

WOODWARD GOVERNOR CO

Form 10-Q

July 25, 2007

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**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 June 30, 2007**
- 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 0-8408

WOODWARD GOVERNOR COMPANY
(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

36-1984010
*(I.R.S. Employer
Identification No.)*

1000 East Drake Road, Fort Collins, Colorado 80525
(Address of principal executive offices)

(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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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 July 18, 2007, 34,474,414 shares of common stock with a par value of \$.002917 cents per share were outstanding.

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Table of Contents**WOODWARD GOVERNOR COMPANY****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**
Consolidated Statements of Earnings

| | Three Months Ended | |
|----------------------------------------------------|-----------------------------------------------------------|-------------|
| | June 30, | |
| | 2007 | 2006 |
| | (Unaudited, in thousands except per share amounts) | |
| Net sales | \$ 269,026 | \$ 217,053 |
| Costs and expenses | | |
| Cost of good sold | 186,055 | 154,089 |
| Selling, general and administrative expenses | 27,345 | 23,234 |
| Research and development costs | 17,011 | 16,793 |
| Amortization of intangible assets | 1,946 | 1,717 |
| Interest expense | 1,156 | 1,299 |
| Interest income | (503) | (754) |
| Other, net | (1,124) | (904) |
| Total costs and expenses | 231,886 | 195,474 |
| Earnings before income taxes | 37,140 | 21,579 |
| Income taxes (benefit) | 13,166 | (7,339) |
| Net earnings | \$ 23,974 | \$ 28,918 |
| Earnings per share: | | |
| Basic | \$ 0.70 | \$ 0.84 |
| Diluted | \$ 0.68 | \$ 0.82 |
| Basic weighted-average common shares outstanding | 34,357 | 34,410 |
| Diluted weighted-average common shares outstanding | 35,338 | 35,254 |
| Cash dividends declared per common share | \$ 0.11 | \$ 0.10 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**WOODWARD GOVERNOR COMPANY****Consolidated Statements of Earnings**

| | Nine Months Ended June 30, | |
|----------------------------------------------------|---------------------------------------------------------------|-------------|
| | 2007 | 2006 |
| | (Unaudited, in thousands except per share amounts) | |
| Net sales | \$ 751,572 | \$ 621,604 |
| Costs and expenses | | |
| Cost of good sold | 519,970 | 448,055 |
| Selling, general and administrative expenses | 84,325 | 69,548 |
| Research and development costs | 46,911 | 41,772 |
| Amortization of intangible assets | 5,856 | 5,230 |
| Interest expense | 3,481 | 3,901 |
| Interest income | (1,563) | (1,995) |
| Other, net | (2,610) | (2,782) |
| Total costs and expenses | 656,370 | 563,729 |
| Earnings before income taxes | 95,202 | 57,875 |
| Income taxes | 33,079 | 5,064 |
| Net earnings | \$ 62,123 | \$ 52,811 |
| Earnings per share: | | |
| Basic | \$ 1.81 | \$ 1.53 |
| Diluted | \$ 1.76 | \$ 1.50 |
| Basic weighted-average common shares outstanding | 34,240 | 34,421 |
| Diluted weighted-average common shares outstanding | 35,199 | 35,268 |
| Cash dividends declared per common share | \$ 0.32 | \$ 0.30 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**WOODWARD GOVERNOR COMPANY****Consolidated Balance Sheets**

| | At June 30, 2007 | At September 30, 2006 |
|---------------------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| | (Unaudited, in thousands) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 68,472 | \$ 83,718 |
| Accounts receivable, less allowance for losses of \$2,114 and \$2,213, respectively | 134,914 | 117,254 |
| Inventories | 188,185 | 149,172 |
| Income taxes receivable | 3,088 | 1,787 |
| Deferred income tax assets | 22,970 | 23,526 |
| Other current assets | 8,591 | 5,777 |
| Current assets | 426,220 | 381,234 |
| Property, plant and equipment, net | 150,600 | 124,176 |
| Goodwill | 133,347 | 132,084 |
| Other intangibles, net | 79,074 | 71,737 |
| Deferred income tax assets | 13,321 | 16,687 |
| Other assets | 6,701 | 9,579 |
| Total assets | \$ 809,263 | \$ 735,497 |
| LIABILITIES | | |
| Short-term borrowings | \$ 4,601 | \$ 517 |
| Current portion of long-term debt | 15,654 | 14,619 |
| Accounts payable | 45,796 | 38,978 |
| Accrued liabilities | 67,147 | 66,877 |
| Current liabilities | 133,198 | 120,991 |
| Long-term debt, less current portion | 46,514 | 58,379 |
| Deferred income tax liabilities | 10,908 | 6,248 |
| Other liabilities | 70,693 | 71,190 |
| Total liabilities | 261,313 | 256,808 |
| Commitments and contingencies | | |
| STOCKHOLDERS EQUITY | | |
| Preferred stock, par value \$0.003 per share, 10,000 shares authorized, no shares issued | | |
| Common stock, par value \$0.002917 per shares, 100,000 shares authorized, 36,480 shares issued | 106 | 106 |

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| | | |
|-------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Additional paid-in capital | 46,658 | 31,960 |
| Accumulated other comprehensive income | 18,234 | 12,619 |
| Deferred compensation | 4,760 | 5,524 |
| Retained earnings | 532,880 | 481,726 |
| | 602,638 | 531,935 |
| Less: Treasury stock at cost, 2,022 shares and 2,426 shares, respectively | 49,928 | 47,722 |
| Treasury stock held for deferred compensation, at cost, 217 shares and 415 shares, respectively | 4,760 | 5,524 |
| Total stockholders' equity | 547,950 | 478,689 |
| Total liabilities and stockholders' equity | \$ 809,263 | \$ 735,497 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**WOODWARD GOVERNOR COMPANY****Consolidated Statements of Cash Flow**

