TEXTRON INC
Form 10-Q
October 28, 2011

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

**Form 10-Q**

**(Mark One)**

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

**For the quarterly period ended October 1, 2011**

**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 1-5480**

**Textron Inc.**

(Exact name of registrant as specified in its charter)

| **Delaware** | **05-0315468** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **40 Westminster Street, Providence, RI** | **02903** |
| (Address of principal executive offices) | (Zip code) |

**(401) 421-2800**

(Registrant s telephone number, including area code)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

| Large accelerated filer þ | 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 Act). Yes o No þ

As of October 14, 2011, there were 278,168,019 shares of common stock outstanding.

**TEXTRON INC.**
**INDEX**


| | Page |
|---|---|
| **PART I. FINANCIAL INFORMATION** | |
| Item 1. Financial Statements | |
| Consolidated Statements of Operations (Unaudited) | 3 |
| Consolidated Balance Sheets (Unaudited) | 4 |
| Consolidated Statements of Cash Flows (Unaudited) | 5 |
| Notes to the Consolidated Financial Statements (Unaudited) | |
| Note 1: Basis of Presentation | 7 |
| Note 2: Special Charges | 7 |
| Note 3: Retirement Plans | 8 |
| Note 4: Comprehensive Income | 8 |
| Note 5: Earnings per Share | 8 |
| Note 6: Accounts Receivable and Finance Receivables | 9 |
| Note 7: Inventories | 15 |
| Note 8: Debt | 15 |
| Note 9: Accrued Liabilities | 15 |
| Note 10: Commitments and Contingencies | 15 |
| Note 11: Derivative Instruments and Fair Value Measurements | 16 |
| Note 12: Income Tax Expense (Benefit) | 18 |
| Note 13: Segment Information | 19 |
| Note 14: Subsequent Events | 19 |
| Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations | 20 |
| Item 3. Quantitative and Qualitative Disclosures about Market Risk | 33 |
| Item 4. Controls and Procedures | 33 |
| **PART II. OTHER INFORMATION** | |
| Item 1. Legal Proceedings | 33 |
| Item 6. Exhibits | 34 |
| Signatures | 34 |

EX-12.1
EX-12.2
EX-31.1
EX-31.2
EX-32.1
EX-32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

**PART I. FINANCIAL INFORMATION**

**Item 1. FINANCIAL STATEMENTS**

**TEXTRON INC.**

**Consolidated Statements of Operations (Unaudited)**

| *(In millions, except per share amounts)* | **Three Months Ended October 1, 2011** | **Three Months Ended October 2, 2010** | **Nine Months Ended October 1, 2011** | **Nine Months Ended October 2, 2010** |
|---|---|---|---|---|
| **Revenues** | | | | |
| Manufacturing revenues | $ 2,782 | $ 2,420 | $ 7,930 | $ 7,207 |
| Finance revenues | 32 | 59 | 91 | 191 |
| Total revenues | 2,814 | 2,479 | 8,021 | 7,398 |
| **Costs, expenses and other** | | | | |
| Cost of sales | 2,313 | 2,037 | 6,593 | 6,000 |
| Selling and administrative expense | 251 | 301 | 850 | 886 |
| Provision for losses on finance receivables | 3 | 29 | 27 | 128 |
| Interest expense | 61 | 67 | 184 | 207 |
| Special charges | | 114 | | 136 |
| Total costs, expenses and other | 2,628 | 2,548 | 7,654 | 7,357 |
| Income (loss) from continuing operations before income taxes | 186 | (69) | 367 | 41 |
| Income tax expense (benefit) | 50 | (21) | 108 | 12 |
| **Income (loss) from continuing operations** | 136 | (48) | 259 | 29 |
| Income (loss) from discontinued operations, net of income taxes | 6 | | 2 | (3) |
| **Net income (loss)** | $ 142 | $ (48) | $ 261 | $ 26 |
| **Basic earnings per share** | | | | |
| Continuing operations | $ 0.49 | $ (0.17) | $ 0.93 | $ 0.11 |
| Discontinued operations | 0.02 | | 0.01 | (0.01) |
| **Basic earnings per share** | $ 0.51 | $ (0.17) | $ 0.94 | $ 0.10 |
| **Diluted earnings per share** | | | | |
| Continuing operations | $ 0.45 | $ (0.17) | $ 0.83 | $ 0.10 |
| Discontinued operations | 0.02 | | | (0.01) |
| **Diluted earnings per share** | $ 0.47 | $ (0.17) | $ 0.83 | $ 0.09 |
| **Dividends per share** | | | | |
| Common stock | $ 0.02 | $ 0.02 | $ 0.06 | $ 0.06 |

*See Notes to the consolidated financial statements.*

Table of Contents

**TEXTRON INC.**
**Consolidated Balance Sheets (Unaudited)**

| *(Dollars in millions)* | October 1, 2011 | January 1, 2011 |
|---|---|---|
| **Assets** | | |
| **Manufacturing group** | | |
| Cash and equivalents | $ 1,517 | $ 898 |
| Accounts receivable, net | 927 | 892 |
| Inventories | 2,607 | 2,277 |
| Other current assets | 1,094 | 980 |
| **Total current assets** | 6,145 | 5,047 |
| Property, plant and equipment, less accumulated depreciation and amortization of $3,080 and $2,869 | 1,957 | 1,932 |
| Goodwill | 1,642 | 1,632 |
| Other assets | 1,687 | 1,722 |
| **Total Manufacturing group assets** | 11,431 | 10,333 |
| **Finance group** | | |
| Cash and equivalents | 25 | 33 |
| Finance receivables held for investment, net | 3,026 | 3,871 |
| Finance receivables held for sale | 245 | 413 |
| Other assets | 554 | 632 |
| **Total Finance group assets** | 3,850 | 4,949 |
| **Total assets** | $ 15,281 | $ 15,282 |
| **Liabilities and shareholders equity** | | |
| **Liabilities** | | |
| **Manufacturing group** | | |
| Short-term and current portion of long-term debt | $ 589 | $ 19 |
| Accounts payable | 805 | 622 |
| Accrued liabilities | 1,957 | 2,016 |
| **Total current liabilities** | 3,351 | 2,657 |
| Other liabilities | 2,808 | 2,993 |
| Long-term debt | 2,473 | 2,283 |
| **Total Manufacturing group liabilities** | 8,632 | 7,933 |
| **Finance group** | | |
| Other liabilities | 364 | 391 |
| Due to Manufacturing group | 602 | 326 |

| | | |
|---|---|---|
| Debt | 2,371 | 3,660 |
| **Total Finance group liabilities** | 3,337 | 4,377 |
| **Total liabilities** | 11,969 | 12,310 |
| **Shareholders equity** | | |
| Common stock | 35 | 35 |
| Capital surplus | 1,275 | 1,301 |
| Retained earnings | 3,282 | 3,037 |
| Accumulated other comprehensive loss | (1,280) | (1,316) |
| | 3,312 | 3,057 |
| Less cost of treasury shares | | 85 |
| **Total shareholders equity** | 3,312 | 2,972 |
| **Total liabilities and shareholders equity** | $ 15,281 | $ 15,282 |
| **Common shares outstanding** (in thousands) | 278,037 | 275,739 |

*See Notes to the consolidated financial statements.*

4

Table of Contents

**TEXTRON INC.**
**Consolidated Statements of Cash Flows (Unaudited)**
For the Nine Months Ended October 1, 2011 and October 2, 2010, respectively

| *(In millions)* | Consolidated 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 261 | $ 26 |
| Less: Income (loss) from discontinued operations | 2 | (3) |
| Income from continuing operations | 259 | 29 |
| Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities: | | |
| Non-cash items: | | |
| Depreciation and amortization | 289 | 282 |
| Provision for losses on finance receivables held for investment | 27 | 128 |
| Portfolio losses on finance receivables | 60 | 76 |
| Deferred income taxes | (1) | 4 |
| Other, net | 123 | 88 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (29) | (7) |
| Inventories | (328) | (383) |
| Other assets | 114 | 186 |
| Accounts payable | 178 | 185 |
| Accrued and other liabilities | (178) | (224) |
| Captive finance receivables, net | 149 | 403 |
| Net cash provided by operating activities of continuing operations | 663 | 767 |
| Net cash used in operating activities of discontinued operations | (3) | (8) |
| Net cash provided by operating activities | 660 | 759 |
| **Cash flows from investing activities:** | | |
| Finance receivables originated or purchased | (149) | (378) |
| Finance receivables repaid | 665 | 1,265 |
| Proceeds on receivable sales | 276 | 501 |
| Capital expenditures | (271) | (134) |
| Net cash used in acquisitions | (3) | (47) |
| Proceeds from sale of repossessed assets and properties | 77 | 92 |
| Other investing activities, net | 53 | 39 |
| Net cash provided by investing activities | 648 | 1,338 |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of long-term debt | 791 | 47 |
| Payments on long-term lines of credit | (1,040) | (1,167) |
| Increase in short-term debt | 227 | |
| Principal payments on long-term debt | (643) | (1,863) |

| | | |
|---|---|---|
| Proceeds from option exercises | 4 | 2 |
| Dividends paid | (17) | (16) |
| Other financing activities, net | (22) | |
| Net cash used in financing activities | (700) | (2,997) |
| Effect of exchange rate changes on cash and equivalents | 3 | (1) |
| **Net increase (decrease) in cash and equivalents** | 611 | (901) |
| Cash and equivalents at beginning of period | 931 | 1,892 |
| Cash and equivalents at end of period | $ 1,542 | $ 991 |

