provided, revenue from those services is recognized over time because control is transferred continuously to customers as Woodward performs the work. As a practical expedient, revenue for services that are short-term in nature are recognized using an output method as the customer is invoiced, as the invoiced amount corresponds directly to Woodward's performance to date on the arrangement.

For services that are not short-term in nature, MRO, and sales of products that have no alternative use to Woodward and an enforceable right to payment with a profit, Woodward uses an actual cost input measure to determine the extent of progress towards completion of the performance obligation. For these revenue streams, revenue is recognized over time as work is performed based on the relationship between actual costs incurred to-date for each contract and the total estimated costs for such contract at completion of the performance obligation (the cost-to-cost method). Woodward has concluded that this measure of progress best depicts the transfer of assets to the customer, because incurred costs are integral to Woodward's completion of the performance obligation under the specific customer contract and correlate directly to the transfer of control to the customer. Contract costs include labor, material and overhead. Contract cost estimates are based on various assumptions to project the outcome of future

events. These assumptions include labor productivity and availability; the complexity of the work to be performed; the cost and availability of materials; the performance of subcontractors; and the availability and timing of funding from the customer. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred.

As a significant change in one or more of these estimates could affect the profitability of its contracts, Woodward reviews and updates its estimates regularly upon receipt of new contracts with customers. Due to uncertainties inherent in the estimation process, it is reasonably possible that completion costs will be revised. Such revisions to costs and revenue are recognized in the period in which the revisions are determined as a cumulative catch-up adjustment. The impact of the adjustment on profit recorded to date on a contract is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance are recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, Woodward recognizes provisions for estimated losses on uncompleted contracts in the period in which such losses are determined. For the three-months ended December 31, 2018, adjustments to revenue related to changes in estimates were immaterial.

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Occasionally Woodward sells maintenance or service arrangements, extended warranties, or other stand ready services. Woodward recognizes revenue from such arrangements as a series of performance obligations over the time period in which the services are available to the customer.

Contract assets

Customer receivables include amounts billed and currently due from customers as well as unbilled amounts (contract assets) and are included in “Accounts receivable” in Woodward’s Condensed Consolidated Balance Sheets. Amounts are billed in accordance with contractual terms, which are generally tied to shipment of the products to the customer, or as work progresses in accordance with contractual terms. Billed accounts receivable are typically due within 60 days.

Consistent with common business practice in China, Woodward’s Chinese subsidiaries accept bankers’ acceptance notes from Chinese customers in settlement of certain customer billed accounts receivable. Bankers’ acceptance notes are financial instruments issued by Chinese financial institutions as part of financing arrangements between the financial institution and a customer of the financial institution. Bankers’ acceptance notes represent a commitment by the issuing financial institution to pay a certain amount of money at a specified future maturity date to the legal owner of the bankers’ acceptance note as of the maturity date. The maturity date of bankers’ acceptance notes varies, but it is Woodward’s policy to only accept bankers’ acceptance notes with maturity dates no more than 180 days from the date of Woodward’s receipt of such draft. Woodward has elected to adopt the practical expedient to not adjust the promised amounts of consideration for the effects of a significant financing component at contract inception as the financing component associated with accepting bankers’ acceptance notes has a duration of less than one year. Woodward’s contracts with customers generally have no other financing components.

Unbilled amounts arise when the timing of billing differs from the timing of revenue recognized, such as when contract provisions require revenue to be recognized over time rather than at a point in time. Unbilled amounts primarily relate to performance obligations satisfied over time when the cost-to-cost method is utilized and the revenue recognized exceeds the amount billed to the customer as there is not yet a right to payment in accordance with contractual terms. Unbilled amounts are recorded as a contract asset when the revenue associated with the contract is recognized prior to billing and derecognized when billed in accordance with the terms of the contract.

Accounts receivable consisted of the following:

	December 31, 2018	September 30, 2018
Billed receivables		
Trade accounts receivable	\$ 332,792	\$ 403,590
Other (Chinese financial institutions)	40,542	23,191
Less: Allowance for uncollectible amounts	(3,995)	(3,938)
Net billed receivables	369,339	422,843
Current unbilled receivables (contract assets), net	120,190	9,160
Total accounts receivable, net	\$ 489,529	\$ 432,003

As of the October 1, 2018 adoption of ASC 606, Woodward recognized unbilled receivables of \$104,907. The remaining change in unbilled receivables was primarily driven by revenue recognized in excess of billings in Woodward’s Aerospace segment.

In addition, as of December 31, 2018 “Other assets” at the Condensed Consolidated Balance Sheets includes \$444 of unbilled receivables not expected to be invoiced and collected within a period of twelve months. As of September 30, 2018, there were no unbilled receivables not expected to be invoiced and collected within a period of twelve months.

Customer billed receivables are recorded at face amounts, less an allowance for doubtful accounts. In establishing the amount of the allowance related to the credit risk of accounts receivable, customer-specific information is considered related to delinquent accounts, past loss experience, bankruptcy filings, deterioration in the customer's operating results or financial position, and current economic conditions. Bad debt losses are deducted from the allowance, and the related accounts receivable balances are written off when the receivables are deemed uncollectible. Recoveries of accounts receivable previously written off are recognized when received. In the three-months ended December 31, 2018, receivables written off were immaterial. An allowance associated with anticipated other adjustments to the selling price or cash discounts is also established and is included in the allowance for uncollectible amounts. Changes to this allowance are recorded as increases or decreases to net sales as adjustments to the transaction price related to variable consideration. In establishing this amount, both customer-specific information and historical experience are considered.

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Unbilled receivables are stated net of adjustments for credit risk and the anticipated impacts of variable consideration on the transaction price, as applicable.

