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Woodward, Inc.

Form 10-K

November 13, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2017

or

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

For the transition period from _____ to _____

Commission file number 000-08408

WOODWARD, INC.

(Exact name of registrant as specified in its charter)

Delaware

36-1984010

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

1081 Woodward Way, Fort Collins, Colorado

80524

(Address of principal executive offices)

(Zip Code)

(970) 482-5811

(Registrant's telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Yes No

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

Yes No

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

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

Emerging growth company

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

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

Yes No

Aggregate market value of registrant’s common stock held by non-affiliates of the registrant, based upon the closing price of a share of the registrant’s common stock on March 31, 2017 as reported on The NASDAQ Global Select Market on that date: \$2,972,702,291. For purposes of this calculation, shares of common stock held by (i) persons holding more than 5% of the outstanding shares of stock, (ii) officers and directors of the registrant, and (iii) the Woodward Governor Company Profit Sharing Trust, Woodward Governor Company Deferred Shares Trust, or the Woodward Charitable Trust, as of March 31, 2017, are excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive of affiliate status.

As of November 9, 2017, 61,238,422 shares of the registrant’s common stock with a par value of \$0.001455 per share were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our proxy statement for the Annual Meeting of Stockholders to be held January 24, 2018, are incorporated by reference into Parts II and III of this Form 10-K, to the extent indicated.

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PART I

Forward Looking Statements

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

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

Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including:

- a decline in business with, or financial distress of, our significant customers;
- global economic uncertainty and instability in the financial markets;
- our ability to manage product liability claims, product recalls or other liabilities associated with the products and services that we provide;
 - our ability to obtain financing, on acceptable terms or at all, to implement our business plans, complete acquisitions, or otherwise take advantage of business opportunities or respond to business pressures;
- the long sales cycle, customer evaluation process, and implementation period of some of our products and services;
 - our ability to implement and realize the intended effects of any restructuring and alignment efforts;
- our ability to successfully manage competitive factors, including prices, promotional incentives, competitor product development, industry consolidation, and commodity and other input cost increases;

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- our ability to manage our expenses and product mix while responding to sales increases or decreases;
- the ability of our subcontractors to perform contractual obligations and our suppliers to provide us with materials of sufficient quality or quantity required to meet our production needs at favorable prices or at all;
- our ability to monitor our technological expertise and the success of, and/or costs associated with, our product development activities;
- consolidation in the aerospace market and our participation in a strategic joint venture with General Electric Company may make it more difficult to secure long-term sales in certain aerospace markets;
- our debt obligations, our debt service requirements, and our ability to operate our business, pursue business strategies and incur additional debt in light of covenants contained in our outstanding debt agreements;
- our ability to manage additional tax expense and exposures;
- risks related to our U.S. Government contracting activities, including liabilities resulting from legal and regulatory proceedings, inquiries, or investigations related to such activities;
- the potential of a significant reduction in defense sales due to decreases in the amount of U.S. Federal defense spending or other specific budget cuts impacting defense programs in which we participate;

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- changes in government spending patterns, priorities, subsidy programs and/or regulatory requirements;
- future impairment charges resulting from changes in the estimates of fair value of reporting units or of long-lived assets;
- future results of our subsidiaries;
- environmental liabilities related to manufacturing activities and/or real estate acquisitions;
- our continued access to a stable workforce and favorable labor relations with our employees;
- physical and other risks related to our operations and suppliers, including natural disasters, which could disrupt production;
- our ability to successfully manage regulatory, tax, and legal matters (including the adequacy of amounts accrued for contingencies, the U.S. Foreign Corrupt Practices Act, international trade regulations, and product liability, patent, and intellectual property matters);
- our financial statements are subject to changes in accounting standards that could adversely impact our profitability or financial position;
- risks related to our common stock, including changes in prices and trading volumes;
- risks from operating internationally, including the impact on reported earnings from fluctuations in foreign currency exchange rates, tariffs, and compliance with and changes in the legal and regulatory environments of the United States and the countries in which we operate;
- risks associated with global political and economic uncertainty in the European Union and elsewhere;
- fair value of defined benefit plan assets and assumptions used in determining our retirement pension and other postretirement benefit obligations and related expenses including, among others, discount rates and investment return on pension assets;
- industry risks, including changes in commodity prices for oil, natural gas, and other minerals, unforeseen events that may reduce commercial aviation, and changing emissions standards;
- our operations may be adversely affected by information systems interruptions or intrusions; and
- certain provisions of our charter documents and Delaware law that could discourage or prevent others from acquiring our company.

