

WOODWARD GOVERNOR CO

Form 10-K

November 29, 2007

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**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, 2007

or

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

For the transition period from -- to --

Commission file number 0-8408

WOODWARD GOVERNOR COMPANY

(Exact name of registrant as specified in its charter)

Delaware

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

1000 East Drake Road,

Fort Collins, Colorado

(Address of principal executive offices)

36-1984010

*(I.R.S. Employer
Identification No.)*

80525

(Zip Code)

Registrant's telephone number, including area code:

(970) 482-5811

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:

Common stock, par value \$.002917 per share

Name of Each Exchange on Which Registered:

NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

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

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 30, 2007 as reported on the NASDAQ Global Select Market on that date: \$1,187,051,000. 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 Governor Company Charitable Trust, as of March 30, 2007, are excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive of affiliate status.

Number of shares of the registrant's common stock outstanding as of November 20, 2007: 33,872,397.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our proxy statement for the 2007 annual meeting of shareholders to be held January 23, 2008, are incorporated by reference into Parts II and III of this Form 10-K, to the extent indicated.

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PART I

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, forecasts, intend, continue, project, target, can, could, may, should, will, would, variations of such words and similar expressions 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. 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 those identified below, under Item 1A. Risk Factors, and elsewhere herein. Therefore, actual results could differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason. Forward-looking statements may include, among others, statements relating to:

Future sales, earnings, cash flow, and other measures of financial performance

Description of our plans and obligations for future operations

The effect of economic downturns or growth in particular regions

The effect of changes in the level of activity in particular industries or markets

The availability and cost of materials, components, services, and supplies

The scope, nature, or impact of acquisition activity and integration into our businesses

The development, production, and support of advanced technologies and new products and services

New business opportunities

The outcome of contingencies

Future repurchases of common stock

Future levels of indebtedness and capital spending

Pension plan assumptions and future contributions

Item 1. Business

General

Woodward Governor Company (Woodward or the Company) is one of the largest independent designers, manufacturers, and service providers of energy control and optimization solutions for reciprocating engine, aircraft

and industrial turbines, and electrical power system equipment. Leading original equipment manufacturers (OEMs) throughout the world use our products and services in the power generation, power distribution, aerospace, transportation, and process industries markets.

We were established in 1870 and incorporated in 1902. We serve global markets from locations worldwide and are headquartered in Fort Collins, Colorado. The mailing address of our headquarters is 1000 East Drake Road, Fort Collins, Colorado 80525, and our telephone number at that location is (970) 482-5811. Our Website is www.woodward.com.

Products and Services

Worldwide demand for fuel-efficient, low emission, high-performance energy systems drives our business. We integrate our technologies into fuel, combustion, fluid, actuation, and electronic control systems for OEMs and

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equipment packagers. Our customers use Woodward systems and components for controlling engines, turbines, and associated equipment in power generation, power distribution, transportation, process industries, and aerospace markets.

Energy control technology and optimization solutions are our strength. We are focused on accurately and precisely controlling energy by integrating our components into systems that improve the emissions performance, reliability, and fuel efficiency of our customers' products, helping ensure a better environment.

To penetrate our markets, our strategy focuses on maintaining and developing expertise in technologies that are used in the development of components and integrated systems for power equipment used by customers worldwide.

Strategic Focus: Energy Control and Optimization Solutions. Our key areas of focus are fluid energy, combustion control, electrical energy, and motion control.

Leverage: Core Technologies. Our core technologies include valves, servo actuators, combustion sensing, digital electronics, fuel injection, electric actuation, ignition, power electronics, pumps, and alternating current measurement and control.

Integrate: Systems. Our systems include fuel systems, combustion systems, fluid systems, actuation systems, and electronic systems.

Apply: OEM and Equipment Packagers. Our OEM and equipment packager customers use our systems and components in their products, including diesel engines, turbines, gas engines, compressors, generator sets, switchgears, and industrial vehicles.

Serve: Market Applications. Ultimately, our systems and components are used in products that are sold into four key markets—electric power, transportation, process industries, and aerospace.

We believe all of our business segments have a significant competitive position within their markets for components and integrated systems. We compete with several other manufacturers, including the in-house operations of certain OEMs. While published information is not available in sufficient detail to enable an accurate assessment, we do not believe any company holds a dominant competitive position. Companies compete principally on technology, price, quality, and customer service. In our opinion, our prices are competitive, and our technology, quality and customer service are favorable competitive factors.