*See Notes to the consolidated financial statements*

5

Table of Contents

**TEXTRON INC.**
**Consolidated Statements of Cash Flows (Unaudited) (Continued)**
For the Nine Months Ended October 1, 2011 and October 2, 2010, respectively

| | Manufacturing Group | | Finance Group | |
|---|---|---|---|---|
| *(In millions)* | **2011** | **2010** | **2011** | **2010** |
| **Cash flows from operating activities:** | | | | |
| Net income (loss) | $ 332 | $ 215 | $ (71) | $ (189) |
| Less: Income (loss) from discontinued operations | 2 | (3) | | |
| Income (loss) from continuing operations | 330 | 218 | (71) | (189) |
| Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used in) operating activities: | | | | |
| Dividends received from TFC | 179 | 355 | | |
| Capital contribution paid to TFC under Support Agreement | (152) | (228) | | |
| Non-cash items: | | | | |
| Depreciation and amortization | 267 | 260 | 22 | 22 |
| Provision for losses on finance receivables held for investment | | | 27 | 128 |
| Portfolio losses on finance receivables | | | 60 | 76 |
| Deferred income taxes | 27 | 28 | (28) | (24) |
| Other, net | 104 | 84 | 19 | 4 |
| Changes in assets and liabilities: | | | | |
| Accounts receivable, net | (29) | (7) | | |
| Inventories | (324) | (382) | | |
| Other assets | 113 | 167 | (3) | 26 |
| Accounts payable | 178 | 185 | | |
| Accrued and other liabilities | (174) | (249) | (4) | 25 |
| Net cash provided by operating activities of continuing operations | 519 | 431 | 22 | 68 |
| Net cash used in operating activities of discontinued operations | (3) | (8) | | |
| Net cash provided by operating activities | 516 | 423 | 22 | 68 |
| **Cash flows from investing activities:** | | | | |
| Finance receivables originated or purchased | | | (343) | (662) |
| Finance receivables repaid | | | 1,008 | 1,825 |
| Proceeds on receivable sales | | | 276 | 628 |
| Capital expenditures | (271) | (134) | | |
| Net cash used in acquisitions | (3) | (47) | | |
| Proceeds from sale of repossessed assets and properties | | | 77 | 92 |
| Other investing activities, net | (27) | (26) | 40 | 40 |

| | | | | |
|---|---|---|---|---|
| Net cash provided by (used in) investing activities | (301) | (207) | 1,058 | 1,923 |
| **Cash flows from financing activities:** | | | | |
| Proceeds from issuance of long-term debt | 496 | | 295 | 47 |
| Payments on long-term lines of credit | | (1,167) | (1,040) | |
| Increase in short-term debt | 227 | | | |
| Intergroup financing | (275) | 150 | 275 | (163) |
| Principal payments on long-term debt | (13) | (130) | (630) | (1,733) |
| Proceeds from option exercises | 4 | 2 | | |
| Capital contributions paid to TFC under Support Agreement | | | 152 | 228 |
| Other capital contributions paid to Finance group | | | 40 | 30 |
| Dividends paid | (17) | (16) | (179) | (355) |
| Other financing activities, net | (22) | | | |
| Net cash provided by (used in) financing activities | 400 | (1,161) | (1,087) | (1,946) |
| Effect of exchange rate changes on cash and equivalents | 4 | (1) | (1) | |
| **Net increase (decrease) in cash and equivalents** | 619 | (946) | (8) | 45 |
| Cash and equivalents at beginning of period | 898 | 1,748 | 33 | 144 |
| Cash and equivalents at end of period | $ 1,517 | $ 802 | $ 25 | $ 189 |

*See Notes to the consolidated financial statements.*

**TEXTRON INC.**
**Notes to the Consolidated Financial Statements (Unaudited)**

**Note 1: Basis of Presentation**

Our consolidated financial statements include the accounts of Textron Inc. and its majority-owned subsidiaries. We have prepared these unaudited consolidated financial statements in accordance with accounting principles generally accepted in the U.S. for interim financial information. Accordingly, these interim financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. The consolidated interim financial statements included in this quarterly report should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended January 1, 2011. In the opinion of management, the interim financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for the fair presentation of our consolidated financial position, results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron Inc. consolidated with its majority-owned subsidiaries that operate in the Cessna, Bell, Textron Systems and Industrial segments. The Finance group, which also is the Finance segment, consists of Textron Financial Corporation, its consolidated subsidiaries and three other finance subsidiaries owned by Textron Inc. We designed this framework to enhance our borrowing power by separating the Finance group. Our Manufacturing group operations include the development, production and delivery of tangible goods and services, while our Finance group provides financial services. Due to the fundamental differences between each borrowing group s activities, investors, rating agencies and analysts use different measures to evaluate each group s performance. To support those evaluations, we present balance sheet and cash flow information for each borrowing group within the consolidated financial statements. All significant intercompany transactions are eliminated from the consolidated financial statements, including retail and wholesale financing activities for inventory sold by our Manufacturing group and financed by our Finance group.

**Note 2: Special Charges**

In the third quarter of 2010, we substantially liquidated the assets held by a Canadian entity within the Finance segment. Accordingly, we recorded a non-cash charge of $91 million ($74 million after-tax) within special charges to reclassify the entity s cumulative currency translation adjustment amount within other comprehensive income to the statement of operations. The reclassification of this amount had no impact on shareholders equity.

In 2010, special charges also included costs incurred under a restructuring program that was completed at the end of 2010. There were no special charges in the first nine months of 2011.

Special charges by segment and type for the three and nine months ended October 2, 2010 are as follows:

| | Restructuring | | | |
|---|---|---|---|---|
| *(In millions)* | Severance Costs | Contract Terminations | Other | Total |
| **Three Months Ended October 2, 2010** | | | | |
| Cessna | $ 15 | $ | $ | $ 15 |
| Textron Systems | 4 | | | 4 |
| Industrial | | 1 | | 1 |
| Finance | 1 | 2 | 91 | 94 |
| | $ 20 | $ 3 | $ 91 | $ 114 |
| **Nine Months Ended October 2, 2010** | | | | |
| Cessna | $ 29 | $ 2 | $ | $ 31 |

| | | | | |
|---|---|---|---|---|
| Bell | 1 | | | 1 |
| Textron Systems | 5 | | | 5 |
| Industrial | | 1 | | 1 |
| Finance | 6 | 3 | 91 | 100 |
| Corporate | (2) | | | (2) |
| | $ 39 | $ 6 | $ 91 | $ 136 |

Table of Contents

An analysis of our restructuring reserve activity is summarized below:

| (In millions) | Severance Costs | Contract Terminations | Total |
|---|---|---|---|
| Balance at January 1, 2011 | $ 57 | $ 5 | $ 62 |
| Cash paid | (40) | (1) | (41) |
| Balance at October 1, 2011 | $ 17 | $ 4 | $ 21 |

**Note 3: Retirement Plans**

We provide defined benefit pension plans and other postretirement benefits to eligible employees. The components of net periodic benefit cost for these plans are as follows:

| | Pension Benefits | | Postretirement Benefits Other Than Pensions | |
|---|---|---|---|---|
| (In millions) | October 1, 2011 | October 2, 2010 | October 1, 2011 | October 2, 2010 |
| **Three Months Ended** | | | | |
| Service cost | $ 32 | $ 31 | $ 2 | $ 2 |
| Interest cost | 82 | 79 | 8 | 9 |
| Expected return on plan assets | (98) | (92) | | |
| Amortization of prior service cost (credit) | 4 | 4 | (2) | (2) |
| Amortization of net loss | 19 | 9 | 3 | 3 |
| Net periodic benefit cost | $ 39 | $ 31 | $ 11 | $ 12 |
| **Nine Months Ended** | | | | |
| Service cost | $ 96 | $ 93 | $ 6 | $ 6 |
| Interest cost | 246 | 237 | 24 | 25 |
| Expected return on plan assets | (294) | (276) | | |
| Amortization of prior service cost (credit) | 12 | 12 | (5) | (4) |
| Amortization of net loss | 57 | 27 | 9 | 9 |
| Net periodic benefit cost | $ 117 | $ 93 | $ 34 | $ 36 |

**Note 4: Comprehensive Income**

Our comprehensive income, net of taxes, is provided below:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| (In millions) | October 1, 2011 | October 2, 2010 | October 1, 2011 | October 2, 2010 |
| Net income (loss) | $ 142 | $ (48) | $ 261 | $ 26 |
| Other comprehensive income (loss): | | | | |

| | | | | |
|---|---|---|---|---|
| Recognition of prior service cost and unrealized losses on pension and postretirement benefits | 15 | 11 | 48 | 31 |
| Deferred gains (losses) on hedge contracts | (17) | 3 | (9) | 10 |
| Recognition of foreign currency translation loss upon substantial liquidation of Canadian entity, net of income tax benefit of $17 | | 74 | | 74 |
| Foreign currency translation and other | (18) | 21 | (3) | (20) |
| Comprehensive income | $ 122 | $ 61 | $ 297 | $ 121 |

**Note 5: Earnings Per Share**

We calculate basic and diluted earnings per share (EPS) based on net income, which approximates income available to common shareholders for each period. Basic earnings per share is calculated using the two-class method, which includes the weighted-average number of common shares outstanding during the period and restricted stock units to be paid in stock that are deemed participating securities as they provide nonforfeitable rights to dividends. Diluted earnings per share considers the dilutive effect of all potential future common stock, including stock options, restricted stock units and the shares that could be issued upon the conversion of our convertible notes and upon the exercise of the related warrants. The convertible note call options purchased in connection with the issuance of the convertible notes are excluded from the calculation of diluted EPS as their impact is always anti-dilutive.

Table of Contents

Upon conversion of our convertible notes, as described in our 2010 Form 10-K, the principal amount would be settled in cash and the excess of the conversion value, as defined, over the principal amount may be settled in cash and/or shares of our common stock. Therefore, only the shares of our common stock potentially issuable with respect to the excess of the notes conversion value over the principal amount, if any, are considered as dilutive potential common shares for purposes of calculating diluted EPS. See Note 8 regarding our cash tender offer pursuant to which we purchased a portion of our convertible notes subsequent to quarter end.

The weighted-average shares outstanding for basic and diluted earnings per share are as follows:

| *(In thousands)* | **Three Months Ended October 1, 2011** | **Three Months Ended October 2, 2010** | **Nine Months Ended October 1, 2011** | **Nine Months Ended October 2, 2010** |
|---|---|---|---|---|
| Basic weighted-average shares outstanding | 278,090 | 274,896 | 277,285 | 274,056 |
| Dilutive effect of convertible notes, warrants, stock options and restricted stock units | 22,776 | | 35,469 | 26,354 |
| Diluted weighted-average shares outstanding | 300,866 | 274,896 | 312,754 | 300,410 |

Stock options to purchase 8 million and 5 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for the three and nine months ended October 1, 2011, respectively, as the exercise prices were greater than the average market price of our common stock for the periods. Stock options to purchase 7 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for both the three and nine months ended October 2, 2010 as the exercise prices were greater than the average market price of our common stock for the periods. These securities could potentially dilute earnings per share in the future. For the three months ended October 2, 2010, the potential dilutive effect of 23 million weighted-average shares of stock options, restricted stock units and the shares that could be issued upon the conversion of our convertible notes and upon the exercise of the related warrants was excluded from the computation of diluted weighted-average shares outstanding as the shares would have an anti-dilutive effect on the loss from continuing operations.

