Eagle Bulk Shipping Inc.
Form 10-Q
August 08, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

o **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 51366

EAGLE BULK SHIPPING INC.
(Exact name of Registrant as specified in its charter)

Republic of the Marshall Islands	**98 0453513**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

477 Madison Avenue
New York, New York 10022
Address of Principal Executive Offices

Registrant s telephone number, including area code: **(212) 785 2500**

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

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

Large accelerated Filer x	Accelerated Filer o
Non-accelerated Filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, par value $0.01 per share, 46,770,486 shares outstanding as of August 7, 2008.

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Part 1 : FINANCIAL INFORMATION

ITEM 1 : FINANCIAL STATEMENTS

EAGLE BULK SHIPPING INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2008 (Unaudited)	December 31, 2007
ASSETS:		
Current Assets:		
Cash	$ 62,996,613	$ 152,903,692
Accounts Receivable	4,298,844	3,392,461
Prepaid Expenses	2,119,223	1,158,113
Total Current Assets	69,414,680	157,454,266
Fixed Assets:		
Advances for Vessel Acquisition	7,650,000	
Vessels and Vessel Improvements, at cost, net of Accumulated Depreciation of $66,211,384 and $52,733,604, respectively	717,738,187	605,244,861
Advances for Vessel Construction	380,671,562	344,854,962
Restricted Cash	10,276,056	9,124,616
Deferred Drydock Costs, net of Accumulated Amortization of $3,702,494 and $2,453,253, respectively	4,168,529	3,918,006
Deferred Financing Costs	14,138,345	14,479,024
Other Assets	4,333,556	932,638
Total Assets	**$ 1,208,390,915**	**$ 1,136,008,373**
LIABILITIES & STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts Payable	$ 1,774,373	$ 3,621,559
Accrued Interest	4,208,254	455,750
Other Accrued Liabilities	2,846,977	1,863,272
Unearned Charter Hire Revenue	5,941,253	4,322,024
Total Current Liabilities	14,770,857	10,262,605
Long-term Debt	665,694,643	597,242,890
Deferred Revenue	8,793,903	
Other Liabilities	12,223,412	13,531,883
Total Liabilities	701,482,815	621,037,378
Stockholders Equity:		
Preferred Stock, $.01 par value, 25,000,000 shares authorized, none issued		

Common shares, $.01 par value, 100,000,000 shares authorized, 46,770,486 and 46,727,153 shares issued and outstanding, respectively	467,704	467,271
Additional Paid-In Capital	607,738,367	602,929,530
Retained Earnings (net of Dividends declared of $215,289,302 and $168,525,482 respectively)	(93,338,441)	(75,826,561)
Accumulated Other Comprehensive Loss	(7,959,530)	(12,599,245)
Total Stockholders Equity	506,908,100	514,970,995
Total Liabilities and Stockholders Equity	**$ 1,208,390,915**	**$ 1,136,008,373**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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EAGLE BULK SHIPPING INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30, 2008	June 30, 2007	Six Months Ended June 30, 2008	June 30, 2007
Revenues, net of Commissions	$ 37,223,200	$ 28,338,047	$ 73,909,216	$ 55,246,579
Vessel Expenses	7,596,479	6,856,581	15,587,740	13,102,479
Depreciation and Amortization	7,390,982	6,046,953	14,727,021	11,837,584
General and Administrative Expenses	4,762,933	1,697,530	9,812,092	6,600,573
Gain on Sale of Vessel				(872,568)
Total Operating Expenses	19,750,394	14,601,064	40,126,853	30,668,068
Operating Income	17,472,806	13,736,983	33,782,363	24,578,511
Interest Expense	3,449,217	3,160,439	6,799,470	6,312,564
Interest Income	(882,541)	(1,348,151)	(2,269,047)	(2,146,536)
Net Interest Expense	2,566,676	1,812,288	4,530,423	4,166,028
Net Income	$ 14,906,130	$ 11,924,695	$ 29,251,940	$ 20,412,483
Weighted Average Shares Outstanding:				
Basic	46,763,160	41,713,820	46,757,849	39,593,975
Diluted	47,123,585	41,811,854	47,047,552	39,658,525
Per Share Amounts:				
Basic Net Income	$ 0.32	$ 0.29	$ 0.63	$ 0.52
Diluted Net Income	$ 0.32	$ 0.29	$ 0.62	$ 0.51
Cash Dividends Declared and Paid	$ 0.50	$ 0.50	$ 1.00	$ 1.01

The accompanying notes are an integral part of these Consolidated Financial Statements.

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EAGLE BULK SHIPPING INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (UNAUDITED)
FOR THE SIX MONTHS ENDED JUNE 30, 2008

	Common Shares	Common Shares Amount	Additional Paid-In Capital	Retained Earnings Net Income	Retained Earnings Cash Dividends	Accumulated Deficit	Other Comprehensive (Loss)	S
2007	46,727,153	$ 467,271	$ 602,929,530			$ (75,826,561)	$ (12,599,245)	$
e Income:								
				$ 29,251,940		29,251,940		
unrealized								
tives							4,639,715	
e Income								
s					$ (46,763,820)	(46,763,820)		
ck Options	13,333	133	237,194					
pensation:								
ck Grants	30,000	300	608,100					
k Grants								
			3,963,543					
	46,770,486	$ 467,704	$ 607,738,367			$ (93,338,441)	$ (7,959,530)	$

The accompanying notes are an integral part of these Consolidated Financial Statements.

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EAGLE BULK SHIPPING INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash Flows from Operating Activities:		
Net Income	$ 29,251,940	$ 20,412,483
Adjustments to Reconcile Net Income to Net Cash provided by Operating Activities:		
Items included in net income not affecting cash flows:		
Depreciation	13,477,780	11,234,675
Amortization of Deferred Drydocking Costs	1,249,241	602,909
Amortization of Deferred Financing Costs	123,219	117,784
Amortization of Prepaid and Deferred Charter Revenue		2,160,000
Non-cash Compensation Expense	4,571,943	3,383,579
Gain on Sale of Vessel		(872,568)
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(906,383)	(791,595)
Prepaid Expenses	(961,110)	24,579
Accounts Payable	(1,847,186)	1,481,907
Accrued Interest	3,752,504	94,759
Accrued Expenses	983,705	(350,612)
Drydocking Expenditures	(1,499,764)	(628,307)
Unearned Charter Hire Revenue	1,619,229	737,176
Net Cash Provided by Operating Activities	49,815,118	37,606,769
Cash Flows from Investing Activities:		
Advances for Vessel Acquisition	(7,650,000)	
Purchase of Vessels and Vessel Improvements	(70,103,682)	(138,803,974)
Advances for Vessel Construction	(82,055,976)	(39,522,428)
Proceeds from Sale of Vessel		12,011,482
Advances for Leasehold Improvements	(69,674)	
Net Cash Used in Investing Activities	(159,879,332)	(166,314,920)
Cash Flows from Financing Activities:		
Issuance of Common Stock	237,327	110,171,870
Equity Issuance Costs		(3,186,989)
Bank Borrowings	68,451,753	74,841,779
Repayment of Bank Debt		(12,440,000)
Changes in Restricted Cash	(1,151,440)	(800,000)
Deferred Financing Costs	(616,685)	(108,675)
Cash Dividends	(46,763,820)	(39,165,910)
Net Cash Provided by Financing Activities	20,157,135	129,312,075
Net (Decrease)/Increase in Cash	(89,907,079)	603,924
Cash at Beginning of Period	152,903,692	22,275,491

Cash at End of Period	$	62,996,613	$	22,879,415
Supplemental Cash Flow Information:				
Cash paid during the period for Interest (including Capitalized interest of $7,729,831 and $1,165,560 respectively and Commitment Fees)	$	14,424,367	$	7,383,525

The accompanying notes are an integral part of these Consolidated Financial Statements.

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EAGLE BULK SHIPPING INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation and General Information

The accompanying consolidated financial statements include the accounts of Eagle Bulk Shipping Inc. and its wholly-owned subsidiaries (collectively, the Company). The Company is engaged in the ocean transportation of dry bulk cargoes worldwide through the ownership and operation of dry bulk vessels. The Company s fleet is comprised of Handymax bulk carriers and the Company operates its business in one business segment.

The Company is a holding company incorporated in 2005, under the laws of the Republic of the Marshall Islands and is the sole owner of all of the outstanding shares of the Republic of the Marshall Islands incorporated wholly-owned subsidiaries. The primary activity of each of the subsidiaries is the ownership of a vessel. The operations of the vessels are managed by a wholly-owned subsidiary of the Company, Eagle Shipping International (USA) LLC, a Republic of the Marshall Islands limited liability company.

As of June 30, 2008, the Company s operating fleet consists of 20 vessels. The Company has a contract for the purchase of a vessel to be delivered in September 2008. The Company also has contracts for the construction of 34 vessels under its newbuilding program. The following table presents certain information concerning the Company s fleet as of June 30, 2008:

No. of Vessels	Dwt	Vessel Type	Delivery	Employment
Vessels in Operation				
20 Vessels	1,021,023	17 Supramax	2005 2008	Time Charter
		3 Handymax	2005	Time Charter
Vessels to be delivered				
1 Vessel	53,000	Supramax	September 2008	Charter Free
4 Vessels	212,400	53,100 dwt series Supramax	2008 2009	3 Vessels on Time Charter and 1 Vessel Charter Free
5 Vessels	280,000	56,000 dwt series Supramax	2008 2010	Charter Free
25 Vessels	1,450,000	58,000 dwt series Supramax	2009 2012	17 Vessels on Time Charter and 8 Vessels Charter Free

The following table represents certain information about the Company s charterers which individually accounted for more than 10% of the Company s gross time charter revenue during the periods indicated:

	% of Consolidated Time Charter Revenue			
	Three Months Ended		Six Months Ended	
Charterer	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007

Charterer A		14.1%		14.4%
Charterer B	26%	25.0%	26%	24.5%
Charterer D		12.1%		14.1%
Charterer H	18%	12.6%	17%	11.8%
Charterer J	10%	11.4%	11%	
Charterer L	19%		19%	
Charterer M	11%		11%	

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The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States, and the rules and regulations of the SEC (Securities and Exchange Commission) which apply to interim financial statements. Accordingly, they do not include all of the information and footnotes normally included in consolidated financial statements prepared in conformity with generally accepted accounting principles in the United States. They should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2007 Annual Report on Form 10-K.

The accompanying unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) that management considers necessary for a fair presentation of its consolidated financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the entire year.

Note 2. Vessels

a. Vessel and Vessel Improvements

At June 30, 2008, the Company s operating fleet consisted of 20 dry bulk vessels. The Company has placed a deposit for the purchase of a Supramax vessel, Redwing, in the amount of $7,650,000 and the vessel is expected to be delivered in September 2008. In June 2008, the Company also took delivery of the Wren, the first of its 35 newbuild vessels. The Wren has been recorded at its fair market value in connection with the acquisition of its construction contract from Kyrini Shipping Inc. in 2007.

Vessel and vessel improvements consist of the following:		
Vessels and Vessel Improvements, at December 31, 2007	$	605,244,861
Purchase of Vessel and vessel improvements		70,103,682
Delivery of Newbuild Vessel		55,867,424
Depreciation Expense		(13,477,780)
Vessels and Vessel Improvements, at June 30, 2008	$	717,738,187

b. Advances for Vessel Construction

The Company had contracted for the construction of 35 Supramax vessels, five in Japan and 30 in China. In June 2008, the first of these vessels, Wren, was constructed in China and delivered to the Company.

As of June 30, 2008, the Company had five Supramax vessels under construction at a shipyard in Japan. These five vessels construction contracts are Japanese yen based and the total cost of these contracts in US dollars is $167,172,089. The Company will incur additional associated costs relating to the construction of these vessels. As of June 30, 2008, the Company has advanced $62,912,091 in progress payments towards these contracts. These vessels are expected to be delivered between 2008 and 2010.

Following the delivery of the first Chinese built vessel, Wren, in June 2008, the Company has 29 Supramax vessels under construction at a shipyard in China. As of June 30, 2008, the total remaining cost of the construction project in China is approximately $1,235,000,000. As of June 30, 2008, the Company has advanced $293,039,542 in progress payments towards the construction of these vessels. These vessels are expected to be delivered between 2008 and 2010. The Company will incur additional costs relating to the construction of these vessels, including capitalized interest, insurance, legal, and technical supervision costs. The Company had acquired the rights to these newbuilding vessels in 2007 from Kyrini Shipping Inc., an unrelated privately held Greek shipping company for consideration of $150,000,000. The acquisition comprised purchase contracts for the construction of the 26 Supramax vessels and time charter employment contracts for 21 of the 26 vessels. The assets and liabilities acquired are required to be recorded at fair value. The Wren, the first of the newbuild vessels which delivered in June 2008, has been recorded at its fair market value. At June 30, 2008, the Company has recorded deferred revenue of $8,793,903 in connection with the assumed time charter on the newbuild vessel and this amount will be amortized to revenue over the life of the time charter assumed on this vessel. The amounts recorded as of June 30, 2008 are preliminary and subject to the completion of a valuation.

Further, the Company had acquired options for the construction of 9 additional Supramax vessels from the shipyard. On December 27, 2007, the Company exercised four of these options and the options for the remaining five vessels expired on March 31, 2008.

As of June 30, 2008, the Company has advanced a net of $380,671,562 in progress payments towards the newbuilding vessels including $24,719,929 in associated costs relating to the construction of these vessels.

Advances for Vessel Construction consist of the following:		
Advances for Vessel Construction, at December 31, 2007	$	344,854,962
Progress Payments		69,173,063
Capitalized Interest		12,337,530
Legal and Technical Supervision Costs		1,379,528
Delivery of Newbuild Vessel		(47,073,521)
Advances for Vessel Construction, at June 30, 2008	$	380,671,562

Note 3. Long-Term Debt

At June 30, 2008, the Company s debt consisted of $665,694,643 in net borrowings under the $1,600,000,000 amended revolving credit facility. These borrowings consisted of $283,343,310 for the 20 vessels currently in operation and $382,351,333 to fund the Company s newbuilding program. During the six months ended June 30, 2008, the Company borrowed $68,451,753 to fund the progress payments for the newbuilding vessels.

For the six months ended June 30, 2008, interest rates on the outstanding debt ranged from 3.11% to 6.04%, including a margin of 0.80% over LIBOR applicable under the terms of the amended revolving credit facility. The weighted average effective interest rate was 5.46%. The Company incurs a commitment fee of 0.25% on the undrawn portion of the revolving credit facility. Interest costs on borrowings used to fund the Company s newbuilding program are capitalized until the vessels are delivered.

Interest Expense, exclusive of capitalized interest, consists of:

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Loan Interest	$ 3,377,560	$ 2,957,413	$ 6,650,973	$ 5,906,167
Commitment Fees	10,345	143,254	25,278	288,613
Amortization of Deferred Financing Costs	61,312	59,772	123,219	117,784
Total Interest Expense	$ 3,449,217	$ 3,160,439	$ 6,799,470	$ 6,312,564

Cash interest paid, exclusive of capitalized interest, in the six month periods ended June 30, 2008 and 2007 amounted to $6,079,939 and $6,217,965, respectively.

Interest-Rate Swaps

The Company has entered into interest rate swaps to effectively convert a portion of its debt from a floating to a fixed-rate basis. Under these swap contracts, exclusive of applicable margins, the Company will pay fixed rate interest and receive floating-rate interest amounts based on three-month LIBOR settings.

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The swaps are designated and qualify as cash flow hedges. As of June 30, 2008, the Company has the following swap contracts outstanding:

- Notional amount of $84,800,000 with a fixed interest rate of 5.24% and maturity in September 2009.

Upon maturity, this amount will commence a new swap with a fixed interest rate of 3.90% and matures in September 2013.

- Notional amount of $25,776,443 with a fixed interest rate of 4.90% and maturity in March 2010
- Notional amount of $10,995,000 with a fixed interest rate of 4.98% and maturity in August 2010
- Notional amount of $202,340,000 with a fixed interest rate of 5.04% and maturity in August 2010
- Notional amount of $100,000,000 with a fixed interest rate of 4.22% and maturity in September 2010
- Notional amount of $30,000,000 with a fixed interest rate of 4.54% and maturity in September 2010
- Notional amount of $25,048,118 with a fixed interest rate of 4.74% and maturity in December 2011
- Notional amount of $36,752,038 with a fixed interest rate of 5.22% and maturity in August 2012
- Notional amount of $81,500,000 with a fixed interest rate of 3.895% and maturity in January 2013

The Company records the fair value of the interest rate swaps as an asset or liability on its balance sheet. The effective portion of the swap is recorded in accumulated other comprehensive income. Accordingly, a liability of $12,223,412 and $13,531,883 has been recorded in Other Liabilities in the Company s balance sheets as of June 30, 2008 and December 31, 2007, respectively.

Foreign Currency Swaps

The Company has entered into foreign exchange swap transactions to hedge foreign currency risks on its capital asset transactions (vessel newbuildings). The swaps are designated and qualify as cash flow hedges.

At June 30, 2008 and December 31, 2007, the Company had outstanding foreign currency swap contracts for notional amounts aggregating 11.28 billion Japanese yen swapped into the equivalent of $104,259,998.

The Company records the fair value of the currency swaps as an asset or liability in its financial statements. The effective portion of the swap is recorded in accumulated other comprehensive income. Accordingly, an amount of $4,263,882 and $932,638 have been recorded in Other Assets in the accompanying balance sheets as of June 30, 2008 and December 31, 2007, respectively.

Note 4. Commitments and Contingencies

Vessel Technical Management Contracts

The Company has technical management agreements for each of its vessels with independent technical managers. The Company paid average monthly technical management fees of $9,537 and $8,895 per vessel during the six months ended June 30, 2008 and 2007, respectively.

Operating Lease

In December 2005, the Company entered into a lease for office space. The lease is secured by a Letter of Credit backed by cash collateral of $124,616 which amount is recorded as Restricted Cash in the accompanying balance sheets. In March 2008, the Company amended the lease to incorporate additional office space. The amended lease expires in 2018. The cash collateral securing the lease has been increased

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by $151,440. The Company has recorded the total Cash collateral of $276,056 as Restricted Cash. The future minimum commitments under the leases for office space as of June 30, 2008 are as follows:

2008	$	324,276
2009		648,552
2010		648,552
2011		788,519
2012		835,175
2013-18		4,523,865
Total	$	7,768,939

As of June 30, 2008, the Company has incurred an amount of $69,674 in leasehold improvements which has been recorded in Other Assets in the accompanying balance sheets. Leasehold improvements will be amortized over the remaining life of the lease.

Note 5. Earnings Per Common Share

The computation of basic earnings per share is based on the weighted average number of common shares outstanding during the period. Diluted net income per share gives effect to the assumed exercise of stock options and restricted stock units using the treasury stock method, unless the impact is anti-dilutive.

	Three Months Ended		Six Months Ended	
	June 30, 2008	**June 30, 2007**	**June 30, 2008**	**June 30, 2007**
Net Income	$ 14,906,130	$ 11,924,695	$ 29,251,940	$ 20,412,483
Weighted Average Shares Basic	46,763,160	41,713,820	46,757,849	39,593,975
Dilutive effect of stock options and restricted stock units	360,425	98,034	289,703	64,550
Weighted Average Shares Diluted	47,123,585	41,811,854	47,047,552	39,658,525
Basic Earnings Per Share	$ 0.32	$ 0.29	$ 0.63	$ 0.52
Diluted Earnings Per Share	$ 0.32	$ 0.29	$ 0.62	$ 0.51

Note 6. Capital Stock

Dividends

The Company s current policy is to declare quarterly dividends to shareholders in March, May, August and November. Payment of dividends is limited by the terms of certain agreements which the Company and its subsidiaries are party to. The Company s revolving credit facility permits it to pay quarterly dividends in amounts up to its cumulative free cash flows which is our earnings before extraordinary or exceptional items, interest, taxes, depreciation and amortization (Credit Agreement EBITDA), less the aggregate amount of interest incurred and net amounts payable under interest rate hedging agreements during the relevant period and an agreed upon reserve for dry-docking for the period, provided that there is not a default or breach of loan covenant under the credit facility and the payment of the dividends would not result in a default or breach of a loan covenant. Depending on market conditions in the dry bulk shipping industry and acquisition opportunities that may arise, the Company may be required to obtain additional debt or equity financing which could affect its dividend policy. However, any determination to pay dividends in the future will be at the discretion of the Board of Directors and will depend upon the Company s results of operations, financial condition, capital restrictions, covenants and other factors deemed relevant by the Board of Directors.

On February 27, 2008, the Company s Board of Directors declared a cash dividend for the fourth quarter of 2007 of $0.50 per share. The aggregate amount of this cash dividend was $23,378,577 and was paid on March 18, 2008 to all shareholders of record as of March 13, 2008.

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On May 6, 2008, the Company s Board of Directors declared a cash dividend for the first quarter of 2008 of $0.50 per share. The aggregate amount of this cash dividend was $23,385,243 and was paid on May 23, 2008 to all shareholders of record as of May 20, 2008.

Note 7. 2005 Stock Incentive Plan

The Company adopted the 2005 Stock Incentive Plan for the purpose of affording an incentive to eligible persons. The 2005 Stock Incentive Plan provides for the grant of equity-based awards, including stock options, stock appreciation rights, restricted stock, restricted stock units, stock bonuses, dividend equivalents and other awards based on or relating to the Company s common shares to eligible non-employee directors, selected officers and other employees and independent contractors. The plan is administered by a committee of the Company s Board of Directors. An aggregate of 2.6 million shares of the Company s common stock has been authorized for issuance under the plan.

In 2006 and 2007, the Company awarded stock options to members of its management and its independent non-employee directors. As of June 30, 2008, options covering 617,334 of the Company s common shares are outstanding with exercise prices ranging from $13.23 to $21.88 per share (the market prices at dates of grant). The options granted to the directors vested and became exercisable on the grant dates. The options granted to members of its management vest and become exercisable over three years. All options expire ten years from the date of grant. For purposes of determining the non-cash compensation cost for the Company s stock option plans using the fair value method of FAS 123(R), the fair value of the options granted was estimated on the date of grant using the Black-Scholes option pricing model.

In 2007, the Company granted restricted stock units (RSUs) to members of its management which vest ratably over three years. In June 2008, the Company granted 833,333 RSUs, vesting ratably over five years, to its Chief Executive Officer as part of an employment agreement. As of June 30, 2008, RSUs covering a total of 1,627,046 of the Company s shares are outstanding. These RSUs also entitle the participant to receive a dividend equivalent payment on the unvested portion of the underlying shares granted under the award, each time the Company pays a dividend to the Company s shareholders. The Company is amortizing to non-cash compensation expense the fair value of the non-vested restricted stock at the grant date. For the three and six months ended June 30, 2008, the amortization charge was $1,974,240 and $3,800,286, respectively. The remaining expense for each of the years ending 2008, 2009, and 2010 will be $6,077,090, $12,154,180 and $11,483,253, respectively, and $11,976,801 thereafter.