Principal Lines of Business

Beginning in the fourth quarter of 2007, we realigned our operations into the following three business segments in order to better align our operations with the evolving nature of our customers and markets:

Turbine Systems combines the former Aircraft Engine Systems business segment with the industrial gas turbine and process industries businesses previously included in the Industrial Controls business segment. Turbine Systems is focused on systems and components that provide energy control and optimization solutions for the aircraft and industrial gas turbine markets.

Engine Systems was formerly part of the Industrial Controls business segment. Engine Systems is focused on systems and components that provide energy control and optimization solutions for the industrial engine and steam turbine markets, which include power generation, transportation, and process industries.

Electrical Power Systems was formerly part of the Industrial Controls business segment. Electrical Power Systems is focused on 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 include power generation, power distribution, transportation, and process industries.

All segment information for the quarters ended December 31, 2006, March 31, 2007, and June 30, 2007 and the years ended September 30, 2005 and 2006 has been restated to reflect the realigned segment structure.

Information about our operations in 2007 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 segment information and certain geographical information are included in the Notes to the Consolidated

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Financial Statements in Item 8 Financial Statements and Supplementary Data. Other information about our business follows.

Turbine Systems

We provide integrated control systems and control components such as electronics, actuators, valves, fuel systems and combustion systems through the Turbine Systems group to OEMs of gas turbines for use in aerospace and industrial power markets. We also sell components as spares or replacements and provide repair and overhaul services to these customers and other customers.

In 2007, customers exceeding 10% of sales in this segment were General Electric Company, United Technologies/Pratt & Whitney and the U.S. government, which accounted for approximately 36%, 14% and 12% of Turbine Systems sales, respectively.

We primarily sell Turbine Systems products and services directly to our customers, although we also generate some aftermarket sales through distributors, dealers, and independent service facilities.

Engine Systems

We provide integrated control systems and control components such as electronics, actuators, valves, fuel systems and combustion systems through the Engine Systems group primarily to OEMs of diesel engines, gas engines, steam turbines, and distributors for use in power generation, marine, transportation, and process applications. We also sell components as spares or replacements, and provide repair and overhaul services, to OEM customers and equipment operators.

In 2007, one customer exceeded 10% of sales in this segment. Caterpillar accounted for approximately 25% of Engine Systems sales.

We primarily sell Engine Systems products and services directly to our OEM customers. We also sell through our global channel partners (distributors, dealers, and independent service facilities) to support our OEM customers and end users.

Electrical Power Systems

We provide integrated control systems and electronic control and protection modules through the Electrical Power Systems group primarily to OEMs of electrical power generation, distribution, conversion (predominantly wind power) and quality equipment using digital controls and inverter technologies. Sales are made primarily to OEMs of generator sets, wind turbine, and switchgear equipment. We also sell components as spares or replacements, and provide other related services to these customers and other customers.

In 2007, customers exceeding 10% of sales in this segment were Repower Systems AG and Ecotecnia, which accounted for approximately 17% and 10% of Electrical Power Systems sales, respectively.

We generally sell Electrical Power Systems products and services directly to our OEM customers, although we also generate sales to end users through distributors. Our customers demand technological solutions to meet their needs for security, quality, reliability, and availability of electrical power networks.

Customers

Some of our customers include Caterpillar, Ecotecnia, General Electric, Repower Systems AG, U.S. government, and United Technologies/Pratt & Whitney.

Two customers individually accounted for more than 10% of consolidated net sales in each of the years 2005 through 2007. Sales to General Electric were made by all of our segments and totaled approximately 20%, 22%, and 23% of sales during the years ended September 30, 2007, 2006, and 2005, respectively. Sales to Caterpillar were made by all of our segments and totaled approximately 10%, 11%, and 13% of sales during the years ended September 30, 2007, 2006, and 2005, respectively.

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Our backlog as of September 30 by segment was as follows (in thousands):

	September 30, 2007	% Expected to be Filled by September 30, 2008	September 30, 2006	% Expected to be Filled by September 30, 2007
Turbine Systems	\$ 331,024	68%	\$ 251,942	95%
Engine Systems	99,812	96	86,462	100
Electrical Power Systems	95,548	73	8,487	100
	\$ 526,384	74	\$ 346,891	96

Backlog orders are not necessarily an indicator of future billing levels because of variations in lead times and customer production demand pull systems.