Billed and unbilled accounts receivable from the U.S. Government were less than 10% of total billed and unbilled accounts receivable at December 31, 2018.

Contract liabilities

Advance payments and billings in excess of revenue recognized represent contract liabilities and are recorded as deferred revenues when customers remit contractual cash payments in advance of Woodward satisfying performance obligations under contractual arrangements, including those with performance obligations satisfied over time. Woodward generally receives advance payments from customers related to maintenance or service arrangements, extended warranties, or other stand ready services, which it recognizes over the performance period. Contract liabilities are derecognized when revenue is recognized and the performance obligation is satisfied. Advance payments and billings in excess of revenue recognized are included in deferred revenue, which is classified as current or noncurrent based on the timing of when Woodward expects to recognize revenue. The current portion is included in "Accrued liabilities" and the noncurrent portion is included in "Other liabilities" at Woodward's Condensed Consolidated Balance Sheets.

Contract liabilities consisted of the following:

	December 31, 2018		September 30, 2018	
	Current	Noncurrent	Current	Noncurrent
Deferred revenue from material rights from GE joint venture formation	\$ 6,988	\$ 232,897	\$ 7,087	\$ 235,300
Deferred revenue advance invoicing and/or prepayments from customers	2,866	-	2,572	-
Liability related to customer supplied inventory	17,283	-	-	-
Deferred revenue from material rights related to engineering and development funding	1,053	86,333	-	-
Net contract liabilities	\$ 28,190	\$ 319,230	\$ 9,659	\$ 235,300

As of the October 1, 2018 adoption of ASC 606, Woodward recognized current liabilities for the noncash consideration provided to Woodward in the form of customer supplied inventory of \$13,141 and current and noncurrent liabilities for deferred revenue from material rights related to engineering and development funding of \$664 and \$79,347, respectively. All other changes in contract liability balances were due to normal operating activities.

Woodward recognized revenue of \$9,760 in the three-months ended December 31, 2018 from contract liabilities balances recorded as of October 1, 2018.

Remaining performance obligations

Remaining performance obligations related to the aggregate amount of the total contract transaction price of firm orders for which the performance obligation has not yet been recognized in revenue as of December 31, 2018 was \$1,630,741, the majority of which relate to Woodward's Aerospace segment. Woodward expects to recognize almost all of these remaining performance obligations within two years after December 31, 2018.

Remaining performance obligations related to material rights that have not yet been recognized in revenue as of December 31, 2018 was \$410,355, of which \$6,585 is expected to be recognized in the remainder of fiscal year 2019, \$9,800 is expected to be recognized in 2020, and the balance is expected to be recognized thereafter. Woodward expects to recognize revenue from performance obligations related to material rights over the life of the underlying programs, which may be as long as forty years.

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Financial statement impact of the adoption of ASC 606

The following schedule quantifies the impact of adopting ASC 606 on the Condensed Consolidated Balance Sheet as of October 1, 2018. The effect of the new standard represents the increase (decrease) in the line item based on the adoption of ASC 606:

	September 30, 2018 as reported	Effect of ASC 606	October 1, 2018 as adjusted
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 83,594	\$ -	\$ 83,594
Accounts receivable, net (1)(2)	432,003	104,907	536,910
Inventories (1)(2)	549,596	(55,002)	494,594
Income taxes receivable (5)	6,397	(959)	5,438
Other current assets	43,207	(154)	43,053
Total current assets	1,114,797	48,792	1,163,589
Property, plant and equipment, net	1,060,005	-	1,060,005
Goodwill	813,250	-	813,250
Intangible assets, net (4)	700,883	(2,519)	698,364
Deferred income tax assets (5)	16,570	(975)	15,595
Other assets (1)(2)(3)	85,144	85,865	171,009
Total assets	\$ 3,790,649	\$ 131,163	\$ 3,921,812
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	\$ 153,635	\$ -	\$ 153,635
Accounts payable	226,285	-	226,285
Income taxes payable (5)	16,745	4,141	20,886
Accrued liabilities (2)(3)	194,513	15,672	210,185
Total current liabilities	591,178	19,813	610,991
Long-term debt, less current portion	1,092,397	-	1,092,397
Deferred income tax liabilities (5)	170,915	3,833	174,748
Other liabilities (3)	398,055	78,631	476,686
Total liabilities	2,252,545	102,277	2,354,822
Stockholders' equity:			
Preferred stock	-	-	-
Common stock	106	-	106
Additional paid-in capital	185,705	-	185,705
Accumulated other comprehensive losses	(74,942)	(41)	(74,983)
Deferred compensation	8,431	-	8,431
Retained earnings	1,966,643	28,927	1,995,570
	2,085,943	28,886	2,114,829
Treasury stock at cost	(539,408)	-	(539,408)
Treasury stock held for deferred compensation	(8,431)	-	(8,431)
Total stockholders' equity	1,538,104	28,886	1,566,990
Total liabilities and stockholders' equity	\$ 3,790,649	\$ 131,163	\$ 3,921,812

- (1) The adoption of ASC 606 changed the revenue recognition practices for a number of revenue generating activities across Woodward's businesses, although the most significant impacts are concentrated in product being produced for customers that have no alternative use to Woodward and Woodward has an enforceable right to payment with a profit, and MRO. The revenue related to these activities, which previously was accounted for on a point in time basis, is now required to use an over time model because the associated contracts meet one or more of the mandatory criteria established in ASC 606, as described above, and are included as current unbilled receivables in "Accounts receivable" and noncurrent unbilled receivables in "Other assets." The change in the timing of revenue recognized in connection with over time contracts similarly changed the timing of manufacturing cost recognition and certain engineering and development costs, which are reflected as a reduction to inventory.