On January 15, 2008, the Company granted 30,000 shares of its common stock to its independent non-employee directors. The fair value of the stock at the grant date is equal to the closing stock price on that date and a total amount of $608,400 has been recorded in non-cash compensation expense for the six months ended June 30, 2008.

Non-cash compensation expenses include profits interests awarded to members of the Company s management by the Company s former principal shareholder, Eagle Ventures LLC. These profits interests diluted only the interests of owners of Eagle Ventures LLC, and did not dilute direct holders of the Company s common stock. However, the Company s statement of operations reflects non-cash charges for compensation related to the profits interests. The non-cash compensation charges were being recorded as an expense over the estimated service period in accordance with SFAS No. 123(R). As Eagle Ventures has sold substantially all of its holdings in the Company, the non-cash, non-dilutive charges relating to profits interests ended in the first quarter of 2007 and there are no charges in future periods. Accordingly, the expense for the six-month period ended June 30, 2007 included $3,137,812 in non-cash, non-dilutive charges relating to the profits interests.

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The non-cash compensation expenses recorded by the Company and included in General and Administrative Expenses are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Stock Option Plans	$ 82,000	$ 124,356	$ 163,257	$ 245,767
Restricted Stock Grants	1,974,240		3,800,286	
Stock Grants			608,400	
Non-dilutive Profits Interests				3,137,812
Total Non-cash compensation expense	$ 2,056,240	$ 124,356	$ 4,571,943	$ 3,383,579

In 2006 and 2007, the Company granted Dividend Equivalent Rights Award (DERs) to its independent non-employee directors and members of its management. These DERs entitle the participant to receive a dividend equivalent payment each time the Company pays a dividend to the Company s shareholders. As of June 30, 2008, DERs equivalent to 632,334 of the Company s common shares are outstanding. For the three and six months ended June 30, 2008, the Company has also recorded in General and Administrative Expense cash compensation expenses of $713,023 and $1,426,046.

Note 9. Subsequent Events

Dividend

On August 5, 2008, the Company s Board of Directors declared a cash dividend for the second quarter of 2008 of $0.50 per share, based on 46,770,486 of the Company s common shares outstanding, payable to all shareholders of record as of August 20, 2008. The aggregate amount of this cash dividend payable to the Company s shareholders on August 26, 2008 is $23,385,243.

Long-Term Debt

On July 3, 2008, the Company entered into an Amendatory Agreement to its $1,600,000,000 revolving credit facility. Among other things, the amended facility provides us with an additional incremental commitment of up to $200,000,000 under the same terms and conditions as the existing facility, subject to satisfaction of certain additional conditions. The Company now also has the ability to purchase additional drybulk vessels in excess of 85,000dwt and over 10 years of age, but no more than 20 years of age, with certain limitations. The agreement also provides for the purchase or acquisition of more than one additional vessel *en bloc* or the acquisition of beneficial ownership in one or more additional vessel(s). The agreement amends the margin applicable over the Libor interest rate on borrowings to 0.95% for the next two years. Thereafter, if the advance ratio is less than 35%, the margin will be 0.80% per year; if the advance ratio is equal to or greater than 35% but less than 60%, the margin will be 0.95%; if the advance ratio is equal to or greater than 60%, the margin will be 1.05%. The agreement also amends the commitment fee on the undrawn portion of the revolving credit facility to 0.30%. In connection with this latest amendment, applicable arrangement fees will be incurred and these fees will be in proportion to the arrangement fees previously incurred when the revolving facility was increased to $1,600,000,000 in 2007. All other terms and conditions remain unchanged.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following is a discussion of the Company s financial condition and results of operation for the three-month and six-month periods ended June 30, 2008 and 2007. This section should be read in conjunction with the consolidated financial statements included elsewhere in this report and the notes to those financial statements.

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended and the Private Securities Litigation Reform Act of 1995 and are intended to be covered by the safe harbor provided for under these sections. These statements may include words such as believe, estimate, project, intend, expect, plan, anticipate, and simil expressions in connection with any discussion of the timing or nature of future operating or financial performance or other events. Forward looking statements reflect management s current expectations and observations with respect to future events and financial performance. Where we express an expectation or belief as to future events or results, such expectation or belief is expressed in good faith and believed to have a reasonable basis. However, our forward-looking statements are subject to risks, uncertainties, and other factors, which could cause actual results to differ materially from future results expressed, projected, or implied by those forward-looking statements. The principal factors that affect our financial position, results of operations and cash flows include, charter market rates, which have recently increased to historic highs, and periods of charter hire, vessel operating expenses and voyage costs, which are incurred primarily in U.S. dollars, depreciation expenses, which are a function of the cost of our vessels, significant vessel improvement costs and our vessels estimated useful lives, and financing costs related to our indebtedness. Our actual results may differ materially from those anticipated in these forward looking statements as a result of certain factors which could include the following: (i) changes in demand in the dry bulk market, including, without limitation, changes in production of, or demand for, commodities and bulk cargoes, generally or in particular regions; (ii) greater than anticipated levels of dry bulk vessel new building orders or lower than anticipated rates of dry bulk vessel scrapping; (iii) changes in rules and regulations applicable to the dry bulk industry, including, without limitation, legislation adopted by international bodies or organizations such as the International Maritime Organization and the European Union or by individual countries; (iv) actions taken by regulatory authorities; (v) changes in trading patterns significantly impacting overall dry bulk tonnage requirements; (vi) changes in the typical seasonal variations in dry bulk charter rates; (vii) changes in the cost of other modes of bulk commodity transportation; (viii) changes in general domestic and international political conditions; (ix) changes in the condition of the Company s vessels or applicable maintenance or regulatory standards (which may affect, among other things, our anticipated dry docking costs); (x) and other factors listed from time to time in our filings with the Securities and Exchange Commission. This discussion also includes statistical data regarding world dry bulk fleet and orderbook and fleet age. We generated some of this data internally, and some were obtained from independent industry publications and reports that we believe to be reliable sources. We have not independently verified this data nor sought the consent of any organizations to refer to their reports in this quarterly report. We disclaim any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws.

Overview

We are Eagle Bulk Shipping Inc., a Republic of Marshall Islands corporation headquartered in New York City. We own one of the largest fleets of Supramax dry bulk vessels in the world. Supramax dry bulk vessels range in size from 50,000 to 60,000 dwt. We transport a broad range of major and minor bulk cargoes, including iron ore, coal, grain, cement and fertilizer, along worldwide shipping routes. As of June 30, 2008, we owned and operated a modern fleet of 20 Handymax dry bulk vessels, 17 of which are of the Supramax class. In addition to our operating fleet of 20 vessels, we have contracted for the purchase of a second-hand Supramax vessel which will be delivered in September 2008. We also have a Supramax newbuilding program for the construction of 35 newbuilding vessels in Japan and China.

The first of these

vessels was delivered to us in June 2008. Upon delivery of all newbuilding vessels by early 2012, our total fleet will consist of 55 vessels with a combined carrying capacity of 3 million dwt.

We are focused on maintaining a high quality fleet that is concentrated primarily in one vessel type Handymax dry bulk carriers and its sub-category of Supramax vessels which are Handymax vessels ranging in size from 50,000 to 60,000 dwt. These vessels have the cargo loading and unloading flexibility of on-board cranes while offering cargo carrying capacities approaching that of Panamax dry bulk vessels, which range in size from 60,000 to 100,000 dwt and rely on port facilities to load and offload their cargoes. We believe that the cargo handling flexibility and cargo carrying capacity of the Supramax class vessels make them attractive to cargo interests and vessel charterers. The 20 vessels in our operating fleet, with an aggregate carrying capacity of 1,021,023 deadweight tons, have an average age of only 6 years compared to an average age for the world Handymax dry dulk fleet of over 15 years.

Each of our vessels is owned by us through a separate wholly owned Republic of the Marshall Islands limited liability company.

We maintain our principal executive offices at 477 Madison Avenue, New York, New York 10022. Our telephone number at that address is (212) 785-2500. Our website address is www.eagleships.com. Information contained on our website does not constitute part of this quarterly report.

Our financial performance since inception is based on the following key elements of our business strategy:

(1) concentration in one vessel category: Supramax class of Handymax dry bulk vessels, which we believe offer size, operational and geographical advantages (over Panamax and Capesize vessels),

(2) our strategy is to charter our vessels primarily pursuant to one- to three-year time charters to allow us to take advantage of the stable cash flow and high utilization rates that are associated with medium to long-term time charters. Reliance on the spot market contributes to fluctuations in revenue, cash flow, and net income. On the other hand, time charters provide a shipping company with a predictable level of revenues. We have entered into time charters for all of our vessels which range in length from one to three years and provide for fixed semi-monthly payments in advance. This strategy is effective in strong and weak dry bulk markets, giving us security and predictability of cashflows when we look at the volatility of the shipping markets,

(3) maintain high quality vessels and improve standards of operation through improved environmental procedures, crew training and maintenance and repair procedures, and

(4) maintain a balance between purchasing vessels as market conditions and opportunities arise and maintaining prudent financial ratios (e.g. leverage ratio).

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We have employed all of our vessels in our operating fleet on time charters for periods ranging from one to three years. The following table represents certain information about the Company s revenue earning charters on its operating fleet as of June 30, 2008:

are reasonable, no assurance can be given that the final outcome of these matters will not be different from that which is reflected in ou

, our valuation allowance was $0.1 million.

ernal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinatio

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RESULTS OF OPERATIONS

Sales

The following table presents the breakdown of consolidated net external sales by segment (in thousands):

Year Ended September 30,	**2008**		**2007**		**2006**	
Segment net sales						
Turbine Systems	$ 595,774	47%	$ 523,842	50%	$ 458,923	54%
Engine Systems	499,318	40	455,200	44	430,448	50
Electrical Power Systems	289,294	23	181,366	17	76,186	9
Total segment net sales	1,384,386	110	1,160,408	111	965,557	113
Less intersegment net sales						
Turbine Systems	(18,470)	(2)	(21,285)	(2)	(20,197)	(2)
Engine Systems	(41,141)	(3)	(41,124)	(4)	(39,829)	(5)
Electrical Power Systems	(66,571)	(5)	(55,662)	(5)	(51,016)	(6)
Consolidated net external sales	$ 1,258,204	100%	$ 1,042,337	100%	$ 854,515	100%

Intersegment sales primarily reflect contract-manufacturing activity across business segments. Turbine Systems and Engine Systems sell electronic controls manufactured by Electrical Power Systems as part of their system offerings. These intersegment activities have been increasing as a result of our Turbine and Engine Systems segments growing their respective external sales.

2008 Compared to 2007

Consolidated net external sales increased 21% from fiscal 2007 to fiscal 2008. The increase was attributable to the following (in thousands):

Consolidated net external sales for year ended September 30, 2007	$ 1,042,337
Turbine Systems volume changes	58,688
Engine Systems volume changes	19,743
Electrical Power Systems volume changes	76,856
Price changes	13,613
Foreign currency translation	46,967
Consolidated net external sales for year ended September 30, 2008	$ 1,258,204

Turbine Systems sales volume changes: Turbine Systems sales performance reflected generally strong demand for our OEM offerings in the industrial and aerospace turbine markets, including our recently introduced control systems for business jets and power generation OEM and the government for military applications. This mix of aerospace growth was consistent with our expectations and reflects the high volume of orders for new aircraft with engines containing increased Woodward content.

Engine Systems sales volume changes: The primary drivers of the growth in sales volume for Engine Systems are increased production in the marine and alternative fuel markets as well as growth in demand in the power and process markets. Engine Systems sales were boosted by demand for our control systems for large, natural gas-powered on-highway vehicles, and our offerings in the marine market.

Electrical Power Systems sales volume changes: Demand in both the power generation and distribution and wind inverter turbine markets continues to drive growth in sales of Electrical Power Systems. The growth in wind turbine inverter demand has been strong. The increase in Electrical Power Systems intercompany sales is the result of higher external sales in Turbines Systems and Engine Systems of products that incorporate electronic controls manufactured by Electrical Power Systems.

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Price changes: Selling price increases were across most products in Turbine Systems and Engine Systems impacting spares and components used in the aerospace aftermarket. These selling price changes were in response prevailing market conditions as prices fluctuated for commodities used to produce mechanical, electrical, or electromagnetic components.

Foreign currency translation: Our worldwide sales activities are primarily denominated in U.S. dollar (USD), European Monetary Unit Euro (the Euro), and Great Britain pound (GBP). As these currencies fluctuate against each other and other currencies, we are exposed to gains or losses on sales transactions. During fiscal 2008, approximately 22% of the increase in net external sales was due to changes in the foreign currency exchange rates.

2007 Compared to 2006

Consolidated net external sales increased 22% from fiscal 2006 to fiscal 2007. The increase was attributable to the following (in thousands):

Consolidated net external sales for year ended September 30, 2006	$ 854,515
Turbine Systems volume changes	54,687
Engine Systems volume changes	9,018
Electrical Power Systems volume changes	5,082
Schaltanlagen-Elektronik-Geräte GmbH & Co. KG (SEG) related revenue	92,776
Price changes	11,327
Foreign currency translation	14,932
Consolidated net external sales for year ended September 30, 2007	$ 1,042,337

Turbine Systems sales volume changes: Turbine Systems improvement reflects the favorable trends in all segments of aerospace business. We saw strong growth in the business and regional aviation markets with order backlogs and deliveries significantly higher than 2006 levels. Overall fleet growth and increased utilization resulted in strong demand for repair and related aftermarket service. Our significant development efforts on the GEnx fuel system for the Boeing Dreamliner, the GP7200 fuel system components for the A380 and the PW600 control system for the Mustang and the Eclipse were making the transition from research to production. We saw a trend toward higher revenue passenger miles incurred by commercial airlines and cargo growth, which drove aircraft usage and had a positive effect on our aftermarket sales. We estimate approximately 40% of Turbine Systems sales were aftermarket for fiscal 2007 and fiscal 2006.

Engine Systems sales volume changes: Demand for power generation, such as large gas and diesel engines, grew with the significant increase in global demand for electricity, particularly in distributed power applications. Growing infrastructure needs in India, China and the rest of Asia played a key role in this growth. Within the transportation market, the marine segment was robust.

Electrical Power Systems sales volume changes: As part of our channel development, we gained new customers in the power generation and distribution market. Electrical Power Systems sales growth of 60% for the year consisted of 55% organic growth and 5% inorganic.

Price changes: Price changes were made primarily in response to material cost increases in Turbine Systems and Engine Systems. The material cost increases were related to price fluctuations of commodities from which mechanical, electronic, or electromagnetic components are produced.

SEG related revenue: On October 31, 2006, we acquired 100% of the stock of SEG. The acquisition provided us with technologies and products that complemented our power generation system solutions. The results of SEG s operations were included in fiscal 2007 net sales from the beginning of November 2006.

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Costs and Expenses

The following table presents costs and expenses (in thousands):

Year Ended September 30,	2008	% of Net Sales	2007	% of Net Sales	2006	% of Net Sales
Net Sales	$ 1,258,204	100.0%	$ 1,042,337	100.0%	$ 854,515	100.0%
Cost of goods sold	$ 882,996	70.2%	$ 728,820	69.9%	$ 612,263	71.6%
Selling, general, and administrative expenses	115,399	9.2	111,297	10.7	92,013	10.8
Research and development costs	73,414	5.8	65,294	6.3	59,861	7.0
Amortization of intangible assets	6,830	0.5	7,496	0.7	6,953	0.8
Interest and other income	(6,805)	(0.5)	(7,790)	(0.8)	(6,995)	(0.8)
Interest and other expenses	4,460	0.3	5,232	0.5	5,923	0.7
Consolidated costs and expenses	$ 1,076,294	85.5%	$ 910,349	87.3%	$ 770,018	90.1%

2008 Compared to 2007

Cost of goods sold increased 21% attributable to the following (in thousands):

Cost of goods sold for the year ended September 30, 2007	$ 728,820
Increase in sales volume	96,314
Foreign currency translation	32,393
Changes in product mix	13,628
Increased non-volume related freight and product expediting costs	4,809
Other	7,032
Cost of goods sold for the year ended September 30, 2008	$ 882,996

Gross margins were approximately flat at 29.8% for the year ended September 30, 2008 compared to 30.1% for the year ended September 30, 2007. The small decrease in gross margins reflects a change in product mix and increased operating costs associated with productivity enhancements and supply chain constraints.

Our foreign locations purchase goods primarily in Euro and GBP. The change in the foreign currency exchange rates to USD resulted in increased costs during fiscal 2008 as compared to fiscal 2007.

Selling, general, and administrative expenses increased 4%, attributable to the following (in thousands):

SG&A for the year ended September 30, 2007	$ 111,297
Accruals for legal and arbitration matters	(4,429)

Variable compensation	2,070
Stock-based compensation expense	628
Foreign currency translation	4,205
Other	1,628
SG&A for the year ended September 30, 2008	$ 115,399

We accrue for individual legal matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss.

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Selling, general, and administrative expenses increased primarily from increases in foreign currency translation rates, increased variable compensation, and costs incurred to open new locations, partially offset by a reduction in costs related to legal and arbitration matters. Selling, general, and administrative expenses decreased as a percent of sales year-to-year from 10.7% in fiscal 2007 to 9.2% in fiscal 2008.

Research and development costs increased 12%, attributable to the following (in thousands):

Research and development for the year ended September 30, 2007	$ 65,294
Turbine Systems development activities	2,401
Engine Systems development activities	2,828
Electrical Power Systems development activities	2,891
Research and development for the year ended September 30, 2008	$ 73,414

Research and development costs increased in the year ended September 30, 2008, as compared to the year ended September 30, 2007, reflecting higher levels of development activity. Research and development costs decreased as a percent of sales year-to-year from 6.3% in fiscal 2007 to 5.8% in fiscal 2008.

In the Turbine Systems segment, we continue to work closely with our customers early in their technology development and preliminary design stages. We help our customers by investing in research and technology development programs that improve fuel efficiency, reduce emissions, and lower total cost of ownership, benefiting both operators and the general public. The result of recent investments can be seen in our integrated fuel system selected by GE Aviation for their GEnx turbofan engine, powering the Boeing 787 Dreamliner and Boeing 747-8 airliner, and the fuel and combustion components we supply for the Pratt & Whitney F135 and GE Rolls-Royce F136 engines powering the Lockheed-Martin Joint Strike Fighter. We are also developing components for the T700-GE-701D engine that will be used for the upgrades to the Sikorsky Black Hawk and Boeing Apache helicopters, components for the Pratt & Whitney 600 family, the Pratt & Whitney geared turbofan for both the Mitsubishi Regional Jet and the Bombardier CSeries, and the CF34-10 and SAM146 turbo engine programs to be used for global regional jets in the Chinese and Russian markets, among others. Within the industrial markets, Woodward fuel systems, controls, and combustion systems are used on the world s most advanced industrial gas turbine power plants, oil and gas production facilities, and military marine applications. Most recently, we have expanded our collaboration with key customers by signing joint technology demonstration or production contracts with GE Aviation and Pratt & Whitney for their next generation of commercial aircraft engines and with GE Energy and Pratt & Whitney Power Systems for their next generation of industrial gas turbine applications.

Engine Systems continues to develop components and integrated systems that allow our customers to meet developed countries future emissions regulations, ever increasing fuel efficiency demands, and support the growing infrastructure needs in India, China, and the rest of Asia. Development projects include components for our market leading Compressed Natural Gas (CNG) systems for buses and trucks, next generation injectors and pumps for diesel fuel systems used in shipping, construction equipment, and power generation markets, a new line of steam turbine control products, and control systems for the new and growing diesel particulate filter market.

Electrical Power Systems is developing a new grid connected inverter platform that enables large scale wind turbine power integration and also supports local grid codes for High/Low Voltage Ride Through, as well as electrical protection and metering devices that provide safe and more reliable electrical power distribution to commercial and industrial users and utilities in a networked environment. In addition, we continue to develop products for Distributed Energy Resource integration based on our latest power generation controls platform.

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2007 Compared to 2006

Cost of goods sold increased 19%, attributable to the following (in thousands):

Cost of goods sold for the year ended September 30, 2006	$ 612,263
Increase in sales volume	31,219
Effects of consolidation of European operations and other	(2,327)
Foreign currency translation	12,692
SEG related production costs	65,963
Other	9,010
Cost of goods sold for the year ended September 30, 2007	$ 728,820

Costs of goods sold benefited from the effects of Engine Systems European consolidation, which we completed in March 2006.

Variable compensation paid to members in direct and indirect manufacturing functions was higher in 2007 than in 2006. Each year, a portion of our members compensation will vary depending on performance-based factors.

Selling, general, and administrative expenses increased 21%, attributable to the following (in thousands):

SG&A for the year ended September 30, 2006	$ 92,013
Accruals for legal and arbitration matters	(5,557)
SEG related SG&A expenses	11,307
Variable compensation	5,430
SEG integration costs	3,000
Stock-based compensation expense	774
Other	4,330
SG&A for the year ended September 30, 2007	$ 111,297

We accrue for individual legal matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss.

Variable compensation paid to members was higher in 2007 than in 2006. Each year, a portion of our members compensation will vary depending on performance-based factors.

We incurred expenses related to completing the acquisition of SEG including dedicated staffing, travel, and telephone costs.

Research and development costs increased 9%, attributable to the following (in thousands):

Research and development for the year ended September 30, 2006	$ 59,861
Turbine Systems development activities	(170)

Engine Systems development activities	1,544
Electrical Power Systems development activities	(841)
SEG development projects	4,900
Research and development for the year ended September 30, 2007	$ 65,294

During fiscal year 2007, we made considerable progress on a new diesel pump in Engine Systems, which will power next generation engines being released into the market in the near future. This pump will sustain higher pressures, temperatures, and speeds than previous models. The SEG acquisition, which is included in the Electrical Power Systems segment, added development activities related to power protection and wind inverter technologies.

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Earnings

Year Ended September 30,	2008	2007	2006
		(In thousands)	
Turbine Systems	$ 116,196	$ 87,353	$ 67,584
Engine Systems	56,471	56,984	40,829
Electrical Power Systems	42,303	20,294	4,475
Total segment earnings	214,970	164,631	112,888
Nonsegment expense	(31,346)	(31,720)	(26,052)
Interest expense and income, net	(1,714)	(923)	(2,339)
Consolidated earnings before income taxes	181,910	131,988	84,497
Income tax expense	(60,030)	(33,831)	(14,597)
Consolidated net earnings	$ 121,880	$ 98,157	$ 69,900

2008 Compared to 2007

Turbine Systems segment earnings increased 33%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2007	$ 87,353
Volume changes	18,661
Selling price changes	8,726
Sales mix	(5,993)
Foreign exchange rate changes	731
Other, net	6,718
Earnings for the year ended September 30, 2008	$ 116,196

The earnings increase in Turbine Systems was principally the result of leverage on modest increases in sales volume over last year, and reflects a stronger mix of OEM aerospace products compared to recent quarters. Sales volume increased due to higher demand for OEM, military, commercial aftermarket, and industrial turbine products. Selling price increases primarily affected spares and components used in the aerospace aftermarket. Turbine Systems also experienced an unfavorable product mix compared to the prior year which negatively impacted earnings, due to greater growth of OEM sales relative to aftermarket sales. Recent program wins and stronger market conditions for our OEM customers have resulted in faster growth to OEMs as compared to our aftermarket customers. Our aftermarket pricing catalog is in GBP while much of our costs are in USD. Earnings increased 1% as a result of changes in GBP during fiscal 2008.