Seasonality

We do not believe sales are subject to significant seasonal variation.

Research and Development

We spent, across our segments, approximately \$65 million for company-sponsored research and development activities in 2007, \$60 million in 2006, and \$50 million in 2005.

Manufacturing

For our segments, our products consist of mechanical, electronic, and electromagnetic components. Mechanical components are machined primarily from aluminum, iron, and steel. Generally there are numerous sources for the raw materials and components used in our products, and they are believed to be sufficiently available to meet expected requirements. We carry certain finished goods and component parts inventory to meet rapid delivery requirements of customers, primarily for aftermarket needs.

Employees

As of September 30, 2007, we employed 4,248 full-time persons of whom 1,464 were located outside of the U.S. We consider the relationships with our employees to be positive.

In the U.S., all of our employees are at-will employees and, therefore, not subject to any type of employment contract or agreement. Our President and Chief Executive Officer and our Chief Financial Officer each has a Change in Control Transition Agreement.

Outside of the U.S., the Company enters into employment contracts and agreements in those countries in which such relationships are mandatory or customary. The provisions of these agreements correspond in each case with the

required or customary terms in the subject jurisdiction.

Patents, Intellectual Property, and Licensing

Products for our segments make use of several patents and trademarks of various durations that we believe are collectively important. However, we do not consider any one patent or trademark material to our business.

Executive Officers of the Registrant

Set forth below is certain information with respect to the current executive officers. There are no family relationships between any of the executive officers listed below.

Thomas A. Gendron, Age 46. President, Chief Executive Officer, and Director since July 2005; President and Chief Operating Officer September 2002 through June 2005; Vice President and General Manager of Industrial

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Controls June 2001 through September 2002; Vice President of Industrial Controls April 2000 through May 2001; Director of Global Marketing and Industrial Controls Business Development February 1999 through March 2000.

Robert F. Weber, Jr., Age 52. Chief Financial Officer and Treasurer since August 2005. Prior to August 2005, Mr. Weber was employed at Motorola, Inc. for 17 years, where he held various positions, including Corporate Vice President and General Manager EMEA Auto. Prior to this role, Mr. Weber served in a variety of financial positions at both a corporate and operating unit level.

Martin V. Glass, Age 50. Group Vice President, Turbine Systems since September 2007; Vice President of the Aircraft Engine Systems Customer Business Segment December 2002 through August 2007; Director of Sales, Marketing and Engineering February 2000 through December 2002.

Dennis Benning, Age 66. Group Vice President, Engine Systems since September 2007; Vice President, Center of Excellence Industrial Controls December 2002 through August 2007; General Manager, Center of Excellence Industrial Controls July 2002 through November 2002; Director of Operations, Aircraft Engine Systems January 2002 through June 2002.

Gerhard Lauffer, Age 46. Group Vice President, Electrical Power Systems since September 2007. Vice President and General Manager Electronic Controls March 2002 through August 2007. Managing Director Leonhard-Reglerbau GmbH 1991 through March 2002.

A. Christopher Fawzy, Age 38. Vice President, General Counsel and Corporate Secretary since June 2007. Prior to joining Woodward, Mr. Fawzy was employed by Mentor Corporation, a global medical device company. He joined Mentor in 2001 and served as Corporate Counsel, then General Counsel in 2003, and was appointed Vice President, General Counsel and Secretary in 2004.

Information available on Woodward's Website

Through a link on the Investor Information section of our Website, we make available the following filings as soon as reasonably practicable after they are electronically filed or furnished to the Securities and Exchange Commission (SEC): our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. Shareholders may obtain, without charge, a single copy of Woodward's 2007 Annual Report on Form 10-K upon written request to the Corporate Secretary, Woodward Governor Company, 1000 East Drake Road, Fort Collins, Colorado, 80525.

Item 1A. Risk Factors

Investment in our securities involves risk. An investor or potential investor should consider the risks summarized in this section when making investment decisions regarding our securities.

Important factors that could individually, or together with one or more other factors, affect our business, results of operations and/or financial condition include, but are not limited to, the following:

Company Risks

Customers that account for a significant portion of our sales may change suppliers, in-source production, or be less successful in the marketplace.