- (2) The value of noncash consideration in the form of exchanged products and other customer provided inventory is reflected in unbilled receivables included in “Accounts receivable,” “Other assets,” and “Inventories,” and in contract liabilities, which are included in “Accrued liabilities.”
- (3) Woodward recorded customer funding of product engineering and development identified as material rights as current and noncurrent deferred revenue contract liabilities included in “Accrued liabilities” and “Other liabilities.” The related customer funded product engineering and development costs were capitalized as costs to fulfill a contract, to the extent of the contractually committed customer funded payments, and are recorded as “Other assets.”
- (4) The net book value of the backlog and customer relationships and contracts intangible assets was adjusted concurrent with the change in the timing of the associated revenue, resulting in a reduction in the net book value of these assets as of the date of adoption.
- (5) The value of tax assets and tax liabilities was impacted by the change in timing of the recognition of assets and liabilities within tax jurisdictions.

The following schedule quantifies the impact of adopting ASC 606 on the Condensed Consolidated Statement of Earnings for the three-months ended December 31, 2018. The effect of the new standard represents the increase (decrease) in the line item based on the adoption of ASC 606.

	Three-Months Ended December 31, 2018, under previous standard	Effect of ASC 606	Three-Months Ended December 31, 2018, as reported
Net sales	\$ 632,641	\$ 20,170	\$ 652,811
Costs and expenses:			
Cost of goods sold	468,690	23,484	492,174
Selling, general, and administrative expenses	52,026	(99)	51,927
Research and development costs	38,714	153	38,867
Interest expense	11,878	-	11,878
Interest income	(371)	-	(371)
Other expense (income), net	(3,179)	-	(3,179)
Total costs and expenses	567,758	23,538	591,296
Earnings before income taxes	64,883	(3,368)	61,515
Income tax expense	13,083	(688)	12,395
Net earnings	\$ 51,800	\$ (2,680)	\$ 49,120
Earnings per share			
Basic earnings per share	\$ 0.84	\$ (0.04)	\$ 0.79
Diluted earnings per share	\$ 0.81	\$ (0.04)	\$ 0.77
Weighted Average Common Shares Outstanding (Note 4):			
Basic	61,818		61,818
Diluted	64,059		64,059

The adoption of ASC 606 resulted in an increase to net sales and cost of goods sold primarily due to the recognition of noncash consideration in the form of customer supplied inventory and the accelerated recognition of revenue and associated cost of goods sold for over time contracts, which would have been recognized at a point in time under the previous standard. The increases were offset by decreases in revenue and cost of goods sold related to the deferral of

amounts due from customers recognized as material rights and over time contracts recognized as of the date of adoption, both of which would otherwise have been recognized as revenue during the period under the previous standard.

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The following schedule quantifies the impact of adopting ASC 606 on the Condensed Consolidated Balance Sheet as of December 31, 2018. The effect of the new standard represents the increase (decrease) in the line item based on the adoption of ASC 606.

	December 31, 2018, under previous standard	Effect of ASC 606	December 31, 2018, as reported
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 71,634	\$ -	\$ 71,634
Accounts receivable, net	374,493	115,036	489,529
Inventories	589,207	(64,707)	524,500
Income taxes receivable	4,677	(908)	3,769
Other current assets	37,181	(177)	37,004
Total current assets	1,077,192	49,244	1,126,436
Property, plant and equipment, net	1,060,556	-	1,060,556
Goodwill	809,480	-	809,480
Intangible assets, net	675,653	(2,367)	673,286
Deferred income tax assets	16,161	(989)	15,172
Other assets	82,806	92,800	175,606
Total assets	\$ 3,721,848	\$ 138,688	\$ 3,860,536
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	\$ 160,000	\$ -	\$ 160,000
Accounts payable	224,890	-	224,890
Income taxes payable	16,393	3,506	19,899
Accrued liabilities	151,471	19,666	171,137
Total current liabilities	552,754	23,172	575,926
Long-term debt, less current portion	1,024,872	-	1,024,872
Deferred income tax liabilities	164,706	3,703	168,409
Other liabilities	374,841	85,621	460,462
Total liabilities	2,117,173	112,496	2,229,669
Stockholders' equity:			
Preferred stock	-	-	-
Common stock	106	-	106
Additional paid-in capital	195,894	-	195,894
Accumulated other comprehensive losses	(64,593)	(55)	(64,648)
Deferred compensation	9,015	-	9,015
Retained earnings	2,008,630	26,247	2,034,877
	2,149,052	26,192	2,175,244
Treasury stock at cost	(535,362)	-	(535,362)
Treasury stock held for deferred compensation	(9,015)	-	(9,015)
Total stockholders' equity	1,604,675	26,192	1,630,867
Total liabilities and stockholders' equity	\$ 3,721,848	\$ 138,688	\$ 3,860,536

The underlying causes of the impacts of the adoption of ASC 606 on the Condensed Consolidated Balance Sheet as of December 31, 2018 are consistent with those as of the date of adoption, October 1, 2018, as discussed above.

The adoption of ASC 606 did not impact cash provided by or used in operating, investing or financing activities in the Condensed Consolidated Statement of Cash Flows for the three-months ended December 31, 2018.

Disaggregation of Revenue

Woodward designs, produces and services reliable, efficient, low-emission, and high-performance energy control products for diverse applications in markets throughout the world. Woodward reports financial results for each of its Aerospace and Industrial reportable segments. Woodward further disaggregates its revenue from contracts with customers by

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primary market and by geographical area as Woodward believes this best depicts how the nature, amount, timing and uncertainty of its revenue and cash flows are affected by economic factors.