**Note 6: Accounts Receivable and Finance Receivables**

**Accounts Receivable**

Accounts receivable is composed of the following:

| *(In millions)* | **October 1, 2011** | **January 1, 2011** |
|---|---|---|
| Commercial | $ 578 | $ 496 |
| U.S. Government contracts | 368 | 416 |
| | 946 | 912 |
| Allowance for doubtful accounts | (19) | (20) |
| | $ 927 | $ 892 |

We have unbillable receivables on U.S. Government contracts that arise when the revenues we have appropriately recognized based on performance cannot be billed yet under terms of the contract. Unbillable receivables within accounts receivable totaled $172 million at October 1, 2011 and $195 million at January 1, 2011.

**Finance Receivables**

Finance receivables by product line, which includes both finance receivables held for investment and finance receivables held for sale, are presented in the following table:

| *(Dollars in millions)* | **October 1, 2011** | **January 1, 2011** |
|---|---|---|
| Aviation | $ 1,927 | $ 2,120 |
| Golf equipment | 141 | 212 |
| Golf mortgage | 703 | 876 |
| Timeshare | 495 | 894 |
| Structured capital | 217 | 317 |
| Other liquidating | 64 | 207 |
| Total finance receivables | 3,547 | 4,626 |
| Less: Allowance for losses | 276 | 342 |
| Less: Finance receivables held for sale | 245 | 413 |
| Total finance receivables held for investment, net | $ 3,026 | $ 3,871 |

*Credit Quality Indicators and Nonaccrual Finance Receivables*

We internally assess the quality of our finance receivables held for investment portfolio based on a number of key credit quality indicators and statistics such as delinquency, loan balance to collateral value, the liquidity position of individual borrowers and guarantors, debt service coverage in the golf mortgage product line and default rates of our notes receivable collateral in the timeshare product line. Because many of these indicators are difficult to apply across an entire class of receivables, we evaluate individual loans on a quarterly basis and classify these loans into three categories based on the key credit quality indicators for the individual loan. These three categories are performing, watchlist and nonaccrual.

We classify finance receivables held for investment as nonaccrual if credit quality indicators suggest full collection is doubtful. In addition, we automatically classify accounts as nonaccrual that are contractually delinquent by more than three months unless collection is not doubtful. Cash payments on nonaccrual accounts, including finance charges, generally are applied to reduce the net investment balance. We resume the accrual of interest when the loan becomes contractually current through payment according to the original terms of the loan or, if a loan has been modified, following a period of performance under the terms of the modification, provided we conclude that collection of all principal and interest is no longer doubtful. Previously suspended interest income is recognized at that time.

Accounts are classified as watchlist when credit quality indicators have deteriorated as compared with typical underwriting criteria, and we believe collection of full principal and interest is probable but not certain. All other finance receivables held for investment that do not meet the watchlist or nonaccrual categories are classified as performing.

A summary of finance receivables held for investment categorized based on the internally assigned credit quality indicators discussed above is as follows:

| | October 1, 2011 | | | | January 1, 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| *(In millions)* | **Performing** | **Watchlist** | **Nonaccrual** | **Total** | **Performing** | **Watchlist** | **Nonaccrual** | **Total** |
| Aviation | $ 1,591 | $ 214 | $ 122 | $ 1,927 | $ 1,713 | $ 238 | $ 169 | $ 2,120 |
| Golf equipment | 91 | 38 | 12 | 141 | 138 | 51 | 23 | 212 |
| Golf mortgage | 225 | 133 | 228 | 586 | 163 | 303 | 219 | 685 |
| Timeshare | 129 | 24 | 214 | 367 | 222 | 77 | 382 | 681 |
| Structured capital | 212 | 5 | | 217 | 290 | 27 | | 317 |
| Other liquidating | 34 | | 30 | 64 | 130 | 11 | 57 | 198 |
| Total | $ 2,282 | $ 414 | $ 606 | $ 3,302 | $ 2,656 | $ 707 | $ 850 | $ 4,213 |
| % of Total | 69.1% | 12.5% | 18.4% | | 63.0% | 16.8% | 20.2% | |

We measure delinquency based on the contractual payment terms of our loans and leases. In determining the delinquency aging category of an account, any/all principal and interest received is applied to the most past-due principal and/or interest amounts due. If a significant portion of the contractually due payment is delinquent, the entire finance receivable balance is reported in accordance with the most past-due delinquency aging category.

Finance receivables held for investment by delinquency aging category is summarized in the tables below:

| *(In millions)* | **Less Than 31 Days Past Due** | **31-60 Days Past Due** | **61-90 Days Past Due** | **Greater Than 90 Days Past Due** | **Total** |
|---|---|---|---|---|---|
| **October 1, 2011** | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Aviation | $ 1,764 | $ 75 | $ 35 | $ 53 | $ 1,927 |
| Golf equipment | 122 | 8 | 5 | 6 | 141 |
| Golf mortgage | 502 | 11 | 13 | 60 | 586 |
| Timeshare | 283 | | | 84 | 367 |
| Structured capital | 217 | | | | 217 |
| Other liquidating | 45 | | | 19 | 64 |
| Total | $ 2,933 | $ 94 | $ 53 | $ 222 | $ 3,302 |
| **January 1, 2011** | | | | | |
| Aviation | $ 1,964 | $ 67 | $ 41 | $ 48 | $ 2,120 |
| Golf equipment | 171 | 13 | 9 | 19 | 212 |
| Golf mortgage | 543 | 12 | 7 | 123 | 685 |
| Timeshare | 533 | 14 | 6 | 128 | 681 |
| Structured capital | 317 | | | | 317 |
| Other liquidating | 166 | 2 | 1 | 29 | 198 |
| Total | $ 3,694 | $ 108 | $ 64 | $ 347 | $ 4,213 |

Table of Contents

We had no accrual status loans that were greater than 90 days past due at October 1, 2011 or at January 1, 2011. At October 1, 2011, the 60+ days contractual delinquency as a percentage of finance receivables held for investment was 8.33%, compared with 9.77% at January 1, 2011.

*Impaired Loans*

We evaluate individual finance receivables held for investment in non-homogeneous portfolios and larger accounts in homogeneous loan portfolios for impairment on a quarterly basis. Finance receivables classified as held for sale are reflected at the lower of cost or fair value and are excluded from these evaluations. A finance receivable is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement based on our review of the credit quality indicators discussed above. Impaired finance receivables include both nonaccrual accounts and accounts for which full collection of principal and interest remains probable, but the account s original terms have been, or are expected to be, significantly modified. If the modification specifies an interest rate equal to or greater than a market rate for a finance receivable with comparable risk, the account is not considered impaired in years subsequent to the modification. There was no significant interest income recognized on impaired loans in the first nine months of 2011 or 2010.

The average recorded investment in impaired loans for the first nine months of 2011 and 2010 is provided below:

| *(In millions)* | **Aviation** | **Golf Equipment** | **Golf Mortgage** | **Timeshare** | **Other Liquidating** | **Total** |
|---|---|---|---|---|---|---|
| **For the nine months ended October 1, 2011** | | | | | | |
| Impaired loans with a related allowance for losses recorded | $ 126 | $ 4 | $ 193 | $ 283 | $ 19 | $ 625 |
| Impaired loans with no related allowance for losses recorded | 21 | | 96 | 54 | 15 | 186 |
| Total | $ 147 | $ 4 | $ 289 | $ 337 | $ 34 | $ 811 |
| **For the nine months ended October 2, 2010** | | | | | | |
| Impaired loans with a related allowance for losses recorded | $ 198 | $ 5 | $ 184 | $ 356 | $ 23 | $ 766 |
| Impaired loans with no related allowance for losses recorded | 14 | 1 | 112 | 70 | 60 | 257 |
| Total | $ 212 | $ 6 | $ 296 | $ 426 | $ 83 | $ 1,023 |

Table of Contents

A summary of impaired finance receivables, excluding leveraged leases, and related allowance for losses is provided below:

| *(In millions)* | Aviation | Golf Equipment | Golf Mortgage | Timeshare | Other Liquidating | Total |
|---|---|---|---|---|---|---|
| **October 1, 2011** | | | | | | |
| Impaired loans with a related allowance for losses recorded: | | | | | | |
| Recorded investment | $ 94 | $ 2 | $ 196 | $ 206 | $ 23 | $ 521 |
| Unpaid principal balance | 95 | 2 | 205 | 245 | 30 | 577 |
| Related allowance | 39 | | 51 | 76 | 12 | 178 |
| Impaired loans with no related allowance for losses recorded: | | | | | | |
| Recorded investment | 26 | | 108 | 73 | 4 | 211 |
| Unpaid principal balance | 27 | | 114 | 87 | 44 | 272 |
| Total impaired loans: | | | | | | |
| Recorded investment | 120 | 2 | 304 | 279 | 27 | 732 |
| Unpaid principal balance | 122 | 2 | 319 | 332 | 74 | 849 |
| Related allowance | 39 | | 51 | 76 | 12 | 178 |
| **January 1, 2011** | | | | | | |
| Impaired loans with a related allowance for losses recorded: | | | | | | |
| Recorded investment | $ 147 | $ 4 | $ 175 | $ 355 | $ 16 | $ 697 |
| Unpaid principal balance | 144 | 5 | 178 | 385 | 15 | 727 |
| Related allowance | 45 | 2 | 39 | 102 | 3 | 191 |
| Impaired loans with no related allowance for losses recorded: | | | | | | |
| Recorded investment | 17 | | 138 | 69 | 30 | 254 |
| Unpaid principal balance | 21 | | 146 | 74 | 89 | 330 |
| Total impaired loans: | | | | | | |
| Recorded investment | 164 | 4 | 313 | 424 | 46 | 951 |
| Unpaid principal balance | 165 | 5 | 324 | 459 | 104 | 1,057 |
| Related allowance | 45 | 2 | 39 | 102 | 3 | 191 |

*Loan Modifications*

Troubled debt restructurings occur when we have either modified the contract terms of finance receivables held for investment for borrowers experiencing financial difficulties or accepted a transfer of assets in full or partial

satisfaction of the loan balance. Modifications often arise in the golf mortgage and timeshare product lines as a result of the lack of financing available to borrowers in these industries. Loans in our golf mortgage product line are typically structured with amortization periods between 20 and 30 years and contractual maturities of between 5 and 10 years, resulting in a significant balloon payment. We modify a significant portion of these loans at, or near the maturity date as a result of this structure.