| | Nine Months Ended June 30, | |
|------------------------------------------------------------------------------|---------------------------------------|-------------|
| | 2007 | 2006 |
| | (Unaudited, in thousands) | |
| Operating activities: | | |
| Net earnings | \$ 62,123 | \$ 52,811 |
| Adjustments to reconcile net earnings to net cash from operating activities: | | |
| Depreciation, depletion and amortization | 26,547 | 22,340 |
| Postretirement settlement gain | (887) | |
| Contractual pension termination benefit | 850 | |
| Net gain of sales of property, plant and equipment | (59) | (186) |
| Stock compensation expense | 2,910 | 2,253 |
| Excess tax benefits from stock compensation | (8,784) | (2,547) |
| Deferred income taxes | 5,247 | (13,364) |
| Reclassification of unrealized losses on derivatives to earnings | 184 | 214 |
| Changes in operating assets and liabilities, net of business acquisition: | | |
| Accounts receivable | (5,817) | (1,860) |
| Inventories | (26,868) | (7,559) |
| Accounts payable and accrued liabilities | (8,982) | (14,874) |
| Income taxes payable | 8,619 | 7,026 |
| Other, net | 1,623 | (1,189) |
| Total adjustment | (5,417) | (9,746) |
| Net cash provided by operating activities | 56,706 | 43,065 |
| Investing activities: | | |
| Payments for purchase of property, plant and equipment | (22,667) | (19,661) |
| Proceeds from sales of property, plant and equipment | 165 | 695 |
| Business acquisition, net of cash acquired | (34,611) | |
| Net cash used in investing activities | (57,113) | (18,966) |
| Financing activities: | | |
| Cash dividends paid | (10,969) | (10,643) |
| Proceeds from sales of treasury stock | 8,612 | 3,287 |
| Purchase of treasury stock | (7,888) | (15,370) |
| Excess tax benefits from stock compensation | 8,784 | 2,547 |
| Net borrowings (payments) under revolving lines | (3,500) | (8,475) |
| Payments of long-term debt | (13,635) | (13,535) |
| Net cash used in financing activities | (18,596) | (42,189) |

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| | | |
|--------------------------------------------------|-----------|-----------|
| Effect of exchange rate changes on cash | 3,757 | 431 |
| Net change in cash and cash equivalents | (15,246) | (17,659) |
| Cash and cash equivalents at beginning of period | 83,718 | 84,597 |
| Cash and cash equivalents at end of period | \$ 68,472 | \$ 66,938 |
| Supplemental cash flow information: | | |
| Interest paid | \$ 4,665 | \$ 5,208 |
| Income taxes paid | 16,492 | 12,648 |
| Non-cash investing activities: | | |
| Liabilities assumed in business acquisition | \$ 24,636 | \$ |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Unaudited, Continued)**
(Amounts in thousands, except per share)**(1) Overview:**

The consolidated balance sheet as of June 30, 2007, the consolidated statements of earnings for the three and nine months ended June 30, 2007 and 2006, and the consolidated statements of cash flows for the nine months ended June 30, 2007 and 2006, were prepared by the Company without audit. The September 30, 2006, consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. Information in this 10-Q report is based in part on estimates and is subject to year-end adjustments and audit. In our opinion, we have made all adjustments necessary to present fairly the Company's financial position as of June 30, 2007, the results of its operations for the three and nine months ended June 30, 2007 and 2006, and its cash flows for the nine months ended June 30, 2007 and 2006. All such adjustments were of a normal and recurring nature. The statements were prepared following the accounting policies described in the Company's 2006 annual report on Form 10-K and should be read with the notes to the consolidated financial statements in the annual report. The consolidated statements of earnings for the three and nine months ended June 30, 2007 are not necessarily indicative of the results to be expected for other interim periods or for the full year.

(2) Earnings per share:

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Numerator: | | | | |
| Net earnings | \$ 23,974 | \$ 28,918 | \$ 62,123 | \$ 52,811 |
| Denominator: | | | | |
| Basic | 34,357 | 34,410 | 34,240 | 34,421 |
| Assumed exercise of stock options | 981 | 844 | 959 | 847 |
| Diluted | 35,338 | 35,254 | 35,199 | 35,268 |
| Income per common share | | | | |
| Basic: | | | | |
| Net earnings | \$ 0.70 | \$ 0.84 | \$ 1.81 | \$ 1.53 |
| Diluted: | | | | |
| Net earnings | \$ 0.68 | \$ 0.82 | \$ 1.76 | \$ 1.50 |

The following stock options were outstanding during the three and nine months ended June 30, 2007 and 2006, but were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

| | Three Months | | Nine Months | |
|---------|---------------------|-------------|-----------------------|-------------|
| | Ended | | Ended June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Options | 4 | 410 | 305 | 339 |

(3) Business acquisition:

On October 31, 2006, we acquired 100 percent of the stock of SEG Schaltanlagen-Elektronik-Geräte GmbH & Co. KG (SEG) and a related receivable from SEG that was held by one of the sellers. The acquisition provides us with technologies and products that complement our power generation system solutions. Headquartered in Kempen,

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)**

Germany, SEG designs and manufactures a wide range of protection and comprehensive control systems for power generation and distribution applications, power inverters for wind turbines, and complete electrical systems for gas and diesel engine based power stations.

The cost of the acquisition of SEG totaled \$44,929, consisting of \$34,611 of cash and \$10,318 of assumed debt obligations. Of this amount, \$12,389 was recognized as intangibles. However, the cost of the acquisition and the related allocation of the acquisition cost are subject to change. The cost of the acquisition may increase or decrease based on the final determination of the direct acquisition costs. Also, we are in the process of finalizing valuations of property, plant and equipment, other intangibles, and estimates of liabilities associated with the acquisition. We currently expect to finalize the cost of the acquisition and the related allocation of the acquisition cost as of the end of the fiscal year.

The results of SEG's operations are included in our consolidated statements of earnings from the beginning of November 2006. If we had completed the acquisition on October 1, 2005, our net sales and net earnings for the three and nine months ended June 30, 2007 and 2006 would not have been materially different from amounts reported in the statements of consolidated earnings.

(4) Income taxes:

Income taxes for the nine months ended June 30, 2007 includes an expense reduction of \$1,177 related to the retroactive extension of the U.S. research and experimentation tax credit. This expense reduction relates to the estimated amount of the credit applicable to the period January 1, 2006 through September 30, 2006. Income taxes for the three and nine months ended June 30, 2006 included a tax benefit of \$13,710 which resulted from changes in valuation allowances related to deferred taxes.