Revenue by primary market for the Aerospace reportable segment was as follows:

	Three-Months Ended December 31, 2018
Commercial OEM	\$ 140,508
Commercial aftermarket	111,348
Defense OEM	101,836
Defense aftermarket	39,195
Total Aerospace segment net sales	\$ 392,887

Revenue by primary market for the Industrial reportable segment was as follows:

	Three-Months Ended December 31, 2018
Reciprocating engines	\$ 196,130
Industrial turbines	49,512
Renewables	14,282
Total Industrial segment net sales	\$ 259,924

The customers who account for approximately 10% or more of net sales to each of Woodward's reportable segments for the three-months ended December 31, 2018 follow:

Customer

Aerospace The Boeing Company, General Electric Company, United Technologies Corporation

Industrial Rolls-Royce PLC, Weichai Westport, General Electric Company

Net sales by geographic area, as determined based on the location of the customer, were as follows:

Three-Months Ended December 31, 2018		
Aerospace	Industrial	Consolidated
\$ 286,745	\$ 49,892	\$ 336,637

United States			
Germany	12,749	63,364	76,113
Europe, excluding Germany	39,612	59,348	98,960
Asia	24,006	79,418	103,424
Other countries	29,775	7,902	37,677
Total net sales	\$ 392,887	\$ 259,924	\$ 652,811

Note 4. 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.

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

	Three-Months Ended	
	December 31,	
	2018	2017
Numerator:		
Net earnings	\$ 49,120	\$ 18,260
Denominator:		
Basic shares outstanding	61,818	61,246
Dilutive effect of stock options and restricted stock	2,241	2,463
Diluted shares outstanding	64,059	63,709
Income per common share:		
Basic earnings per share	\$ 0.79	\$ 0.30
Diluted earnings per share	\$ 0.77	\$ 0.29

The following stock option grants were outstanding during the three-months ended December 31, 2018 and 2017, but were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive.

	Three-Months	
	Ended	
	December 31,	
	2018	2017
Options	1,426	754
Weighted-average option price	\$ 79.22	\$ 78.75

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,	
	2018	2017
Weighted-average treasury stock shares held for deferred compensation obligations	206	193

Note 5. Business acquisition

In fiscal year 2018, the Company, and its wholly-owned subsidiary, Woodward Aken GmbH (collectively, the “Purchasers”), entered into a Share Purchase Agreement (the “L’Orange Agreement”) with MTU Friedrichshafen GmbH (“MTU”) and MTU America Inc. (together with MTU, the “Sellers”), both of which were subsidiaries of Rolls-Royce PLC (“Rolls-Royce”). Pursuant to the L’Orange Agreement, the Purchasers agreed to acquire all of the outstanding shares of stock of L’Orange GmbH, together with its wholly-owned subsidiaries in China and Germany, as well as all of the outstanding equity interests of its affiliate, Fluid Mechanics LLC, and their related operations (collectively, “L’Orange”), for total consideration (including cash consideration and the assumption of certain liabilities) of €700,000, or approximately \$811,000 based on the foreign currency exchange rate as of the date Woodward executed cross currency swaps in connection with the financing of the transaction as described in Note 8, Derivative instruments and hedging activities. The total consideration to be paid is subject to customary post-closing adjustments. The transactions contemplated by the L’Orange

Agreement were completed on June 1, 2018 (the “Closing”) and L’Orange became a subsidiary of the Company. Following the Closing, L’Orange was renamed “Woodward L’Orange”.

Woodward L’Orange is a supplier of fuel injection systems for industrial diesel, heavy fuel oil and dual-fuel engines. Woodward L’Orange supplies fuel injection technology for engines that power a wide range of industrial applications including marine power and propulsion systems, special-application off road vehicles, locomotives, oil and gas processing, and power generation. Woodward L’Orange serves many large specialist diesel engine manufacturers, including Rolls-Royce Power Systems’ subsidiaries, MTU and Bergen Engines, and other low to high speed engine builders. Woodward L’Orange has been integrated into the Company’s Industrial segment.

In connection with the Closing, MTU and a subsidiary of Rolls-Royce, and Woodward L’Orange, entered into a long-term supply agreement, dated June 1, 2018 (the “LTSA”). Pursuant to the terms of the LTSA, Woodward L’Orange will continue to supply to MTU and its affiliates within Rolls-Royce certain liquid fuel injection systems, injectors, pumps and other associated parts and components for industrial diesel, heavy fuel oil and dual-fuel engines in a manner consistent with the supply of such products prior to the transaction. The LTSA has an initial term that extends through December 31, 2032. During the term of the LTSA, MTU will continue to purchase certain of these products exclusively from Woodward L’Orange, subject to certain limitations specified therein, at pricing negotiated at arms-length.

ASC Topic 805, “Business Combinations” (“ASC 805”), provides a framework to account for acquisition transactions under U.S. GAAP. The preliminary purchase price of L’Orange, prepared consistent with the required ASC 805 framework, is allocated as follows:

Cash paid to Sellers	\$ 780,401
Less acquired cash and restricted cash	(9,286)
Total purchase price	\$ 771,115

The cash consideration was financed through the use of cash on hand, the issuance of an aggregate principal amount of \$400,000 of senior unsecured notes in a series of private placement transactions and \$167,420 borrowed under Woodward’s existing revolving credit agreement (see Note 14, Credit Facilities, short-term borrowings and long-term debt). In connection with these borrowings, the Company entered into cross currency swap transactions, which effectively lowered the interest rate on each tranche of the senior unsecured notes and the borrowings under the existing revolving credit agreement (see Note 8, Derivative instruments and hedging activities).