Engine Systems segment earnings decreased 1%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2007	$ 56,984

Volume changes	9,240
Selling price changes	3,391
Sales mix	(5,525)
Foreign exchange rate changes	562
Increased non-volume related freight and product expediting costs	(4,809)
Other, net	(3,372)
Earnings for the year ended September 30, 2008	$ 56,471

Sales volume increases were primarily in the power generation and marine markets. Selling price increases were across most products to offset increased material costs. Engine Systems also experienced an unfavorable sales mix compared to the prior year. Engine Systems sells, manufactures and purchases product in several foreign currencies including USD, Euro, CNY, Yen, and GBP. The percentage of sales in a particular foreign currency may

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be significantly different from the percentage of costs incurred in that currency. As a result of Engine Systems significant international footprint, changes in foreign currency can have a large impact on its earnings. During fiscal 2008, the changes in foreign currency rates resulted in a 1% net increase in earnings.

The increased freight costs were the result of increased expediting costs associated with supply chain constraints, product line moves, and fuel surcharges related to increased global fuel costs. Global fuel costs have declined significantly since September 30, 2008. Future volatility in fuel costs may impact future earnings results.

Electrical Power Systems segment earnings increased 108%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2007	$ 20,294
Volume changes	19,118
Selling price changes	1,496
Sales mix	(2,110)
Foreign exchange rate changes	5,883
Other, net	(2,378)
Earnings for the year ended September 30, 2008	$ 42,303

The improvement in earnings reflects the integration of our acquisition in October 2006 of SEG. Sales volume is higher due to inverter products sold into wind power applications. A change in sales mix and changes in the external market put pressure on margins. Foreign currency translation earnings increased primarily as a result of the change in the Euro against the USD during fiscal 2008. A significant portion of Electrical Power Systems sales and many costs are transacted in Euro which is then translated into USD for financial statement purposes. Also, a significant portion of Electrical Power Systems product costs are incurred in USD which contributed to increased margins on sales denominated in Euros. During fiscal 2008, the favorable changes in the euro resulted in a 29% net increase in earnings.

Nonsegment expenses decreased 1% in 2008 as compared to 2007, attributable to the following (in thousands):

Nonsegment expenses for the year ended September 30, 2007	$ 31,720
Accruals for a legal matters and arbitration	(4,376)
Stock-based compensation expense	739
Other	3,263
Nonsegment expenses for the year ended September 30, 2008	$ 31,346

Among the other factors affecting nonsegment expenses are normal variations in legal and other professional services. We accrue for individual legal matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss. For more information about contingencies, see Note 18 to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Financial Data.

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Income taxes were provided at an effective rate on earnings before income taxes of 33.0% in fiscal 2008 compared to 25.6% in fiscal 2007. The change in the effective tax rate was attributable to the following (as a percent of earnings before income taxes):

Effective tax rate for the year ended September 30, 2007	25.6%
Adjustments of the beginning-of-year balance of valuation allowances for deferred tax assets	(1.5)
Change in estimates of taxes for previous periods and audit settlements in 2008 as compared to 2007	9.0
Research credit in 2008 as compared to 2007	2.1
German tax law changes	(2.3)
Other changes, net	0.1
Effective tax rate for the year ended September 30, 2008	33.0%

The fiscal 2008 change in the beginning-of-year valuation allowances reduced income tax expense by $2.7 million. We establish valuation allowances to reflect the estimated amount of deferred tax assets that might not be realized. Both positive and negative evidence are considered in forming our judgment as to whether a valuation allowance is appropriate, and more weight is given to evidence that can be objectively verified. Valuation allowances are reassessed whenever there are changes in circumstances that may cause a change in our judgments. In fiscal 2008, additional objective evidence became available regarding earnings in tax jurisdictions that have unexpired net operating loss carryforwards that affected our judgment about the valuation allowance. Income taxes for both fiscal 2008 and fiscal 2007 were affected by changes in estimates of income taxes for previous years. In both years, the changes were primarily related to settlements and resolutions of income tax matters. These changes reduced the effective tax rate for fiscal 2008 by approximately 1.2% and for fiscal 2007 approximately 10.2% of pretax earnings.

The effective tax rate comparison between fiscal 2008 and fiscal 2007 was also affected by the retroactive extension of the tax credit for increasing research activities available in fiscal 2007 but not in fiscal 2008. This credit expired on December 31, 2007. Another retroactive extension was approved in October 2008 that will benefit our effective tax rate in fiscal 2009. Among the other changes in our effective tax rate were the effects of changes in the relative mix of earnings by tax jurisdiction.

2007 Compared to 2006

Turbine Systems segment earnings increased 29%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2006	$ 67,584
Volume changes	15,843
Selling price changes	6,775
Variable compensation	(6,421)
Other, net	3,572
Earnings for the year ended September 30, 2007	$ 87,353

Sales volume changes are discussed above as part of the discussion of the changes in net external sales.

Selling price increases primarily affected industrial OEM products and spares and components used in the aerospace aftermarket.

Variable compensation paid to Turbine Systems members was higher in 2007 than in 2006, driven by performance-based factors.

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Engine Systems segment earnings increased 40%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2006	$ 40,829
Volume changes	10,591
Selling price changes	4,552
Margin changes	5,687
Reduced costs related to 2006 restructuring	2,327
Reduction in other selling, general and administrative expenses, including exchange rate gains/(loss)	1,200
Variable compensation	(4,596)
Other	(3,606)
Earnings for the year ended September 30, 2007	$ 56,984

After flat sales in fiscal 2006, many of Engine Systems domestic and international markets began experiencing growth in fiscal 2007. Sales volumes increased and were matched with a modest price increase. Improvements in gross margins were the result of productivity gains and a favorable product shipment mix. Quality improvements reduced warranty and scrap expenses. Other selling, general, and administrative expenses decreased due to reduced currency losses associated with Engine Systems non-U.S. locations.

The stronger sales environment, improved margins, and increased profitability resulted in higher performance-based variable compensation expenses in fiscal 2007.

Electrical Power Systems segment earnings increased 353%, attributable to the following (in thousands):

Earnings for the year ended September 30, 2006	$ 4,475
Sales volume	4,769
Improvements in material costs	2,853
Acquisition of SEG	13,041
Variable compensation	(998)
Research and development costs, excluding SEG	841
Increase in selling, general and administrative expenses	(1,245)
Other	(3,442)
Earnings for the year ended September 30, 2007	$ 20,294

On October 31, 2006, we acquired 100% of the stock of SEG. SEG had sales of approximately $60.0 million in calendar year 2005. This business adds dimension and range to our core technologies and product portfolio for the power generation market, including protection and comprehensive control systems for power distribution applications, and power inverters for wind turbines areas we have targeted for growth.

Nonsegment expenses increased 22%, attributable to the following (in thousands):

Nonsegment expenses for the year ended September 30, 2006	$ 26,052
Accruals for a legal matter	(3,171)

Stock-based compensation expense	911
Variable compensation	3,332
Other	4,596
Nonsegment expenses for the year ended September 30, 2007	$ 31,720

We accrue for individual legal matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss.

Among the other factors affecting nonsegment expenses are normal variations in legal and other professional services.

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Income taxes were provided at an effective rate on earnings before income taxes of 25.6% in fiscal 2007 compared to 17.3% in 2006. The change in the effective tax rate was attributable to the following (as a percent of earnings before income taxes):

Effective tax rate for the year ended September 30, 2006	17.3%
Adjustments of the beginning-of-year balance of valuation allowances for deferred tax assets	16.2
Change in estimates of taxes for previous periods and audit settlements in 2007 as compared to 2006	(8.9)
Research credit in 2007 as compared to 2006	(1.5)
Change in German income tax rate	2.3
Other changes, net	0.2
Effective tax rate for the year ended September 30, 2007	25.6%

The fiscal 2006 change in the beginning-of-year valuation allowances reduced income tax expense by $13.7 million. Exclusive of this item, the effective tax rate for fiscal 2006 was 33.5%. We establish valuation allowances to reflect the estimated amount of deferred tax assets that might not be realized. Both positive and negative evidence are considered in forming our judgment as to whether a valuation allowance is appropriate, and more weight is given to evidence that can be objectively verified. Valuation allowances are reassessed whenever there are changes in circumstances that may cause a change in our judgments. In fiscal 2006 and fiscal 2007, additional objective evidence became available regarding earnings in tax jurisdictions that have unexpired net operating loss carryforwards that affected our judgment about the valuation allowance.

Income taxes for both fiscal 2007 and fiscal 2006 were affected by changes in estimates of income taxes for previous years. In 2007, the changes were primarily related to the settlement of income tax audits. These changes reduced the effective tax rate for fiscal 2007 by approximately 10.2% of pretax earnings. In fiscal 2006, the changes were primarily related to the favorable resolution of certain tax matters. These changes reduced the effective tax rate for fiscal 2006 by approximately 1.3% of pretax earnings.

The effective tax rate comparison between fiscal 2007 and fiscal 2006 was also affected by the extension of the tax credit for increasing research activities. This credit expired on December 31, 2005 but was retroactively reinstated in December 2006, and we recognized a benefit to our effective tax rate for fiscal 2007 reflecting the extension.

Among the other changes in our effective tax rate were the effects of changes in the amounts of extraterritorial income exclusion and the effects of changes in the relative mix of earnings by tax jurisdiction.

Outlook

The economy over the last several months has been significantly impacted by financial institution credit crises ultimately impacting the broader credit markets and the financing available to many companies, both in the U.S. and abroad. More significantly to Woodward, at the moment, the rapid weakening of the Euro and the GBP coupled with our continuing growth in Europe is having a pronounced impact on our outlook for 2009.

Preparation for the impacts of market fluctuations has been a strategic objective for a number of years and Woodward is well positioned to maintain liquidity and relative profitability in the event of potential sales declines. We have been investing more broadly both regionally and across our markets to reduce specific risk with respect to any one economy or market. Our focus on energy control and optimization across a wide range of applications and resources mitigates fluctuations in any one area. Further, our products are key components of critical infrastructure projects where government funding may supplement private financing. We are focusing on our core competencies to better serve our customers, driving improvements in the cash conversion cycle, reducing operating costs in many areas, and have locked in favorable long-term financing.

At this time, our order volumes indicate a modest increase in sales volumes in 2009. However, the significant effects of rapidly weakened European currencies may offset this increase and we now anticipate organic sales to be flat to slightly up.

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FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

Assets

(In Thousands) at September 30,	2008	2007
Turbine Systems	$ 371,275	$ 330,969
Engine Systems	242,350	250,908
Electrical Power Systems	133,928	109,674
Nonsegment assets	179,464	138,216
Consolidated total assets	$ 927,017	$ 829,767

Turbine Systems segment assets increased primarily due to increases in accounts receivable and inventory in response to increases in sales volume. In addition, property, plant, and equipment increased due to equipment purchases and the modernization of the segment s largest manufacturing facility. We plan to begin construction of a state-of-the-art test facility for aircraft engine fuel and control systems in Rockford, Illinois, on which we expect to invest approximately $25.0 million within the next two years.

Engine Systems segment assets decreased primarily due to decreases in accounts receivable, property, plant and equipment, and intangible assets. Accounts receivable decreased as a result of an improvement in the management of accounts receivable. The decreases in property, plant, and equipment and intangible assets were due to normal depreciation and amortization, as well as transfer of certain assets to other segments or nonsegment use. These decreases were offset by an increase in inventory in response to increases in sales volume.

Electrical Power Systems segment assets increased primarily as a result of increases in accounts receivable and inventory in response to increases in sales volume and purchases of property, plant, and equipment.

Nonsegment assets increased primarily because of an increase in cash and cash equivalents related to increases in sales volume offset by the repurchase of common stock. Changes in cash are discussed more fully in a separate section of this Management s Discussion and Analysis.

Other Balance Sheet Measures

(In Thousands) at September 30,	2008	2007
Working capital	$ 369,211	$ 275,611
Long-term debt, less current portion	33,337	45,150
Other liabilities	67,695	57,404
Stockholders equity	629,628	544,431

Working capital (current assets less current liabilities) increased at September 30, 2008 from September 30, 2007 primarily as a result of an increase in sales volume which led to an increase in inventories and accounts receivable, and a decrease in short-term borrowings, partially offset by an increase in accounts payable and accrued liabilities.

As discussed in Note 22 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data, on October 1, 2008, we completed the acquisition of MPC in a transaction valued at approximately $383.0 million.

On October 6, 2008, we completed the acquisition of the outstanding capital stock of MotoTron and the intellectual property assets owned by its parent company, Brunswick Corporation, that are used in connection with the MotoTron business for approximately $17.0 million.

The October 2008 acquisitions of MPC and MotoTron, including the repayment of certain obligations associated with these acquisitions, were primarily financed with a total of $400.0 million of debt issued on October 1, 2008 and October 30, 2008, as discussed below.

Long-term debt, less current portion decreased as a result of payments made during the period. As of September 30, 2008, we had a revolving line of credit facility with a syndicate of U.S. banks totaling $225.0 million,

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with an option to increase the amount of the line to $350.0 million. In addition, we have other line of credit facilities, which are generally reviewed annually for renewal, which totaled $19.9 million at both September 30, 2008 and 2007.

Also, we have additional short-term borrowing capabilities tied to net amounts on deposit at certain foreign financial institutions under which $4.0 million had been advanced as of September 30, 2008 and $5.5 million had been advanced as of September 30, 2007. The total amount of borrowings under all facilities was $4.0 million at September 30, 2008 and $5.5 million at September 30, 2007. The weighted-average interest rate for outstanding borrowings under these line of credit facilities, which were at rates significantly lower than those typical in the U.S., was 3.0% September 30, 2008 and 3.8% at September 30, 2007.

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 ratio, and a maximum consolidated debt to earnings before income taxes, depreciation, and amortization (EBITDA) ratio, as defined in the agreements. We were in compliance with all covenants at September 30, 2008.

Term Loan Credit Agreement

As discussed in Note 22 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data, On October 1, 2008, we entered into a Term Loan Credit Agreement (the Term Loan Credit Agreement). The Term Loan Credit Agreement provides for a $150.0 million unsecured term loan facility, and may be expanded by up to $50.0 million of additional indebtedness from time to time, subject to the our compliance with certain conditions and the lenders participation. The Term Loan Credit Agreement generally bears interest at LIBOR plus 1.00% to 2.25%, requires quarterly principal payments of $1,875 beginning in March, 2009, and matures in October 2013.

The Term Loan Credit Agreement contains customary terms and conditions, including, among others, covenants that place limits on our ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell our assets, merge or consolidate with other persons, make capital expenditures, make certain investments, make certain restricted payments and enter into material transactions with affiliates. The Term Loan Credit Agreement contains financial covenants requiring that (a) our ratio of consolidated net debt to EBITDA not exceed 3.5 to 1.0 and (b) we have a minimum consolidated net worth of $400.0 million plus 50% of net income for any fiscal year and 50% of the net proceeds of certain issuances of capital stock, in each case on a rolling four quarter basis. The Term Loan Credit Agreement also contains events of default customary for such financings, the occurrence of which would permit the lenders to accelerate the amounts due.

Our obligations under the Term Loan Credit Agreement are guaranteed by Woodward FST, Inc., our wholly owned subsidiary (Woodward FST).

A portion of the proceeds from the Term Loan Credit Agreement was used to finance the MPC acquisition.

Note Purchase Agreement

On October 1, 2008, we entered into a Note Purchase Agreement (the Note Purchase Agreement) relating to the sale by Woodward of an aggregate principal amount of $250.0 million comprised of (a) $100.0 million aggregate principal amount of Series B Senior Notes due October 1, 2013 (the Series B Notes), (b) $50.0 million aggregate principal amount of Series C Senior Notes due October 1, 2015 (the Series C Notes) and (c) $100.0 million aggregate principal amount of Series D Senior Notes due October 1, 2018 (the Series D Notes and, together with the Series B Notes and

Series C Notes, the Notes) in a series of private placement transactions. On October 1, 2008, $200.0 million aggregate principal amount of Notes were sold, comprised of $80.0 million aggregate principal amount of the Series B Notes, $40.0 million aggregate principal amount of the Series C Notes and $80.0 million aggregate principal amount of the Series D Notes. In connection with the Note Purchase Agreement entered into on October 1, 2008, we issued an additional $50.0 million aggregate principal amount of Notes with similar maturities and interest rates on October 30, 2008. The Notes issued in the private placement have not been registered under the Securities Act of 1933 and may not be offered or sold in the U.S. absent registration or an applicable exemption from registration requirements.

The Series B Notes have a maturity date of October 1, 2013 and generally bear interest at a rate of 5.63% per annum. The Series C Notes have a maturity date of October 1, 2015 and generally bear interest at a rate of 5.92% per annum. The Series D Notes have a maturity date of October 1, 2018 and generally bear interest at a rate of 6.39% per annum. Under certain circumstances, the interest rate on each series of Notes is subject to increase if our leverage ratio of consolidated net debt to consolidated EBITDA increases beyond 3.5 to 1.0. Interest on the Notes is payable semi-annually on April 1 and October 1 of each year until all principal is paid. Interest payments commence on April 1, 2009.

Our obligations under the Note Purchase Agreement and the Notes rank equal in right of payment with all of our other unsecured unsubordinated debt, including our outstanding debt under the Term Loan Credit Agreement.

The Note Purchase Agreement contains restrictive covenants customary for such financings, including, among other things, covenants that place limits on our ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell our assets, merge or consolidate with other persons, and enter into material transactions with affiliates. The Note Purchase Agreement also contains events of default customary for such financings, the occurrence of which would permit the Purchasers of the Notes to accelerate the amounts due.

The Note Purchase Agreement contains financial covenants requiring that our (a) ratio of consolidated net debt to consolidated EBITDA not exceed 4.0 to 1.0 during any material acquisition period, or 3.5 to 1.0 at any other time on a rolling four quarter basis, and (b) consolidated net worth at any time equal or exceed $425.0 million plus 50% of consolidated net earnings for each fiscal year beginning with the fiscal year ending September 30, 2008. Additionally, under the Note Purchase Agreement, we may not permit the aggregate amount of priority debt to at any time exceed 20% of our consolidated net worth at the end of the then most recently ended fiscal quarter.

We are permitted at any time, at our option, to prepay all any part of the then outstanding principal amount of any series of the Notes at 100% of the principal amount of the series of Notes to be prepaid (but, in the case of partial prepayment, not less than $1.0 million), together with interest accrued on such amount to be prepaid to the date of payment, plus any applicable make-whole amount. The make-whole amount is computed by discounting the remaining scheduled payments of interest and principal of the Notes being prepaid at a discount rate equal to the sum of 50 basis points and the yield to maturity of U.S. treasury securities having a maturity equal to the remaining average life of the Notes being prepaid.

A portion of the proceeds from the issuance of the Notes was used to finance the MPC acquisition.

Commitments and contingencies at September 30, 2008, include various matters arising from the normal course of business. See previous discussion in Item 3. Legal Proceedings and Note 18 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data.

Stockholders equity at September 30, 2008, increased 16% over the prior fiscal year. Increases due to net earnings, sales of treasury stock, and income tax benefits from the exercise of stock options by employees during fiscal 2008 were partially offset by cash dividend payments and purchases of treasury stock.

In July 2006, the Board of Directors authorized the repurchase of up to $50.0 million of our outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period (the 2006 Authorization). During fiscal year 2007, we purchased $38.6 million of our common stock under the 2006

Authorization. Pursuant to the 2006 Authorization, in August 2007, we entered into an agreement with J.P. Morgan Chase Bank whereby we purchased approximately 989,000 common stock shares in exchange for $31.1 million at an average price of $31.47 per common share. This arrangement with J.P. Morgan Chase Bank completed the stock repurchase program previously authorized in July 2006.

During September 2007, the Board of Directors authorized a new stock repurchase of up to $200.0 million of our outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period that will end in October 2010 (the 2007 Authorization).

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During fiscal 2008, we purchased a total of $31.9 million of our common stock under the 2007 Authorization at an average price of $29.94 per share. A two-for-one stock split was approved by stockholders at the 2007 annual meeting of stockholders on January 23, 2008. This stock split became effective for stockholders at the close of business on February 1, 2008. The effects of the stock split are reflected in the financial statements filed as part of this Form 10-K. In addition, in accordance with stock option plan provisions, the terms of all outstanding stock option awards were proportionately adjusted.

Cash Flows

Year Ended September 30,	2008	2007	2006
		(In thousands)	
Net cash provided by operating activities	$ 125,354	$ 117,718	$ 80,536
Net cash used in investing activities	(35,909)	(67,048)	(31,015)
Net cash used in financing activities	(48,904)	(66,496)	(51,433)
Effect of exchange rate on changes	(2,343)	3,743	1,033
Net increase (decrease) in cash and cash equivalents	38,198	(12,083)	(879)
Cash and cash equivalents at beginning of the year	71,635	83,718	84,597
Cash and cash equivalents at the end of the year	$ 109,833	$ 71,635	$ 83,718

2008 Compared to 2007

Net cash flows provided by operating activities increased by $7.6 million compared to fiscal 2007, primarily due to an increase in net earnings and collections of income tax refunds, partially offset by an increase in working capital to support our growing business.

Net cash flows used in investing activities decreased by $31.1 million compared to fiscal 2007, primarily as a result of a business acquisition during fiscal 2007.

Capital expenditures increased by $9.1 million in fiscal 2008 compared to fiscal 2007. We are currently planning to begin construction of a state-of-the-art test facility for aircraft engine fuel and control systems in Rockford, Illinois. We expect to invest approximately $25.0 million for this test facility within the next two years, approximately $9.0 million to modernize and upgrade other Rockford facilities, and the balance for various other projects including systems test capability expansions in Colorado and a new facility in Poland. We continue to support our advanced test facilities and core manufacturing process improvements.

Increases in capital expenditures are expected to be funded through cash flows from operations and available revolving lines of credit.

Net cash flows used in financing activities decreased by $17.6 million from fiscal 2007, primarily as a result of reduced repurchases of treasury stock in fiscal 2008 and increases in excess tax benefits from stock compensation compared to fiscal 2007.

Overall, cash and cash equivalents increased by $38.2 million during fiscal 2008 to $109.8 million at year end. We believe cash on hand and available short-term borrowings at year end should continue to provide us with significant liquidity to fund on-going operations. The debt to total capitalization ratio was 7.2% as of September 30, 2008, compared to 10.9% as of September 30, 2007. Share purchases of treasury stock totaled to $39.8 million in fiscal 2008 and $51.0 million in fiscal 2007. The balance remaining at September 30, 2008 on the September 2007 authorization is $168.1 million.

2007 Compared to 2006

Net cash flows provided by operating activities increased by $37.2 million during fiscal 2007 as compared to fiscal 2006 primarily due to an increase in net earnings and deferred income taxes, partially offset by an increase in working capital.

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Net cash flows used in investing activities increased by $36.0 million during fiscal 2007 as compared to fiscal 2006 primarily as a result of a business acquisition.