(5) Inventories:

| | At June 30, 2007 | At September 30, 2006 |
|------------------|-----------------------------|----------------------------------|
| Raw materials | \$ 7,046 | \$ 5,495 |
| Component parts | 104,066 | 91,644 |
| Work in progress | 43,981 | 30,124 |
| Finished goods | 33,092 | 21,909 |
| | \$ 188,185 | \$ 149,172 |

(6) Property, plant and equipment:

| At June 30, 2007 | At September 30, 2006 |
|-----------------------------|----------------------------------|
|-----------------------------|----------------------------------|

| | | | | |
|------------------------------------|----|---------|----|---------|
| Land | \$ | 12,055 | \$ | 9,800 |
| Buildings and equipment | | 176,713 | | 158,276 |
| Machinery and equipment | | 277,320 | | 248,907 |
| Construction in progress | | 8,607 | | 11,181 |
| | | 474,695 | | 428,164 |
| Less accumulated depreciation | | 324,095 | | 303,988 |
| Property, plant and equipment, net | \$ | 150,600 | \$ | 124,176 |

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)**

| | Three Months Ended | | Nine Months Ended | |
|----------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Depreciation expense | \$ 7,162 | \$ 5,871 | \$ 20,690 | \$ 17,110 |

(7) Goodwill:**Industrial Controls:**

| | |
|----------------------------------------|-----------|
| Balance at September 30, 2006 | \$ 69,962 |
| Foreign currency exchange rate changes | 1,263 |
| Balance at June 30, 2007 | \$ 71,225 |

Aircraft Engine Systems:

| | |
|-------------------------------------------------|-----------|
| Balance at September 30, 2006 and June 30, 2007 | \$ 62,122 |
|-------------------------------------------------|-----------|

Consolidated:

| | |
|----------------------------------------|------------|
| Balance at September 30, 2006 | \$ 132,084 |
| Foreign currency exchange rate changes | 1,263 |
| Balance at June 30, 2007 | \$ 133,347 |

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Notes to Consolidated Financial Statements (Continued)

(8) Other intangibles net:

| | At June 30, 2007 | At September 30, 2006 |
|---------------------------------|---------------------|--------------------------|
| Industrial Controls: | | |
| Customer relationships | | |
| Acquired | \$ 36,387 | \$ 37,387 |
| Less accumulated amortization | 12,313 | 11,414 |
| | 24,074 | 25,973 |
| Other | | |
| Acquired | 43,346 | 31,072 |
| Less accumulated amortization | 14,616 | 12,739 |
| | 28,730 | 18,333 |
| Total | \$ 52,804 | \$ 44,306 |
| Aircraft Engine Systems: | | |
| Customer relationships | | |
| Acquired | \$ 28,547 | \$ 28,547 |
| Less accumulated amortization | 8,644 | 7,930 |
| | 19,903 | 20,617 |
| Other | | |
| Acquired | 11,785 | 11,785 |
| Less accumulated amortization | 5,418 | 4,971 |
| | 6,367 | 6,814 |
| Total | \$ 26,270 | \$ 27,431 |
| Consolidated: | | |
| Customer relationships | | |
| Acquired | \$ 64,934 | \$ 65,934 |
| Less accumulated amortization | 20,957 | 19,344 |
| | 43,977 | 46,590 |
| Other | | |
| Acquired | 55,131 | 42,857 |
| Less accumulated amortization | 20,034 | 17,710 |

| | | | | |
|-------|--|-----------|----|--------|
| | | 35,097 | | 25,147 |
| Total | | \$ 79,074 | \$ | 71,737 |

Amortization expense associated with intangibles is expected to be approximately \$7,800; \$7,100; \$6,700; \$6,600; and \$6,500 for 2007, 2008, 2009, 2010 and 2011, respectively.

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)****(9) Accrued liabilities:**

| | At June 30, 2007 | At September 30, 2006 |
|------------------------------------|-----------------------------|----------------------------------|
| Salaries and other member benefits | \$ 36,562 | \$ 28,673 |
| Warranties | 5,977 | 5,832 |
| Legal matter | | 8,500 |
| Taxes, other than income | 2,586 | 4,391 |
| Other, net | 22,022 | 19,481 |
| | \$ 67,147 | \$ 66,877 |

Provisions of our sales agreements include product warranties customary to such agreements. We establish accruals for specifically identified warranty issues that are probable to result in future costs. We also accrue for warranty costs on a non-specific basis whenever past experience indicates that such costs are probable and can be reasonably estimated. A reconciliation of accrued product warranties from September 30, 2006, to June 30, 2007, follows:

| | |
|---------------------------------------------------------|----------|
| Balance at September 30, 2006 | \$ 5,832 |
| Accruals related to warranties issued during the period | 4,244 |
| Adjustments to pre-existing warranty liabilities | (587) |
| Settlements of amounts accrued | (3,608) |
| Foreign currency exchange rate changes | 96 |
| Balance at June 30, 2007 | \$ 5,977 |

(10) Other liabilities:

| | At June 30, 2007 | At September 30, 2006 |
|-----------------------------------------------------------------------------------|-----------------------------|----------------------------------|
| Net accrued retirement benefits, less amounts recognized with accrued liabilities | \$ 52,810 | \$ 55,075 |
| Other, net | 17,883 | 16,115 |
| | \$ 70,693 | \$ 71,190 |

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)****(11) Retirement benefits:**