These factors are representative of the risks, uncertainties, and assumptions that could cause actual outcomes and results to differ materially from what is expressed or forecast in our forward-looking statements. Other factors are discussed under the caption “Risk Factors” in Part I, Item 1A in this Annual Report on Form 10-K for the fiscal year ended September 30, 2017 (this “Form 10-K”). We undertake no obligation to revise or update any forward-looking statements for any reason, except as required by applicable law.

Unless we have indicated otherwise or the context otherwise requires, references in this Form 10-K to “Woodward,” “the Company,” “we,” “us,” and “our” refer to Woodward, Inc. and its consolidated subsidiaries.

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

Item 1. Business

General

Woodward enhances the global quality of life, creating innovative energy control solutions that optimize the performance, efficiency and emissions of our customers' products. We are an independent designer, manufacturer, and service provider of energy control and optimization solutions. We design, produce and service reliable, efficient, low-emission, and high-performance energy control products for diverse applications in challenging environments. We have production and assembly facilities in the United States, Europe and Asia, and promote our products and services through our worldwide locations.

Our strategic focus is providing energy control and optimization solutions for the aerospace and industrial markets. The precise and efficient control of energy, including motion, fluid, combustion and electrical energy, is a growing requirement in the markets we serve. Our customers look to us to optimize the efficiency, emissions and operation of power equipment in both commercial and defense operations. Our core technologies leverage well across our markets and customer applications, enabling us to develop and integrate cost-effective and state-of-the-art fuel, combustion, fluid, actuation and electronic systems. We focus primarily on serving original equipment manufacturers ("OEMs") and equipment packagers, partnering with them to bring superior component and system solutions to their demanding applications. We also provide aftermarket repair, maintenance, replacement and other service support for our installed products.

Our components and integrated systems optimize performance of commercial aircraft, defense aircraft, military ground vehicles and other equipment, gas and steam turbines, wind turbines, including converters and power grid related equipment, industrial diesel, gas, bio-diesel and dual fuel reciprocating engines, and electrical power systems. Our innovative motion, fluid, combustion, and electrical energy control systems help our customers offer more cost-effective, cleaner, and more reliable equipment.

Woodward was established in 1870, incorporated in 1902, and is headquartered in Fort Collins, Colorado. The mailing address of our world headquarters is 1081 Woodward Way, Fort Collins, Colorado 80524. Our telephone number at that location is (970) 482-5811, and our website is www.woodward.com. None of the information contained on our website is incorporated into this document by reference.

Markets and Principal Lines of Business

We serve the aerospace and industrial markets through our two reportable segments – Aerospace and Industrial. Our customers require technological solutions to meet their needs for performance, efficiency, and reliability, and to reduce their costs of operation.

Within the aerospace market, we provide systems, components and solutions for both commercial and defense applications. Our key focus areas within this market are:

- Propulsion and combustion control solutions for turbine powered aircraft; and
- Fluid and motion control solutions for critical aerospace and defense applications.

Within the industrial market, our key focus areas are:

- Applications and control solutions for machines that produce electricity utilizing conventional or renewable energy sources; and
- Fluid, motion, and combustion control solutions for complex oil and gas, industrial, and transportation applications.

Additional information about our operations in fiscal year 2017 and outlook for the future, including certain segment information, is included in “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Additional information about our business segments and certain geographical information is included in Note 20, Segment information and Note 21, Supplemental quarterly financial data (Unaudited), to the Consolidated Financial Statements in “Item 8 – Financial Statements and Supplementary Data.”

Products, Services and Applications

Aerospace

Our Aerospace segment designs, manufactures and services systems and products for the management of fuel, air, combustion and motion control. These products include fuel pumps, metering units, actuators, air valves, specialty valves, fuel nozzles, and thrust reverser actuation systems for turbine engines and nacelles, as well as flight deck controls, actuators, servocontrols, motors and sensors for aircraft. These products are used on commercial and private aircraft and rotorcraft, as well as on military fixed-wing aircraft and rotorcraft, guided weapons, and other defense systems.

We have significant content on a wide variety of commercial aircraft, rotorcraft and business jet platforms, such as the Airbus A320neo, Boeing 737 MAX and 787, Bell 429 and Gulfstream G650. We also have significant content on defense applications such

as Blackhawk and Apache helicopters, F-18 and F-35 fighter jets, and guided tactical weapons (for example, the Joint Direct Attack Munition (“JDAM”)).

Revenues from the Aerospace segment are generated by sales to OEMs, tier-one suppliers, and prime contractors, and through aftermarket sales of components, such as provisioning spares or replacements, and spare parts. We also provide aftermarket maintenance, repair and overhaul, as well as other services to commercial airlines, repair facilities, military depots, third party repair shops, and other end users.