We have fewer customers than many other companies with similar sales volumes. Two customers individually accounted for more than 10% of consolidated net sales in each of the years 2005 through 2007. Sales to General Electric were made by all of our segments and totaled approximately 20%, 22%, and 23% of sales during the years ended September 30, 2007, 2006, and 2005, respectively. Sales to Caterpillar were made by all of our segments and totaled approximately 10%, 11%, and 13% of sales during the years ended September 30, 2007, 2006, and 2005, respectively. Our sales could decrease significantly if a large customer were to change suppliers, in-source production, or be less successful in the markets in which it participates.

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Sales may not achieve the level forecast.

We use inputs from various sources in developing our sales forecast, including customer and third-party forecasts of sales volumes and purchase requirements in our markets. Each of these sources could be overstated. In addition, general business and economic conditions and industry-specific business and economic conditions change over time, potentially resulting in lower sales.

Many of our expenses may not be able to be reduced in proportion to a sales shortfall.

Many of our expenses are relatively fixed in relation to changes in sales volumes. Some of these expenses are related to past capital expenditures or business acquisitions in the form of depreciation and amortization expense. Others are related to expenditures driven by levels of business activity other than the level of sales, including manufacturing overhead. As a result, we might be unable to reduce spending quickly enough to compensate for a reduction in sales, which would adversely affect our earnings.

Suppliers may be unable to provide us with materials of sufficient quality or quantity required to meet our production needs or at favorable prices.

We are dependent upon suppliers for parts and raw materials used in the manufacture of components that we sell to our customers. We may experience an increase in costs for parts or materials that we source from our suppliers, or we may experience a shortage of materials for various reasons, such as high overall demand creating shortages in parts and supplies we use, financial distress, work stoppages, natural disasters, or production difficulties that may affect one or more of our suppliers. A significant increase in our costs, or a protracted interruption of supplies for any reason may adversely affect our financial condition and results of operations.

Product development activities may not be successful or may be more costly than currently anticipated.

Our business involves a significant level of product development activities, generally in connection with our customers' own development activities. If these activities are not as successful as currently anticipated, or if they are more costly than currently anticipated, future sales and/or earnings could be lower.

Activities necessary to integrate an acquisition may result in costs in excess of current expectations or be less successful than anticipated.

We completed a business acquisition in October 2006 and we may acquire other businesses in the future. If actual integration costs are higher than amounts assumed, or we are unable to integrate the assets and personnel acquired in an acquisition as anticipated, our future earnings may be lower than anticipated.

Changes in the estimates of fair value of reporting units or of long-lived assets may result in future impairment charges.

Over time, the fair values of long-lived assets change. We test goodwill for impairment annually, and more often if circumstances require. We also test property, plant, and equipment, and other intangibles for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Future impairment charges may occur if estimates of fair values decrease, which would reduce future earnings.

Future subsidiary results may change the amount of valuation allowances provided for deferred income tax assets.

We establish valuation allowances to reflect the estimated amount of deferred tax assets that might not be realized. The underlying analysis is performed for individual tax jurisdictions, generally at a subsidiary level. Future subsidiary results, actual or forecasted, could change the outcome of our analysis and change the amount of valuation allowances provided for deferred income tax assets.

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Manufacturing activities may result in future environmental liabilities.

We use hazardous materials in our manufacturing operations. We also own facilities that were formerly owned and operated by others that used hazardous materials. The risk that a release of hazardous materials has occurred in the past, or will occur in the future, cannot be completely eliminated. As a result, we may need to undertake future environmental remediation activities that would negatively affect our future earnings and financial position.

Our performance depends on continued access to a stable workforce and on favorable labor relations with our employees.

Competition for technical personnel in the industry in which we compete is intense. Our future success depends in part on our continued ability to hire, assimilate, and retain qualified personnel. There is no assurance that we will continue to be successful in recruiting qualified employees in the future. Any significant increases in labor costs, deterioration of employee relations, slowdowns or work stoppages at any of our locations, whether due to employee turnover, changes in availability of qualified technical personnel or otherwise, could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

Our intellectual property rights may not be sufficient to protect all our products or technologies.

Our success depends in part on our ability to obtain patents or rights to patents, protect trade secrets, operate without infringing upon the proprietary rights of others, and prevent others from infringing on our patents, trademarks, and other intellectual property rights. We will be able to protect our intellectual property from unauthorized use by third parties only to the extent that it is covered by valid and enforceable patents, trademarks, or licenses. Patent protection generally involves complex legal and factual questions and, therefore, enforceability of patent rights cannot be predicted with certainty; thus, any patents that we own or license from others may not provide us with adequate protection against competitors. Moreover, the laws of certain foreign countries do not recognize intellectual property rights or protect them to the same extent as do the laws of the United States.