We provide various benefits to eligible members of our Company, including pension benefits associated with defined benefit plans and retirement healthcare benefits. Components of net periodic benefit cost and Company contributions for these plans were as follows:

| | Three Months Ended June 30, 2007 | | Nine Months Ended June 30, 2007 | |
|----------------------------------------------------|-------------------------------------------------|-------------|------------------------------------------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Retirement pension benefits: United States | | | | |
| Pension benefits cost, net | | | | |
| Interest cost | \$ 259 | \$ 285 | \$ 776 | \$ 856 |
| Expected return on plan assets | (329) | (294) | (987) | (884) |
| Amortization of prior service cost | (65) | | (195) | |
| Amortization of loss | 61 | 63 | 183 | 189 |
| | \$ (74) | \$ 54 | \$ (223) | \$ 161 |
| Company contributions | \$ | \$ | \$ | \$ |
| | | | | |
| | Three Months Ended June 30, 2007 | | Nine Months Ended June 30, 2007 | |
| | 2007 | 2006 | 2007 | 2006 |
| Retirement pension benefits: other countries | | | | |
| Pension benefits cost, net | | | | |
| Service cost | \$ 330 | \$ 281 | \$ 972 | \$ 900 |
| Interest cost | 641 | 538 | 1,904 | 1,623 |
| Expected return on plan assets | (601) | (488) | (1,785) | (1,474) |
| Amortization of unrecognized transition obligation | 22 | 22 | 67 | 68 |
| Amortization of prior service cost | (2) | (2) | (6) | (6) |
| Amortization of loss | 95 | 98 | 281 | 297 |
| Contractual termination benefits | (132) | | 711 | |
| | \$ 353 | \$ 449 | \$ 2,144 | \$ 1,408 |
| Company contributions | \$ 657 | \$ 423 | \$ 1,939 | \$ 1,020 |

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)**

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|------------------------------------|----------------------------------------|-------------|---------------------------------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Retirement healthcare benefits | | | | |
| Periodic benefit cost, net | | | | |
| Service cost | \$ 75 | \$ 96 | \$ 224 | \$ 287 |
| Interest cost | 619 | 688 | 1,857 | 2,066 |
| Amortization of prior service cost | (630) | (630) | (1,890) | (1,890) |
| Amortization of loss | 65 | 299 | 195 | 897 |
| Curtailment gain | (6) | | (893) | |
| | \$ 122 | \$ 453 | \$ (507) | \$ 1,360 |
| Company contributions | \$ 716 | \$ 892 | \$ 1,854 | \$ 2,160 |

Both the contractual termination benefits cost and the settlement gains reflected in the tables above were recognized in the Industrial Controls segment. The contractual termination benefits reflect an increase in our pension obligations for certain participants as a result of workforce management actions. The settlement gains reflect settlements with certain participants who relieved us of obligations for future retirement healthcare payments.

We are entitled to a federal subsidy under the Medicare Prescription Drug, Improvement and Modernization Act of 2003. We received no subsidy for the three months and a subsidy of \$563 for the nine months ended June 30, 2007. We currently expect to receive an additional \$238 during the year ending September 30, 2007. We paid prescription drug benefits of \$534 during the three months and \$1,718 during the nine months ended June 30, 2007. We expect to pay additional prescription drug benefits of approximately \$550 for the year ending September 30, 2007.

(12) Accumulated other comprehensive earnings:

Accumulated other comprehensive earnings, of \$18,234 at June 30, 2007, consisted of the following items:

Accumulated foreign currency translation adjustments:

| | |
|-----------------------------------------------|-----------|
| Balance at September 30, 2006 | \$ 17,100 |
| Translation adjustments | 8,713 |
| Taxes associated with translation adjustments | (3,310) |
| Balance at June 30, 2007 | \$ 22,503 |

Accumulated unrealized derivative losses:

| | |
|-------------------------------------------------|----------|
| Balance at September 30, 2006 | \$ (484) |
| Reclassification of interest expense | 184 |
| Taxes associated with interest reclassification | (70) |

| | |
|------------------------------------------------------------|------------|
| Balance at June 30, 2007 | \$ (370) |
| Accumulated minimum pension liability adjustments: | |
| Balance at September 30, 2006 | \$ (3,997) |
| Minimum pension liability adjustment | 158 |
| Taxes associated with minimum pension liability adjustment | (60) |
| Balance at June 30, 2007 | \$ (3,899) |

Table of Contents**WOODWARD****Notes to Consolidated Financial Statements (Continued)****(13) Total comprehensive earnings:**

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Net earnings | \$ 23,974 | \$ 28,918 | \$ 62,123 | \$ 52,811 |
| Other comprehensive earnings | | | | |
| Foreign currency translation adjustments | 1,338 | 1,969 | 5,403 | 1,553 |
| Reclassification of unrealized losses on derivatives to earnings | 38 | 44 | 114 | 132 |
| Minimum pension liability adjustment | | | 98 | |
| Total comprehensive earnings | \$ 25,350 | \$ 30,931 | \$ 67,738 | \$ 54,496 |

(14) Contingencies:

The Company is currently involved in pending or threatened litigation or other legal proceedings regarding product liability, employment and commercial matters arising from the normal course of business. The Company accrues for individual matters that it believes are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss, including \$9,500 previously accrued on a specific legal matter, most of which was accrued during fiscal 2006. There are also individual matters that we believe the likelihood of a loss when ultimately resolved is less than likely but more than remote, which are not accrued. While it is possible that there could be additional losses that have not been accrued, the Company currently believes the possible additional loss in the event of an unfavorable resolution of each matter is less than \$10,000 in the aggregate.

The Company was a defendant in the legal matter referenced above, which was a class action lawsuit filed in the U.S. District Court for Northern District of Illinois regarding alleged discrimination on the basis of race, national origin, and gender in our Winnebago County, Illinois, facilities. On April 17, 2007, a U.S. District Court Judge granted final approval of a Consent Decree that included a \$5,000 settlement of the class action and EEOC matters, with the balance of the previously accrued amount relating to legal and other associated expenses, all of which were paid during this fiscal year. We do not expect to incur any additional settlement or legal expenses related to this matter.

In addition, on April 30, 2007, the Company was notified of an adverse arbitration ruling on a matter that was initiated by the Company and outstanding since 2002. As a result of the ruling, the Company incurred a pre-tax loss in the second fiscal quarter of \$4,026 in relation to the arbitration finding.

The Company files income tax returns in various jurisdictions worldwide, which are subject to audit. The Company has accrued for our estimate of the most likely amount of expenses that the Company believes will result from income tax audit adjustments.

The Company does not recognize contingencies that might result in a gain until such contingencies are resolved and the related amounts are realized.

In the event of a change in control of the Company, the Company may be required to pay termination benefits to certain executive officers.