Net cash flows used in financing activities increased by $15.1 million during fiscal 2007 as compared to fiscal 2006 primarily as a result of an increase in the purchase of treasury stock and payments on our borrowing under the revolving lines of credit, partially offset by increased sales of treasury stock. In August 2007, the Company entered into an accelerated stock repurchase agreement. See Note 1 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data for further discussion.

Off-Balance Sheet Arrangements and Contractual Obligations

Contractual Obligations

A summary of our consolidated contractual obligations and commitments as of September 30, 2008 is as follows:

Year Ending September 30,	2009	2010	2011	2012	2013	Thereafter
			(In thousands)			
Long-term debt principal	$ 11,377	$ 11,197	$ 11,064	$ 10,878	$	$
Interest on debt obligations	2,473	1,755	1,047	347		
Operating leases	4,400	3,800	3,100	2,900	2,500	3,100
Rebates	3,000	3,000	1,200			
Purchase obligations	132,997	2,222				
Other	530					22,046
Total	$ 154,777	$ 21,974	$ 16,411	$ 14,125	$ 2,500	$ 25,146

Purchase obligations include amounts committed under legally enforceable contracts or purchase orders for goods and services with defined terms as to price, quantity, delivery, and termination liability.

Interest obligations on floating rate debt instruments are calculated for future periods using interest rates in effect at the end of fiscal 2008. See Note 11 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data for further details on our long-term debt.

Rebates reflect contractually required payments to customers, which may be subsequently recovered, and exclude payments of future rebate obligations to customers that will likely be paid in connection with future sales activity.

The other obligations amount represents our best reasonable estimate for uncertain tax positions at this time and may change in future periods, as the timing of the payments and whether such payments will actually be required cannot be reasonable estimated.

The above table does not reflect the following items:

Contributions to our retirement pension benefit plans which we estimate will total approximately $2.4 million in 2009. Pension contributions in future years will vary as a result of a number of factors, including actual plan asset returns and interest rates.

Contributions to our healthcare benefit plans which we estimate will total $2.8 million in 2009, less the amount of federal subsidies associated with our prescription drug benefits that we receive estimated to be $0.5 million. Retirement healthcare contributions are made on a pay-as-you-go basis as payments are made to healthcare providers, and such contributions will vary as a result of changes in the future cost of healthcare benefits provided for covered retirees.

Guarantees and letters of credit totaling approximately $8.2 million were outstanding as of September 30, 2008, some of which were secured by cash and cash equivalents at financial institutions or by Woodward line of credit facilities.

As discussed in Note 22 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data, an aggregate $400.0 million of additional debt was issued on October 1, 2008 and October 30, 2008, a substantial portion of which was used to finance the MPC acquisition. Scheduled future principal payments on the $400.0 million of debt issued in October 2008, and associated interest expense, estimated based on rates in effect at October 31, 2008, are as follows (in thousands):

Year Ending September 30,	Principal	Interest
2009	$ 5,625	$ 23,078
2010	7,500	22,949
2011	7,500	22,527
2012	7,500	22,125
2013	7,500	21,682
Thereafter	364,375	37,888
Total	$ 400,000	150,249

Recently Adopted and Issued But Not Yet Effective Accounting Standards

A. Accounting changes and recently adopted accounting standards:

Income taxes

FIN 48: In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48) which provides guidance on the financial statement recognition, measurement, reporting, and disclosure of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 addresses the determination of whether tax benefits, either permanent or temporary, should be recorded in the financial statements. For those tax benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by the taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Woodward adopted the provisions of FIN 48 on October 1, 2007, as required. The change in measurement criteria caused Woodward to recognize a decrease in the retained earnings component of stockholders equity of $7,702. For additional information, see Note 4, Income Taxes to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data.

B. Issued but not yet effective accounting standards:

SFAS 157: In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about a Company s financial assets and liabilities that are measured at fair value. SFAS 157 does not change existing guidance on whether or not an instrument is carried at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS 157-1) which excludes SFAS No. 13, Accounting for

Leases and certain other accounting pronouncements that address fair value measurements, from the scope of SFAS 157. In February 2008, the FASB issued FSP No. FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2) which provides a one-year delayed application of SFAS 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We are required to adopt SFAS 157 as amended by FSP FAS 157-1 and FSP FAS 157-2 on October 1, 2008, the beginning of fiscal 2009. The adoption is not expected to have a material impact on our consolidated financial statements.

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active (FSP FAS 157-3), which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, FSP FAS 157-3 clarifies how (1) management s internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in FSP FAS 157-3 is effective immediately and will apply to us upon adoption of SFAS 157.

SFAS 159: In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 is expected to expand the use of fair value accounting but does not affect existing standards which require certain assets or liabilities to be carried at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS 159, a company may choose, at specified election dates, to measure eligible items at fair value and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. As a result, SFAS 159 is effective for us in the first quarter of fiscal 2009. We do not plan to apply SFAS 159.

EITF 07-3: In June 2007, the Emerging Issues Task Force (EITF) issued EITF 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities (EITF 07-3). EITF 07-3 addresses the diversity that exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. The EITF concluded that an entity must defer and capitalize non-refundable advance payments made for research and development activities, and expense these amounts as the related goods are delivered or the related services are performed. EITF 07-3 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 (fiscal 2009 for us). We do not expect the adoption of EITF 07-03 to have a material impact on our consolidated financial statements.

EITF 07-1: In November 2007, the EITF issued EITF 07-1, Accounting for Collaborative Arrangements (EITF 07-1). EITF 07-1, which will be applied retrospectively, requires expanded disclosures for contractual arrangements with third parties that involve joint operating activities and may require reclassifications to previously issued financial statements. EITF 07-1 is effective for interim or annual reporting periods beginning after December 15, 2008 (fiscal 2010 for us). We are currently evaluating the impact EITF 07-1 may have on our consolidated financial statements.

SFAS 141(R): In December 2007, the FASB issued SFAS No. 141 (Revised) Business Combinations (SFAS 141(R)). SFAS 141(R) is intended to improve, simplify, and converge internationally the accounting for business combinations. Under SFAS 141(R), an acquiring entity in a business combination must recognize the assets acquired, liabilities assumed, and any noncontrolling interest in the acquired entity at the acquisition date fair values, with limited exceptions. In addition, SFAS 141(R) requires the acquirer to disclose all information that investors and other users need to evaluate and understand the nature and financial impact of the business combination. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, we will record and disclose business combinations under the revised standard beginning October 1, 2009.

SFAS 160: In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of Accounting Research Bulletin (ARB) 51, (SFAS 160). This statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 establishes accounting and reporting standards that require (i) noncontrolling interests to be reported as a component of equity, (ii) changes in a parent s ownership interest while the parent retains its controlling interest be accounted for as equity transactions, and (iii) any retained noncontrolling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value. SFAS 160 is to be applied prospectively to business combinations consummated on or after the beginning of the first annual reporting period on or after December 15, 2008. SFAS 160 is effective for fiscal years beginning after December 15, 2008. As a result, SFAS 160 is effective for us in the first quarter of fiscal 2010. We are currently evaluating the impact SFAS 160 may have on our consolidated financial statements.

SFAS 161: In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. The new standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (fiscal 2010 for us). We are currently assessing the impact that SFAS 161 may have on our consolidated financial statements.

FSP FAS 142-3: In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3), which improves the consistency of the useful life of a recognized intangible asset among various pronouncements. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 (fiscal 2010 for us). We are currently assessing the impact that FSP FAS 142-3 may have on consolidated financial statements.

SFAS 162: In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. The new standard is effective 60 days following the Security and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We are currently assessing the impact that SFAS 162 may have on our consolidated financial statements.

FSP EITF 03-6-1: In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Stock-Based Payment Transactions are Participating Securities (FSP EITF 03-6-1). The FSP addresses whether instruments granted in stock-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in paragraphs 60 and 61 of SFAS No. 128, Earnings Per Share. The new FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years (fiscal 2010 for us). Early application is not permitted. Our unvested options are not eligible to receive dividends; therefore, FSP EITF 03-06-1 will not have any impact on our consolidated financial statements.

FSP FAS 133-1: In September 2008, the FASB issued FSP No. FAS 133-1 Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 (FSP FAS 133-1) and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161. This FSP amends SFAS No. 133 to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FIN No. 45 to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the FASB s intent about the effective date of SFAS No. 161. This FSP is effective for fiscal years ending after November 15, 2008. We expect to adopt this FSP for periods ending on and after December 31, 2008. We are currently assessing the impact that FSP FAS 133-1 may have on our consolidated financial statements.

Recent Market Events

Current market conditions and economic events have significantly impacted the financial condition, liquidity and outlook for a wide range of companies, including many companies outside the financial services sectors. We have considered the potential impact of such conditions and events as it relates to currently reported financial results of operations and liquidity, including consideration of the possible impact of other than temporary impairment, auction rate securities, and counterparty credit risk and hedge accounting. We do not believe that current market conditions and economic events have significantly impacted our results of operations or current liquidity, nor do we believe that, based on our current investment policies and contractual relationships, we are subject to greater risk from such factors than applies to other companies of similar size and market breadth.

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Financing Arrangements

Payments on our senior notes outstanding as of September 30, 2008, totaling $44.5 million, are due from fiscal 2009 through fiscal 2012. Payments on our senior notes issued on October 1 and October 30, 2008 are due in fiscal 2009 through fiscal 2019. Also, we have a $225.0 million line of credit facility that includes an option to increase the amount of the line up to $350.0 million, subject to our compliance with certain conditions and the participation of the lenders that does not expire until October 2012.

As described in Note 22 to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data, we entered into a Term Loan Credit Agreement on October 1, 2008 that provides for a $150.0 million unsecured term loan facility, and may be expanded by up to $50.0 million of additional indebtedness, subject to our compliance with certain conditions and the participation of the lenders. On October 1, 2008, we also entered into a Note Purchase Agreement relating to our sale of an aggregate principal amount of $250.0 million comprised of (a) $100.0 million aggregate principal amount of Series B Notes due October 1, 2013, (b) $50.0 million aggregate principal amount of Series C Notes due October 1, 2015 and (c) $100.0 million aggregate principal amount of Series D Notes due October 1, 2018. On October 1, 2008, $200.0 million aggregate principal amount of Notes were sold, comprised of $80.0 million aggregate principal amount of the Series B Notes, $40.0 million aggregate principal amount of the Series C Notes, and $80.0 million aggregate principal amount of the Series D Notes. On October 30, 2008, we issued an additional $50.0 million aggregate principal amount of Notes with similar maturities and interest rates.

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.

Outlook

The economy over the last several months has been buffeted with financial institution credit crises ultimately impacting the broader credit markets and the financing available to many companies, both in the U.S. and abroad. Preparation for the impacts of market fluctuations has been a strategic objective for a number of years and Woodward is better positioned at this time to maintain liquidity and relative profitability in the face of potential sales declines than in the past. Future cash flows from operations and available revolving lines of credit are expected to be adequate to meet our cash requirements over the next twelve months.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

Market Risk and Risk Management

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

Interest Rate Exposure

Derivative instruments utilized by us are viewed as risk management tools, involve little complexity, and are not used for trading or speculative purposes. To manage interest rate risk related to the $400 million of long-term debt issued in October 2008, we used a treasury lock which locked in interest rates on future debt. The treasury lock agreement was designated as a cash flow hedge against interest rate risk on a portion of the debt issued in October 2008.

A portion of our long-term debt is sensitive to changes in interest rates. We monitor trends in interest rates as a basis for determining whether to enter into fixed rate or variable rate debt agreements, the duration of such agreements, and whether to use hedging strategies. Our primary objective is to minimize our long-term costs of borrowing. At September 30, 2008, our long-term debt consisted of variable and fixed rate agreements. As

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measured at September 30, 2008, a hypothetical 1% immediate increase in interest rates would reduce the fair value of our long-term debt by approximately $0.8 million.

The actuarial assumptions used to calculate the funding status of our post-retirement benefit plans and future returns on associated plan assets are sensitive to changes in interest rates. The following information illustrates the sensitivity of the net periodic benefit cost and the projected benefit obligation to a change in the discount rate and in the return on benefit plan assets. Amounts relating to foreign plans are translated at the spot rate on September 30, 2008. The sensitivities reflect the impact of changing one assumption at a time and are specific to base conditions at September 30, 2008. It should be noted that economic factors and conditions often affect multiple assumptions simultaneously and the effects of changes in assumptions are not necessarily linear.

		Increase/(Decrease) in		
Assumption	**Change**	**2009 Net Periodic Benefit Cost**	**2008 Projected Service and Interest Costs**	**Accumulated Post Retirement Benefit Obligation**
			(In thousands)	
Retirement Pension Benefits:				
Change in discount rate	1% increase	$ (107)	$ (122)	$ (3,680)
	1% decrease	114	330	4,693
Retirement Healthcare Benefits:				
Change in discount rate	1% increase	N/A	N/A	(3,162)
	1% decrease	N/A	N/A	3,705
Change in healthcare cost trend rate	1% increase	3,939	275	N/A
	1% decrease	(3,411)	(240)	N/A

Foreign Currency Exposure

We are impacted by changes in foreign currency rates through sales and purchasing transactions when we sell product in functional currencies different from the currency in which product and manufacturing costs were incurred. The functional currencies of our worldwide facilities primarily include the USD, the Euro, and the GBP. Our purchasing and sales activities are primarily denominated in the USD, the Euro, and the GBP. We may be impacted by changes in the relative buying power of our customers, which may impact sales volumes either positively or negatively. As these currencies fluctuate against each other, and other currencies, we are exposed to foreign currency risk on sales, purchasing transactions, and labor.

Our reported financial results of operations, including the reported value of our assets and liabilities, are also impacted by changes in foreign currency rates. The assets and liabilities of substantially all of our subsidiaries outside the U.S. are translated at period end rates of exchange for each reporting period. Earnings and cash flow statements are translated at weighted-average rates of exchange. Although these translation changes have no immediate cash impact, the translation changes may impact future borrowing capacity, debt covenants, and overall value of our net assets.

Currency exchange rates vary daily and often one currency strengthens against the USD while another currency weakens. Because of the complex interrelationship of the worldwide supply chains and distribution channels, it is difficult to quantify the impact of a particular change in exchange rates.

We estimate that a 10% increase (or decrease) in the purchasing power of the USD against all other currencies for one year would increase (or decrease) net sales by less than 5%. The impact on pretax earnings would be minimal.

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Item 8. ***Financial Statements and Supplementary Data***

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Woodward Governor Company
Fort Collins, Colorado

We have audited the accompanying consolidated balance sheet of Woodward Governor Company and subsidiaries (the Company) as of September 30, 2008 and the related consolidated statements of earnings, stockholders equity, and cash flows for the year then ended. Our audit also included the financial statement schedule listed in the Index at Item 15. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the Company for the years ended September 30, 2007 and 2006 were audited by other auditors whose report, dated November 29, 2007, expressed an unqualified opinion on those statements and included an explanatory paragraph concerning a change in accounting for share-based payments effective October 1, 2005 and a change in the manner the Company presented obligations associated with defined benefit pension and other postretirement plans effective September 30, 2007.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2008 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Woodward Governor Company and subsidiaries as of September 30, 2008, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for uncertain tax positions on October 1, 2007 in accordance with the Financial Accounting Standards Board s Interpretation No. 48, Accounting for Uncertainty in Income Taxes.

We have also audited the adjustments to the 2007 and 2006 consolidated financial statements to retrospectively apply the two-for-one stock split as discussed in Note 1 to the consolidated financial statements. Our procedures included (1) comparing the amounts shown in the earnings per share disclosures for 2007 and 2006 to the Company s underlying accounting analysis, (2) comparing the previously reported shares outstanding and statement of earnings amounts per the Company s accounting analysis to the previously issued consolidated financial statements, and (3) recalculating the additional shares to give effect to the stock split and testing the mathematical accuracy of the underlying analysis. In our opinion, such retrospective adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2007 and 2006 consolidated financial statements of the Company other than with respect to the retrospective adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2007 and 2006 consolidated financial statements taken as a whole.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of September 30, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 19, 2008 expressed an unqualified opinion on the Company s internal control over financial reporting.

Deloitte & Touche LLP

Denver, Colorado
November 19, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of Woodward Governor Company

In our opinion, the consolidated balance sheet as of September 30, 2007 and the related consolidated statements of earnings, stockholders equity and cash flows for each of two years in the period ended September 30, 2007, before the effects of the adjustments to retrospectively reflect the two-for-one stock split described in Note 1B, present fairly, in all material respects, the financial position of Woodward Governor Company and its subsidiaries at September 30, 2007, and the results of their operations and their cash flows for each of the two years in the period ended September 30, 2007, in conformity with accounting principles generally accepted in the United States of America (the 2007 financial statements before the effects of the adjustments discussed in Note 1B are not presented herein). In addition, in our opinion, the financial statement schedule for the each of the two years in the period ended September 30, 2007 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements before the effects of the adjustments described above. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits, before the effects of the adjustments described above, of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were not engaged to audit, review, or apply any procedures to the adjustments to retrospectively reflect the two-for-one stock split described in Note 1B and accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have properly applied. Those adjustments were audited by other auditors.

PricewaterhouseCoopers LLP

Chicago, Illinois
November 29, 2007

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Consolidated Statements of Earnings **WOODWARD GOVERNOR COMPANY**

	Year Ended September 30,		
	2008	2007	2006
	(In thousands, except per share amounts)		
Net sales	$ 1,258,204	$ 1,042,337	$ 854,515
Costs and expenses:			
Cost of goods sold	882,996	728,820	612,263
Selling, general, and administrative expenses	115,399	111,297	92,013
Research and developments costs	73,414	65,294	59,861
Amortization of intangible assets	6,830	7,496	6,953
Interest expense	3,834	4,527	5,089
Interest income	(2,120)	(3,604)	(2,750)
Other income	(4,685)	(4,186)	(4,245)
Other expense	626	705	834
Total costs and expenses	1,076,294	910,349	770,018
Earnings before income taxes	181,910	131,988	84,497
Income taxes	(60,030)	(33,831)	(14,597)
Net earnings	$ 121,880	$ 98,157	$ 69,900
Earnings per share:			
Basic	$ 1.80	$ 1.43	$ 1.02
Diluted	$ 1.75	$ 1.39	$ 0.99
Weighted-average common shares outstanding:			
Basic	67,564	68,489	68,702
Diluted	69,560	70,487	70,382

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Balance Sheets **WOODWARD GOVERNOR COMPANY**

	At September 30, 2008	At September 30, 2007
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 109,833	$ 71,635
Accounts receivable, less allowance for losses of $1,648 and $1,886, respectively	178,128	152,826
Inventories	208,317	172,500
Income taxes receivable		9,461
Deferred income tax assets	25,128	23,754
Other current assets	16,649	8,429
Total current assets	538,055	438,605
Property, plant and equipment, net	168,651	158,998
Goodwill	139,577	141,215
Other intangibles, net	66,106	73,018
Deferred income tax assets	6,208	11,250
Other assets	8,420	6,681
Total assets	$ 927,017	$ 829,767
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 4,031	$ 5,496
Current portion of long-term debt	11,560	15,940
Accounts payable	65,427	57,668
Income taxes payable	2,235	
Accrued liabilities	85,591	83,890
Total current liabilities	168,844	162,994
Long-term debt, less current portion	33,337	45,150
Deferred income tax liabilities	27,513	19,788
Other liabilities	67,695	57,404
Total liabilities	297,389	285,336
Commitments and contingencies (Notes 4, 14, 17, and 18)		
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 and 100,000 shares authorized, 72,960 shares issued and outstanding	106	106
Additional paid-in capital	68,520	48,641
Accumulated other comprehensive income	20,319	23,010

Deferred compensation	5,283	4,752
Retained earnings	663,442	565,136
	757,670	641,645
Less: Treasury stock at cost, 5,261 shares and 5,231 shares, respectively	(122,759)	(92,462)
Treasury stock held for deferred compensation, at cost, 404 shares and 430 shares, respectively	(5,283)	(4,752)
Total stockholders equity	629,628	544,431
Total liabilities and stockholders equity	$ 927,017	$ 829,767

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended September 30, 2008	2007	2006
	(In thousands)		
Cash flows from operating activities:			
Net earnings	$ 121,880	$ 98,157	$ 69,900
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	35,450	32,924	29,017
Post retirement settlement gain		(871)	
Contractual pension termination benefit		715	340
Net loss (gain) on sale of property, plant and equipment	1,229	(199)	84
Stock-based compensation	4,588	3,849	2,942
Excess tax benefits from stock-based compensation	(15,355)	(9,787)	(3,305)
Deferred income taxes	10,960	12,473	(13,481)
Reclassification of unrealized gains and losses on derivatives to earnings	204	247	286
Changes in operating assets and liabilities, net of business acquisition:			
Accounts receivable	(26,470)	(20,765)	(8,730)
Inventories	(36,661)	(8,592)	1,140
Accounts payable and accrued liabilities	6,078	16,962	(2,514)
Current income taxes	27,089	2,952	9,785
Other	(3,638)	(10,347)	(4,928)
Net cash provided by operating activities	125,354	117,718	80,536
Cash flows from investing activities:			
Payments for purchase of property, plant and equipment	(37,516)	(31,984)	(31,713)
Proceeds from sale of property, plant and equipment	1,607	225	698
Business acquisition, net of cash acquired		(35,289)	
Net cash used in investing activities	(35,909)	(67,048)	(31,015)
Cash flows from financing activities:			
Cash dividends paid	(15,872)	(14,747)	(13,742)
Proceeds from sales of treasury stock as a result of exercise of stock options	9,440	7,856	4,163
Purchases of treasury stock	(39,801)	(50,952)	(22,306)
Excess tax benefits from stock compensation	15,355	9,788	3,305
Net payments from borrowings under revolving lines of credit	(1,465)	(2,760)	(8,025)
Payments of long-term debt	(16,257)	(15,681)	(14,510)
Proceeds from cash flow hedge	108		
Debt financing costs	(412)		
Other payments			(318)
Net cash used in financing activities	(48,904)	(66,496)	(51,433)

Effect of exchange rate changes on cash and cash equivalents	(2,343)	3,743	1,033
Net change in cash and cash equivalents	38,198	(12,083)	(879)
Cash and cash equivalents at beginning of period	71,635	83,718	84,597
Cash and cash equivalents at end of period	$ 109,833	$ 71,635	$ 83,718
Supplemental cash flow information:			
Interest expense paid	$ 4,216	$ 4,870	$ 5,334
Income taxes paid	33,735	21,169	19,131
Income tax refunds received	13,579		
Non-cash investing activities:			
Long-term debt assumed in business acquisition		10,319	
Purchases of property, plant and equipment on account	3,583		
Sales of assets on account	433		

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Stockholders Equity **WOODWARD GOVERNOR COMPANY**