If third parties claim we are infringing their intellectual property rights, we could suffer significant litigation, indemnification, or licensing expenses or be prevented from marketing our products.

Our commercial success depends significantly on our ability to operate without infringing the patents and other proprietary rights of others. However, regardless of our intent, our current or future technologies may infringe the patents or violate other proprietary rights of third parties. In the event of such infringement or violation we may face expensive litigation or indemnification obligations and may be prevented from selling existing products and pursuing product development or commercialization.

Product liability claims, product recalls or other liabilities associated with the products and services we provide may force us to pay substantial damage awards and other expenses that could exceed our accruals and insurance coverages.

The manufacture and sale of our products and the services we provide expose us to risk of product liability and other tort claims. Both currently and in the past, we have had a number of product liability claims relating to our products, and we will be subject to additional product liability claims in the future for both past and current products, some of which may have a negative impact on our business. We also provide certain services to our customers. As a result, we are subject to claims with respect to the services provided. In providing such services, we may rely on subcontractors to perform all or a portion of the contracted services. It is possible that we could be liable to our customers for work performed by a subcontractor. If a product liability or other claim or series of claims, including class action claims, is brought against us for uninsured liabilities or in excess of our insurance coverage or accruals, our business could

suffer and such claim could have a material adverse effect on our results of operations or financial condition.

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Amounts accrued for contingencies may be inadequate to cover the amount of loss when the matters are ultimately resolved.

In addition to intellectual property and product liability matters, we are currently involved or may become involved in pending or threatened litigation or other legal proceedings regarding employment and contractual matters arising from the normal course of business. We accrue for individual matters that we believe are likely to result in a loss when ultimately resolved using estimates of the most likely amount of loss. There may be additional losses that have not been accrued that would reduce future earnings.

Changes in the legal environment in which we operate may affect future sales and expenses.

We operate in a number of countries and are affected by a variety of laws and regulations, including employment, import, export, business acquisitions, environmental, and taxation matters, among others. Unexpected changes in the legal environment may result in lower sales or increased expenses in the future.

Operations and suppliers outside the United States may be subject to additional risks.

Our principal plants include facilities in China and Germany, as well as the United States. We also have suppliers for materials and parts outside the United States. The operations and sources of supply outside the United States could be disrupted by a natural disaster, war, political unrest, terrorist activity, public health concerns, or other unforeseen events that would be less likely to occur in the United States. Disruption of an overseas operation or significant supplier could adversely affect our business, financial condition, and results of operations.

Changes in foreign currency exchange rates may decrease margins associated with our sales.

We have situations in which sales agreements and the related cost of sales are predominately denominated in different currencies. These may involve foreign sales and domestic costs, or vice versa. Each of these situations involve the risk that the margins associated with these sales could be lower than previous sales or forecasts because of changes in foreign currency exchange rates.

Changes in assumptions may increase the amount of retirement pension and healthcare benefit obligations and related expense.

Accounting for retirement pension and healthcare benefit obligations and related expense requires the use of assumptions, including a weighted-average discount rate, an expected long-term rate of return on assets, and a net healthcare cost trend rate, among others. Benefit obligations and benefit costs are sensitive to changes in these assumptions. As a result, assumption changes could result in increases in our obligation amounts and expenses.

Industry Risks

Competitors may develop breakthrough technologies that are adopted by our customers.

Many of the components and systems we sell are used in harsh environments with stringent emissions standards. The technological expertise we have developed and maintained could become less valuable if a competitor were to develop a breakthrough technology that would allow them to match the performance of existing technologies at a lower cost. A breakthrough technology could also accelerate the rate of change in customer demands beyond what existing technologies are capable of achieving.

Changes in competitor strategies may reduce the demand for our products.

Companies compete on the basis of providing products that meet the needs of customers, as well as on the basis of price, quality, and customer service. Changes in competitive conditions, including the availability of new products and services, the introduction of new channels of distribution, and changes in OEM and aftermarket pricing, could negatively affect future sales.

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Unforeseen events may occur that significantly reduce commercial airline travel.