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| | Three Months Ended | | Nine Months Ended | |
|---------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Industrial Controls: | | | | |
| External net sales | \$ 177,013 | \$ 137,930 | \$ 488,659 | \$ 394,419 |
| Intersegment sales | 417 | 519 | 1,618 | 1,367 |
| Segment earnings | 22,904 | 16,406 | 63,341 | 41,058 |
| Aircraft Engine Systems: | | | | |
| External net sales | 92,013 | \$ 79,123 | 262,913 | \$ 227,185 |
| Intersegment sales | 660 | 1,619 | 2,552 | 3,733 |
| Segment earnings | 21,814 | 14,753 | 61,466 | 45,619 |

The difference between total segment earnings and the consolidated earnings before income tax follows:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Total segment earnings | \$ 44,718 | \$ 31,159 | \$ 124,807 | \$ 86,677 |
| Nonsegment expenses | (6,925) | (9,035) | (27,687) | (26,896) |
| Interest expense, net | (653) | (545) | (1,918) | (1,906) |
| Consolidated earnings before income taxes | \$ 37,140 | \$ 21,579 | \$ 95,202 | \$ 57,875 |

Segment assets were as follows:

| | At June 30, | At September 30, |
|---------------------------|--------------------|-------------------------|
| | 2007 | 2006 |
| Industrial Controls | \$ 439,977 | \$ 360,577 |
| Aircraft Engine Systems | 240,323 | 229,269 |
| Nonsegment assets | 128,963 | 145,651 |
| Consolidated total assets | 809,263 | 735,497 |

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

The following discussion and analysis should be read in conjunction with our Unaudited Consolidated Financial Statements and related Notes thereto contained elsewhere in this Quarterly Report of Form 10-Q (the Report). The information contained in this Report is not a complete description of our business or the risks associated with an investment in our securities. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended September 30, 2006, Quarterly Report on Form 10-Q for the period ended March 31, 2007, and subsequent reports on Form 8-K, which discuss our business in greater detail.

The section entitled Risk Factors set forth in Item 1A (and incorporating other filings by reference) under Part II Other Information, and similar discussions in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition. These risks, in addition to the other information in this Report and in our other filings with the SEC, should be carefully considered before deciding to purchase, hold or sell our securities.

Various statements in this Report, in future filings by us with the SEC, in our press releases and in our oral statements made by or with the approval of authorized personnel, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on current expectations and are indicated by words or phrases such as anticipate, estimate, expect, intend, project, forecast, outlook, plan, believe, can, could, should, may, will, seek, and similar words or phrases and involve known and uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Some of the factors that could affect our financial performance or cause actual results to differ from our estimates in, or underlying, such forward-looking statements are set forth under Item 1A -Risk Factors or elsewhere in this Report and include, without limitation, potential problems with suppliers, changes in the competitive marketplace, potential loss of key customers, significant product liability or other claims, product recalls, difficulties with new product development, the introduction of new products by our competitors, changes in the economy, FAA or other regulatory actions affecting new or existing products, changes in government regulations, use of hazardous or environmentally sensitive materials, inability to implement new information technology systems, inability to integrate new acquisitions, fluctuation in foreign currency exchange rates, and other events. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, we cannot assure you that the forward-looking information contained in this Form 10-Q will, in fact, transpire.

Overview

Woodward designs, manufactures, and services energy control systems and components for aircraft and industrial engines and turbines and electronic control systems for both power generation and distribution. Leading Original Equipment Manufacturers (OEMs) throughout the world use our products and services in the aerospace, power generation, transportation and process industry markets.

Our strategic focus is Energy Control and Optimization Solutions. The control of energy fluid energy, combustion, electrical energy and motion is a growing requirement in the markets we serve. Our customers look to us to optimize the efficiency, emissions, and operations of power equipment. Our core technologies leverage well across our markets and customer applications, enabling us to develop and integrate cost-effective and state-of-the-art fuel, combustion,

fluid, actuation, and electronic systems. We focus primarily on OEMs and equipment packagers, partnering with them to bring superior component and system solutions to their demanding applications.

We have two operating segments: Industrial Controls and Aircraft Engine Systems. Industrial Controls is focused on systems and components that provide energy control and optimization solutions for industrial markets, which includes power generation, transportation, and process industries. Aircraft Engine Systems is focused on systems and components that provide energy control and optimization solutions for the aerospace market. We use

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

Industrial Controls segment earnings for the third quarter increased to 12.9% of sales from 11.9% of sales a year ago. Industrial Controls segment earnings for the nine-month period increased to 13.0% of sales from 10.4% of sales a year ago. This improvement is primarily attributable to continuous improvement efforts related to operating margins and the positive impact of higher sales on our fixed cost base.

Aircraft Engine Systems third quarter earnings increased to 23.7% of sales from 18.6% from the third quarter a year ago. Aircraft Engine Systems nine-month period earnings increased to 23.4% of sales from 20.1% from the same period a year ago. This improvement reflects a favorable product mix due to increased aftermarket sales partially offset by an increase in research and development costs.

Our nine-month period results this year also included the effect of the retroactive extension of the U.S. research and experimentation tax credit, which improved net earnings by \$1,177 or \$0.03 per diluted share. The nine-month period results for 2006 benefited from a reduction in the deferred tax asset valuation allowance of \$13,710 or \$0.39 per diluted share.

At June 30, 2007, our total assets were \$809,263, including \$68,472 in cash and cash equivalents, and our total debt was \$66,769. Together with our line of credit, we are well positioned to fund expanded research and development and to explore other investment opportunities consistent with our focused strategies.

Critical Accounting Policies

We consider the accounting policies used in preparing our financial statements to be critical accounting policies when they are both important to the portrayal of our financial condition and results of operations, and require us to make difficult, subjective, or complex judgments. Critical accounting policies normally result from the need to make estimates about the effect of matters that are inherently uncertain. Management has discussed the development and selection of our critical accounting policies with the Audit Committee of the Company's Board of Directors. In each of the areas that were identified as critical accounting policies, our judgments, estimates, and assumptions are impacted by conditions that change over time. As a result, in the future there could be changes in our assets and liabilities, increases or decreases in our expenses, and additional losses or gains that are material to our financial condition and results of operations. Our critical accounting policies are discussed more fully in the Management's Discussion and Analysis section in our annual report on Form 10-K for the year ended September 30, 2006.