The types of modifications we typically make include extensions of the original maturity date of the contract, extensions of revolving borrowing periods, delays in the timing of required principal payments, deferrals of interest payments, advances to protect the value of our collateral and principal reductions contingent on full repayment prior to the maturity date.

Finance receivables held for investment that were modified during the three- and nine-month periods of 2011 and are categorized as troubled debt restructurings, excluding related allowances for doubtful accounts and transfers of assets in satisfaction of the loan balance, are summarized below.

| *(Dollars in millions)* | **Number of Customers** | **Pre-Modification Recorded Investment** | **Post-Modification Recorded Investment** | **Recorded Investment at October 1, 2011** |
|---|---|---|---|---|
| **For the Three Months Ended October 1, 2011** | | | | |
| Golf mortgage | 7 | $ 38 | $ 35 | $ 35 |
| Timeshare | 3 | 136 | 136 | 133 |
| **For the Nine Months Ended October 1, 2011** | | | | |
| Golf mortgage | 21 | $ 166 | $ 165 | $ 163 |
| Timeshare | 9 | 219 | 219 | 158 |

Table of Contents

Due to the nature of these restructurings, the financial effect of the modifications included in the above table was insignificant. Modified finance receivables are classified as impaired loans and are evaluated on an individual basis to determine whether reserves are required. Our reserve evaluation includes an estimate of the likelihood that the borrower will be able to perform under the contractual terms of the modification. Subsequent payment defaults or delinquency trends of finance receivables modified as troubled debt restructurings are also factored into the evaluation of impaired loans for reserving purposes as a default decreases the likelihood that the borrower will be able to perform under the terms of future modifications. During the first nine months of 2011, we had four customer defaults in our timeshare product line for finance receivables that had been modified as troubled debt restructurings within the previous twelve months. The recorded investment for these customers totaled $171 million, excluding related allowances for doubtful accounts, at October 1, 2011.
We may foreclose, repossess or receive collateral when a customer no longer has the ability to make payment. These transfers of assets in full or partial satisfaction of the loan balance are also considered troubled debt restructurings if the fair value of the assets transferred is less than our recorded investment. Similar to the troubled debt restructurings described above, these loans typically have been classified as impaired loans prior to the asset transfer; therefore, reserves have already been established related to the loan. As a result, for the three and nine months ended October 1, 2011, respectively, charge-offs of $19 million and $58 million upon the transfer of such assets were largely offset by previously established reserves.
Troubled debt restructurings resulting in transfers of assets in satisfaction of the loan balance that occurred during the three and nine months of 2011 are as follows.

| *(Dollars in millions)* | **Number of Customers** | **Pre-Modification Recorded Investment** | **Post-Modification Asset Balance** |
|---|---|---|---|
| **For the Three Months Ended October 1, 2011** | | | |
| Aviation | 5 | $ 17 | $ 11 |
| Golf mortgage | 2 | 14 | 7 |
| Timeshare | 1 | 30 | 24 |
| **For the Nine Months Ended October 1, 2011** | | | |
| Aviation | 19 | $ 46 | $ 27 |
| Golf mortgage | 3 | 23 | 14 |
| Timeshare | 2 | 96 | 60 |

*Allowance for Losses*
We maintain the allowance for losses on finance receivables held for investment at a level considered adequate to cover inherent losses in the portfolio based on management s evaluation and analysis by product line. For larger balance accounts specifically identified as impaired, including large accounts in homogeneous portfolios, a reserve is established based on comparing the carrying value with either a) the expected future cash flows, discounted at the finance receivable s effective interest rate; or b) the fair value, if the finance receivable is collateral dependent. The expected future cash flows consider collateral value; financial performance and liquidity of our borrower; existence and financial strength of guarantors; estimated recovery costs, including legal expenses; and costs associated with the repossession/foreclosure and eventual disposal of collateral. When there is a range of potential outcomes, we perform multiple discounted cash flow analyses and weight the potential outcomes based on their relative likelihood of

occurrence using the probability-weighted approach.
The evaluation of our portfolios is inherently subjective as it requires estimates. These estimates include the amount and timing of future cash flows expected to be received on impaired finance receivables and the underlying collateral, which may differ from actual results. While our analysis is specific to each individual account, the most critical factors included in this analysis vary by product line. For the aviation product line, these factors include industry valuation guides, physical condition of the aircraft, payment history, and existence and financial strength of guarantors. For the golf equipment line, the critical factors are the age and condition of the collateral, while the factors for the golf mortgage line include historical golf course, hotel or marina cash flow performance; estimates of golf rounds and price per round or occupancy and room rates; market discount and capitalization rates; and existence and financial strength of guarantors. For the timeshare product line, the critical factors are the historical performance of consumer notes receivable collateral, real estate valuations, operating expenses of the borrower, the impact of bankruptcy court rulings on the value of the collateral, legal and other professional expenses and borrower s access to capital.
We also establish an allowance for losses by product line to cover probable but specifically unknown losses existing in the portfolio. For homogeneous portfolios, including the aviation and golf equipment product lines, the allowance is established as a percentage of non-recourse finance receivables, which have not been identified as requiring specific reserves. The percentage is based on a combination of factors, including historical loss experience, current delinquency and default trends, collateral values, and both general economic and specific industry trends. For non-homogeneous portfolios, including the

Table of Contents

golf mortgage and timeshare product lines, the allowance is established as a percentage of watchlist balances, as defined on page 10, which represents a combination of assumed default likelihood and loss severity based on historical experience, industry trends and collateral values. In establishing our allowance for losses to cover accounts not specifically identified, the most critical factors for the aviation product line include the collateral value of the portfolio, historical default experience and delinquency trends; for golf equipment, factors considered include historical loss experience and delinquency trends; and for golf mortgage, factors include an evaluation of individual loan credit quality indicators such as delinquency, loan balance to collateral value, debt service coverage, existence and financial strength of guarantors, historical progression from watchlist to nonaccrual status and historical loss severity. For the timeshare product line, we evaluate individual loan credit quality indicators such as borrowing base shortfalls for revolving notes receivable facilities, default rates of our notes receivable collateral, borrower s access to capital, historical progression from watchlist to nonaccrual status and estimates of loss severity based on analysis of impaired loans in the product line.

Finance receivables held for investment are written down to the fair value (less estimated costs to sell) of the related collateral at the earlier of the date when the collateral is repossessed or when no payment has been received for six months unless management deems the receivable collectable. Finance receivables are charged off when the remaining balance is deemed to be uncollectible.

A rollforward of the allowance for losses on finance receivables held for investment and a summary of its composition, based on how the underlying finance receivables are evaluated for impairment, is presented below. The finance receivables reported in the following table specifically exclude $217 million and $281 million of leveraged leases at October 1, 2011 and October 2, 2010, respectively, in accordance with authoritative accounting standards:

| *(In millions)* | **Aviation** | **Golf Equipment** | **Golf Mortgage** | **Timeshare** | **Structured Capital and Other Liquidating** | **Total** |
|---|---|---|---|---|---|---|
| **For the nine months ended October 1, 2011** | | | | | | |
| **Allowance for losses** | | | | | | |
| Beginning balance | $ 107 | $ 16 | $ 79 | $ 106 | $ 34 | $ 342 |
| Provision for losses | 18 | (3) | 4 | 7 | 1 | 27 |
| Net charge-offs and transfers | (27) | (4) | (11) | (35) | (16) | (93) |
| Ending balance | $ 98 | $ 9 | $ 72 | $ 78 | $ 19 | $ 276 |
| Ending balance based on individual evaluations | 39 | | 51 | 76 | 12 | 178 |
| Ending balance based on collective evaluation | 59 | 9 | 21 | 2 | 7 | 98 |
| **Finance receivables** | | | | | | |
| Individually evaluated for impairment | $ 120 | $ 2 | $ 304 | $ 279 | $ 27 | $ 732 |
| Collectively evaluated for impairment | 1,807 | 139 | 282 | 88 | 37 | 2,353 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance at end of period | $ 1,927 | $ 141 | $ 586 | $ 367 | $ 64 | $ 3,085 |
| **For the nine months ended October 2, 2010** | | | | | | |
| **Allowance for losses** | | | | | | |
| Beginning balance | $ 114 | $ 9 | $ 65 | $ 79 | $ 74 | $ 341 |
| Provision for losses | 27 | 12 | 61 | 37 | (9) | 128 |
| Net charge-offs | (36) | (5) | (48) | (5) | (20) | (114) |
| Ending balance | $ 105 | $ 16 | $ 78 | $ 111 | $ 45 | $ 355 |
| Ending balance based on individual evaluations | 47 | 2 | 38 | 99 | 7 | 193 |
| Ending balance based on collective evaluation | 58 | 14 | 40 | 12 | 38 | 162 |
| **Finance receivables** | | | | | | |
| Individually evaluated for impairment | $ 180 | $ 6 | $ 289 | $ 442 | $ 70 | $ 987 |
| Collectively evaluated for impairment | 2,002 | 194 | 438 | 565 | 266 | 3,465 |
| Balance at end of period | $ 2,182 | $ 200 | $ 727 | $ 1,007 | $ 336 | $ 4,452 |

Table of Contents

**Note 7: Inventories**

| *(In millions)* | October 1, 2011 | January 1, 2011 |
|---|---|---|
| Finished goods | $ 1,079 | $ 784 |
| Work in process | 2,303 | 2,125 |
| Raw materials | 406 | 506 |
| | 3,788 | 3,415 |
| Progress/milestone payments | (1,181) | (1,138) |
| | $ 2,607 | $ 2,277 |

**Note 8: Debt**

In September 2011, we issued $250 million in 4.625% Notes due 2016 and $250 million in 5.950% Notes due 2021 for total net proceeds of $496 million. We also commenced a cash tender offer in September that expired on October 12, 2011 for any and all of our approximately $600 million in outstanding 4.50% convertible senior notes due 2013.