	Year Ended September 30, 2008	2007	2006
	(In thousands, except per share amounts)		
Common stock:			
Beginning and ending balance	$ 106	$ 106	$ 106
Additional paid-in capital:			
Beginning balance	$ 48,641	$ 31,960	$ 25,854
(Gain) loss on sales of treasury stock	(628)	1,957	(141)
Tax benefits applicable to exercise of stock options	15,355	9,787	3,305
Stock-based compensation	4,588	3,849	2,942
Deferred compensation transfer	564	1,088	
Ending balance	$ 68,520	$ 48,641	$ 31,960
Accumulated other comprehensive income:			
Beginning balance	$ 23,010	$ 12,619	$ 10,904
Foreign currency translation adjustments, net	(4,071)	10,514	2,525
Reclassification of unrealized losses on derivatives to earnings, net	127	153	177
Proceeds from cash flow hedge, net	67		
Impact of implementing SFAS 158, net		(980)	
Minimum post-retirement benefits liability adjustments, net	1,186	704	(987)
Ending balance	$ 20,319	$ 23,010	$ 12,619
Deferred compensation:			
Beginning balance	$ 4,752	$ 5,524	$ 5,402
Deferred compensation invested in the company s common stock	841	2,006	165
Deferred compensation settled with the company s common stock	(310)	(2,778)	(43)
Ending balance	$ 5,283	$ 4,752	$ 5,524
Retained earnings:			
Beginning balance	$ 565,136	$ 481,726	$ 425,568
Net earnings	121,880	98,157	69,900
Impact of implementing FIN 48	(7,702)		
Cash dividends $0.235, $0.215 and $0.20 per common share, respectively	(15,872)	(14,747)	(13,742)
Ending balance	$ 663,442	$ 565,136	$ 481,726
Treasury stock:			
Beginning balance	$ 92,462	$ 47,722	$ 29,963
Purchases of treasury stock	39,801	50,952	22,820

Sales of treasury stock	(9,323)	(5,900)	(5,061)
Deferred compensation transfer	(181)	(312)	
Ending balance	$ 122,759	$ 92,462	$ 47,722
Treasury stock held for deferred compensation:			
Beginning balance	$ 4,752	$ 5,524	$ 5,402
Deferred compensation transfer	745	1,875	
Stock distributions	(310)	(2,778)	(43)
Automatic dividend reinvestment	96	131	165
Ending balance	$ 5,283	$ 4,752	$ 5,524

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Stockholders Equity (Continued) **WOODWARD GOVERNOR COMPANY**

	Year Ended September 30,		
	2008	2007	2006
	(In thousands, except per share amounts)		
Total stockholders equity:			
Beginning balance	$ 544,431	$ 478,689	$ 432,469
Effect of changes among components of stockholders equity			
Additional paid-in capital	19,879	16,681	6,106
Accumulated other comprehensive earnings	(2,691)	10,391	1,715
Deferred compensation	531	772	122
Retained earnings	98,306	83,410	56,158
Treasury stock	(30,297)	(44,740)	(17,759)
Treasury stock held for deferred compensation	(531)	(772)	(122)
Total effect of changes among components of stockholders equity	85,197	65,742	46,220
Ending balance	$ 629,628	$ 544,431	$ 478,689
Total comprehensive earnings:			
Net earnings	$ 121,880	$ 98,157	$ 69,900
Other comprehensive earnings:			
Foreign currency translation adjustments, net	(4,071)	10,514	2,525
Reclassification of unrealized losses on derivatives to earnings, net	127	153	177
Gain on cash flow hedge, net	67		
Post-retirement benefit adjustments, net	1,186	704	(987)
Total other comprehensive earnings	(2,691)	11,371	1,715
Total comprehensive earnings	$ 119,189	$ 109,528	$ 71,615
Common stock, number of shares:			
Beginning and ending balance	72,960	72,960	72,960
Treasury stock, number of shares:			
Beginning balance	5,231	4,852	4,308
Purchases of treasury stock	1,384	1,680	1,440
Sales of treasury stock	(1,330)	(1,233)	(896)
Deferred compensation transfer	(24)	(68)	
Ending balance	5,261	5,231	4,852
Treasury stock held for deferred compensation, number of shares:			
Beginning balance	430	830	828
Deferred compensation transfer	24	68	
Stock distributions	(53)	(474)	(8)

Automatic dividend reinvestment	3	6	10
Ending balance	404	430	830

See accompanying Notes to Consolidated Financial Statements.

WOODWARD GOVERNOR COMPANY

Notes to Consolidated Financial Statements
(amounts in thousands, except per share)

Note 1. Operations and summary of significant accounting policies

A. Nature of operations

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

Woodward was established in 1870 and incorporated in 1902. Woodward serves global markets and is headquartered in Fort Collins, Colorado. Woodward s principal plants are located in the U.S., China, Germany, and Poland. The Company operates other facilities in Brazil, India, Japan, the Netherlands, and the United Kingdom, which are used primarily for sales and service activities.

During fiscal years 2008, 2007, and 2006, Woodward operated in the following three business segments:

> **Turbine Systems** is focused on developing and manufacturing systems and components that provide energy control and optimization solutions for the aircraft and industrial gas turbine markets.
>
> **Engine Systems** is focused on developing and manufacturing systems and components that provide energy control and optimization solutions for the industrial engine and steam turbine markets, which includes power generation, transportation, and process industries.
>
> **Electrical Power Systems** is focused on developing and manufacturing systems and components that provide power sensing and energy control systems that improve the security, quality, reliability, and availability of electrical power networks for industrial markets, which includes power generation, power distribution, transportation, and process industries.

B. Summary of significant accounting policies

Principles of consolidation: The Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) and include the accounts of Woodward and its majority-owned subsidiaries. Transactions within and between these companies are eliminated. Results of joint ventures in which Woodward does not have a controlling financial interest are included in the financial statements using the equity method of accounting.

Stock-split: A two-for-one stock split was approved by stockholders at the 2007 annual meeting of stockholders on January 23, 2008. The stock split became effective for stockholders at the close of business on February 1, 2008. The number of shares and per share amounts reported in the Consolidated Financial Statements has been updated from amounts reported prior to February 1, 2008, to reflect the effects of the split. In addition, in accordance with stock option plan provisions, the terms of all outstanding stock option awards were proportionally adjusted.

Use of estimates: The preparation of financial statements prepared in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses recognized during the reporting period. Actual results could differ materially from Woodward s estimates.

Reclassifications: Certain reclassifications have been made to prior year balances in order to conform to the current year s presentation.

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Notes to Consolidated Financial Statements (Continued)
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Foreign currency: The assets and liabilities of substantially all subsidiaries outside the U.S. are translated at year-end rates of exchange, and earnings and cash flow statements are translated at weighted-average rates of exchange. Translation adjustments are accumulated with other comprehensive earnings as a separate component of stockholders equity and are presented net of tax effects in the Consolidated Statements of Stockholders Equity. The effects of changes in exchange rates on loans between consolidated subsidiaries that are not expected to be repaid in the foreseeable future are also accumulated with other comprehensive earnings.

The Company is exposed to market risks related to fluctuations in foreign exchange rates because some sales transactions, and the assets and liabilities of its domestic and foreign subsidiaries, are denominated in foreign currencies. Selling, general, and administrative expenses include net foreign currency transaction losses of $1,454 in 2008, $249 in 2007 and $903 in 2006.

Revenue recognition: The provisions of Staff Accounting Bulletin No. 104 and all other related interpretations have been applied. Sales are generally recognized when delivery of product has occurred or services have been rendered and there is persuasive evidence of a sales arrangement, selling prices are fixed or determinable, and collectability from the customer is reasonably assured. Revenue from sales arrangements with multiple deliverables are recognized when there is pervasive evidence of a sales arrangement for each individual deliverable.

Product delivery is generally considered to have occurred when the customer has taken title and assumed the risks and rewards of ownership of the products. In countries whose laws provide for retention of some form of title by sellers enabling recovery of goods in the event of customer default on payment, product delivery is considered to have occurred when the customer has assumed the risks and rewards of ownership of the products. Most of the sales are made directly to customers that use Woodward products, although products are also sold to distributors, dealers, and independent service facilities. Sales terms for distributors, dealers, and independent service facilities are substantially similar to Woodward s sales terms for direct customers.

Customer Rebates: Woodward sometimes agrees to make rebate payments to customers related to anticipated sales activity. Payments made to customers are accounted for as a reduction of revenue unless they are made in exchange for identifiable goods or services with fair values that can be reasonably estimated. These reductions in revenues are recognized immediately to the extent that the payments cannot be attributed to anticipated future sales, and are recognized in future periods to the extent that the payments relate to future sales, based on the specific facts and circumstances underlying each payment. Payments that are probable and can be reasonably estimated are accrued at expected rates based on anticipated sale activity.

Stock-based compensation: The provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (SFAS 123R) requiring that compensation cost relating to stock-based payment awards made to employees and directors be recognized in the financial statements have been applied. Non-qualified stock option awards are issued under Woodward s stock-based compensation plans. The cost for such awards is measured at the grant date based on the fair value of the award. Historical company information is the primary basis for selection of the expected term, expected volatility, and expected dividend yield assumptions used to estimate the fair value of the options on the date of grant.

The portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods, which is generally the vesting period of the awards.

SFAS 123R requires forfeitures to be estimated at the time of the grant in order to estimate the portion of the award that will ultimately vest. The estimate is based on Woodward s historical rates of forfeitures and is updated periodically.

Research and development costs: Expenditures related to new product development activities are expensed when incurred and are separately reported in the Consolidated Statements of Earnings.

WOODWARD GOVERNOR COMPANY

Notes to Consolidated Financial Statements (Continued)
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Income taxes: Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of Woodward s assets and liabilities. Woodward provides for taxes that may be payable if undistributed earnings of overseas subsidiaries were to be remitted to the U.S., except for those earnings that it considers to be permanently reinvested.

Cash equivalents: Highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

Cash and cash equivalents are maintained with several financial institutions. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions with reputable credit and therefore bear minimal credit risk. Woodward holds cash and cash equivalents at financial institutions in excess of amounts covered by federal depository insurance.

Accounts receivable: Virtually all Woodward s sales are made on credit and result in accounts receivable, which are recorded at the amount invoiced. In the normal course of business, not all accounts receivable are collected and, therefore, an allowance for losses of accounts receivable is provided equal to the amount that Woodward believes ultimately will not be collected. Customer-specific information is considered related to delinquent accounts, past loss experience, and current economic conditions in establishing the amount of its allowance. Accounts receivable 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.

Inventories: Inventories are valued at the lower of cost or market, with cost being determined on a first-in, first-out basis. Component parts include items that can be sold separately as finished goods or included in the manufacture of other products.

Property, plant, and equipment: Property, plant, and equipment are recorded at cost and are depreciated over the estimated useful lives of the assets, ranging from five to 40 years for buildings and improvements and three to fifteen years for machinery and equipment. Assets are depreciated using the straight-line method. Assets are tested for recoverability whenever events or circumstances indicate the carrying value may not be recoverable.

Purchase Accounting: The provisions of SFAS No. 141, Business Combinations and related interpretations have been applied. Business combinations are accounted for using the purchase method of accounting. Under the purchase method, assets and liabilities are recorded at their fair values as of the acquisition date, including intangible assets. Acquisition costs in excess of amounts assigned to assets acquired and liabilities assumed are recorded as goodwill.

Goodwill: Woodward tests goodwill on the reporting unit level on an annual basis and more often if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test consist of comparing the fair value of the reporting unit, determined using discounted cash flows, with its carrying amount including goodwill, and, if the carrying amount of the reporting unit exceeds its fair value, comparing the implied value of goodwill with its carrying amount. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss would be recognized to reduce the carrying amount to its implied fair value. There was no impairment charge recorded in fiscal 2008, fiscal 2007, or fiscal 2006.

Other intangibles: Other intangibles are recognized apart from goodwill whenever an acquired intangible asset arises from contractual or other legal rights, or whenever it is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged, either individually or in combination with a related contract, asset, or liability. All of Woodward s intangibles have an estimated useful life and are being amortized. Impairment losses are recognized if the carrying amount of an intangible exceeds its fair value.

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Estimated lives over which intangible assets are amortized, on a straight line basis, at September 30, 2008 were as follows:

Customer relationships	10 - 30 years
Intellectual property	15 years
Process technology	8 - 30 years
Patents	10 - 14 years
Other intangibles	15 years

Deferred compensation: Deferred compensation obligations will be settled either by delivery of a fixed number of shares of Woodward s common stock (in accordance with certain eligible members irrevocable elections) or in cash. Woodward has contributed shares of its common stock into a trust established for the future settlement of deferred compensation obligations that are payable in shares of Woodward s common stock. Common stock held by the trust is reflected in the Consolidated Balance Sheet as treasury stock held for deferred compensation and the related deferred compensation obligation is reflected as a separate component of equity in amounts equal to the fair value of the common stock at the dates of contribution. These accounts are not adjusted for subsequent changes in fair value of the common stock. Deferred compensation obligations that will be settled in cash are accounted for on an accrual basis in accordance with the terms of the underlying contract and are reflected in the Consolidated Balance Sheet as an accrued liability.

Investments: Woodward holds marketable equity securities related to its deferred compensation program. In accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities and based on Woodward s intentions regarding these instruments, marketable equity securities are classified as trading securities. The trading securities are reported at fair value, with realized gains and losses recognized in earnings. The trading securities are included in Other current assets. The associated obligation to provide benefits is included in Other liabilities.

Derivatives: The Company is exposed to various market risks that arise from transactions entered into in the normal course of business. The Company utilizes derivative instruments such as treasury lock agreements to lock in fixed rates on future debt issuances that qualify as cash flow or fair value hedges to mitigate the risk of variability in cash flows related to future interest payments attributable to changes in the designated benchmark rate. The Company complies with SFAS Nos. 133, 137, 138 and 149 (collectively SFAS 133) pertaining to the accounting for these derivatives and hedging activities which require all such interest rate hedge instruments to be recorded on the balance sheet at fair value. Cash flows related to the instrument designated as a qualifying hedge are reflected in the accompanying Consolidated Statements of Cash Flows in the same categories as the cash flows from the items being hedged. Accordingly, cash flows relating to the settlement of interest rate derivatives hedging the forecasted issuance of debt have been reflected upon settlement as a component of financing cash flows. The resulting gain or loss from such settlement is deferred to other comprehensive income and reclassified to interest expense over the term of the underlying debt. This reclassification of the deferred gains and losses impacts the interest expense recognized on the underlying debt that was hedged and is therefore reflected as a component of operating cash flows in periods subsequent to settlement. The periodic settlement of interest rate derivatives hedging outstanding variable rate debt is recorded as an adjustment to interest expense and is therefore reflected as a component of operating cash flows.

Post-retirement benefits: The Company provides various benefits to certain employees through defined benefit plans and retirement healthcare benefit plans. For financial reporting purposes, net periodic benefits expense and related obligations are calculated using a number of significant actuarial assumptions. Changes in net periodic expense may occur in the future due to changes in these assumptions.

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The weighted average actuarial assumptions used in measuring the net periodic benefit cost and plan obligations of retirement pension benefits were as follows:

	Year Ended September 30,					
	United States			Other Countries		
	2008	2007	2006	2008	2007	2006
Weighted-average assumptions used to determine benefit obligation at September 30:						
Discount rate	6.5%	6.1%	5.6%	4.7%	4.8%	4.4%
Rate of compensation increase	N/A	N/A	4.5	3.7	3.8	3.4
Weighted-average assumptions used to determine net periodic benefit cost for years ended September 30:						
Discount rate	6.1	5.6	5.3	5.7	4.4	4.1
Rate of compensation increase	N/A	N/A	4.5	3.7	3.8	3.2
Long-term rate of return on plan assets	7.5	8.0	8.0	5.6	5.8	5.6

The discount rate assumption is intended to reflect the rate at which the retirement benefits could be effectively settled based upon the assumed timing of the benefit payments. In the U.S., Woodward used a bond portfolio matching analysis based on recently traded, non-callable bonds rated AA- or better by Standard & Poors, which have at least $25.0 million outstanding. In the United Kingdom, Woodward used the AA corporate bond index (applicable for bonds over 15 years) and government bond yields (for bonds over 15 years) to determine a blended rate to use as the benchmark. In Japan, Woodward used AA-rated corporate bond yields (for bonds of 12.5 years) as the benchmark. Woodward s assumed rates do not differ significantly from any of these benchmarks.

The investment objectives for the pension plan assets are designed to generate returns that will enable the pension plans to meet their future obligations. The precise amount for which these obligations will be settled depends on future events, including the life expectancy of the plan participants. These obligations are estimated using actuarial assumptions, based on the current economic environment. The strategy balances the requirements to generate returns, using the higher-returning assets such as equity securities with the need to control risk in the pension plan with less volatile assets, such as fixed-income securities. Risks include, among others, the likelihood of the pension plans becoming underfunded, thereby increasing their dependence on contributions from Woodward. The assets are managed by professional investment firms and performance is evaluated against specific benchmarks. In the U.S., assets are primarily invested in broadly diversified passive vehicles.

The weighted average actuarial assumptions used in measuring the net periodic benefit cost and plan obligations of retirement healthcare benefits follows:

	Year Ended September 30,		
	2008	2007	2006

Weighted-average discount rate assumptions used to determine benefit obligation at September 30	6.5%	6.1%	5.6%
Weighted-average discount rate assumptions used to determine net periodic benefit cost for years ended September 30	6.1%	5.6%	5.3%

The discount rate assumption is intended to reflect the rate at which the retirement benefits could be effectively settled based upon the assumed timing of the benefit payments. In the U.S., Woodward used a bond portfolio matching analysis based on recently traded, non-callable bonds rated AA- or better by Standard & Poors, which have at least $25.0 million outstanding. In the United Kingdom, Woodward used the AA corporate bond index (applicable for bonds over 15 years) and government bond yields (for bonds over 15 years) to determine a blended rate to use as the benchmark. Woodward s assumed rates do not differ significantly from any of these benchmarks.

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For retirement healthcare benefits, Woodward assumed net healthcare cost trend rates of 8.0% in 2009, decreasing gradually to 5.0% in 2011, and remaining at 5.0% thereafter. A 1.0% increase in assumed healthcare cost trend rates would have increased the total of the service and interest cost components by approximately $275 and increased the benefit obligation at the end of the year by approximately $3,939 in 2008. Likewise, a 1.0% decrease in the assumed rates would have decreased the total of service and interest cost components by $240 and decreased the benefit obligation by approximately $3,411 in 2008.

Stockholders equity: In July 2006, the Board of Directors authorized the repurchase of up to $50,000 of Woodward s outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period (the 2006 Authorization). During fiscal 2007, Woodward purchased $38,649 of its common stock under the 2006 Authorization. The 2006 Authorization is closed.

In September 2007, the Board of Directors authorized a new stock repurchase of up to $200,000 of Woodward s outstanding shares of common stock on the open market or in privately negotiated transactions over a three-year period that will end in October 2010 (the 2007 Authorization). During fiscal 2008, Woodward purchased a total of $31,925 of its common stock under the 2007 Authorization.

Advertising Costs: Woodward expenses all advertising costs as incurred and they are classified within selling, general, and administrative expenses. Advertising costs were not material for all years presented.

Shipping and Handling Costs: Product freight costs are included in cost of goods sold.

Note 2. Recently adopted and issued but not yet effective accounting standards

A. Accounting changes and recently adopted accounting standards:

Income taxes

FIN 48: In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48) which provides guidance on the financial statement recognition, measurement, reporting, and disclosure of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 addresses the determination of whether tax benefits, either permanent or temporary, should be recorded in the financial statements. For those tax benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by the taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Woodward adopted the provisions of FIN 48 on October 1, 2007, as required. The change in measurement criteria caused Woodward to recognize a decrease in the retained earnings component of stockholders equity of $7,702. For additional information, see Note 4, Income Taxes.

B. Issued but not yet effective accounting standards:

SFAS 157: In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about a Company s financial assets and liabilities that are measured at fair value. SFAS 157 does not change existing guidance on whether or not an instrument is carried at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS 157-1) which excludes SFAS No. 13, Accounting for Leases and certain other accounting pronouncements that address fair value measurements, from the scope of SFAS 157. In February 2008, the FASB issued FSP No. FAS 157-2, Effective

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Date of FASB Statement No. 157 (FSP FAS 157-2) which provides a one-year delayed application of SFAS 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Woodward is required to adopt SFAS 157 as amended by FSP FAS 157-1 and FSP FAS 157-2 on October 1, 2008, the beginning of fiscal 2009. The adoption is not expected to have a material impact on the consolidated financial statements.

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active (FSP FAS 157-3), which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, FSP FAS 157-3 clarifies how (1) management s internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in FSP FAS 157-3 is effective immediately and will apply to the Company upon adoption of SFAS 157.

SFAS 159: In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 is expected to expand the use of fair value accounting but does not affect existing standards that require certain assets or liabilities to be carried at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS 159, a company may choose, at specified election dates, to measure eligible items at fair value and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. As a result, SFAS 159 is effective for Woodward in the first quarter of fiscal 2009. Woodward does not plan to apply SFAS 159.

EITF 07-3: In June 2007, the Emerging Issues Task Force (EITF) issued EITF 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities (EITF 07-3). EITF 07-3 addresses the diversity that exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. The EITF concluded that an entity must defer and capitalize non-refundable advance payments made for research and development activities, and expense these amounts as the related goods are delivered or the related services are performed. EITF 07-3 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 (fiscal 2009 for Woodward). Woodward does not expect the adoption of EITF 07-03 to have a material impact on its consolidated financial statements.

EITF 07-1: In November 2007, the EITF issued EITF 07-1, Accounting for Collaborative Arrangements (EITF 07-1). EITF 07-1, which will be applied retrospectively, requires expanded disclosures for contractual arrangements with third parties that involve joint operating activities and may require reclassifications to previously issued financial statements. EITF 07-1 is effective for interim or annual reporting periods beginning after December 15, 2008 (fiscal 2010 for Woodward). Woodward is currently evaluating the impact EITF 07-1 may have on consolidated financial statements.

SFAS 141(R): In December 2007, the FASB issued SFAS No. 141 (Revised) Business Combinations (SFAS 141(R)). SFAS 141(R) is intended to improve, simplify, and converge internationally the accounting for business combinations. Under SFAS 141(R), an acquiring entity in a business combination must recognize the assets acquired, liabilities assumed, and any noncontrolling interest in the acquired entity at the acquisition date fair values, with limited exceptions. In addition, SFAS 141(R) requires the acquirer to disclose all information that investors and other users need to evaluate and understand the nature and financial impact of the business combination. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2008. Earlier adoption is

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prohibited. Accordingly, Woodward will record and disclose business combinations under the revised standard beginning October 1, 2009.

SFAS 160: In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of Accounting Research Bulletin (ARB) 51, (SFAS 160). This statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 establishes accounting and reporting standards that require (i) noncontrolling interests to be reported as a component of equity, (ii) changes in a parent s ownership interest while the parent retains its controlling interest be accounted for as equity transactions, and (iii) any retained noncontrolling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value. SFAS 160 is to be applied prospectively to business combinations consummated on or after the beginning of the first annual reporting period on or after December 15, 2008. SFAS 160 is effective for fiscal years beginning after December 15, 2008. As a result, SFAS 160 is effective for Woodward in the first quarter of fiscal 2010. Woodward is currently evaluating the impact SFAS 160 may have on its consolidated financial statements.