Market Risks

Our long-term debt is sensitive to changes in interest rates. Also, assets, liabilities, and commitments that are to be settled in cash and are denominated in foreign currencies for transaction purposes are sensitive to changes in currency exchange rates. These market risks are discussed more fully in the Management's Discussion and Analysis section in our annual report on Form 10-K for the year ended September 30, 2006.

Results of Operations

Sales

**Three Months Ended
June 30,**

**Nine Months Ended
June 30,**

| | 2007 | 2006 | 2007 | 2006 |
|-------------------------|-------------|-------------|-------------|-------------|
| Industrial Controls | \$ 177,013 | \$ 137,930 | \$ 488,659 | \$ 394,419 |
| Aircraft Engine Systems | 92,013 | 79,123 | 262,913 | 227,185 |
| Consolidated net sales | \$ 269,026 | \$ 217,053 | \$ 751,572 | \$ 621,604 |

Industrial Controls external net sales increased in the three and nine months ended June 30, 2007, compared to the same periods a year ago primarily due to the business acquisition, discussed below, and higher sales in the power generation, marine and turbine markets.

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Aircraft Engine Systems external net sales increased in the three and nine months ended June 30, 2007, compared to the same periods a year ago. The increase was related to higher production levels of aircraft engines by our customers to support the requirements of Boeing, Airbus, and other airframe manufacturers. In addition, aircraft usage has increased which has positively affected our aftermarket sales.

Costs and Expenses

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Cost of goods sold | \$ 186,055 | \$ 154,089 | \$ 519,970 | \$ 448,055 |
| Selling, general and administrative expenses | 27,345 | 23,234 | 84,325 | 69,548 |
| Research and development costs | 17,011 | 16,793 | 46,911 | 41,772 |
| Other expenses | 3,234 | 3,184 | 9,805 | 9,612 |
| Interest and other income | (1,759) | (1,826) | (4,641) | (5,258) |
| Consolidated costs and expenses | \$ 231,886 | \$ 195,474 | \$ 656,370 | \$ 563,729 |

Cost of goods sold increased in both the three months and nine months ended June 30, 2007, as compared to the same periods last year, primarily due to the business acquisition and an increase in sales volume.

Gross margins (as measured by net sales less cost of goods sold) increased to 30.8% for the three and nine months ended June 30, 2007 from 29.0% and 27.9% for the three and nine months ended June 30, 2006, respectively. The improvement in gross margins reflects higher sales on our fixed overhead costs and the result of continued cost reduction initiatives.

Selling, general and administrative expenses increased in both the three months and nine months ended June 30, 2007, as compared to the same periods last year primarily due to inclusion of the operating results of a business acquisition and higher professional fees. Sales, general and administrative expenses as a percent of sales decreased slightly for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 and remained constant for the nine-month periods.

Research and development costs increased in the nine months ended June 30, 2007, as compared to the same period last year, reflecting higher levels of development activity and the inclusion of our business acquisition, discussed below. Research and development costs decreased as a percent of sales period-to-period.

In Industrial Controls, we are working closely with our customers early in their own development and design stages, helping them by developing components and integrated systems that allow them to meet emissions requirements, increase fuel efficiency, and lower their costs. We also continue to develop products for the turbine auxiliary and diesel particulate filter after-treatment burner system markets. These markets offer multiple opportunities to leverage our energy control and optimization solutions.

Aircraft Engine Systems is developing new aircraft turbine programs for both commercial and military aircraft. Most significantly, we are developing components and an integrated fuel system for the new GEnx turbofan engine for the Boeing 787, Airbus A350, and Boeing 747-8, and components for the GE Rolls-Royce F136 and Pratt & Whitney F135 engines that are the two propulsion choices to power Lockheed Martin's Joint Strike Fighter aircraft, and

components for the T700-GE-701D engine that will be used to upgrade the Sikorsky Black Hawk and Boeing Apache helicopters, among others.

Table of Contents**Earnings**

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Industrial Controls | \$ 22,904 | \$ 16,406 | \$ 63,341 | \$ 41,058 |
| Aircraft Engine Systems | 21,814 | 14,753 | 61,466 | 45,619 |
| Total segment earnings | 44,718 | 31,159 | 124,807 | 86,677 |
| Nonsegment expense | (6,925) | (9,035) | (27,687) | (26,896) |
| Interest income and expense | (653) | (545) | (1,918) | (1,906) |
| Consolidated earnings before income taxes | 37,140 | 21,579 | 95,202 | 57,875 |
| Income tax (benefit) | 13,166 | (7,339) | 33,079 | 5,064 |
| Consolidated net earnings | \$ 23,974 | \$ 28,918 | \$ 62,123 | \$ 52,811 |

Industrial Controls segment earnings increased in both the three months and nine months ended June 30, 2007, as compared to the same periods last year due to the following:

| | Three-Month | Nine-Month |
|---------------------------------------------|--------------------|-------------------|
| | Period | Period |
| At June 30, 2006 | \$ 16,406 | \$ 41,058 |
| Increase in sales volume | 10,684 | 23,799 |
| Improved gross margins | 4,684 | 21,776 |
| Variable compensation | (2,245) | (5,777) |
| Operating expenses of the acquired business | (4,007) | (10,256) |
| Other, net | (2,618) | (7,259) |
| At June 30, 2007 | \$ 22,904 | \$ 63,341 |

The earnings increase is primarily attributable to our business acquisition, discussed below, and continuous improvement efforts related to operating margins and the positive impact of higher sales on our fixed costs base.

Industrial Controls segment earnings also included the results of our business acquisition, discussed below. The operating expenses of the acquired business reflected above are for selling, general and administrative expenses and research and development costs.

On October 31, 2006, we acquired 100 percent of the stock of SEG Schaltanlagen-Elektronik-Geräte GmbH & Co. KG (SEG) and a related receivable from SEG that was held by one of the sellers. The acquisition provides us with technologies and products that complement our power generation system solutions. Headquartered in Kempen, Germany, SEG designs and manufactures a wide range of protection and comprehensive control systems for power generation and distribution applications, power inverters for wind turbines, and complete electrical systems for gas

and diesel engine based power stations.