Industrial

Our Industrial segment designs, produces and services systems and products for the management of fuel, air, fluids, gases, motion, combustion and electricity. These products include actuators, valves, pumps, injectors, solenoids, ignition systems, speed controls, electronics and software, power converters, sensors and other devices that measure, communicate and protect electrical distribution systems. Our products are used on industrial gas turbines (including heavy frame and aeroderivative turbines), steam turbines, reciprocating engines (including engines on natural gas vehicles), electric power generation and power distribution systems, wind turbines, and compressors. The equipment on which our products are found is used to generate and distribute power; to extract and distribute fossil and renewable fuels; in the mining of other commodities; and to convert fuel to work in marine, mobile, and industrial equipment applications.

Revenues from our Industrial segment are generated primarily by sales to OEMs and by providing aftermarket products and other related services to our OEM customers. Our Industrial segment also sells products through an independent network of distributors and, in some cases, directly to end users.

Customers

For the fiscal year ended September 30, 2017, approximately 43% of our consolidated net sales were made to our five largest customers. Sales to our five largest customers represented approximately 42% of our consolidated net sales for the fiscal year ended September 30, 2016 and approximately 40% of our consolidated net sales for the fiscal year ended September 30, 2015.

Sales to our largest customer, General Electric, accounted for approximately 16% of our consolidated net sales in the fiscal year ended September 30, 2017, 17% of our consolidated net sales in the fiscal year ended September 30, 2016, and 18% of our consolidated net sales in the fiscal year ended September 30, 2015. Our accounts receivable from General Electric represented approximately 10% of total accounts receivable as of September 30, 2017 and 14% as of September 30, 2016. We believe General Electric and our other significant customers are creditworthy and will be able to satisfy their credit obligations to us.

The following customers account for approximately 10% or more of sales to each of our reportable segments for the fiscal year ended September 30, 2017.

	Customer
Aerospace	The Boeing Company, United Technologies Corporation, General Electric Company
Industrial	General Electric Company
Competitive Environment	

Our products and product support services are sold worldwide into a variety of markets. In all markets, we compete on the basis of differentiated technology and design, product performance and conformity with customer specifications. Additional factors are customer service and support, including on-time delivery and customer partnering, product quality, price, reputation and local presence. Both of our segments operate in uniquely competitive environments.

We believe that new competitors face significant barriers to entry into many of our markets, including various government mandated certification requirements to compete in the aerospace and industrial markets in which we participate.

Aerospace industry has significant product certification requirements to meet safety regulations, which form a basis for competition as well as a barrier to entry. Technological innovation and design, product performance and conformity with customer specifications, and product quality and reliability are of utmost importance in the aerospace and defense industry. In addition, on-time delivery, pricing, and joint development capabilities with customers are points of competition within this market.

Our customers include airframe and aircraft engine OEM manufacturers and suppliers to these manufacturers. We supply these customers with technologically innovative system and component solutions and align our technology roadmaps with our customers. We focus on responding to needs for reduced cost and weight, emission control and reliability improvements.

We compete with numerous companies around the world that specialize in fuel and air management, combustion, electronic control, aircraft motion control, flight deck control, and thrust reverser products. Our competitors in aerospace include divisions of Eaton, Honeywell, Moog, and Parker Hannifin, and United Technologies Corporation Aerospace Systems (“UTC Aerospace Systems”) and its subsidiaries. In addition, some of our OEM customers are capable of developing and manufacturing similar

products internally. Several competitors are also customers for our products, such as Honeywell, Parker Hannifin, and UTC Aerospace Systems.

Our products offer high levels of field reliability, which provides end users an advantage in life-cycle cost. We address competition in aftermarket service through responsiveness to our customers' needs, providing short turnaround times, greater performance such as longer time between repairs, and maintaining a global presence.

Some of our customers are affiliated with our competitors through ownership or joint venture agreements. We compete in part by establishing relationships with our customers' engineering organizations, and by offering innovative technical and commercial solutions to meet their market requirements. During fiscal year 2016 we entered into a strategic joint venture ("JV") with General Electric Company ("GE"), acting through its GE Aviation business unit. The JV sells fuel systems for GE's large engine programs and is described further in Note 4, Joint Venture, in the Notes to the Consolidated Financial Statements in "Item 8 – Financial Statements and Supplementary Data."

Industrial operates in the global markets for industrial turbines, industrial reciprocating engines, electric power generation systems, power distribution networks, and wind turbines. Many of these markets are subject to regulatory product and performance certifications to meet emissions and safety requirements, which form a basis for competition as well as a barrier to entry.