In accordance with the terms of the tender offer, for each $1,000 principal amount of the convertible notes purchased, a holder received a cash payment of $1,524 plus accrued and unpaid interest up to the October 13, 2011 settlement date. In the aggregate, the holders of convertible notes validly tendered $225 million principal amount, or 37.5%, of the convertible notes. Excluding accrued interest, we paid $342 million in cash for the tendered convertible notes. In accordance with the applicable authoritative accounting guidance, we have determined the fair value of the liability component of the convertible notes purchased in the tender offer to be $234 million, with the balance of $108 million representing the equity component. The carrying value of the tendered convertible notes, including unamortized issuance costs, was $200 million, so a pretax loss of $34 million will be recognized in the fourth quarter of 2011, along with a $108 million reduction to shareholders equity. We have classified $200 million of the convertible notes as current at October 1, 2011, based on the settlement subsequent to quarter end. Immediately following the settlement in October, we had approximately $375 million principal amount of convertible notes outstanding, which are convertible at the holder s option, under certain circumstances described in our 2010 Form 10-K.

**Note 9: Accrued Liabilities**

We provide limited warranty and product maintenance programs, including parts and labor, for certain products for periods ranging from one to five years. Changes in our warranty and product maintenance liabilities are as follows:

| | Nine Months Ended | |
|---|---|---|
| *(In millions)* | October 1, 2011 | October 2, 2010 |
| Accrual at the beginning of period | $ 242 | $ 263 |
| Provision | 162 | 129 |
| Settlements | (173) | (162) |
| Adjustments to prior accrual estimates | (11) | 12 |
| Accrual at the end of period | $ 220 | $ 242 |

**Note 10: Commitments and Contingencies**

We are subject to legal proceedings and other claims arising out of the conduct of our business, including proceedings and claims relating to commercial and financial transactions; government contracts; compliance with applicable laws and regulations; production partners; product liability; employment; and environmental, safety and health matters. Some of these legal proceedings and claims seek damages, fines or penalties in substantial amounts or remediation of environmental contamination. As a government contractor, we are subject to audits, reviews and investigations to determine whether our operations are being conducted in accordance with applicable regulatory requirements. Under federal government procurement regulations, certain claims brought by the U.S. Government could result in our being suspended or debarred from U.S. Government contracting for a period of time. On the basis of information presently available, we do not believe that existing proceedings and claims will have a material effect on our financial position or results of operations.

**Note 11. Derivative Instruments and Fair Value Measurements**

We measure fair value at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We prioritize the assumptions that market participants would use in pricing the asset or liability into a three-tier fair value hierarchy. This fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and the lowest priority (Level 3) to unobservable inputs in which little or no market data exist, requiring companies to develop their own assumptions. Observable inputs that do not meet the criteria of Level 1, and include quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets and liabilities in markets that are not active are categorized as Level 2. Level 3 inputs are those that reflect our estimates about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. Valuation techniques for assets and liabilities measured using Level 3 inputs may include methodologies such as the market approach, the income approach or the cost approach and may use unobservable inputs such as projections, estimates and management s interpretation of current market data. These unobservable inputs are utilized only to the extent that observable inputs are not available or cost-effective to obtain.

**Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

The assets and liabilities that are recorded at fair value on a recurring basis consist primarily of our derivative financial instruments, which are categorized as Level 2 in the fair value hierarchy. The fair value amounts of these instruments that are designated as hedging instruments are provided below:

| | | | Asset (Liability) | |
|---|---|---|---|---|
| *(In millions)* | **Borrowing Group** | **Balance Sheet Location** | **October 1, 2011** | **January 1, 2011** |
| **Assets** | | | | |
| Interest rate exchange contracts* | Finance | Other assets | $ 27 | $ 34 |
| Foreign currency exchange contracts | Manufacturing | Other current assets | 12 | 39 |
| Total | | | $ 39 | $ 73 |
| **Liabilities** | | | | |
| Interest rate exchange contracts* | Finance | Other liabilities | $ (9) | $ (6) |
| Foreign currency exchange contracts | Manufacturing | Accrued liabilities | (6) | (2) |
| Total | | | $ (15) | $ (8) |

* *Interest rate exchange contracts represent fair value hedges.*

The Finance group s interest rate exchange contracts are not exchange traded and are measured at fair value utilizing widely accepted, third-party developed valuation models. The actual terms of each individual contract are entered into a valuation model, along with interest rate and foreign exchange rate data, which is based on readily observable market data published by third-party leading financial news and data providers. Credit risk is factored into the fair value of these assets and liabilities based on the differential between both our credit default swap spread for liabilities and the counterparty s credit default swap spread for assets as compared with a standard AA-rated counterparty; however, this had no significant impact on the valuation at October 1, 2011. At October 1, 2011 and January 1, 2011, we had interest rate exchange contracts with notional amounts upon which the contracts were based of $882 million

and $1.1 billion, respectively.
Foreign currency exchange contracts are measured at fair value using the market method valuation technique. The inputs to this technique utilize current foreign currency exchange forward market rates published by third-party leading financial news and data providers. These are observable data that represent the rates that the financial institution uses for contracts entered into at that date; however, they are not based on actual transactions so they are classified as Level 2. At October 1, 2011 and January 1, 2011, we had foreign currency exchange contracts with notional amounts upon which the contracts were based of $710 million and $635 million, respectively.
The Finance group also has investments in other marketable securities totaling $22 million and $51 million at October 1, 2011 and January 1, 2011, respectively, that are classified as available for sale. These investments are classified as Level 2 as the fair value for these notes was determined based on observable market inputs for similar securitization interests in markets that are relatively inactive compared with the market environment in which they were originally issued and based on bids received from prospective purchasers.
*Fair Value Hedges*
Our Finance group enters into interest rate exchange contracts to mitigate exposure to changes in the fair value of its fixed-rate receivables and debt due to fluctuations in interest rates. By using these contracts, we are able to convert our fixed-rate cash flows to floating-rate cash flows. The amount of ineffectiveness on our fair value hedges and the gain (loss) recorded in the Consolidated Statements of Operations were both insignificant in the first nine months of 2011 and 2010.

*Cash Flow Hedges*
We manufacture and sell our products in a number of countries throughout the world, and, therefore, we are exposed to movements in foreign currency exchange rates. The primary purpose of our foreign currency hedging activities is to manage the volatility associated with foreign currency purchases of materials, foreign currency sales of products, and other assets and liabilities in the normal course of business. We primarily utilize forward exchange contracts and purchased options with maturities of no more than three years that qualify as cash flow hedges and are intended to offset the effect of exchange rate fluctuations on forecasted sales, inventory purchases and overhead expenses. At October 1, 2011, we had a net deferred gain of $7 million in Accumulated other comprehensive loss related to these cash flow hedges. Net gains and losses recognized in earnings and Accumulated other comprehensive loss on these cash flow hedges, including gains and losses related to hedge ineffectiveness, were not material in the three- and nine-month periods ended October 1, 2011 and October 2, 2010. We do not expect the amount of gains and losses in Accumulated other comprehensive loss that will be reclassified to earnings in the next twelve months to be material.
We hedge our net investment position in major currencies and generate foreign currency interest payments that offset other transactional exposures in these currencies. To accomplish this, we borrow directly in foreign currency and designate a portion of foreign currency debt as a hedge of net investments. We also may utilize currency forwards as hedges of our related foreign net investments. We record changes in the fair value of these contracts in other comprehensive income to the extent they are effective as cash flow hedges. If a contract does not qualify for hedge accounting or is designated as a fair value hedge, changes in the fair value of the contract are recorded in earnings. Currency effects on the effective portion of these hedges, which are reflected in the foreign currency translation adjustment account within OCI, produced a $10 million after-tax loss for the first nine months of 2011, resulting in an accumulated net gain balance of $4 million at October 1, 2011. The ineffective portion of these hedges was insignificant.

**Assets Recorded at Fair Value on a Nonrecurring Basis**

The table below presents those assets that are measured at fair value on a nonrecurring basis that had fair value measurement adjustments during the first nine months of 2011 and 2010. These assets were measured using significant unobservable inputs (Level 3) and include the following:

| | Balance at | | Gain (Loss) Nine Months Ended | |
|---|---|---|---|---|
| *(In millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| *Finance Group* | | | | |
| Impaired finance receivables | $ 348 | $ 525 | $ (73) | $ (130) |
| Finance receivables held for sale | 245 | 252 | (22) | (17) |
| Other assets | 115 | 126 | (26) | (38) |

*Impaired Finance Receivables* Impaired nonaccrual finance receivables are included in the table above since the measurement of required reserves on our impaired finance receivables is significantly dependent on the fair value of the underlying collateral. Fair values of collateral are determined based on the use of appraisals, industry pricing guides, input from market participants, our recent experience selling similar assets or internally developed discounted cash flow models. Fair value measurements recorded on impaired finance receivables resulted in charges to provision for loan losses.
*Finance Receivables Held for Sale* Finance receivables held for sale are recorded at the lower of cost or fair value. As a result of our plan to exit the non-captive Finance business certain finance receivables are classified as held for sale. In addition, during the third quarter of 2011, we reclassified $98 million of timeshare finance receivables from held for investment to held for sale based on an agreement in place at the end of the quarter. We determined a sale of these finance receivables is consistent with our goal to maximize the economic value of our portfolio and accelerate cash

collections. At October 1, 2011, the finance receivables held for sale are primarily assets in the timeshare and golf mortgage product lines. Timeshare finance receivables classified as held for sale were identified at the individual loan level; whereas golf course mortgages were identified as a portion of a larger portfolio with common characteristics based on the intention to balance the sale of certain loans with the collection of others to maximize economic value. These finance receivables are recorded at fair value on a nonrecurring basis during periods in which the fair value is lower than the cost value.

There are no active, quoted market prices for our finance receivables. The estimate of fair value was determined based on the use of discounted cash flow models to estimate the exit price we expect to receive in the principal market for each type of loan in an orderly transaction, which includes both the sale of pools of similar assets and the sale of individual loans. The models we used incorporate estimates of the rate of return, financing cost, capital structure and/or discount rate expectations of current market participants combined with estimated loan cash flows based on credit losses, payment rates and credit line

utilization rates. Where available, assumptions related to the expectations of current market participants are compared with observable market inputs, including bids from prospective purchasers of similar loans and certain bond market indices for loans perceived to be of similar credit quality. Although we utilize and prioritize these market observable inputs in our discounted cash flow models, these inputs are not typically derived from markets with directly comparable loan structures, industries and collateral types. Therefore, all valuations of finance receivables held for sale involve significant management judgment, which can result in differences between our fair value estimates and those of other market participants.