The cost of the acquisition of SEG totaled \$44,929, consisting of \$34,611 of cash and \$10,318 of assumed debt obligations. Of this amount, \$12,389 was recognized as intangibles. However, the cost of the acquisition and the related allocation of the acquisition cost are subject to change. The cost of the acquisition may increase or decrease based on the final determination of the direct acquisition costs. Also, we are in the process of finalizing valuations of property, plant and equipment, other intangibles, and estimates of liabilities associated with the acquisition. We currently expect to finalize the cost of the acquisition and the related allocation of the acquisition cost as of the end of the fiscal year.

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Aircraft Engine Systems segment earnings increased in the three and nine months ended June 30, 2007 as compared to the same periods last year due to the following:

| | Three-Month Period | Nine-Month Period |
|--------------------------------|-------------------------------|------------------------------|
| At June 30, 2006 | \$ 14,753 | \$ 45,619 |
| Increase in sales volume | 4,429 | 12,170 |
| Improved gross margins | 2,390 | 6,010 |
| Variable compensation | (1,493) | (3,692) |
| Research and development costs | 2,142 | 2,561 |
| Other, net | (407) | (1,202) |
| At June 30, 2007 | \$ 21,814 | \$ 61,466 |

The increase in earnings reflects a favorable product mix due to increased aftermarket sales, partially offset by an increase in research and development costs.

Income taxes were provided at an effective rate on earnings before income taxes of 35.4% and 34.7% for the three and nine months ended June 30, 2007, respectively. During the nine months ended June 30, 2007, the U.S. research and experimentation tax credit was extended and made retroactive to January 1, 2006. As a result, we reflected the effect of the extension in our first quarter this year, which reduced our income tax expense by \$1,177. This relates to the amount of the credit attributable to the period January 1, 2006 through September 30, 2006. Income taxes for the three and nine months ended June 30, 2006 included a tax benefit of \$13,710 which resulted from changes in valuation allowances related to deferred taxes.

Among other changes in our effective tax rate are the effects of changes in the relative mix of earnings by tax jurisdiction, which affect the comparison of foreign and state income tax rates relative to the United States federal statutory rate.

Financial Condition*Assets*

| | At June 30, 2007 | At September 30, 2006 |
|---------------------------|-----------------------------|----------------------------------|
| Industrial Controls | \$ 439,977 | \$ 360,577 |
| Aircraft Engine Systems | 240,353 | 229,269 |
| Nonsegment assets | 128,933 | 145,651 |
| Consolidated total assets | \$ 809,263 | \$ 735,497 |

Industrial Controls segment assets increased in the nine months ended June 30, 2007, primarily as a result of the business acquisition, discussed above.

Aircraft Engine Systems segment assets increased in the nine months ended June 30, 2007, primarily due to an increase in inventory levels.

Nonsegment assets decreased in the nine months ended June 30, 2007, primarily because of a decrease in cash and cash equivalents related to the business acquisition. Changes in cash are discussed more fully in a separate section of this Management's Discussion and Analysis.

Table of Contents**Other Balance Sheet Measures**

| | At June 30, 2007 | At September 30, 2006 |
|--------------------------------------|-----------------------------|----------------------------------|
| Working capital | \$ 293,022 | \$ 260,243 |
| Long-term debt, less current portion | 46,514 | 58,379 |
| Other liabilities | 70,693 | 71,190 |
| Shareholders' equity | 547,950 | 478,689 |

Working capital (current assets less current liabilities) increased at June 30, 2007 from September 30, 2006 primarily as a result of an increase in inventories and accounts receivable, partially offset by an increase in short-term borrowings and accounts payable.

Long-term debt, less current portion decreased in the nine months ended June 30, 2007, as a result of payments made during the period. We currently have a revolving line of credit facility with a syndicate of U.S. banks totaling \$100,000, with an option to increase the amount of the line to \$175,000 if we choose. The line of credit facility expires on March 11, 2010. In addition, we have other line of credit facilities, which totaled \$17,700 at September 30, 2006, that are generally reviewed annually for renewal. The total amount of borrowings under all facilities was \$4,601 and \$517 at June 30, 2007 and September 30, 2006, respectively.

Provisions of debt agreements include covenants customary to such agreements that require us to maintain specified minimum or maximum financial measures and place limitations on various investing and financing activities. The agreements also permit the lenders to accelerate repayment requirements in the event of a material adverse event. Our most restrictive covenants require us to maintain a minimum consolidated net worth, a maximum consolidated debt to consolidated operating cash flow, and a maximum consolidated debt to Earnings Before Income taxes, Depreciation and Amortization, as defined in the agreements. We were in compliance with all covenants at June 30, 2007.

Commitments and contingencies at June 30, 2007, include various matters arising from the normal course of business. We are currently involved in pending or threatened litigation or other legal proceedings regarding product liability, employment and commercial matters arising from the normal course of business. We accrue for individual matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss, including \$9,500 previously accrued on a specific legal matter, most of which was accrued during fiscal 2006. There are also individual matters that we believe the likelihood of a loss when ultimately resolved is less than likely but more than remote, which are not accrued. While it is possible that there could be additional losses that have not been accrued, we currently believe the possible additional loss in the event of an unfavorable resolution of each matter is less than \$10,000 in the aggregate.

We were a defendant in the legal matter referenced above, which was a class action lawsuit filed in the U.S. District Court for Northern District of Illinois regarding alleged discrimination on the basis of race, national origin, and gender in our Winnebago County, Illinois, facilities. On April 17, 2007, a U.S. District Court Judge granted final approval of a Consent Decree that included a \$5,000 settlement of the class action and EEOC matters, with the balance of the previously amount accrued relating to legal and other associated expenses, all of which were paid during this fiscal year. We do not expect to incur any additional settlement or legal expenses related to this matter.

In addition, on April 30, 2007, we were notified of an adverse arbitration ruling on a matter that was initiated by us and outstanding since 2002. As a result of the ruling, we incurred a pre-tax loss in our second fiscal quarter of \$4,026

in relation to the arbitration finding.