The allocation of the purchase price to the assets acquired and liabilities assumed was accounted for under the purchase method of accounting in accordance with ASC 805. Assets acquired and liabilities assumed in the transaction were recorded at their estimated acquisition date fair values, while transaction costs associated with the acquisition were expensed as incurred. Woodward’s preliminary allocation was based on an evaluation of the appropriate fair values and represents management’s best estimate based on available data.

Due to the timing of the transaction, Woodward is in the process of finalizing valuations of current assets, property, plant and equipment (including estimated useful lives), goodwill, intangible assets (including estimated useful lives), and all current and noncurrent liabilities other than the valuation of the pension obligation, the valuation of which is complete. Additionally, Woodward is finalizing the projected combined future tax rate to be applied to the valuation of assets, which could impact the valuation of goodwill and intangible assets. The final determination of the fair value of assets and liabilities will be completed within the one year measurement period as allowed by ASC 805.

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The following table, which is preliminary and subject to change, summarizes the estimated fair values of the assets acquired and liabilities assumed at the Closing. Any potential adjustments will be made retroactively and could be material to the preliminary values presented below.

Accounts receivable	\$ 26,538
Inventories (1)	72,392
Other current assets	1,385
Property, plant, and equipment	89,772
Goodwill	257,447
Intangible assets	573,427
Total assets acquired	1,020,961
Other current liabilities	41,997
Deferred income tax liabilities	166,927
Other noncurrent liabilities	40,922
Total liabilities assumed	249,846
Net assets acquired	\$ 771,115

(1) Inventories include a \$16,324 adjustment to state work in progress and finished goods inventories at their fair value as of the acquisition date. The entire inventory fair value adjustment was recognized as a noncash increase to cost of goods sold ratably over the estimated inventory turnover period during the year ending September 30, 2018.

In connection with the acquisition of L'Orange, Woodward assumed the defined benefit pension obligations of the L'Orange defined benefit pension plans (the "Woodward L'Orange Pension Plans"). Woodward's assumption of the liability associated with the Woodward L'Orange Pension Plans was part of the total consideration paid by Woodward to acquire L'Orange and thus reduced Woodward's cash payment for the transaction. As of June 1, 2018, the total liability recognized by the Company associated with the Woodward L'Orange Pension Plans was \$39,257, of which \$1,143 was considered current.

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

	Estimated Amounts	Weighted-Average Useful Life	Amortization Method
Intangible assets with finite lives:			
Customer relationships and contracts	\$ 388,705	22 years	Straight-line
Process technology	74,260	22 years	Straight-line
Backlog	42,932	1 year	Accelerated
Other	232	3 years	Straight-line
Intangible asset with indefinite life:			
Trade name	67,298	Indefinite	Not amortized
Total	\$ 573,427		

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For the three-months ended December 31, 2018, Woodward recorded amortization expense associated with the acquired intangibles of \$11,693. Future amortization expense associated with the acquired intangibles as of December 31, 2018 is expected to be:

Year Ending September 30:

2019 (remaining)	\$ 21,543
2020	19,627
2021	22,586
2022	22,535
2023	22,535
Thereafter	356,994
	\$ 465,820

The preliminary purchase price allocation resulted in the recognition of \$257,447 of goodwill. Only the portion of goodwill which relates to the U.S. operations of Woodward L'Orange is expected to be deductible for tax purposes. The Company has included all of the goodwill in its Industrial segment. The goodwill represents the estimated value of potential expansion with new customers, the opportunity to further develop sales opportunities with new customers, other synergies including supply chain savings expected to be achieved through the integration of Woodward L'Orange with Woodward's Industrial segment, and intangible assets that do not qualify for separate recognition, such as value of the assembled Woodward L'Orange workforce that is not included within the estimated value of the acquired backlog and customer relationship intangible assets.

Pro forma results for Woodward giving effect to the L'Orange acquisition

The following unaudited pro forma financial information presents the combined results of operations of Woodward and Woodward L'Orange as if the acquisition had been completed as of the beginning of the prior fiscal year, or October 1, 2016. The unaudited pro forma financial information is presented for informational purposes and is not indicative of the results of operations that would have been achieved if the acquisition and related borrowings had taken place on October 1, 2016, nor are they indicative of future results.

The unaudited pro forma financial information for the three-months ended December 31, 2018 includes Woodward's results, including the post-acquisition results of Woodward L'Orange, since June 1, 2018, and the pre-acquisition results of L'Orange for that period. The unaudited pro forma financial information for the three-months ended December 31, 2017 combines Woodward's results with the pre-acquisition results of L'Orange for that period.

Prior to the L'Orange acquisition by Woodward, L'Orange was a wholly owned subsidiary of Rolls-Royce, and as such was not a standalone entity for financial reporting purposes. Accordingly, the historical operating results of L'Orange may not be indicative of the results that might have been achieved, historically or in the future, if L'Orange had been a standalone entity.

The unaudited pro forma results for the three-months ended December 31, 2018 and December 31, 2017 follow:

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	Three-Months Ended December 31, 2018		Three-Months Ended December 31, 2017	
	As reported	Pro forma	As reported	Pro forma
Net sales	\$ 652,811	\$ 652,811	\$ 470,148	\$ 565,993
Net earnings	49,120	53,739	18,260	20,999
Earnings per share:				
Basic earnings per share	\$ 0.79	\$ 0.87	\$ 0.30	\$ 0.34
Diluted earnings per share	0.77	0.84	0.29	0.33

The unaudited pro forma results for all periods presented include adjustments made to account for certain costs and transactions that would have been incurred had the acquisition been completed as of October 1, 2016, including amortization charges for acquired intangible assets, eliminations of intercompany transactions, adjustments for acquisition transaction

costs, adjustments for depreciation expense for property, plant, and equipment, and adjustments to interest expense. These adjustments are net of any applicable tax impact and were included to arrive at the pro forma results above.