SFAS 161: In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. The new standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (fiscal 2010 for Woodward). Woodward is currently assessing the impact that SFAS 161 may have on its consolidated financial statements.

FSP FAS 142-3: In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3), which improves the consistency of the useful life of a recognized intangible asset among various pronouncements. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 (fiscal 2010 for Woodward). Woodward is currently assessing the impact that FSP FAS 142-3 may have on its consolidated financial statements.

SFAS 162: In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. The new standard is effective 60 days following the Security and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Woodward is currently assessing the impact that SFAS 162 may have on its consolidated financial statements.

FSP EITF 03-6-1: In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities (FSP EITF 03-6-1). The FSP addresses whether instruments granted in stock-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in paragraphs 60 and 61 of SFAS No. 128, Earnings Per Share. The new FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years (fiscal 2010 for Woodward). Early application is not permitted. Woodward s unvested options are not eligible to receive dividends; therefore, FSP EITF 03-06-1 will not have any impact on its consolidated financial statements.

FSP SFAS 133-1: In September 2008, the FASB issued FSP No. FAS 133-1 Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 (FSP FAS 133-1) and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161 . This FSP amends

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SFAS No. 133 to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FIN No. 45 to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the FASB s intent about the effective date of SFAS No. 161. This FSP is effective for fiscal years ending after November 15, 2008. Woodward expects to adopt this FSP for periods ending on and after December 31, 2008. Woodward is currently assessing the impact that FSP No. FAS 133-1 may have on its consolidated financial statements.

Note 3. Business acquisitions

On October 31, 2006, Woodward acquired 100 percent of the stock of Schaltanlagen-Elektronik-Geräte GmbH & Co. KG (SEG), and a related receivable from SEG that was held by one of the sellers, for $35,289, including $10,319 of assumed debt obligations. The transaction was financed with available cash. The acquisition provides Woodward with technologies and products that complement its 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.

As part of the acquisition, Woodward implemented a plan to exit from a project-based segment of the business. Costs related to exiting this line of business have been accrued as business termination costs, including involuntary employee termination benefits and relocation costs. Due to changes in the market, Woodward no longer expects to exit from the project-based segment of the business. Woodward estimates that the implementation of the remaining restructuring to this business will be completed in fiscal year 2009.

Accrued termination costs, October 1, 2006	$ 1,753
Payments	(448)
Foreign currency translation	218
Accrued termination costs, September 30, 2007	1,523
Payments	(128)
Changes in estimates	(599)
Foreign currency translation	5
Accrued termination costs, September 30, 2008	$ 801

The results of SEG s operations are included in Woodward s Consolidated Statements of Earnings from the beginning of November 2006. If the acquisition had been completed on October 1, 2006, Woodward s net sales and net earnings for the fiscal year ended September 30, 2007 would not have been materially different from amounts reported in the Consolidated Statements of Earnings.

Note 4. Income taxes

Income taxes consisted of the following:

Year Ended September 30,	**2008**	**2007**	**2006**
Current:			
Federal	$ 26,689	$ 6,204	$ 21,117
State	4,080	3,416	3,223
Foreign	17,583	10,465	3,994
Deferred	11,678	13,746	(13,737)
	$ 60,030	$ 33,831	$ 14,597

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Earnings before income taxes by geographical area consisted of the following:

Year Ended September 30,	2008	2007	2006
United States	$ 96,934	$ 93,818	$ 70,037
Germany	46,239	22,012	5,991
Other countries	38,737	16,158	8,469
	$ 181,910	$ 131,988	$ 84,497

Deferred income taxes presented in the Consolidated Balance Sheets are related to the following:

At September 30,	2008	2007
Deferred tax assets:		
Retirement healthcare and early retirement benefits	$ 14,528	$ 16,913
Foreign net operating loss carryforwards	4,579	11,007
Inventory	14,828	14,491
Other	20,637	23,744
Valuation allowance	(129)	(2,596)
Total deferred tax assets, net of valuation allowance	54,443	63,559
Deferred tax liabilities:		
Intangibles net	(33,354)	(29,761)
Other	(17,266)	(18,582)
Total deferred tax liabilities	(50,620)	(48,343)
Net deferred tax assets	$ 3,823	$ 15,216

The foreign net operating loss carryforwards as of September 30, 2008 may be carried forward indefinitely.

At September 30, 2008, Woodward has not provided for taxes on undistributed foreign earnings of $32,642 that it considers permanently reinvested. These earnings could become subject to income taxes if they are remitted as dividends, are loaned to Woodward, or if it sells its stock in the subsidiaries. However, the Company believes that foreign tax credits would largely offset any income tax that might otherwise be due.

The changes in the valuation allowance were as follows:

Year Ended September 30,	**2008**	**2007**	**2006**
Beginning balance	$ (2,596)	$ (2,566)	$ (17,769)
Change in valuation allowance that existed at the beginning of the year	2,689	(116)	13,710
Current activity related to deferred items	(222)	(302)	
Foreign net operating loss carryforward		388	1,493
Ending balance	$ (129)	$ (2,596)	$ (2,566)

Deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Both positive and negative evidence are considered in forming Woodward s judgment as to whether a valuation allowance is appropriate, and more weight is given to evidence that can be objectively verified. Valuation allowances are reassessed whenever there are changes in circumstances that may cause a change in judgment. In fiscal 2008, 2007,

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and 2006, additional objective evidence became available regarding earnings in tax jurisdictions that had unexpired net operating loss carryforwards that affected Woodward s judgment about the valuation allowance that existed at the beginning of the year.

Foreign net operating loss carryforward amounts in the preceding table included the translation effects of changes in foreign currency exchange rates.

The reasons for the differences between Woodward s effective income tax rate and the U.S. statutory federal income tax rate were as follows:

Percent of pretax Earnings Year Ended September 30,	**2008**	**2007**	**2006**
Statutory rate	35.0%	35.0%	35.0%
Adjustments of the beginning-of-year balance of valuation allowances for deferred tax assets	(1.5)		(16.2)
State income taxes, net of federal tax benefit	1.5	2.0	2.4
Foreign loss effect			0.3
Foreign tax rate differences		0.1	1.1
Foreign sales benefits		(0.4)	(2.3)
German tax law changes		2.3	
ESOP dividends on allocated stock shares	(0.4)	(0.5)	(0.7)
Research credit	(0.3)	(2.4)	(0.9)
Retroactive extension of research credit		(0.9)	
Change in estimate of taxes for previous periods and audit settlements	(1.2)	(10.2)	(1.3)
Other items, net	(0.1)	0.6	(0.1)
Effective rate	33.0%	25.6%	17.3%

The changes in estimate of taxes for previous periods are primarily related to the favorable resolution of certain tax matters for 2008 and 2007, and to increases in the amount of certain credits claimed and changes in the amount of certain deductions taken as compared to prior estimates for 2006.

In June 2006, the FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48), which provides guidance on the financial statement recognition, measurement, reporting and disclosure of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 addresses the determination of whether tax benefits, either permanent or temporary, should be recorded in the financial statements. For those tax benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by the taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Woodward adopted the provisions of FIN 48 on October 1, 2007, as required. The change in measurement criteria caused Woodward to recognize a decrease in the retained earnings component of stockholders equity of $7,702.

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A reconciliation of the beginning and ending amounts of gross unrecognized tax benefits is as follows:

Balance at October 1, 2007	$ 20,509
Tax positions related to the current year	5,819
Tax positions related to prior years	(74)
Lapse of applicable statute of limitations	(3,678)
Balance at September 30, 2008	$ 22,576

At September 30, 2008, the amount of unrecognized tax benefits that would impact Woodward s effective tax rate, if recognized, was $17,086. At this time, Woodward estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by up to $8,308 in the next twelve months through completion of reviews by various worldwide tax authorities.

Woodward recognizes interest and penalties related to unrecognized tax benefits in tax expense. Woodward had accrued interest and penalties of $5,956 and $4,396 as of September 30, 2008, and October 1, 2007, respectively.

Woodward s tax returns are audited by U.S., state, and foreign tax authorities and these audits are at various stages of completion at any given time. Fiscal years remaining open to examination in significant foreign jurisdictions include 2002 and forward. Woodward is subject to U.S. and state income tax examinations for fiscal years 2003 and forward.

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Note 5. Earnings per share

Net earnings per share basic is computed by dividing net earnings available to common stockholders by the weighted average number of shares of common stock outstanding for the period. Net earnings per share diluted reflect the potential dilution that could occur if options were exercised.

The average shares outstanding decreased during fiscal 2008 as a result of shares repurchased under Woodward s ongoing stock repurchase program. (See Note 1. Operations and summary of significant accounting policies.) Woodward repurchases common stock at times management deems appropriate, given current market valuations. The following is a reconciliation of net earnings to net earnings per share basic and net earnings per share diluted:

Year Ended September 30,	2008	2007	2006
Numerator:			
Net earnings	$ 121,880	$ 98,157	$ 69,900
Denominator:			
Basic	67,564	68,489	68,702
Assumed exercise of stock options	1,996	1,998	1,680
Diluted	69,560	70,487	70,382
Income per common share:			
Basic	$ 1.80	$ 1.43	$ 1.02
Diluted	$ 1.75	$ 1.39	$ 0.99

The weighted-average shares of common stock outstanding for basic earnings per share included the weighted-average treasury stock shares held for deferred compensation obligations of 417, 558, and 828 for fiscal 2008, 2007, and 2006, respectively.

The following outstanding stock options were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive:

Year Ended September 30,	2008	2007	2006
Options	398	636	716
Weighted-average option price	$ 32.68	$ 18.54	$ 13.59

Note 6. Inventories

At September 30,	**2008**	**2007**
Raw materials	$ 16,221	$ 10,808
Component parts	118,248	92,737
Work in progress	41,047	36,220
Finished goods	32,801	32,735
	$ 208,317	$ 172,500

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(amounts in thousands, except per share)

Note 7. Property, plant, and equipment

At September 30,	2008	2007
Land	$ 13,343	$ 12,469
Buildings and equipment	188,359	182,765
Machinery and equipment	286,074	277,100
Construction in progress	16,524	15,749
	504,300	488,083
Less accumulated depreciation	(335,649)	(329,085)
Property, plant, and equipment, net	$ 168,651	$ 158,998

Depreciation expense totaled $28,620 in fiscal 2008, $25,428 in fiscal 2007, and $22,064 in fiscal 2006.

Note 8. Goodwill

	September 30, 2007	Additions/ Adjustments	Translation Gains/(Losses)	September 30, 2008
Turbine Systems	$ 86,565	$	$	$ 86,565
Engine Systems	37,736	(675)	(1,430)	35,631
Electrical Power Systems	16,914	675	(208)	17,381
Consolidated	$ 141,215	$	$ (1,638)	$ 139,577

	September 30, 2006	Additions/ Adjustments	Translation Gains/(Losses)	September 30, 2007
Turbine Systems	$ 86,565	$	$	$ 86,565
Engine Systems	36,703		1,033	37,736
Electrical Power Systems	8,816	6,296	1,802	16,914
Consolidated	$ 132,084	$ 6,296	$ 2,835	$ 141,215

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Note 9. Other intangibles net

	September 30, 2008			September 30, 2007		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Customer relationships:						
Turbine Systems	$ 44,327	$ (15,268)	$ 29,059	$ 44,327	$ (13,791)	$ 30,536
Engine Systems	20,607	(9,877)	10,730	20,607	(8,003)	12,604
Electrical Power Systems	2,190	(386)	1,804	2,609	(424)	2,185
Total	$ 67,124	$ (25,531)	$ 41,593	$ 67,543	$ (22,218)	$ 45,325
Intellectual property:						
Turbine Systems	$	$	$	$	$	$
Engine Systems	12,705	(5,408)	7,297	16,163	(6,175)	9,988
Electrical Power Systems	2,790	(1,220)	1,570	4,564	(4,374)	190
Total	$ 15,495	$ (6,628)	$ 8,867	$ 20,727	$ (10,549)	$ 10,178
Process technology:						
Turbine Systems	$ 11,941	$ (4,113)	$ 7,828	$ 11,941	$ (3,715)	$ 8,226
Engine Systems	5,350	(2,853)	2,497	5,350	(2,318)	3,032
Electrical Power Systems	1,338	(1,129)	209	1,351	(971)	380
Total	$ 18,629	$ (8,095)	$ 10,534	$ 18,642	$ (7,004)	$ 11,638
Patents:						
Turbine Systems	$	$	$	$ 3,056	$ (2,852)	$ 204
Engine Systems						
Electrical Power Systems	4,442	(693)	3,749	4,486	(335)	4,151
Total	$ 4,442	$ (693)	$ 3,749	$ 7,542	$ (3,187)	$ 4,355
Other intangibles:						
Turbine Systems	$	$	$	$	$	$
Engine Systems				315	(275)	40
Electrical Power Systems	1,563	(200)	1,363	1,578	(96)	1,482
Total	$ 1,563	$ (200)	$ 1,363	$ 1,893	$ (371)	$ 1,522

Consolidated	$	107,253	$	(41,147)	$	66,106	$	116,347	$	(43,329)	$	73,018

Amortization expense totaled $6,830 in fiscal 2008, $7,496 in fiscal 2007, and $6,953 in fiscal 2006.

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Amortization expense associated with current intangibles is expected to be:

Year Ending September 30:	
2009	$ 6,184
2010	6,059
2011	6,017
2012	6,017
2013	5,839
Thereafter	35,990
	$ 66,106

Note 10. Short-term borrowings

Short-term borrowings reflect interest bearing advances subject to a cash pooling agreement on certain foreign bank accounts and are collateralized by the associated bank account balances. Total borrowing capacity varies daily in relation to net amounts on deposit in the associated bank accounts. The weighted-average interest rate for outstanding borrowings was 3.0% and 3.8%, at September 30, 2008 and 2007, respectively. The rates were lower than is typical in the U.S. because of borrowing rates available in foreign countries.

Note 11. Long-term debt and line of credit facilities

Long-term debt consisted of the following:

At September 30,	**2008**	**2007**
Senior notes 6.39%, due October 2011; unsecured	$ 42,857	$ 53,572
Term note 5.19%, due July 2008; unsecured		4,375
Term note 4.25% 6.95%, due May 2009 to September 2012, secured by land and buildings	1,659	2,526
Fair value hedge adjustment for unrecognized discontinued hedge gains	381	617
	44,897	61,090
Less: current portion	(11,560)	(15,940)
Long-term debt, less current portion	$ 33,337	$ 45,150

The senior notes are held by multiple institutions. The term notes are held by banks in Germany.

The current portion of long-term debt at September 30, 2008 includes $183 related to the fair value hedge adjustment for unrecognized discontinued hedge gains.

Required future principal payments of the senior notes and the term notes are as follows:

Year Ending September 30,	
2009	$ 11,377
2010	11,197
2011	11,064
2012	10,878

Prior to the issuance of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) Woodward entered into certain interest rate swaps that were designated as fair value hedges of its long-term debt. The discontinuance of these interest rate swaps resulted in gains that are recognized as a reduction

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of interest expense over the term of the associated debt using the effective interest method. The unrecognized portion of the gain is presented as an adjustment to long-term debt based on the accounting guidance in effect at the time the interest rate swaps were discontinued. If SFAS 133 had been issued and adopted when these interest rate swaps were entered into, the unrecognized potion of the gain would be presented in accumulated other comprehensive income rather than as an adjustment to long-term debt.

In September 2008, the Company entered into treasury lock agreements with a notional amount totaling $100,000 that qualified as cash flow hedges under SFAS 133. The objective of this derivative instrument was to hedge the risk of variability in cash flows related to future interest payments of a portion of the anticipated future debt issuances attributable to changes in the designated benchmark interest rate. The hedges were closed-out prior to September 30, 2008 resulting in a gain of approximately $108 and the gain is recorded in accumulated other comprehensive income as of September 30, 2008. The gain on the close-out of the treasury lock agreements will be recognized as a reduction of interest expense over the scheduled term of the hedged debt (seven years) issued on October 1, 2008 using the effective interest method.

Provisions of the debt agreements, including the $225,000 revolving line of credit facility described below, include covenants customary to such agreements that require Woodward 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. The most restrictive covenants require the maintenance of a minimum consolidated net worth, a maximum ratio of consolidated debt to consolidated operating cash flow, and a maximum ratio of consolidated debt to earnings before interest, taxes, depreciation, and amortization (EBITDA), as defined in the agreements. Woodward is in compliance with all covenants.

As of September 30, 2008, Woodward had a $225,000 revolving line of credit facility that involved unsecured financing arrangements with a syndicate of U.S. banks. The agreement provided for an option to increase the amount of the line to $350,000 and has an expiration date of October 2012. Interest rates on borrowings under the agreement vary with LIBOR, the federal funds rate, or the prime rate.

Woodward also had various foreign lines of credit. The lines are generally reviewed annually for renewal and are subject to the usual terms and conditions applied by the banks. Several of the lines assess commitment fees.

Borrowing capacity under lines of credit consisted of the following:

At September 30,	**2008**	**2007**
U.S. revolving line of credit facility	$ 225,000	$ 100,000
Various foreign lines of credit	19,903	19,867
Total borrowing capacity under revolving lines of credit	244,903	119,867
Less: borrowings outstanding	( )	( )
Available line of credit borrowing capacity	$ 244,903	$ 119,867

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Note 12. Accrued liabilities

At September 30,	2008	2007
Salaries and other member benefits	$ 51,773	$ 47,578
Warranties	7,232	5,675
Taxes, other than income	6,908	6,682
Accrued retirement benefits	5,865	6,132
Other	13,813	17,823
	$ 85,591	$ 83,890

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

At September 30,	2008	2007
Warranties, beginning of period	$ 5,675	$ 5,832
Increases to accruals	7,477	4,911
Settlements of amounts accrued	(5,800)	(5,715)
Foreign currency exchange rate changes	(120)	647
Warranties, end of period	$ 7,232	$ 5,675

Note 13. Other liabilities

At September 30,	2008	2007
Net accrued retirement benefits, less amounts recognized with accrued liabilities	$ 42,103	$ 46,145
Other	25,592	11,259
	$ 67,695	$ 57,404

Note 14. Retirement benefits

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

Woodward provides health-care and life insurance benefits to certain retired employees and their covered dependents and beneficiaries. Generally, employees who have attained age 55 and have rendered 10 or more years of service are eligible for these postretirement benefits. Certain retirees are required to contribute to plans in order to maintain coverage.

On September 30, 2007, Woodward adopted SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158), which requires the recognition of the funded status of defined pension and postretirement plans in the statement of financial position. The funded status is measured as the difference between the fair market value of the plan assets and the benefit obligation. For a defined benefit pension plan, the benefit obligation is the projected benefit obligation; for any other defined benefit postretirement plan, such as a retiree health care plan, the benefit obligation is the accumulated postretirement benefit obligation. Any over-funded status should be recognized as an asset and any underfunded status should be recognized as a liability.

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As part of the initial recognition of the funded status, any transitional asset/(liability), prior service cost/(credit) or actuarial gain/(loss) that has not yet been recognized as a component of net periodic cost should be recognized in the Accumulated Other Comprehensive Income section of the Consolidated Statements of Stockholders Equity, net of tax. Accumulated Other Comprehensive Income will be adjusted as these amounts are subsequently recognized as a component of net periodic benefit costs in future periods.

The recognition of the funded status requirement and certain disclosure provisions of SFAS 158 were effective for Woodward as of the end of fiscal 2007. Retrospective application of SFAS 158 was not permitted. The initial incremental recognition of the funded status under SFAS 158 that is reflected upon adoption in the Accumulated Other Comprehensive Income section of Consolidated Statements of Stockholders Equity was an after tax decrease to equity of $980.

The impact of adopting the provisions of SFAS 158 on the components of the Consolidated Balance Sheet as of September 30, 2007 is as follows:

	Before Application of SFAS 158	Adjustment Increases/ (Decreases)	After Application of SFAS 158
Retirement Pension Benefits:			
Deferred tax asset	$ 1,980	$ 816	$ 2,796
Total assets	1,980	816	2,796
Pension obligation	(4,674)	(2,916)	(7,590)
Accumulated other comprehensive income, net of taxes	3,293	2,100	5,393
Total stockholders equity	3,293	2,100	5,393
Total liabilities and equity	(1,381)	(816)	(2,197)
Retirement Healthcare Benefits:			
Deferred tax liability		(687)	(687)
Pension obligation	(46,494)	1,807	(44,687)
Accumulated other comprehensive income, net of taxes		(1,120)	(1,120)
Total stockholders equity		(1,120)	(1,120)

A. Defined Contribution Plans

Substantially all U.S. employees are eligible to participate in the U.S. defined contribution plan. Certain foreign employees also are eligible to participate in foreign plans.

The amount of expense associated with defined contribution plans totaled $14,877 in fiscal 2008, $13,487 in fiscal 2007, and $13,684 in fiscal 2006. The amount of contributions associated with the multiemployer plan totaled $613 in fiscal 2008, $572 in fiscal 2007, and $635 in fiscal 2006.

B. Pension benefits associated with defined benefit plans

Woodward has defined benefit plans which provide pension benefits for certain retired employees in the U.S., the United Kingdom, and Japan. Approximately 575 current employees may receive future benefits under the plans. The defined benefit plans in the U.S. were frozen in January 2007 and no additional employees may participate in the U.S. plans and no additional service costs will be incurred. A September 30 measurement date is utilized to value plan assets and obligations for all of Woodward s defined benefit pension plans.

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Woodward s investment policies and strategies for plan assets focus on maintaining diversified investment portfolios that provide for growth while minimizing risk to principal. The target allocation ranges for plan assets in the U.S. and in the United Kingdom, which represented about 81% of total foreign plan assets at September 30, 2008, are 50% for equity securities and 50% for debt securities. The remaining foreign plan assets are in Japan, and Woodward s investment manager uses asset allocations that are customary in that country. The expected long-term rates of return on plan assets were based on Woodward s current asset allocations and the historical long-term performance for each asset class, as adjusted for existing market conditions.

Salary increase assumptions are based upon historical experience and anticipated future management actions. In determining the long-term rate of return on plan assets, Woodward assumes that the historical long-term compound growth rates of equity and fixed-income securities will predict the future returns of similar investments in the plan portfolio. Investment management and other fees paid out of the plan assets are factored into the determination of asset return assumptions.

Net periodic benefit costs consists of the following components reflected as expense in Woodward s Consolidated Statements of Earnings:

	United States			Other Countries		
Year Ended September 30,	**2008**	**2007**	**2006**	**2008**	**2007**	**2006**
Components of net periodic benefit cost:						
Service cost	$	$	$	$ 945	$ 1,294	$ 1,360
Interest cost	1,122	1,034	1,142	2,814	2,554	2,200
Expected return on plan assets	(1,362)	(1,317)	(1,180)	(3,005)	(2,424)	(1,998)
Amortization of:						
Unrecognized transition obligation				99	89	91
Unrecognized losses	118	244	251	181	360	402
Recognized prior service cost (benefit)	(260)	(259)	1	(10)	(8)	(8)
Contractual termination benefits					715	340
Net periodic benefit cost (benefit)	$ (382)	$ (298)	$ 214	$ 1,024	$ 2,580	$ 2,387

An amendment was made to one of Woodward s retirement pension benefit plans in 2006 that modified the amount of pension benefits payable to participants retiring after January 1, 2007.