We file income tax returns in various jurisdictions worldwide, which are subject to audit. We have accrued for our estimate of the most likely amount of expenses that we believe will result from income tax audit adjustments.

We do not recognize contingencies that might result in a gain until such contingencies are resolved and the related amounts are realized.

In the event of a change in control of the Company, we may be required to pay termination benefits to certain executive officers.

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Stockholders' equity increased in the nine months ended June 30, 2007. Increases due to Net Earnings and sales of Treasury Stock during the nine months were partially offset by cash dividend payments and purchases of Treasury Stock.

On July 25, 2006, the Board of Directors authorized the repurchase of up to \$50,000 of our outstanding shares of common stock on the open market and private transactions over a three-year period that will end on July 25, 2009. Through June 30, 2007, we have purchased \$6,936, or 221 shares, of our common stock under this authorization.

Contractual Obligations

We have various contractual obligations, including obligations related to long-term debt, operating leases, purchases, retirement pensions, and retirement healthcare. These contractual obligations are summarized and discussed more fully in the Management's Discussion and Analysis in our 2006 annual report on Form 10-K for the year ended September 30, 2006.

Cash Flows

| | Nine Months Ended June 30, | |
|-------------------------------------------|---------------------------------------|-------------|
| | 2007 | 2006 |
| Net cash provided by operating activities | \$ 56,706 | \$ 43,065 |
| Net cash used in investing activities | 57,113 | 18,966 |
| Net cash used in financing activities | 18,596 | 42,189 |

Net cash flows provided by operating activities increased by \$13,641 in the nine months ended June 30, 2007, as compared to the same period a year ago primarily due to an increase in Net Earnings and Deferred Income Taxes, partially offset by an increase in Inventories.

Net cash flows used in investing activities increased by \$38,147 in the nine months ended June 30, 2007, compared to the same period a year ago primarily as a result of a business acquisition.

Net cash flows used in financing activities decreased by \$23,593 million in the nine months ended June 30, 2007, as compared to the same period a year ago primarily as a result of increased sales of Treasury Stock and a decrease in the purchase of Treasury Stock and payments on our borrowing under the revolving lines of credit.

Financing Arrangements

Payments on our senior notes, totaling \$53,600, are due over the 2008 - 2012 timeframe. Also, we have a \$100,000 line of credit facility that includes an option to increase the amount of the line up to \$175,000 that does not expire until March 11, 2010. Despite these factors, it is possible that business acquisitions could be made in the future that would require amendments to existing debt agreements and the need to obtain additional financing.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of improving financial reporting by

mitigating volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The provisions of FAS 159 are effective for the Company's fiscal year beginning October 1, 2008. We are currently evaluating the impact that the adoption of this statement will have on our consolidated financial position, results of operations and related disclosures.

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. The provisions of FAS 157 are effective for the Company's fiscal year beginning October 1, 2008. We are currently evaluating the impact that the adoption of this statement will have on our consolidated financial position, results of operations and related disclosures.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest expense on our long-term debt is sensitive to changes in interest rates. Also, assets, liabilities and commitments that are to be settled in cash and are denominated in foreign currencies are sensitive to changes in currency exchange rates. These market risks are discussed more fully in the Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended September 30, 2006.

Item 4. Controls and Procedures

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

Thomas A. Gendron and Robert F. Weber, Jr. evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-Q. Based on their evaluation, they concluded that our disclosure controls and procedures were effective in achieving the objectives for which they were designed as described in the preceding paragraph.

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding legal proceedings is contained in Note 14 to the Consolidated Financial Statements contained in this Report and is incorporated by reference.

Item 1A. Risk Factors

Investment in our securities involves risk. An investor or potential investor should consider the risks summarized in Item 1A. Risk Factors in our annual report on Form 10-K for the year ended September 30, 2006, when making investment decisions regarding our securities.

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

(c) (d)(2)
Maximum
Number
(or Approximate

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Dollar Value) of Shares That May Yet be Purchased Under the Plans or Programs |
|--------------------------------------|-----------------------------------------------------------------|---------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|
| April 1, 2007 through April 30, 2007 | | | | \$ 43,064,045 |
| May 1, 2007 through May 31, 2007 | | | | \$ 43,064,045 |
| June 1, 2007 through June 30, 2007 | 362(1) | \$ 55.82 | | \$ 43,064,045 |

- (1) We purchased 362 shares on the open market related to the reinvestment of dividends for treasury shares held for deferred compensation in June 2007.
- (2) On July 25, 2006, the Board of Directors authorized the repurchase of up to \$50 million of our outstanding shares of common stock on the open market and private transactions over a three-year period that will end on

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July 25, 2009. Through June 30, 2007 we purchased \$6.9 million of our common stock under this authorization. There have been no terminations or expirations since the approval date.

Sales of common stock issued from treasury to one of the Company's directors during the nine months ended June 30, 2007, consisted of the following:

| | Total Shares Purchased | Consideration Received |
|-------------------|-----------------------------------|-----------------------------------|
| November 16, 2006 | 270 | \$ 9,985 |
| January 25, 2007 | 149 | 6,018 |
| May 1, 2007 | 119 | 5,962 |

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

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of the security holders.

Item 6. Exhibits

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

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SIGNATURES

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

WOODWARD GOVERNOR COMPANY

/s/ THOMAS A. GENDRON
Thomas A. Gendron,
Chairman and Chief Executive Officer

Date: July 24, 2007

/s/ ROBERT F. WEBER, JR.
Robert F. Weber, Jr.,
Chief Financial Officer and Treasurer

Date: July 24, 2007

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WOODWARD GOVERNOR COMPANY

EXHIBIT INDEX

| Exhibit Number | Description |
|---------------------------|---------------------------------------------------------------------------------------------|
| 10.12 | Compensatory Arrangement with A. Christopher Fawzy dated May 23, 2007, filed as an exhibit. |
| 31.1 | Rule 13a-14(a)/15d-14(a) certifications of Thomas A. Gendron |
| 31.2 | Rule 13a-14(a)/15d-14(a) certifications of Robert F. Weber, Jr |
| 32.1 | Section 1350 certifications |