The operating results of Woodward L'Orange have been included in Woodward's operating results for the periods subsequent to the completion of the acquisition on June 1, 2018. Woodward L'Orange contributed net sales of \$87,680 for the three-months ended December 31, 2018 and net income before income taxes of \$10,602 for the three-months ended December 31, 2018.

Woodward incurred acquisition financing related costs of \$3,799 for three-months ended December 31, 2018, which are included in "Interest expense" in the Condensed Consolidated Statements of Earnings.

Note 6. 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") to develop, manufacture and support fuel systems 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 had 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, which began on January 4, 2017, subject to certain claw-back conditions. Woodward records annual payments received as deferred income and includes them in Net cash provided by operating activities on the Condensed Consolidated Statement of Cash Flows. Neither Woodward nor GE contributed any tangible assets to the JV.

Under previous accounting guidance, Woodward concluded that the formation of the JV was not the culmination of an earnings event and deferred recognition of the consideration paid until earned in the future. Under ASC 606, Woodward also concluded the formation of the JV was not a culmination of an earnings event and has further concluded that the consideration paid or receivable from GE represents a material right. Accordingly, under both ASC 606 and the previous standard, Woodward concluded it was appropriate to defer the consideration received as a liability and recognized it as an increase to net sales in proportion to revenue realized on sales of applicable fuel systems within the scope of the JV. Recognition to net sales in a particular period is determined 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 revenue from material rights in connection with the JV formation included accrued liabilities of \$6,988 as of December 31, 2018 and \$7,087 as of September 30, 2018, and other liabilities of \$232,897 as of December 31, 2018 and \$235,300 as of September 30, 2018. Amortization of the deferred income (material right) recognized as an increase to sales was \$1,777 for the three-months ended December 31, 2018 and \$1,053 for the three-months ended December 31, 2017.

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 Woodward. Other income includes income of \$1,465 for the three-months ended December 31, 2018 and income of \$596 for the three-months ended December 31, 2017 related to Woodward's equity interest in the

earnings of the JV. During the three-months ended December 31, 2018, Woodward received a \$4,500 cash distribution from the JV, which is included in Net cash provided by operating activities on the Condensed Consolidated Statement of Cash Flows. Woodward received no cash distributions from the JV during the three-months ended December 31, 2017. Woodward's net investment in the JV, which is included in other assets, was \$6,576 as of December 31, 2018 and \$9,611 as of September 30, 2018.

Woodward's net sales include \$12,833 for the three-months ended December 31, 2018 of sales to the JV, compared to \$12,975 for the three-months ended December 31, 2017. Woodward recorded a reduction to sales of \$9,182 for the three-months ended December 31, 2018 related to royalties paid to the JV by Woodward on sales by Woodward directly to third party aftermarket customers, compared to \$5,408 for the three-months ended December 31, 2017. The Condensed Consolidated Balance Sheets include "Accounts receivable" of \$6,916 at December 31, 2018, and \$10,499 at September 30, 2018, related to amounts the JV owed Woodward, and include "Accounts payable" of \$3,063 at December 31, 2018, and \$2,944 at September 30, 2018, related to amounts Woodward owed the JV.

Upon the October 1, 2018 adoption of ASC 606, Woodward recorded \$57,529 of revenue recognized in prior periods for the JV's engineering and development projects as an increase to contract liabilities in "Other liabilities" and \$57,529 of costs

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recognized in prior periods as costs to fulfill a contract in “Other assets.” During the quarter ended December 31, 2018, Woodward recognized an additional \$4,428 of contract liabilities in “Other liabilities” and \$4,428 of additional costs to fulfill a contract in “Other assets.”

Note 7. 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 are significant to the valuation of the instruments.

The table below presents information about Woodward’s financial assets and liabilities that are measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques Woodward utilized to determine such fair value.

	At December 31, 2018				At September 30, 2018			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets:								
Cash	\$ 63,723	\$ -	\$ -	\$ 63,723	\$ 59,838	\$ -	\$ -	\$ 59,838
Investments in reverse repurchase agreements	161	-	-	161	4,582	-	-	4,582
Investments in term deposits with foreign banks	7,750	-	-	7,750	19,174	-	-	19,174
Equity securities	19,059	-	-	19,059	19,730	-	-	19,730
Total financial assets	\$ 90,693	\$ -	\$ -	\$ 90,693	\$ 103,324	\$ -	\$ -	\$ 103,324
Financial liabilities:								
Cross currency interest rate swaps	\$ -	\$ 4,437	\$ -	\$ 4,437	\$ -	\$ 23,000	\$ -	\$ 23,000
Total financial liabilities	\$ -	\$ 4,437	\$ -	\$ 4,437	\$ -	\$ -	\$ -	\$ 23,000

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" in the Condensed Consolidated Balance Sheets. 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.

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. As of September 30, 2018, \$3,635 of the term deposits with foreign banks were restricted in use as they were pledged collateral for short-term borrowings. The restriction lapsed during the first quarter of fiscal year 2019 when the related short-term borrowings were paid.

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 expense (income), net" on the Condensed Consolidated Statements of Earnings. The trading securities

are included in “Other assets” in the Condensed Consolidated Balance Sheets. 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.

Cross currency interest rate swaps: Woodward holds cross currency interest rate swaps, which are accounted for at fair value. The swaps are included in “Other liabilities” in the Condensed Consolidated Balance Sheets. The fair values of Woodward’s cross currency interest rate swaps are determined using a market approach that is based on observable inputs other than quoted market prices, including contract terms, interest rates, currency rates, and other market factors.