*Other assets* Other assets include repossessed assets and properties, operating assets received in satisfaction of troubled finance receivables and other investments, which are accounted for under the equity method of accounting and have no active, quoted market prices. The fair value of these assets is determined based on the use of appraisals, industry pricing guides, input from market participants, our recent experience selling similar assets or internally developed discounted cash flow models. For our other investments, the discounted cash flow models incorporate assumptions specific to the nature of the investments business and underlying assets.

**Assets and Liabilities Not Recorded at Fair Value**

The carrying value and estimated fair values of our financial instruments that are not reflected in the financial statements at fair value are as follows:

| | October 1, 2011 | | January 1, 2011 | |
|---|---|---|---|---|
| *(In millions)* | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| **Manufacturing group** | | | | |
| Long-term debt, excluding leases | $ (2,703) | $ (3,079) | $ (2,172) | $ (2,698) |
| **Finance group** | | | | |
| Finance receivables held for investment, excluding leases | 2,648 | 2,216 | 3,345 | 3,131 |
| Debt | (2,371) | (2,250) | (3,660) | (3,528) |

Fair value for the Manufacturing group debt is determined using market observable data for similar transactions. At October 1, 2011 and January 1, 2011, approximately 45% and 33%, respectively, of the fair value of term debt for the Finance group was determined based on observable market transactions. The remaining Finance group debt was determined based on discounted cash flow analyses using observable market inputs from debt with similar duration, subordination and credit default expectations. We utilize the same valuation methodologies to determine the fair value estimates for finance receivables held for investment as used for finance receivables held for sale.

**Note 12: Income Tax Expense (Benefit)**

For the three and nine months ended October 1, 2011, income tax expense equated to an effective income tax rate of 27% and 29%, compared to the Federal statutory income tax rate of 35%. In the third quarter of 2011, the rate was significantly lower than the statutory income tax rate due to a 3% benefit associated with the early termination of certain leveraged leases and a 6% benefit associated with a higher proportion of income attributable to international operations in countries with lower tax rates for both periods.

For the three and nine months ended October 2, 2010, income tax expense (benefit) equated to an effective income tax rate of (30%) and 29%, compared to the Federal statutory income tax rate of 35%. The third quarter 2010 effective tax rate benefit differs from the U.S. Federal statutory rate primarily due to a detriment of 21% related to the nondeductible portion of a cumulative currency translation charge resulting from the substantial liquidation of a Canadian entity within the Finance segment, as discussed in Note 2. This detriment was partially offset by a 16% benefit related to a higher proportion of income attributable to international operations in countries with lower tax rates. For the nine months ended October 2, 2010, the effective tax rate provision differs from the U.S. Federal statutory rate primarily due to a 36% detriment related to the nondeductible portion of a cumulative currency

translation charge resulting from the substantial liquidation of a Canadian entity within the Finance segment and a 27% detriment related to a change in the tax treatment of the Medicare Part D program related to U.S. health-care legislation enacted in the first quarter of 2010, offset by a 69% benefit related to changes in the functional currency of two Canadian subsidiaries and benefits related to a higher proportion of income attributable to international operations in countries with lower tax rates.

Table of Contents

**Note 13: Segment Information**

We operate in, and report financial information for, the following five business segments: Cessna, Bell, Textron Systems, Industrial and Finance. Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit for the manufacturing segments excludes interest expense, certain corporate expenses and special charges. The measurement for the Finance segment excludes special charges and includes interest income and expense along with intercompany interest expense. Provisions for losses on finance receivables involving the sale or lease of our products are recorded by the selling manufacturing division when our Finance group has recourse to the Manufacturing group.

Our revenues by segment and a reconciliation of segment profit to income from continuing operations before income taxes are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(In millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| **REVENUES** | | | | |
| *Manufacturing Group* | | | | |
| Cessna | $ 771 | $ 535 | $ 1,979 | $ 1,603 |
| Bell | 894 | 825 | 2,515 | 2,266 |
| Textron Systems | 462 | 460 | 1,359 | 1,452 |
| Industrial | 655 | 600 | 2,077 | 1,886 |
| | 2,782 | 2,420 | 7,930 | 7,207 |
| *Finance Group* | 32 | 59 | 91 | 191 |
| Total revenues | $ 2,814 | $ 2,479 | $ 8,021 | $ 7,398 |
| **SEGMENT OPERATING PROFIT** | | | | |
| *Manufacturing Group* | | | | |
| Cessna | $ 33 | $ (31) | $ | $ (52) |
| Bell | 143 | 107 | 354 | 289 |
| Textron Systems | 47 | 50 | 149 | 175 |
| Industrial | 37 | 37 | 153 | 137 |
| | 260 | 163 | 656 | 549 |
| *Finance Group* | (24) | (51) | (101) | (180) |
| Segment profit | 236 | 112 | 555 | 369 |
| Corporate expenses and other, net | (13) | (35) | (75) | (89) |
| Interest expense, net for Manufacturing group | (37) | (32) | (113) | (103) |
| Special charges | | (114) | | (136) |
| Income (loss) from continuing operations before income taxes | $ 186 | $ (69) | $ 367 | $ 41 |

**Note 14. Subsequent Events**

On October 13, 2011, we repurchased 37.5% of our outstanding convertible notes pursuant to the cash tender offer disclosed in Note 8. Subsequently, on October 25, 2011, we entered into separate agreements with each of the

counterparties to the call option and warrant transactions entered into when the notes were originally issued to adjust the number of shares of common stock covered by these instruments. Accordingly, we reduced the number of common shares covered under the call options from 45.7 million shares to 28.6 million shares. This equates to the number of shares of common stock into which the $225 million principal amount of the repurchased notes would have been currently convertible. In addition, the warrants were amended to reduce the number of shares covered by the warrants to 28.0 million and to change the expiration dates specified in the original agreement to correspond with the final settlement period for the call options. Pursuant to these amendments, we received $135 million for the call option transaction and paid $133 million for the warrant transaction, and the net amount will be recorded within shareholders equity.

On October 25, 2011, we also entered into capped call transactions with the counterparties for a cost of $32 million. The capped call transactions cover an aggregate of 17.1 million shares of our common stock. The capped call transactions have a strike price of $13.125 per share and a cap price of $15.75 per share. The capped call transactions will expire in May 2013. We may elect for the settlement of the capped call transactions, if any, to be paid to us in shares of our common stock or cash or in a combination of cash and shares of common stock. Based on the structure of the capped call, the transactions meet all of the applicable accounting criteria for equity classification and will be classified within shareholders equity.

Table of Contents

**Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Consolidated Results of Operations**

**Revenues**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Revenues | $ 2,814 | $ 2,479 | $ 8,021 | $ 7,398 |
| % change compared with prior period | 13.5% | | 8.4% | |

Revenues increased $335 million, 13.5%, in the third quarter of 2011, compared with the third quarter of 2010, as revenue increases in the Cessna, Bell, and Industrial segments were partially offset by lower revenue in the Finance segment. The net revenue increase included the following factors:

- Higher Cessna revenues of $236 million, primarily due to higher volume largely reflecting more business jet deliveries;
- Higher Bell revenues of $69 million, largely due to higher volume in our military programs, which included more deliveries of V-22 and H-1 aircraft; and
- An increase in Industrial segment revenues of $55 million, primarily due to a favorable foreign exchange impact of $23 million, largely related to the euro, and higher volume of $14 million, primarily reflecting higher automotive industry demand;
- Partially offset by lower revenues at the Finance segment of $27 million, primarily attributable to the lower average finance receivable portfolio balance resulting from the continued liquidation.

Revenues increased $623 million, 8.4%, in the first nine months of 2011, compared with the corresponding period of 2010, as revenue increases in the Cessna, Bell, and Industrial segments were partially offset by lower revenue in the Finance and Textron Systems segments. The net revenue increase included the following factors:

- Higher Cessna revenues of $376 million, primarily due to the impact of higher Citation business jet volume and the mix of light- and mid-size jets sold during the period;
- Higher Bell revenues of $249 million, largely due to higher volume in our military programs, which included more deliveries of V-22 and H-1 aircraft; and
- An increase in Industrial segment revenues of $191 million, primarily due to higher volume of $82 million, primarily reflecting higher automotive industry demand, and a favorable foreign exchange impact of $73 million, largely related to the euro; partially offset by
- Lower revenues at the Finance segment of $100 million, primarily attributable to the lower average finance receivable portfolio balance resulting from the continued liquidation; and
- A decrease in Textron Systems revenue of $93 million, primarily due to $125 million in lower volume in the UAS and Mission Support and Other product lines, partially offset by higher Weapons and Sensors volume of $43 million.

**Cost of Sales and Selling and Administrative Expense**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Operating expenses | $ 2,564 | $ 2,338 | $ 7,443 | $ 6,886 |
| % change compared with prior period | 9.7% | | 8.1% | |

| | | | | |
|---|---|---|---|---|
| Cost of sales | $ 2,313 | $ 2,037 | $ 6,593 | $ 6,000 |
| % change compared with prior period | 13.5% | | 9.9% | |
| Gross margin percentage of Manufacturing revenues | 16.9% | 15.8% | 16.9% | 16.7% |
| Selling and administrative expenses | $ 251 | $ 301 | $ 850 | $ 886 |
| % change compared with prior period | (16.6)% | | (4.1)% | |

Manufacturing cost of sales and selling and administrative expenses together comprise our operating expenses. Changes in operating expenses are more fully discussed in our Segment Analysis below.

20

Consolidated manufacturing cost of sales as a percentage of Manufacturing revenues was 83.1% and 84.2% in the third quarter of 2011 and 2010, respectively, largely reflecting a favorable mix of Citation business jets sold and a benefit from cost improvement initiatives realized in the Cessna segment in the third quarter of 2011. On a dollar basis, consolidated manufacturing cost of sales increased $276 million, 14%, in the third quarter of 2011, compared with the third quarter of 2010, principally due to higher sales volume in the Cessna, Bell and Industrial segments. Consolidated manufacturing cost of sales as a percentage of Manufacturing revenues was 83.1% and 83.3% in the first nine months of 2011 and 2010, respectively. On a dollar basis, consolidated cost of sales increased $593 million, 10%, in the first nine months of 2011, principally due to higher sales volume changes in the Cessna, Bell, and Industrial segments.