Our Turbine Systems segment accounted for 48% of our sales in 2007, with the majority of sales tied to commercial aviation. Market demand for our components and systems would be negatively affected by reductions in commercial airline travel and commercial airlines' financial difficulties. Certain events have had a notable negative effect on passenger flight miles in the past, such as the terrorist actions of 2001, and the airlines' revenues.

Increasing emission standards that drive certain product sales may be eased or delayed.

We sell components and systems that have been designed to meet demanding emission standards, including standards that have not yet been implemented but are intended to be soon. If these emission standards are eased, our future sales could be lower as potential customers select alternative products or delay adoption of our products.

Natural gas prices may increase significantly and disproportionately to other sources of fuels used for power generation.

Commercial producers of electricity use many of our components and systems, most predominately in their power plants that use natural gas as their fuel source. Commercial producers of electricity are often in a position to manage the use of different power plant facilities and make decisions based on operating costs. If natural gas prices were to increase significantly and disproportionately to other sources of fuels, it is likely that the use of our components and systems would decrease.

The U.S. government may reduce defense funding or the mix of programs to which such funding is allocated.

The level of U.S. defense spending is subject to periodic congressional appropriation actions, which can change. The mix of programs to which such funding is allocated is also uncertain. A portion of our sales of components and systems is to the U.S. government, primarily in the aerospace market. If the amount of spending was to decrease, or there was a shift from certain aerospace programs to other programs, our sales could decrease.

Changes in foreign currency exchange rates or in interest rates may reduce the demand for our products.

Changes in foreign currency exchange rates or in interest rates affects demand for capital purchases. Each of the markets in which we sell operates globally and is influenced by foreign currency exchange rates. Also, capital expenditures tend to decrease as interest rates and economic uncertainty rise.

Investment Risks

The historic market price of our common stock may not be indicative of future market prices.

The market price of our common stock changes over time. The trading price of our common stock ranged from a low of \$32.65 per share to a high of \$66.28 per share in fiscal 2007. The causes of stock price volatility are related to many factors both within and outside management's control. As a result, we may not be able to maintain or increase the value of our common stock.

The typical trading volume of our common stock may affect an investor's ability to sell significant share holdings in the future without negatively affecting share price.

We currently have approximately 34 million shares of common stock outstanding. While the level of trading activity will vary by day, the typical trading level represents only a small percentage of shares outstanding. As a result, a seller

of a significant number of shares in a short period of time could negatively affect our share price.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

Our principal plants are as follows:

United States

Fort Collins, Colorado Turbine Systems, Engine Systems and Electrical Power Systems manufacturing, engineering, and corporate headquarters

Loveland, Colorado Turbine Systems and Engine Systems manufacturing and partially leased to a third party

Niles, Illinois Engine Systems manufacturing and engineering

Rockford, Illinois Turbine Systems manufacturing and engineering

Rockton, Illinois Turbine Systems manufacturing and repair and overhaul

Zeeland, Michigan Turbine Systems manufacturing and engineering

Greenville, South Carolina (leased) Turbine Systems manufacturing and engineering

Other Countries

Suzhou, Peoples Republic of China (leased) Engine Systems manufacturing

Aken, Germany (leased) Engine Systems manufacturing and engineering

Kempen, Germany Electrical Power Systems manufacturing and engineering

Stuttgart, Germany (leased) Electrical Power Systems manufacturing

Prestwick, Scotland, United Kingdom (leased) Turbine Systems repair and overhaul

Tianjin, China (leased) Engine Systems manufacturing

Krakow, Poland (leased) Electrical Power Systems manufacturing and engineering

In addition to the principal plants listed above, we own facilities in Japan, the Netherlands, and United Kingdom, and lease several facilities in locations worldwide, which are used primarily for sales and service activities.

Our principal plants are suitable and adequate for the manufacturing and other activities performed at those plants, and we believe our utilization levels are generally high. With continuing advancements in manufacturing technology and operational improvements, we believe we can continue to increase production without additional plants.

Item 3. Legal Proceedings

We are 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. These matters are discussed in the Notes to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data. We currently do 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.

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

There were no matters submitted to a vote of security holders during the fourth quarter of 2007.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is listed on the NASDAQ Global Select Market and at November 20, 2007, there were approximately 1,220 holders of record. Cash dividends were declared quarterly during 2007 and 2006. The amount of cash dividends per share and the high and low sales price per share for our common stock for each fiscal quarter in 2007 and 2006 are included in the Notes to the Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data.

(a) Recent Sales of Unregistered Securities

Sales of