Trade accounts receivable, accounts payable, and short-term borrowings 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, 2018		At September 30, 2018	
		Estimated Fair Value	Carrying Cost	Estimated Fair Value	Carrying Cost
Assets:					
Notes receivable from municipalities	2	\$ 13,473	\$ 13,143	\$ 13,458	\$ 13,462
Investments in short-term time deposits	2	10,163	10,168	8,883	8,874
Liabilities:					
Long-term debt	2	\$ (1,017,257)	\$ (1,027,659)	\$ (1,094,987)	\$ (1,095,292)

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, Woodward received long-term notes from municipalities within the states of Illinois and 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 2.7% at December 31, 2018 and 3.1% at September 30, 2018.

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 was determined to be 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 short-term time deposits was 6.4% at December 31, 2018 and 6.3% at September 30, 2018.

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 3.8% at December 31, 2018 and 3.5% at September 30, 2018.

Note 8. 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.

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 counterparties that are believed to be creditworthy. 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.

Derivative instruments not designated or qualifying as hedging instruments

In May 2018, Woodward entered into cross currency interest rate swap agreements that synthetically convert \$167,420 of floating-rate debt under Woodward's existing revolving credit agreement to Euro denominated floating-rate debt in conjunction with the L'Orange acquisition (the "Floating-Rate Cross Currency Swap"). Also in May 2018, Woodward entered into cross currency interest rate swap agreements that synthetically convert an aggregate principal amount of \$400,000 of fixed-rate debt associated with the 2018 Note Purchase Agreement (as defined at Note 14, Credit facilities short-term borrowings and long-term debt) to Euro denominated fixed-rate debt (the "Fixed-Rate Cross Currency Swaps"). The cross currency interest rate swaps, which effectively reduce the interest rate on the underlying fixed and floating-rate debt under the 2018 Notes (as defined at Note 14, Credit facilities short-term borrowings and long-term debt) and Woodward's existing revolving credit agreement, respectively, is recorded as a reduction to "Interest expense" in Woodward's Condensed Consolidated Statements of Earnings.

Derivatives instruments in fair value hedging relationships

Concurrent with the entry into the Floating-Rate Cross Currency Swap, a corresponding Euro denominated intercompany loan receivable with identical terms and notional amount as the underlying Euro denominated floating-rate debt, with a reciprocal cross currency interest rate swap, was entered into by Woodward Barbados Financing SRL ("Barbados"), a wholly owned subsidiary of Woodward, and is designated as a fair value hedge under the criteria prescribed in ASC Topic 815, Derivatives and Hedging ("ASC 815"). The objective of the derivative instrument is to hedge against the foreign currency exchange risk attributable to the spot remeasurement of the Euro denominated intercompany loan.

Only the change in the fair value related to the cross currency basis spread, or excluded component, of the derivative instrument is recognized in accumulated other comprehensive (losses) earnings ("OCI"). The remaining change in the fair value of the derivative instrument is recognized in foreign currency transaction gain or loss included in "Selling, general and administrative costs" in Woodward's Condensed Consolidated Statements of Earnings. The change in the fair value of the derivative instrument in foreign currency transaction gain or loss offsets the change in the spot remeasurement of the intercompany Euro denominated loan. Hedge effectiveness is assessed based on the fair value changes of the derivative instrument, after excluding any fair value changes related to the cross currency basis spread. The initial cost of the cross currency basis spread is recorded in earnings each period through the swap accrual process. There is no credit-risk-related contingent features associated with the floating-rate cross currency interest rate swap.

Derivative instruments in cash flow hedging relationships

In conjunction with the entry into the Fixed-Rate Cross Currency Swaps, five corresponding intercompany loans receivable, with identical terms and amounts of each tranche of the underlying aggregate principal amount of \$400,000 of fixed-rate debt, and reciprocal cross currency interest rate swaps were entered into by Barbados, which are designated as cash flow hedges under the criteria prescribed in ASC 815. The objective of these derivative instruments is to hedge the risk of variability in cash flows attributable to the foreign currency exchange risk of cash flows for future principal and interest payments associated with the Euro denominated intercompany loans over a fifteen year period.

Changes in the fair values of the derivative instruments are recognized in accumulated OCI and reclassified to foreign currency transaction gain or loss included in "Selling, general and administrative costs" in Woodward's Condensed Consolidated Statements of Earnings. Reclassifications out of accumulated OCI of the change in fair value occur each reporting period based upon changes in the spot rate remeasurement of the Euro denominated intercompany loans,

including associated interest. Hedge effectiveness is assessed based on the fair value changes of the derivative instruments and deemed to be highly effective in offsetting exposure to variability in foreign exchange rates. There are no credit-risk-related contingent features associated with these fixed-rate cross currency interest rate swaps.

In June 2013, in connection with Woodward's expected refinancing of current maturities on its then existing long-term debt, Woodward entered into a treasury lock agreement with a notional amount of \$25,000 that qualified as a cash flow hedge under ASC 815. The objective of this derivative instrument was to hedge the risk of variability in cash flows attributable to changes in the designated benchmark interest rate over a seven-year period related to the future principal and interest payments on a portion of anticipated future debt issuances. The treasury lock agreement was terminated in August 2013 and the resulting gain of \$507 was recorded as a reduction to accumulated OCI, net of tax, and is being recognized as a decrease to interest expense over a seven-year period. Woodward expects to reclassify \$72 of net unrecognized gains on terminated derivative instruments from accumulated OCI to earnings during the next twelve months.