Contractual pension termination benefits were associated with workforce reductions of members covered by one of Woodward s retirement pension benefit plans. The workforce reductions were related to the consolidation of manufacturing operations that were initially accrued for in 2004. The expense was recognized in the Engine Systems segment.

The amounts expected to be amortized from Accumulated Other Comprehensive Income and reported as a component of net periodic benefit cost during fiscal 2009 is as follows:

	United States	Other Countries
Net transition obligation	$	$ (74)
Prior service cost (benefit)	(260)	7
Net actuarial losses (gains)	118	(124)

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The following table provides a reconciliation of the changes in the projected benefit obligation and fair value of assets for the retirement pension plans:

At or for the Year Ended September 30,	United States 2008	United States 2007	Other Countries 2008	Other Countries 2007
Changes in projected benefit obligation:				
Projected benefit obligation at beginning of year	$ 18,676	$ 18,716	$ 59,628	$ 57,072
Service cost			945	1,294
Interest cost	1,122	1,034	2,814	2,554
Contribution by participants			69	122
Net actuarial gains	(1,299)	(547)	(8,989)	(2,775)
Foreign currency exchange rate changes			(3,798)	3,958
Benefits paid	(543)	(527)	(3,384)	(3,312)
Curtailment gain			(13)	
Contractual termination cost (benefits)			(1,630)	715
Projected benefit obligation at end of year	$ 17,956	$ 18,676	$ 45,642	$ 59,628
Changes in fair value of plan assets:				
Fair value of plan assets at beginning of year	$ 18,438	$ 16,709	$ 52,276	$ 40,812
Actual return on plan assets	(2,549)	2,256	(4,284)	2,504
Foreign currency exchange rate changes			(3,794)	3,431
Contributions by the company			2,582	8,719
Contributions by plan participants			69	122
Settlements			(1,631)	
Benefits paid	(543)	(527)	(3,384)	(3,312)
Fair value of plan assets at end of year	$ 15,346	$ 18,438	$ 41,834	$ 52,276
Reconciliation of accrued obligation and total amounts recognized:				
Funded status at end of year	$ (2,610)	$ (238)	$ (3,808)	$ (7,352)
Unrecognized prior service cost (benefit)	(2,890)	(3,149)	37	(56)
Unrecognized net losses (gains)	5,842	3,348	19	8,046
Unrecognized transition obligation			(145)	
Net amounts recognized	$ 342	$ (39)	$ (3,897)	$ 638
Accrued benefit liability	$ (2,610)	$ (238)	$ (3,808)	$ (7,352)
Deferred taxes	1,122	76	986	2,720
Accumulated other comprehensive income (loss)	1,830	123	(1,075)	5,270

Net amounts recognized	$	342	$	(39)	$	(3,897)	$	638

The underfunded status of the plans declined from $7,590 in fiscal 2007 to $6,418 in fiscal 2008, primarily due to actuarial gains resulting, in part, from the increase in the discount rate and contributions made during the year.

Woodward makes periodic cash contributions to its defined pension plans.

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The accumulated benefit obligation is the present value of pension benefits (whether vested or unvested) attributed to employee service rendered before the measurement date and based on employee service and compensation prior to that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were as follow, at or for the year ended September 30:

	United States		Other Countries	
	2008	**2007**	**2008**	**2007**
Projected benefit obligation	$ (17,956)	$ (18,676)	$ (45,642)	$ (59,628)
Accumulated benefit obligation	(17,956)	(18,676)	(43,497)	(56,097)
Fair value of plan assets	15,346	18,438	41,834	52,276

The allocation of pension plan assets as of the respective measurement dates is as follows at September 30:

	United States		Other Countries	
	2008	**2007**	**2008**	**2007**
Equity securities	52%	60%	42%	44%
Debt securities	48%	40%	58%	38%
Insurance contracts				5%
Other				13%
	100%	100%	100%	100%

Pension assets at September 30, 2008 and 2007 do not include any direct investment in Woodward s equity securities.

Substantially all pension benefit payments are made from assets of the pension plans. Using foreign exchange rates as of September 30, 2008 and expected future service, it is anticipated that the future benefit payments will be as follows:

Year Ending September 30,	**United States**	**Other Countries**
2009	$ 604	$ 2,823
2010	656	2,922
2011	737	3,155
2012	829	3,032
2013	922	3,228

2014 - 2018	6,240	17,043

Woodward expects its contributions for retirement pension benefits will be $0 in the United States and $2,426 in other countries in 2009.

C. Retirement healthcare benefit plans

Woodward has retirement healthcare benefit plans in the U.S. and the United Kingdom that provides healthcare benefits for approximately 1,100 retired employees and may provide future benefits to approximately 140 active employees, upon retirement. Benefits include the option to elect company provided healthcare insurance benefits to age 65 and a Medicare supplemental plan after age 65. The retirement healthcare benefit plans were

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frozen in January 2007 and no additional employees may participate in the plans. A September 30 measurement date is utilized to value plan assets and obligations for all of Woodward s retirement healthcare benefit plans.

Net periodic benefit costs consists of the following components reflected as expense in Woodward s Consolidated Statements of Earnings:

Year Ended September 30,	**2008**	**2007**	**2006**
Components of net periodic benefit cost:			
Service cost	$ 242	$ 297	$ 381
Interest cost	2,452	2,474	2,753
Recognized losses	192	259	1,198
Recognized prior service cost	(2,520)	(2,520)	(2,520)
Cost of buyout events		(871)	
Net periodic cost (benefit)	$ 366	$ (361)	$ 1,812

During fiscal 2007, Woodward provided an option for certain retirees to receive a cash settlement in lieu of future payments. The expense related to retirees who accepted the offer is included in the cost of buyout events.

As part of our retirement healthcare benefits, Woodward provides a prescription drug benefit that is at least actuarially equivalent to Medicare Part D. As a result, Woodward is entitled to a federal subsidy that was introduced by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. Subsidies received are as follows:

Year Ended September 30,	**2008**	**2007**	**2006**
Prescription drug benefits paid	$ 3,180	$ 2,318	$ 2,336
Federal subsidy received	166	924	

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The following table provides a reconciliation of the changes in the projected benefit obligation and fair value of assets for the retirement healthcare benefits for the years ended September 30:

	2008	2007
Changes in projected benefit obligation:		
Benefit obligation at beginning of year	$ 44,687	$ 51,557
Service cost	242	297
Interest cost	2,453	2,475
Contribution by participants	2,407	2,663
Net actuarial gain	(3,493)	(5,896)
Foreign currency exchange rate changes	(88)	188
Benefits paid	(6,342)	(5,237)
Settlement gain		(2,284)
Plan amendments	(2,531)	
Part D Medicare reimbursement	166	924
Benefit obligation at end of year	$ 37,501	$ 44,687
Changes in fair value of plan assets:		
Fair value of plan assets at beginning of year	$	$
Special termination benefit cost		(737)
Contributions by the company	3,935	3,310
Contributions by plan participants	2,407	2,663
Benefits paid	(6,342)	(5,236)
Fair value of plan assets at end of year	$	$
Reconciliation of accrued obligation and total amounts recognized:		
Funded status at end of year	$ (37,501)	$ (44,687)
Unrecognized prior service cost	(5,426)	(5,418)
Unrecognized net (gain) loss	(90)	3,611
Net amounts recognized	$ (43,017)	$ (46,494)
Accrued benefit liability	$ (37,501)	$ (44,687)
Deferred taxes	(2,100)	(687)
Accumulated other comprehensive income	(3,416)	(1,120)
Net amounts recognized	$ (43,017)	$ (46,494)

The accumulated benefit obligation is the present value of healthcare benefits (whether vested or unvested) attributed to employee service rendered before the measurement date and based on employee service and compensation prior to that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. The projected benefit obligation and accumulated benefit obligation were as follows:

Year Ended September 30,	**2008**	**2007**
Projected benefit obligation/Accumulated postretirement benefit obligation	$ (37,501)	$ (44,687)

WOODWARD GOVERNOR COMPANY

Notes to Consolidated Financial Statements (Continued)
(amounts in thousands, except per share)

For retirement healthcare benefits, Woodward assumed net healthcare cost trend rates of 8.0% in 2009, decreasing gradually to 5.0% in 2011, and remaining at 5.0% thereafter. A 1.0% increase in assumed healthcare cost trend rates would have increased the total of the service and interest cost components by approximately $275 and increased the benefit obligation at the end of the year by approximately $3,939 in 2008. Likewise, a 1.0% decrease in the assumed rates would have decreased the total of service and interest cost components by $240 and decreased the benefit obligation by approximately $3,411 in 2008.

Using foreign exchange rates as of September 30, 2008 and expected future service, it is anticipated that the future benefit payments will be as follows:

Year Ending September 30,	
2009	$ 2,756
2010	2,924
2011	3,012
2012	3,079
2013	3,137
2014 - 2018	16,216

Woodward expects its contributions for retirement healthcare benefits will be approximately $2,783 in fiscal 2009, less amounts received as federal subsidies expected to be $473.

Note 15. Stock options

Stock options are granted to key management members and directors of the Company. These options are granted with an exercise price equal to the market price of Woodward s stock at the date of grant, and generally with a four-year graded vesting schedule and a term of 10 years. Vesting would be accelerated in the event of retirement, disability, or death of a participant, or change in control of the Company, as defined. Woodward recognizes stock compensation on a straight-line basis over the requisite service period of the entire award for options with graded vesting schedules. Stock for exercised stock options is issued from treasury stock shares.

Provisions governing the stock option grants are included in the 2006 Omnibus Incentive Plan (the 2006 Plan) and the 2002 Stock Option Plan (the 2002 Plan). The 2006 Plan was approved by stockholders and became effective on January 25, 2006. No further grants will be made under the 2002 Plan. The 2006 Plan made 7,410 stock shares available for grants made on or after January 25, 2006, to members and directors of the company, subject to annual award limits as specified in the Plan, of which 6,222 were available for future grants as of September 30, 2008.

The fair value of options granted during the fiscal years ended September 30, 2008, 2007, and 2006 was estimated on the date of grant using the Black-Scholes-Merton option-pricing model with the following assumptions by grant year:

Year Ended September 30,	**2008**	**2007**	**2006**

Expected term	7 years	7 years	7 years
Expected volatility	37.0%	37.0%	37.0%
Expected dividend yield	1.7%	1.7%	1.7%
Risk-free interest rate range used	3.73%	4.4% - 5.0%	4.5% - 4.6%

The risk-free interest rate was selected based on yields from U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options being valued.

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Changes in outstanding stock options were as follows:

	Number	Weighted-Average Exercise Price
Balance at September 30, 2005	5,998	$ 6.98
Options granted	734	13.52
Options exercised	(920)	5.16
Options forfeited	(4)	7.81
Balance at September 30, 2006	5,808	8.09
Options granted	774	18.78
Options exercised	(1,208)	6.40
Options forfeited	(98)	13.74
Balance at September 30, 2007	5,276	9.94
Options granted	446	32.74
Options exercised	(1,329)	6.52
Options forfeited	(6)	18.49
Balance at September 30, 2008	4,387	13.29

Changes in nonvested stock options during 2008 were as follows:

	Number	Weighted-Average Exercise Price
Balance at September 30, 2007	1,747	14.90
Options granted	446	32.74
Options vested	(748)	13.45
Options forfeited	(6)	18.49
Balance at September 30, 2008	1,439	21.17

At September 30, 2008, there was $6,440 of unrecognized compensation cost related to nonvested awards, which Woodward expects to recognize over a weighted-average period of 1.2 years. Information about stock options that have vested, or are expected to vest, and are exercisable at September 30, 2008, were as follows:

	Number	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years	Aggregate Intrinsic Value
Options vested or expected to vest	3,694	$ 12.04	5.0	$ 85,807
Options exercisable	2,948	9.44	4.2	76,150

Stock-based expense recognized under SFAS 123(R) was as follows (in thousands):

Year Ended September 30,	**2008**	**2007**	**2006**
Employee stock-based compensation expense	$ 4,588	$ 3,849	$ 2,942

The weighted-average grant date fair value of options granted was $13.09 for 2008, $7.36 for 2007, and $5.22 for 2006.

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Other information follows:

Year Ended September 30,	**2008**	**2007**	**2006**
Total fair value of stock options vested	$ 3,841	$ 3,114	$ 2,668
Total intrinsic value of options exercised	40,316	19,247	9,056
Cash received from exercises of stock options	5,216	5,875	4,139
Tax benefit realized from exercise of stock options	15,355	9,787	3,406

Note 16. Accumulated other comprehensive earnings

Accumulated other comprehensive earnings consisted of the following items:

Year Ended September 30,	**2008**	**2007**
Accumulated foreign currency translation adjustments:		
Beginning balance	$ 27,614	$ 17,100
Translation adjustments, net of reclassification to earnings	(6,135)	16,874
Taxes associated with translation adjustments	2,064	(6,360)
Ending balance	23,543	27,614
Accumulated unrealized derivative losses:		
Beginning balance	(331)	(484)
Proceeds from cash flow hedge, net of taxes	67	
Reclassification to interest expense	205	247
Taxes associated with interest reclassification	(78)	(94)
Ending balance	(137)	(331)
Accumulated minimum post-retirement benefit liability adjustments:		
Beginning balance	(4,273)	(3,997)
Minimum benefit liability adjustment	3,125	3,789
Taxes associated with benefit adjustments	(1,939)	(3,085)
Implementation of SFAS 158, net of taxes		(980)
Ending balance	(3,087)	(4,273)
Total accumulated other comprehensive income	$ 20,319	$ 23,010

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Note 17. Commitments and guarantees

Woodward has entered into operating leases for certain facilities and equipment with terms in excess of one year under agreements that expire at various dates. Some leases require the payment of property taxes, insurance, and maintenance costs in addition to rental payments. Future minimum rental payments required under these leases are as follows:

Year Ending September 30,	
2009	$ 4,400
2010	3,800
2011	3,100
2012	2,900
2013	2,500
Thereafter	3,100

Rent expense for all operating leases totaled $6,503 in fiscal 2008, $5,524 in fiscal 2007, and $4,610 in fiscal 2006.

Woodward enters into unconditional purchase obligation arrangements (i.e., issuance of purchase orders, obligations to transfer funds in the future for fixed or minimum quantities of goods or services at fixed or minimum prices, such as take-or-pay contracts) in the normal course of business to ensure that adequate levels of sourced product are available to Woodward. Future minimum unconditional purchase obligations are as follows:

Year Ending September 30,	
2009	$ 132,977
2010	2,222

Guarantees and letters of credit totaling approximately $8,200 were outstanding as of September 30, 2008, some of which were secured by cash and cash equivalents at financial institutions or by Woodward line of credit facilities.

Note 18. Contingencies

Woodward is currently involved in pending or threatened litigation or other legal proceedings regarding employment, product liability, and contractual matters arising from the normal course of business. The Company has accrued for individual matters that it believes are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss. There are also individual matters that management believes the likelihood of a loss when ultimately resolved is less than likely but more than remote, which were not accrued. While it is possible that there could be additional losses that have not been accrued, management currently believes the possible additional loss in the event of an unfavorable resolution of each matter is less than $10.0 million in the aggregate.

MPC Products Corporation (MPC), which was acquired by Woodward on October 1, 2008, as described in Note 22, Subsequent Events, is subject to an investigation by the U.S. Department of Justice (the DOJ) regarding certain of its pricing practices prior to 2006 related to government contracts. MPC and the U.S. Attorney for the Northern District of Illinois have reached a settlement in principle and are in the process of finalizing and obtaining approvals within the DOJ. Final disposition will be subject to acceptance and approval by the U.S. District Court. It is anticipated that any settlement of the matter would involve the payment of monetary fines and other amounts by MPC. MPC is also in the process of working with the U.S. Department of Defense to resolve any administrative matters that may arise out of the investigation. There can be no assurance as to the resolution of these matters. The purchase price for MPC reflects the amount agreed to in principle by MPC with the U.S. Attorney. Any resulting fines or other sanctions beyond this amount could have a material negative impact on Woodward.

WOODWARD GOVERNOR COMPANY

Notes to Consolidated Financial Statements (Continued)
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Woodward currently does not have any administrative or judicial proceedings arising under any Federal, State, or local provisions regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment.

Woodward 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, Woodward may be required to pay termination benefits to certain executive officers.

Note 19. Financial instruments

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

	At September 30,			
	2008		2007	
	Estimated Fair Value	Carrying Cost	Estimated Fair Value	Carrying Cost
Cash and cash equivalents	$ 109,833	$ 109,833	$ 71,635	$ 71,635
Investments in deferred compensation program	3,931	3,931		
Short-term borrowings	(4,031)	(4,031)	(5,496)	(5,496)
Long-term debt, including current portion	(44,836)	(44,516)	(60,473)	(60,473)
Obligations for deferred compensation program	(3,931)	(3,931)		

The fair values of cash and cash equivalents and short-term borrowings at variable interest rates are assumed to be equal to their carrying amounts. Cash and cash equivalents have short-term maturities and short-term borrowings have short-term maturities and market interest rates.

Investments and obligations related to the deferred compensation program used to provide deferred compensation benefits to certain employees are assumed to be equal to their carrying amounts since both the asset and the liability are marked to market value each reporting period.

The fair value of long-term debt at fixed interest rates was estimated based on a model that discounted future principal and interest payments at interest rates available to the Company at the end of the year for similar debt of the same maturity. The weighted-average interest rates used to estimate the fair value of long-term debt at fixed interest rates were 6.0% at September 30, 2008, and 6.3% at September 30, 2007.

Note 20. Segment information:

During fiscal years 2008, 2007 and 2006, Woodward operated in the following three business segments:

Turbine Systems is focused on developing and manufacturing systems and components that provide energy control and optimization solutions for the aircraft and industrial gas turbine markets.

Engine Systems is focused on developing and manufacturing systems and components that provide energy control and optimization solutions for industrial markets, which includes power generation, transportation, and process industries.

Electrical Power Systems is focused on developing and manufacturing systems and components that provide power sensing and energy control systems that improve the security, quality, reliability, and availability of electrical power networks for industrial markets, which includes power generation, power distribution, transportation, and process industries.

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On October 1, 2008, Woodward completed the acquisition of MPC and Techni-Core, Inc. (Techni-Core) which formed the basis for its fourth business segment Airframe Systems. Additional information about Airframe Systems and the acquisition is included in Note 22, Subsequent Events.

Airframe Systems is focused is focused on developing and manufacturing high-performance electromechanical motion control systems, including sensors, primarily for aerospace applications.

The accounting policies of the segments are the same as those described in Note 1, Operations and summary of significant accounting policies. Intersegment sales and transfers are made at established intersegment selling prices generally intended to approximate selling prices to unrelated parties. The determination of segment earnings does not reflect allocations of certain corporate expenses, which are designated as nonsegment expenses, and is before interest expense, interest income, and income taxes.

Segment assets consist of accounts receivable, inventories, property, plant, and equipment net, goodwill, and other intangibles net.

Summarized financial information for Woodward s segments follows:

At or for the Year Ended September 30,	**2008**	**2007**	**2006**
Segment net sales:			
Turbine Systems			
External net sales	$ 577,304	$ 502,557	$ 438,726
Intersegment sales	18,470	21,285	20,197
Total segment net sales	595,774	523,842	458,923
Engine Systems			
External net sales	458,177	414,076	390,619
Intersegment sales	41,141	41,124	39,829
Total segment net sales	499,318	455,200	430,448
Electrical Power Systems			
External net sales	222,723	125,704	25,170
Intersegment sales	66,571	55,662	51,016
Total segment net sales	289,294	181,366	76,186
Consolidated			
External net sales	1,258,204	1,042,337	854,515
Intersegment sales	126,182	118,071	111,042
Total segment net sales	$ 1,384,386	$ 1,160,408	$ 965,557

Segment earnings:			
Turbine Systems	$ 116,196	$ 87,353	$ 67,584
Engine Systems	56,471	56,984	40,829
Electrical Power Systems	42,303	20,294	4,475
Total segment earnings	214,970	164,631	112,888
Nonsegment expenses	(31,346)	(31,720)	(26,052)
Interest expense and income, net	(1,714)	(923)	(2,339)
Consolidated earnings before income taxes	$ 181,910	$ 131,988	$ 84,497

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At or for the Year Ended September 30,	2008	2007	2006
Segment assets:			
Turbine Systems	$ 371,275	$ 330,969	$ 317,688
Engine Systems	242,350	250,908	231,485
Electrical Power Systems	133,928	109,674	40,672
Total segment assets	747,553	691,551	589,845
Unallocated corporate property, plant and equipment, net	13,226	6,651	4,577
Other unallocated assets	166,238	131,565	141,075
Consolidated total assets	$ 927,017	$ 829,767	$ 735,497
Segment depreciation and amortization:			
Turbine Systems	$ 14,586	$ 12,133	$ 14,764
Engine Systems	13,034	14,271	12,148
Electrical Power Systems	6,002	5,572	1,455
Total segment depreciation and amortization	33,622	31,976	28,367
Unallocated corporate amounts	1,828	948	650
Consolidated depreciation and amortization	$ 35,450	$ 32,924	$ 29,017
Segment capital expenditures:			
Turbine Systems	$ 17,710	$ 12,490	$ 14,540
Engine Systems	14,817	13,164	14,098
Electrical Power Systems	4,531	5,124	2,098
Total segment capital expenditures	37,058	30,778	30,736
Unallocated corporate amounts	4,041	1,206	977
Consolidated capital expenditures	$ 41,099	$ 31,984	$ 31,713

Two customers individually accounted for more than 10% of consolidated net sales in each of the fiscal years 2006 through 2008. Sales to the first customer were made by all of Woodward s segments and totaled approximately 17%, 20%, and 22% of sales during the years ended September 30, 2008, 2007, and 2006, respectively. Sales to the second customer were made by all of Woodward s segments and totaled approximately 10%, 10%, and 11% of sales during the years ended September 30, 2008, 2007, and 2006, respectively.

One customer accounted for more than 10% of accounts receivable as of September 30, 2008 and 2007. Accounts receivable from this customer totaled approximately 20% and 21% of accounts receivable at September 30, 2008 and

2007, respectively.