We compete with numerous companies that specialize in various engine, turbine, and power management products, and our OEM customers are often capable of developing and manufacturing similar products internally. Many of our customers are large global OEMs that require suppliers to support them around the world and to meet increasingly higher requirements in terms of safety, quality, delivery, reliability and cost.

Competitors include ABB, Emerson, Heinzmann GmbH & Co., Hoerbiger, Invensys, L'Orange GmbH, Meggitt, Robert Bosch AG, and Schweitzer Electric. OEM customers with internal capabilities for similar products include Caterpillar, Cummins, General Electric, Siemens and Wartsila.

We believe we are a market leader in providing our customers advanced technology and superior product performance at a competitive price. We focus on developing and maintaining close relationships with our OEM customers' engineering teams. Competitive success is based on the development of innovative components and systems that are aligned with the OEMs' technology roadmaps to achieve future reliability, emission, efficiency, and fuel flexibility targets.

Government Contracts and Regulation

Portions of our business, particularly in our Aerospace segment, are heavily regulated. We contract with numerous U.S. Government agencies and entities, including all of the branches of the U.S. military, the National Aeronautics and Space Administration ("NASA"), and the Departments of Defense, Homeland Security, and Transportation. We also contract with similar government authorities outside the United States, subject in all cases to applicable law.

The U.S. Government, and potentially other governments, may terminate any of our government contracts, or any government contracts under which we are a subcontractor, at their convenience, as well as for default based on specified performance measurements. If any of our U.S. government contracts were to be terminated for convenience, we generally would be entitled to receive payment for work completed and allowable termination or cancellation costs. If any of our U.S. government contracts were to be terminated for our default, the U.S. Government generally would pay only for the work accepted, and could require us to pay the difference between the original contract price and the cost to re-procure the contract items, net of the work accepted from the original contract. The U.S. Government could also hold us liable for damages resulting from the default.

We must comply with, and are affected by, laws and regulations relating to the formation, administration and performance of U.S. Government contracts. These laws and regulations, among other things:

- require accurate, complete and current disclosure and certification of cost and pricing data in connection with certain contracts;
- impose specific and unique cost accounting practices that may differ from accounting principles generally accepted in the United States (“U.S. GAAP”), and therefore require robust systems to reconcile;
- impose regulations that define allowable and unallowable costs and otherwise govern our right to reimbursement under certain cost-based U.S. Government contracts;
- impose manufacturing specifications and other quality standards that may be more restrictive than for non-government business activities; and
- restrict the use and dissemination of information classified for national security purposes due to the regulations of the U.S. Government and foreign governments pertaining to the export of certain products and technical data.

Sales made directly to U.S. Government agencies and entities, or indirectly through third party manufacturers utilizing Woodward parts and subassemblies, collectively represented 23% of our sales for fiscal year 2017, 21% of our sales for fiscal year 2016, and 18% of our sales for fiscal year 2015. The level of U.S. spending for defense, alternative energy and other programs, and the mix of programs to which such funding is allocated, is subject to periodic congressional appropriation actions, and is subject to change, including elimination, at any time.

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U.S. Government related sales from our reportable segments for fiscal years 2017, 2016 and 2015 were as follows:

	Direct U.S. Government Sales	Indirect U.S. Government Sales	Commercial Sales	Total
Year ended September 30, 2017				
Aerospace	\$ 106,685	\$ 362,536	\$ 873,118	\$ 1,342,339
Industrial	3,726	10,814	741,806	756,346
Total net external sales	\$ 110,411	\$ 373,350	\$ 1,614,924	\$ 2,098,685
Percentage of total net sales	5 %	18 %	77 %	100 %
Year ended September 30, 2016				
Aerospace	\$ 103,026	\$ 310,952	\$ 819,198	\$ 1,233,176
Industrial	6,550	9,845	773,507	789,902
Total net external sales	\$ 109,576	\$ 320,797	\$ 1,592,705	\$ 2,023,078
Percentage of total net sales	5 %	16 %	79 %	100 %
Year ended September 30, 2015				
Aerospace	\$ 92,322	\$ 258,391	\$ 810,170	\$ 1,160,883
Industrial	4,836	8,839	863,745	877,420
Total net external sales	\$ 97,158	\$ 267,230	\$ 1,673,915	\$ 2,038,303
Percentage of total net sales	5 %	13 %	82 %	100 %
Seasonality				

We do not believe our sales, in total or in either business segment, are subject to significant seasonal variation. However, our sales have generally been lower in the first quarter of our fiscal year as compared to the immediately preceding quarter due to fewer working days resulting from the observance of various holidays and scheduled plant shutdowns for annual maintenance.

Sales Order Backlog

Our backlog of unshipped sales orders by segment as of October 31, 2017 and 2016 was as follows:

October
31,
2017