Derivatives instruments in net investment hedging relationships

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 Agreement”) 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 (the “Series M Notes”). Woodward designated the Series M Notes as a hedge of a foreign currency exposure of Woodward’s net investment in its Euro denominated functional currency subsidiaries. On the Series M Notes, a foreign exchange gain of \$649 for the three-months ended December 31, 2018 and a foreign exchange loss of \$743 for the three-months ended December 31, 2017 are included in foreign currency translation adjustments within total comprehensive (losses) earnings.

Impact of derivative instruments designated as qualifying hedging instruments

The following table discloses the impact of derivative instruments designated as qualifying hedging instruments on Woodward’s Condensed Consolidated Statements of Earnings:

Derivatives in:	Location	Three-Months Ended December 31, 2018		
		Amount of (Income) Expense Recognized in Earnings on Derivative	Amount of (Gain) Loss Recognized in Accumulated OCI on Derivative	Amount of (Gain) Loss Reclassified from Accumulated OCI into Earnings
Cross currency interest rate swap agreement designated as fair value hedges	Selling, general and administrative expenses	\$ (2,389)	\$ (2,505)	\$ (2,252)
Cross currency interest rate swap agreements designated as cash flow hedges	Selling, general and administrative expenses	(5,556)	(16,058)	(5,556)
Treasury lock agreement designated as cash flow hedge	Interest expense	(18)	-	(18)
		\$ (7,963)	\$ (18,563)	\$ (7,826)
Derivatives in:	Location	Three-Months Ended December 31, 2017		
		Amount of (Income) Expense Recognized in	Amount of (Gain) Loss Recognized in Accumulated OCI on	Amount of (Gain) Loss Reclassified from Accumulated OCI into

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		Earnings on Derivative	Derivative	Earnings on
Cross currency interest rate swap agreement designated as fair value hedges	Selling, general and administrative expenses	\$ -	\$ -	\$ -
Cross currency interest rate swap agreements designated as cash flow hedges	Selling, general and administrative expenses	-	-	-
Treasury lock agreement designated as cash flow hedge	Interest expense	(18)	-	(18)
		\$ (18)	\$ -	\$ (18)

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 OCI were net losses of \$10,578 as of December 31, 2018 and net losses of \$21,315 as of September 30, 2018.

Note 9. Supplemental statement of cash flows information

	Three-Months Ended December 31,	
	2018	2017
Interest paid, net of amounts capitalized	\$ 16,754	\$ 11,302
Income taxes paid	15,858	7,695
Income tax refunds received	444	1,772
Non-cash activities:		
Purchases of property, plant and equipment on account	4,580	10,631
Impact of the adoption of ASC 606 (Note 3)	28,886	-

Note 10. Inventories

	December 31, 2018	September 30, 2018
Raw materials	\$ 98,641	\$ 80,999
Work in progress	124,773	118,010
Component parts (1)	307,938	298,820
Finished goods	57,854	51,767
Customer supplied inventory (Note 3)	17,283	-

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On-hand inventory for which control has transferred to the customer (Note 3)	(81,989)	-
	\$ 524,500	\$ 549,596

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

Note 11. Property, plant, and equipment

	December 31, 2018	September 30, 2018
Land and land improvements	\$ 93,958	\$ 94,146
Buildings and building improvements	566,562	565,065
Leasehold improvements	17,897	17,954
Machinery and production equipment	677,086	668,986
Computer equipment and software	125,272	124,788
Office furniture and equipment	32,210	31,533
Other	19,396	19,366
Construction in progress	109,325	103,036
	1,641,706	1,624,874
Less accumulated depreciation	(581,150)	(564,869)
Property, plant, and equipment, net	\$ 1,060,556	\$ 1,060,005

In the second quarter of fiscal year 2018, the Company announced its decision to relocate its Duarte, California operations to the Company's newly renovated Drake Campus in Fort Collins, Colorado. The Company has identified assets held for sale with a carrying value of \$8,097 at December 31, 2018 and \$8,306 at September 30, 2018, the majority of which are included in "Land and land improvements" and "Buildings and buildings improvements" which relate to the land, building and building improvements, and other assets at the Duarte facility. The assets held for sale are included in the Company's Aerospace segment. The carrying value of the remaining assets at the Duarte facility was approximately \$11,980

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as of December 31, 2018, of which the Company has identified approximately \$325 that is planned to be disposed of as a result of the relocation.

The Company assessed whether the decision to relocate from its Duarte facility could indicate a potential impairment of the assets at the Duarte facility and concluded that the assets were not impaired as of December 31, 2018.

Included in “Office furniture and equipment” and “Other” is \$1,650 at December 31, 2018 and September 30, 2018, of gross assets acquired on capital leases, and accumulated depreciation included \$1,261 at December 31, 2018 and \$1,158 at September 30, 2018 of amortization associated with the capital lease assets.

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 for its Aerospace segment. This campus is intended to support Woodward’s expected growth in its Aerospace segment 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 \$30,585 at December 31, 2018 and \$32,248 at September 30, 2018 associated with new equipment purchases for the greater-Rockford, Illinois campus and costs of \$7,555 at December 31, 2018 and \$3,967 at September 30, 2018 associated with new equipment purchases and the renovation of the Drake Campus.

For the three-months ended December 31, 2018 and 2017, Woodward had depreciation expense as follows:

	Three-Months Ended December 31,	
	2018	2017
Depreciation expense	\$ 21,169	\$ 14,827

For the three-months ended December 31, 2018 and 2017, Woodward capitalized interest that would have otherwise been included in interest expense of the following:

	Three-Months Ended December 31,	
	2018	2017
Capitalized interest	\$ 227	\$ 601

Note 12. Goodwill