On a consolidated basis, selling and administrative expense decreased $50 million, 17%, to $251 million in the third quarter of 2011, compared with the third quarter of 2010, primarily due to lower corporate expense, largely due to a reduction in stock-based compensation expense reflecting changes in our stock price, along with an $18 million reduction in operating expense at the Finance segment, largely reflecting the liquidation of the non-captive commercial finance business. For the first nine months of 2011, selling and administrative expense decreased $36 million, 4%, to $850 million, compared with the corresponding period of 2010, primarily due to lower operating expense at the Finance segment largely reflecting the liquidation of the non-captive commercial finance business.

**Interest Expense**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Interest expense | $ 61 | $ 67 | $ 184 | $ 207 |
| % change compared with prior period | (9.0)% | | (11.1)% | |

Interest expense on the Consolidated Statement of Operations includes interest for both the Finance and Manufacturing borrowing groups with interest related to intercompany borrowings eliminated. Our consolidated interest expense decreased for both the third quarter and first nine months of 2011, compared to the corresponding periods of 2010, primarily due to a decrease for the Finance group, largely due to the reduction in its debt as it liquidates the non-captive commercial finance business.

**Special Charges**

Special charges of $114 million in the third quarter of 2010 and $136 million in the first nine months of 2010 included costs incurred under the restructuring program that was completed at the end of 2010 which primarily related to severance costs in the Cessna, Finance and Textron Systems segments. In addition, special charges included a $91 million pre-tax non-cash charge in the Finance segment. In the third quarter of 2010, we substantially liquidated the assets held by a Canadian entity within the Finance segment and reclassified the entity s cumulative currency translation adjustment amount within other comprehensive income to the statement of operations. The reclassification of this amount resulted in a $74 million after-tax charge, which had no impact on shareholders equity. There were no special charges in 2011.

**Income Tax Expense**

For the three and nine months ended October 1, 2011, income tax expense equated to an effective income tax rate of 27% and 29%, compared to the Federal statutory income tax rate of 35%. In the third quarter of 2011, the rate was significantly lower than the statutory income tax rate due to a 3% benefit associated with the early termination of certain leveraged leases and a 6% benefit associated with a higher proportion of income attributable to international operations in countries with lower tax rates for both periods.

For the three and nine months ended October 2, 2010, income tax expense (benefit) equated to an effective income tax rate of (30%) and 29%, compared to the Federal statutory income tax rate of 35%. The third quarter 2010 effective tax rate benefit differs from the U.S. Federal statutory rate primarily due to a detriment of 21% related to the

nondeductible portion of a cumulative currency translation charge resulting from the substantial liquidation of a Canadian entity within the Finance segment, as discussed above under Special Charges. This detriment was partially offset by a 16% benefit related to a higher proportion of income attributable to international operations in countries with lower tax rates. For the nine months ended October 2, 2010, the effective tax rate provision differs from the U.S. Federal statutory rate primarily due to a 36% detriment related to the nondeductible portion of a cumulative currency translation charge resulting from the substantial liquidation of a Canadian entity within the Finance segment and a 27% detriment related to a change in the tax treatment of the Medicare Part D program related to U.S. health-care legislation enacted in the first quarter of 2010, offset by a 69% benefit related to changes in the functional currency of two Canadian subsidiaries and benefits related to a higher proportion of income attributable to international operations in countries with lower tax rates.

Table of Contents

**Backlog**

| *(In millions)* | | January 2, 2010 | | January 1, 2011 | July 2, 2011 | | October 1, 2011 |
|---|---|---|---|---|---|---|---|
| Bell* | $ | 6,192 | $ | 6,473 | $ 6,172 | $ | 6,365 |
| Cessna | | 4,893 | | 2,928 | 2,522 | | 2,163 |
| Textron Systems | | 1,664 | | 1,598 | 1,550 | | 1,528 |

At Cessna, backlog decreased from year end and the prior quarter end, primarily reflecting deliveries in excess of orders.
*Backlog at Bell for prior periods as shown in the table above has been revised from the amounts previously reported, primarily to correct an error made in the fourth quarter of 2009 when the full value of a V-22 contract was included in backlog rather than Bell s proportionate share. Following our discovery of this error in October 2011, we conducted an internal review of backlog for the V-22 program as well as the rest of Bell s backlog and determined that the net impact, after including additional minor errors identified in our review, was a $781 million reduction in Bell s backlog from the amount previously reported as of July 2, 2011. After adjusting for Bell s backlog error, at January 2, 2010 and January 1, 2011, total year-end U.S. Government backlog was $7.1 billion and $7.6 billion, respectively, and total year-end Textron backlog was $12.8 billion and $11.0 billion, respectively.

**Segment Analysis**

We operate in, and report financial information for, the following five business segments: Cessna, Bell, Textron Systems, Industrial and Finance. Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit for the manufacturing segments excludes interest expense, certain corporate expenses and special charges. The measurement for the Finance segment excludes special charges and includes interest income and expense along with intercompany interest expense.
In our discussion of comparative results for the Manufacturing group, changes in revenue and segment profit typically are expressed for our commercial business in terms of volume, pricing, foreign exchange and acquisitions. Additionally, changes in segment profit may be expressed in terms of mix, inflation and cost performance. Volume changes in revenue represent increases/decreases in the number of units delivered or services provided. Pricing represents changes in unit pricing. Foreign exchange is the change resulting from translating foreign-denominated amounts into U.S. dollars at exchange rates that are different from the prior period. Acquisitions refer to the results generated from businesses that were acquired within the previous 12 months. For segment profit, mix represents a change due to the composition of products and/or services sold at different profit margins. Inflation represents higher material, wages, benefits, pension or other costs. Cost performance reflects an increase or decrease in research and development, depreciation, selling and administrative costs, warranty, product liability, quality/scrap, labor efficiency, overhead, product line profitability, start-up, ramp up and cost-reduction initiatives or other manufacturing inputs.
Approximately 34% of our 2010 revenues were derived from contracts with the U.S. Government. For our segments that have significant contracts with the U.S. Government, we typically express changes in segment profit related to the government business in terms of volume, changes in program performance or changes in contract mix. Changes in volume that are discussed in net sales typically drive corresponding changes in our segment profit based on the profit rate for a particular contract. Changes in program performance typically relate to profit recognition associated with revisions to total estimated costs at completion that reflect improved or deteriorated operating performance or award fee rates. Changes in contract mix refer to changes in operating margin due to a change in the relative volume of contracts with higher or lower fee rates such that the overall average margin rate for the segment changes.

**Cessna**

| Three Months Ended | Nine Months Ended |
|---|---|

| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
|---|---|---|---|---|
| Revenues | $ 771 | $ 535 | $ 1,979 | $ 1,603 |
| Operating expenses | 738 | 566 | 1,979 | 1,655 |
| Segment profit (loss) | 33 | (31) | | (52) |
| Profit margin | 4.3% | (5.8)% | | (3.2)% |

Table of Contents

The following factors contributed to the change in Cessna s revenue for the periods:

| *(In millions)* | Q3 2011 versus Q3 2010 | YTD 2011 versus YTD 2010 |
|---|---|---|
| Volume and mix | $ 236 | $ 363 |
| Pricing | | 13 |
| Total change | $ 236 | $ 376 |

In the third quarter of 2011, Cessna s revenues increased $236 million, 44%, compared with the corresponding period of 2010 primarily due to higher Citation business jet volume, largely due to the delivery of 47 Citation business jets in the third quarter of 2011, compared with 26 in the third quarter of 2010. During the third quarter of 2011, the portion of Cessna s revenue derived from aftermarket sales and services represented 26% of Cessna s revenue, compared with 31% in the third quarter of 2010, largely due to the higher business jet volume.

In the first nine months of 2011, Cessna s revenues increased $376 million, 23%, compared with the corresponding period of 2010, primarily due to higher Citation business jet volume and the mix of light- and mid-size jets sold during the period, which had a $276 million impact, and higher aftermarket volume of $54 million. The higher Citation business jet volume was largely due to the delivery of 116 jets in the first nine months of 2011, compared with 100 in the corresponding period of 2010. During the first nine months of 2011, the portion of Cessna s revenue derived from aftermarket sales and services represented 29% of Cessna s revenue, compared with 31% in the corresponding period of 2010, largely due to the higher business jet volume.

The following factors contributed to the change in Cessna s segment profit for the periods:

| *(In millions)* | Q3 2011 versus Q3 2010 | YTD 2011 versus YTD 2010 |
|---|---|---|
| Volume and mix | $ 52 | $ 66 |
| Performance | 16 | (16) |
| Other | (4) | 2 |
| Total change | $ 64 | $ 52 |

Cessna s segment profit increased $64 million in the third quarter of 2011, compared with the corresponding period of 2010, primarily due to higher volume and mix of $52 million and favorable performance of $16 million. Performance included the following:

$10 million related to manufacturing cost improvement initiatives realized during the period; partially offset by $8 million in higher engineering and development expenses as we increased our investment in future product offerings.

Cessna s operating expenses increased by $172 million, 30%, in the third quarter of 2011, compared with the corresponding period of 2010, primarily due to higher sales volume, which resulted in a $130 million increase in direct material and labor costs and a $46 million increase in manufacturing overhead. As discussed above, operating expenses also increased due to higher engineering and development expenses.

Cessna s segment profit was $52 million higher in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to higher volume and mix of $66 million, partially offset by unfavorable performance of $16 million. Performance included the following:

$31 million in higher engineering and development expenses, primarily due to new product development, partially offset by

$15 million related to cost improvement initiatives realized during the period.

Cessna s operating expenses increased by $324 million, 20%, in the first nine months of 2011, compared with the corresponding period of 2010, principally due to higher sales volume, which resulted in a $226 million increase in direct material and labor costs and a $56 million increase in manufacturing overhead. As discussed above, operating expenses also increased due to higher engineering and development expenses.