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Notes to Consolidated Financial Statements (Continued)
(amounts in thousands, except per share)

External net sales by geographical area, as determined by the location of the customer invoiced, were as follows:

Year Ended September 30,	**2008**	**2007**	**2006**
External net sales:			
United States	$ 528,318	$ 494,237	$ 449,617
Europe	433,101	340,292	226,039
Asia	198,086	133,738	123,639
Other countries	98,699	74,070	55,220
Consolidated external net sales	$ 1,258,204	$ 1,042,337	$ 854,515

Property, plant, and equipment net by geographical area, as determined by the physical location of the assets, were as follows:

At September 30,	**2008**	**2007**
United States	$ 108,897	$ 100,336
Germany	37,427	36,544
Other countries	22,327	22,118
Consolidated total property, plant, and equipment, net	$ 168,651	$ 158,998

Note 21. Supplementary financial data (Unaudited)

	2008 Fiscal Quarters			
	First	**Second**	**Third**	**Fourth**
Net sales	$ 272,063	$ 305,753	$ 329,847	$ 350,541
Gross profit(1)	81,233	95,376	97,892	100,707
Earnings before income taxes	38,488	43,648	49,096	50,678
Net earnings	25,325	29,714	32,414	34,427
Earnings per share:				
Basic	0.37	0.44	0.48	0.51
Diluted	0.36	0.43	0.47	0.50
Cash dividends per share	0.055	0.060	0.060	0.060
Common stock price per share(2):				
High	36.22	34.52	42.77	48.62

Low	29.69	24.50	26.27	33.00
Close	33.98	26.72	35.66	35.27

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Notes to Consolidated Financial Statements (Continued)
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	2007 Fiscal Quarters			
	First	**Second**	**Third**	**Fourth**
Net sales	$ 226,248	$ 256,298	$ 269,026	$ 290,765
Gross profit(1)	68,504	80,126	82,971	81,916
Earnings before income taxes	26,652	31,410	37,140	36,786
Net earnings(3)	17,887	20,262	23,974	36,034
Net earnings per share:				
Basic	0.26	0.30	0.35	0.53
Diluted	0.26	0.29	0.34	0.51
Cash dividends per share	0.050	0.055	0.055	0.055
Common stock price per share(2):				
High	20.47	22.55	29.50	33.14
Low	16.33	19.18	20.33	26.81
Close	19.86	20.59	26.84	31.20

Notes:

1. *Gross profit represents net sales less cost of goods sold.*

2. *Per share amounts have been updated from amounts reported prior to February 1, 2008, to reflect the effects of a two-for-one stock split.*

3. *Net earnings included net tax adjustments of $10,293 in the fourth quarter of fiscal 2007. These adjustments included a benefit of $13,286 from the favorable resolution of issues with tax authorities and a charge of $2,993 for the adjustment of deferred taxes as a result of a statutory tax rate change in Germany.*

Note 22. Subsequent Events

A. Financing activities

Term Loan Credit Agreement On October 1, 2008, the Woodward entered into a Term Loan Credit Agreement (the Term Loan Credit Agreement), by and among the Company, the institutions from time to time parties thereto, as lenders, and JPMorgan Chase Bank, National Association, as administrative agent. The Term Loan Credit Agreement provides for a $150.0 million unsecured term loan facility, and may be expanded by up to $50.0 million of additional indebtedness from time to time, subject to the Company s compliance with certain conditions and the lenders participation. The Term Loan Credit Agreement generally bears interest at LIBOR plus 1.00% to 2.25%, requires quarterly principal payments of $1,875 beginning in March 2009, and matures in October 2013.

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

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Notes to Consolidated Financial Statements (Continued)
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The Company s obligations under the Term Loan Credit Agreement are guaranteed by Woodward FST, Inc., a wholly owned subsidiary of the Company.

Note Purchase Agreement Also on October 1, 2008, Woodward entered into a Note Purchase Agreement (the Note Purchase Agreement) relating to the sale by Woodward of an aggregate principal amount of $250.0 million comprised of (a) $100.0 million aggregate principal amount of Series B Senior Notes due October 1, 2013 (the Series B Notes), (b) $50.0 million aggregate principal amount of Series C Senior Notes due October 1, 2015 (the Series C Notes) and (c) $100.0 million aggregate principal amount of Series D Senior Notes due October 1, 2018 (the Series D Notes and, together with the Series B Notes and Series C Notes, the Notes) in a series of private placement transactions. On October 1, 2008, $200.0 million aggregate principal amount of Notes were sold, comprised of $80.0 million aggregate principal amount of the Series B Notes, $40.0 million aggregate principal amount of the Series C Notes and $80.0 million aggregate principal amount of the Series D Notes.

In connection with the Note Purchase Agreement, on October 30, 2008, Woodward sold an additional $50.0 million aggregate principal amount of Notes comprised of (a) $20.0 million aggregate principal amount of Series B Notes, (b) $10.0 million aggregate principal amount of Series C Notes, and (c) $20.0 million aggregate principal amount of Series D Notes in another series of private placement transactions.

The Notes issued in the private placements have not been registered under the Securities Act of 1933 and may not be offered or sold in the U.S. absent registration or an applicable exemption from registration requirements.

The Series B Notes have a maturity date of October 1, 2013 and generally bear interest at a rate of 5.63% per annum. The Series C Notes have a maturity date of October 1, 2015 and generally bear interest at a rate of 5.92% per annum. The Series D Notes have a maturity date of October 1, 2018 and generally bear interest at a rate of 6.39% per annum. Under certain circumstances, the interest rate on each series of Notes is subject to increase if Woodward s leverage ratio of consolidated net debt to consolidated EBITDA increases beyond 3.5 to 1.0. Interest on the Notes is payable semi-annually on April 1 and October 1 of each year until all principal is paid. Interest payments commence on April 1, 2009.

The obligations under the Note Purchase Agreement and the Notes rank equal in right of payment with all of Woodward s other unsecured unsubordinated debt, including its outstanding debt under the Term Loan Credit Agreement.

The Note Purchase Agreement contains restrictive covenants customary for such financings, including, among other things, covenants that place limits on Woodward s ability to incur liens on assets, incur additional debt (including a leverage or coverage based maintenance test), transfer or sell its assets, merge or consolidate with other persons, and enter into material transactions with affiliates. The Note Purchase Agreement also contains events of default customary for such financings, the occurrence of which would permit the Purchasers of the Notes to accelerate the amounts due.

The Note Purchase Agreement contains financial covenants requiring that Woodward s (a) ratio of consolidated net debt to consolidated EBITDA not exceed 4.0 to 1.0 during any material acquisition period, or 3.5 to 1.0 at any other time on a rolling four quarter basis, and (b) consolidated net worth at any time equal or exceed $425.0 million plus

50% of consolidated net earnings for each fiscal year beginning with the fiscal year ending September 30, 2008. Additionally, under the Note Purchase Agreement, Woodward may not permit the aggregate amount of priority debt to at any time exceed 20% of its consolidated net worth at the end of the then most recently ended fiscal quarter.

Woodward is permitted at any time, at its option, to prepay all, or from time to time to prepay any part of, the then outstanding principal amount of any series of the Notes at 100% of the principal amount of the series of Notes to be prepaid (but, in the case of partial prepayment, not less than $1.0 million), together with interest accrued on such amount to be prepaid to the date of payment, plus any applicable make-whole amount. The make-whole

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amount is computed by discounting the remaining scheduled payments of interest and principal of the Notes being prepaid at a discount rate equal to the sum of 50 basis points and the yield to maturity of U.S. treasury securities having a maturity equal to the remaining average life of the Notes being prepaid.

A portion of the proceeds from the issuances in connection with Term Loan Purchase Agreement and the Note Purchase Agreement was used to finance the MPC acquisition.

Required future principal payments of senior and term notes outstanding at the end of 2008 and the $400,000 senior notes issued in October 2008 are as follows:

Year Ending September 30,	
2009	$ 17,002
2010	18,697
2011	18,564
2012	18,378
2013	7,500
Thereafter	364,375

B. MPC acquisition

On October 1, 2008, Woodward acquired all of the outstanding stock of Techni-Core and all of the outstanding stock of MPC not held by Techni-Core for approximately $383.0 million. The Company paid cash at closing of approximately $334.7 million, a portion of which was used by the Company to repay the outstanding debt of MPC in an aggregate amount equal to approximately $18.6 million. MPC is an industry leader in the manufacture of high-performance electromechanical motion control systems primarily for aerospace applications. The main product lines include high performance electric motors and sensors, analog and digital control electronics, rotary and linear actuation systems, and flight deck and fly-by-wire systems for commercial and military aerospace programs. MPC will form the basis of a fourth Woodward business segment, Airframe Systems beginning in fiscal 2009. The cost of the acquisition may increase or decrease based on the outcome of a purchase price adjustment procedure customary to purchase agreements and the final determination of the direct acquisition costs. Woodward is in the process of finalizing valuations of property, plant, and equipment, other intangibles, and estimates of liabilities associated with the acquisition.

C. MotoTron acquisition

On October 6, 2008, Woodward acquired all of the outstanding capital stock of MotoTron Corporation (MotoTron) and the intellectual property assets owned by its parent company, Brunswick Corporation, that are used in connection with the MotoTron business for approximately $17.0 million in cash, subject to certain adjustments. MotoTron specializes in software tools and processes used to rapidly develop control systems for marine, power generation, industrial and other engine equipment applications. MotoTron is expected to be integrated into the Engine Systems business segment. The cost of this acquisition has not been finalized. The cost of the acquisition may increase or decrease based on the outcome of a purchase price adjustment procedure customary to purchase agreements and the final determination of the direct acquisition costs. Woodward is in the process of finalizing valuations of property, plant, and equipment, other intangibles, and estimates of liabilities associated with the acquisition.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

On December 6, 2007, the Audit Committee of the Board of Directors (the Audit Committee) recommended and approved the dismissal of PricewaterhouseCoopers LLP (PwC) as the Company s independent registered public accounting firm. On that same day, the Audit Committee appointed Deloitte & Touche, LLP (Deloitte) as the Company s independent registered public accounting firm. Details of the events were filed under Item 4.01 of Form 8-K on December 11, 2007. There have been no disagreements or any reportable events requiring disclosure under Item 304(b) of Regulation S-K.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), which are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act 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 Exchange Act is accumulated and communicated to management, including our principal executive officer (Thomas A. Gendron, chief executive officer and president) and principal financial officer (Robert F. Weber, Jr., chief financial officer and treasurer), as appropriate, to allow timely decisions regarding required disclosures.

Thomas A. Gendron, our chief executive officer and president and Robert F. Weber, Jr., our chief financial officer and treasurer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-K. Based on, and as of the date of, their evaluation, they concluded that our disclosure controls and procedures were effective.

Management s Annual Report on Internal Control Over Financial Reporting

We are responsible for establishing and maintaining adequate internal control over financial reporting for the company. We have evaluated the effectiveness of internal control over financial reporting using the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and, based on that evaluation, have concluded that the company s internal control over financial reporting was effective as of September 30, 2008, the end of the company s most recent fiscal year.

Deloitte & Touche, LLP, an independent registered public accounting firm, conducted an integrated audit of Woodward s internal control over financial reporting as of September 30, 2008, as stated in their report included in Item 9a Controls and Procedures.

Internal control over financial reporting is a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external purposes in accordance with

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generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the fourth fiscal quarter covered by this Form 10-K that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Woodward Governor Company
Fort Collins, Colorado

We have audited the internal control over financial reporting of Woodward Governor Company and subsidiaries (the Company) as of September 30, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended September 30, 2008 of the Company and our report dated November 19, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the

Company s adoption of the Financial Accounting Standards Board s Interpretation No. 48, Accounting for Uncertainty in Income Taxes.

Deloitte & Touche, LLP

Denver, Colorado
November 19, 2008

Item 9B. ***Other Information***

There is no information required to be disclosed in a report on Form 8-K during the fourth quarter of 2008 that was not reported on Form 8-K.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

The information required by this item relating to our directors and nominees, regarding compliance with Section 16(a) of the Securities Act of 1934, and regarding our Audit Committee is included under the captions Board of Directors, Board Meetings and Committees Audit Committee (including information with respect to audit committee financial experts), Stock Ownership of Management, and Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement related to the 2008 Annual Meeting of Stockholders to be held January 22, 2009 and is incorporated herein by reference.

The information required by this item relating to our executive officers is included under the caption Executive Officers of the Registrant in Item 1 of this report.

We have adopted a code of ethics that applies to our principal executive officer and our principal financial and accounting officer. This code of ethics is posted on our Website. The Internet address for our Website is www.woodward.com, and the code of ethics may be found from our main Web page by clicking first on Investor Information and then on Corporate Governance, and finally on Woodward Codes of Business Conduct and Ethics.

We intend to satisfy any disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of this code of ethics by posting such information to our Website, at the address and location specified above.

Item 11. ***Executive Compensation***

Information regarding executive compensation is under the captions Board Meetings and Committees Director Compensation, Compensation Committee Report on Compensation Discussion and Analysis, Compensation Committee Interlocks and Insider Participation, and Executive Compensation in our Proxy Statement for the 2008 Annual Meeting of Stockholders to be held January 22, 2009, and is incorporated herein by reference, except the section captioned Compensation Committee Report on Compensation Discussion and Analysis is hereby furnished and not filed with this annual report on Form 10-K.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information regarding security ownership of certain beneficial owners and management and related stockholder matters is under the tables captioned Stock Ownership of Management, Persons Owning More than Five Percent of Woodward Stock, and Executive Compensation Equity Compensation Plan Information (as of September 30, 2008), in our Proxy Statement for the 2008 Annual Meeting of Stockholders to be held January 22, 2009, and is incorporated herein by reference.

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Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information set forth under Board Meetings and Committees Related Person Transactions Policies and Procedures, Board of Directors and Audit Committee Report to Stockholders in our Proxy Statement for the 2008 Annual Meeting of the Stockholders to be held January 22, 2009 is incorporated herein by reference except the section captioned Audit Committee Report is hereby furnished and not filed with this annual report on Form 10-K.

Item 14. *Principal Accounting Fees and Services*

Information regarding principal accounting fees and services is under the captions Audit Committee Report to Stockholders Audit Committee s Policy on Pre-Approval of Services Provided by Independent Registered Public Accounting Firm and Fees Paid to Deloitte and Touche, LLP and PricewaterhouseCoopers LLP in our Proxy Statement for the 2008 Annual Meeting of Stockholders to be held January 22, 2009, and is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a) (1) *Consolidated Financial Statements:*

	Page Number in Form 10-K
Report of Independent Registered Public Accounting Firm	45
Consolidated Statements of Earnings for the years ended September 30, 2008, 2007, and 2006	47
Consolidated Balance Sheets at September 30, 2008 and 2007	48
Consolidated Statements of Cash Flows for the years ended September 30, 2008, 2007, and 2006	49
Consolidated Statements of Stockholders Equity for the years ended September 30, 2008, 2007, and 2006	50
Notes to Consolidated Financial Statements	52

(a) (2) *Consolidated Financial Statement Schedules*

Valuation and Qualifying Accounts	96

Financial statements and schedules other than those listed above are omitted for the reason that they are not applicable, are not required, or the information is included in the financial statements or the footnotes.

(a) (3) *Exhibits Filed as Part of This Report:*

2.1	Stock Purchase Agreement, dated August 19, 2008, by and among Woodward Governor Company, MPC Products Corporation, Techni-Core, Inc., The Successor Trustees of the Joseph M. Roberti Revocable Trust dated December 29, 1992, Maribeth Gentry, as Successor Trustee of the Vincent V. Roberti Revocable Trust dated April 4, 1991 and the individuals and entities named in Schedule I thereto filed as an Exhibit 10.1 to Current Report on Form 8-K, dated August 21, 2008 and incorporated herein by reference.
2.2	Amendment No. 1, dated October 1, 2008, to the Stock Purchase Agreement, dated August 19, 2008, by and among Woodward Governor Company, MPC Products Corporation, Techni-Core, Inc., The Successor Trustees of the Joseph M. Roberti Revocable Trust dated December 29, 1992, Maribeth Gentry, as Successor Trustee of the Vincent V. Roberti Revocable Trust dated April 4, 1991 and the individuals and entities named in Schedule I thereto, filed as Exhibit 10.6 to Current Report on Form 8-K filed October 7, 2008 and incorporated herein by reference.
3(i)(a)	Restated Certificate of Incorporation, as amended October 3, 2007, filed as an exhibit
3(i)(b)	Restated Certificate of Incorporation, as amended January 23, 2008, filed as an exhibit
3(ii)	Amended and Restated Bylaws, filed as an Exhibit 3.1 to Current Report on Form 8-K, dated January 29, 2008 and incorporated herein by reference
4.1	Note Purchase Agreement dated October 15, 2001, filed as Exhibit 4 to Form 10-Q for the three months ended December 31, 2001 and incorporated herein by reference

10.1	Long-Term Management Incentive Compensation Plan, filed as Exhibit 10(c) to Form 10-K for the year ended September 30, 2000 and incorporated herein by reference
10.2	Annual Management Incentive Compensation Plan, filed as Exhibit 10(d) to Form 10-K for the year ended September 30, 2000 and incorporated herein by reference
10.3	2002 Stock Option Plan, effective January 1, 2002 filed as Exhibit 10 (iii) to Form 10-Q for the three months ended March 31, 2002 and incorporated herein by reference
10.4	Executive Benefit Plan (non-qualified deferred compensation plan), filed as Exhibit 10(e) to Form 10-K for the year ended September 30, 2002 and incorporated herein by reference
10.5	Form of Outside Director Stock Purchase Agreement with James L. Rulseh, filed as Exhibit 10(j) to Form 10-K for the year ended September 30, 2002 and incorporated herein by reference

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10.6	Form of Transitional Compensation Agreement with Thomas A. Gendron filed as Exhibit 10 to Form 10-Q for the three months ended December 31, 2002 and incorporated herein by reference
10.7	Summary of Non-Employee Director Meeting Fees and Compensation, filed as an exhibit
10.8	Material Definitive Agreement with Thomas A. Gendron, filed on Form 8-K filed August 1, 2005 and incorporated herein by reference
10.9	Material Definitive Agreement with Robert F. Weber, Jr., filed on Form 8-K filed August 24, 2005 and incorporated herein by reference
10.10	2006 Omnibus Incentive Plan, effective January 25, 2006, filed as Exhibit 4.1 to Registration Statement on Form S-8 effective April 28, 2006 and incorporated herein by reference
10.11	Form of Transitional Compensation Agreement with Robert F. Weber, Jr., dated August 22, 2005, filed as exhibit 10.11 to Form 10-K for the year ended September 30, 2005 and incorporated herein by reference
10.12	Material Definitive Agreement with A. Christopher Fawzy, filed as Exhibit 10.12 to Form 10-Q for the nine months ended June 30, 2007 and incorporated herein by reference
10.13	Amended Executive Benefit Plan, filed as Exhibit 10.13 to Form 10-K for the year ended September 30, 2007 and incorporated herein by reference
10.14	Form of Non-Qualified Stock Option Agreement filed as Exhibit 99.2 to Current Report on Form 8-K, dated November 16, 2007 and incorporated herein by reference
10.15	Second Amended and Restated Credit Agreement, filed as Exhibit 99.1 to Current Report on Form 8-K, dated October 25, 2007 and incorporated herein by reference
10.16	Summary of Executive Officer Compensation, filed as an exhibit
10.17	Dennis Benning Post Retirement Relocation Agreement, filed as Exhibit 10.17 to Form 10-K for the year ended September 30, 2007 and incorporated herein by reference
10.18	Dennis Benning Promotion Letter dated October 1, 2008, filed as an exhibit
10.19	Chad Preiss Promotion Letter dated October 1, 2008, filed as an exhibit
10.20	Term Loan Credit Agreement, dated October 1, 2008, by and among Woodward Governor Company, the institutions from time to time parties thereto as lenders and JPMorgan Chase Bank, National Association, as administrative agent, filed as Exhibit 10.1 to Current Report on Form 8-K filed October 7, 2008 and incorporated herein by reference.
10.21	Note Purchase Agreement, dated October 1, 2008, by and among Woodward Governor Company and the purchasers named therein, filed as Exhibit 10.2 to Current Report on Form 8-K filed October 7, 2008 and incorporated herein by reference.
10.22	Amendment No. 1, dated October 1, 2008, to the Note Purchase Agreement, dated as of October 15, 2001 by and among Woodward Governor Company and the purchasers named therein, filed as Exhibit 10.3 to Current Report on Form 8-K filed October 7, 2008 and incorporated herein by reference.
10.23	Amendment No. 2 and Consent, dated October 1, 2008, to the Second Amended and Restated Credit Agreement, dated as of October 25, 2007, by and among Woodward Governor Company, certain foreign subsidiary borrowers of Woodward Governor Company from time to time parties thereto, the institutions from time to time parties thereto, as lenders, JPMorgan Chase Bank, National Association, as administrative agent, Wachovia Bank N.A. and Wells Fargo Bank N.A., as syndication agents, and Deutsche Bank Securities Inc., as documentation agent, filed as Exhibit 10.4 to Current Report on Form 8-K filed October 7, 2008 and incorporated herein by reference.
11	Statement on computation of earnings per share, included in Note 5 of Notes to Consolidated Financial Statements
14	Code of Ethics filed as Exhibit 14 to Form 10-K for the year ended September 30, 2003 and incorporated herein by reference

21	Subsidiaries, filed as an exhibit
23(i)	Consent of current Independent Registered Public Accounting Firm, filed as an exhibit

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23(ii)	Consent of prior Independent Registered Public Accounting Firm, filed as an exhibit
31(i)	Rule 13a-14(a)/15d-14(a) certification of Thomas A. Gendron, filed as an exhibit
31(ii)	Rule 13a-14(a)/15d-14(a) certification of Robert F. Weber, Jr., filed as an exhibit
32(i)	Section 1350 certifications, filed as an exhibit

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SIGNATURES

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

Woodward Governor Company

/s/ Thomas A. Gendron

Thomas A. Gendron
Chairman of the Board,
Chief Executive Officer, and President
(Principal Executive Officer)

Date: November 19, 2008

/s/ Robert F. Weber, Jr.

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

Date: November 19, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ John D. Cohn	Director	November 19, 2008
John D. Cohn		
/s/ Paul Donovan	Director	November 19, 2008
Paul Donovan		
/s/ Thomas A. Gendron	Chairman of the Board and Director	November 19, 2008
Thomas A. Gendron		
/s/ John A. Halbrook	Director	November 19, 2008
John A. Halbrook		
/s/ Michael H. Joyce	Director	November 19, 2008

Michael H. Joyce		
/s/ Mary L. Petrovich	Director	November 19, 2008
Mary L. Petrovich		
/s/ Larry E. Rittenberg	Director	November 19, 2008
Larry E. Rittenberg		

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Signature	Title	Date
/s/ James R. Rulseh	Director	November 19, 2008
James R. Rulseh		
/s/ Dr. Ronald Sega	Director	November 19, 2008
Dr. Ronald Sega		
/s/ Michael T. Yonker	Director	November 19, 2008
Michael T. Yonker		

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WOODWARD GOVERNOR COMPANY AND SUBSIDIARIES

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended September 30, 2008, 2007, and 2006
(In thousands)

Column A	Column B	Column C Additions		Column D	Column E
Description	Balance at Beginning of Year	Charged to Costs and Expenses	Charged to Other Accounts(a)	Deductions(b)	Balance at End of Year
Allowance for doubtful accounts:					
2008	$ 1,886	$ 415	$ 71	$ (724)	$ 1,648
2007	2,213	167	(331)	(163)	1,886
2006	1,965	249	363	(364)	2,213

Notes:

(a) Includes recoveries of accounts previously written off.

(b) Represents accounts written off and foreign currency translation adjustments. Currency translation adjustments resulted in a decrease in the reserve of $48 in fiscal 2008 and increases in the reserve of $187 in fiscal 2007 and $43 in fiscal 2006.

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EXHIBIT INDEX

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