Table of Contents

**Bell**

| *(Dollars in millions)* | Three Months Ended October 1, 2011 | Three Months Ended October 2, 2010 | Nine Months Ended October 1, 2011 | Nine Months Ended October 2, 2010 |
|---|---|---|---|---|
| Revenues | | | | |
| V-22 program | $ 363 | $ 301 | $ 1,081 | $ 869 |
| Other military | 266 | 229 | 695 | 637 |
| Commercial | 265 | 295 | 739 | 760 |
| Total revenues | 894 | 825 | 2,515 | 2,266 |
| Operating expenses | 751 | 718 | 2,161 | 1,977 |
| Segment profit | 143 | 107 | 354 | 289 |
| Profit margin | 16.0% | 13.0% | 14.1% | 12.8% |

Bell manufactures helicopters, tiltrotor aircraft, and related spare parts and provides services for military and/or commercial markets. Bell s major U.S. Government programs at this time are the V-22 tiltrotor aircraft and the H-1 helicopter platforms, which are both in the production stage and represent a significant portion of Bell s revenues from the U.S. Government. During 2011, we continued to ramp up production and deliveries to meet customer schedule requirements for these programs.
The following factors contributed to the change in Bell s revenue for the periods:

| *(In millions)* | Q3 2011 versus Q3 2010 | YTD 2011 versus YTD 2010 |
|---|---|---|
| Volume and mix | $ 65 | $ 236 |
| Other | 4 | 13 |
| Total change | $ 69 | $ 249 |

Bell s revenues increased $69 million, 8%, in the third quarter of 2011, compared with the corresponding period of 2010, primarily due to higher volume. We delivered 9 V-22 aircraft during the third quarter of 2011, compared with 7 deliveries in the third quarter of 2010, which was the primary driver in the $62 million, 21%, increase in V-22 revenues. Other military revenues increased $37 million, 16%, primarily due to higher H-1 deliveries, partially offset by lower production support volume of $23 million. We delivered 7 H-1 aircraft in the third quarter of 2011, compared with 5 deliveries in the third quarter of 2010. Commercial revenues decreased $30 million, 10%, in the third quarter of 2011, primarily reflecting the change in mix of aircraft sold during the quarter and lower aftermarket volume of $12 million. We delivered 26 commercial aircraft in the third quarter of 2011, compared with 24 aircraft in the third quarter of 2010.
Bell s revenues increased $249 million, 11%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to higher volume. We delivered 27 V-22 aircraft during the first nine months of 2011, compared with 19 deliveries in the corresponding period of 2010, which was the primary driver in the $212 million, 24%, increase in V-22 revenues. We also delivered 19 H-1 aircraft in the first nine months of 2011, compared with 11 deliveries in the corresponding period of 2010. Other military revenues increased $58 million, 9%, in 2011 largely due to the higher deliveries of H-1 aircraft, partially offset by a $58 million decrease in aftermarket volume reflecting the completion of several non-recurring programs in 2010, along with timing of deliveries for other programs.

Commercial revenues decreased $21 million, 3%, primarily reflecting the change in mix of aircraft sold during the quarter. We delivered 63 commercial aircraft in the first nine months of 2011, compared with 60 aircraft in the corresponding period of 2010.

The following factors contributed to the change in Bell s segment profit for the periods:

| *(In millions)* | **Q3 2011 versus Q3 2010** | **YTD 2011 versus YTD 2010** |
|---|---|---|
| Performance | $ 48 | $ 86 |
| Volume and mix | (11) | (20) |
| Other | (1) | (1) |
| Total change | $ 36 | $ 65 |

Bell s segment profit increased $36 million, 34%, in the third quarter of 2011, compared with the third quarter of 2010, primarily due to improved program performance of $48 million, partially offset by volume and mix of $11 million, largely related to the mix of commercial aircraft sold in the quarter. Bell s improved performance included the following:

$28 million resulting from improved manufacturing efficiencies in our military programs, and

Table of Contents

$14 million in lower selling and administrative costs in our commercial business.

Bell s operating expenses increased $33 million, 5%, in the third quarter of 2011, compared with the corresponding period of 2010, primarily due to higher net sales volume discussed above.

Bell s segment profit increased $65 million, 22%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to improved program performance of $86 million, partially offset by volume and mix of $20 million, primarily due to the mix in commercial aircraft sold. Bell s improved performance included the following:

$94 million resulting from improved manufacturing efficiencies in our military programs, partially offset by a $21 million program adjustment recognized in the second quarter of 2010 related to the recognition of profit on the H-1 and V-22 programs for reimbursement of prior year costs.

Bell s operating expenses increased $184 million, 9%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to higher sales volume discussed above.

**Textron Systems**

| | **Three Months Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Revenues | $ 462 | $ 460 | $ 1,359 | $ 1,452 |
| Operating expenses | 415 | 410 | 1,210 | 1,277 |
| Segment profit | 47 | 50 | 149 | 175 |
| Profit margin | 10.2% | 10.9% | 11.0% | 12.1% |

The following factors contributed to the change in Textron Systems revenue for the periods:

| *(In millions)* | **Q3 2011 versus Q3 2010** | **YTD 2011 versus YTD 2010** |
|---|---|---|
| Volume and mix | $ | $ (97) |
| Other | 2 | 4 |
| Total change | $ 2 | $ (93) |

Revenues at Textron Systems increased $2 million, 0.4%, in the third quarter of 2011, compared with the third quarter of 2010. Volume was flat, reflecting the following changes:

Higher Weapons and Sensors revenue of $35 million, primarily due to higher Sensor Fuzed Weapon volume related to a foreign military sales contract, partially offset by

Lower Unmanned Aircraft Systems (UAS) volume of $29 million, largely due to lower deliveries and to the timing of revenues from various programs.

Revenues at Textron Systems decreased $93 million, 6%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to lower volume, reflecting the following changes:

Lower UAS volume of $84 million, largely due to lower deliveries and to the timing of revenues from various programs, and

Lower Mission Support and Other product line volume of $41 million, largely due to the completion of several test and training programs, partially offset by

Higher Weapons and Sensors revenue of $43 million, largely due to higher Sensor Fuzed Weapon volume.

The following factors contributed to the change in Textron Systems segment profit for the periods:

| | **Q3 2011** | **YTD 2011** |
|---|---|---|

| *(In millions)* | **versus Q3 2010** | **versus YTD 2010** |
|---|---|---|
| Volume and mix | $ (7) | $ (27) |
| Other | 4 | 1 |
| Total change | $ (3) | $ (26) |

25

**Table of Contents**

Segment profit at Textron Systems decreased $3 million, 6%, and operating expenses increased $5 million, 1%, in the third quarter of 2011, compared with the third quarter of 2010, primarily due to the change in mix of profit rates on military contracts during the quarter.
Segment profit at Textron Systems decreased $26 million, 15%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to the impact of lower volume and mix described above. Textron Systems operating expenses decreased $67 million, 5%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to the mix of contracts during the quarter.

**Industrial**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(Dollars in millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Revenues: | | | | |
| Fuel systems and functional components | $ 433 | $ 394 | $ 1,354 | $ 1,217 |
| Other industrial | 222 | 206 | 723 | 669 |
| Total revenues | 655 | 600 | 2,077 | 1,886 |
| Operating expenses | 618 | 563 | 1,924 | 1,749 |
| Segment profit | 37 | 37 | 153 | 137 |
| Profit margin | 5.6% | 6.2% | 7.4% | 7.3% |

The following factors contributed to the change in Industrial s revenue for the periods:

| *(In millions)* | **Q3 2011 versus Q3 2010** | **YTD 2011 versus YTD 2010** |
|---|---|---|
| Volume | $ 14 | $ 82 |
| Foreign exchange | 23 | 73 |
| Acquisitions, net of dispositions | 11 | 22 |
| Other | 7 | 14 |
| Total change | $ 55 | $ 191 |

Industrial segment sales increased $55 million, 9%, in the third quarter of 2011, compared with the third quarter of 2010. Sales of the segment s fuel systems and functional components increased $39 million, 10%, in the third quarter of 2011, compared with the third quarter of 2010, primarily due to a favorable foreign exchange impact of $20 million, largely related to the euro, and higher volume of $17 million, reflecting higher automotive industry demand. Other industrial revenues increased primarily due to the impact of acquisitions, net of dispositions.
Industrial segment sales increased $191 million, 10%, in the first nine months of 2011, compared with the corresponding period of 2010. Sales of the segment s fuel systems and functional components increased $137 million, 11%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to higher volume of $77 million, reflecting higher automotive industry demand, and a favorable foreign exchange impact of $62 million, largely related to the euro. Other industrial revenues increased primarily due to the $22 million impact of acquisitions, pricing and $11 million in favorable foreign exchange.
The following factors contributed to the change in Industrial s segment profit for the periods:

| *(In millions)* | **Q3 2011 versus Q3 2010** | **YTD 2011 versus YTD 2010** |
|---|---|---|
| Volume | $ 1 | $ 19 |
| Performance | 1 | 17 |
| Inflation, net of pricing | (6) | (29) |
| Other | 4 | 9 |
| Total change | $ | $ 16 |

Industrial segment profit was unchanged in the third quarter of 2011, compared with the third quarter of 2010.

Table of Contents

Operating expenses for the Industrial segment increased $55 million, 10%, in the third quarter of 2011, compared with the third quarter of 2010, largely due to a $20 million impact from foreign exchange related to the euro, $17 million in higher direct material costs due to higher sales volume and $15 million in cost inflation for commodity and material components throughout the Industrial businesses.

Industrial segment profit increased $16 million, 12%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to a $19 million impact from higher volume and improved performance of $17 million, partially offset by inflation, net of pricing of $29 million. Performance was favorable for the period due to continued cost reduction activities and improved manufacturing leverage resulting from higher volume. Inflation, net of pricing, of $29 million was primarily due to higher direct material costs for commodity and material components throughout the Industrial businesses that exceeded related price increases, principally in the fuel systems and functional components product line.

Operating expenses for the Industrial segment increased $175 million, 10%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to a $67 million impact from foreign exchange related to the euro, a $60 million increase in direct material costs due to higher sales volume, and $29 million in inflation for direct materials related to various commodity and material components throughout the Industrial businesses.

**Finance**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *(In millions)* | **October 1, 2011** | **October 2, 2010** | **October 1, 2011** | **October 2, 2010** |
| Revenues | $ 32 | $ 59 | $ 91 | $ 191 |
| Provision for losses on finance receivables | 3 | 29 | 27 | 128 |
| Segment profit (loss) | (24) | (51) | (101) | (180) |

Our plan to exit the non-captive commercial finance business in our Finance segment is being effected through a combination of orderly liquidation and selected sales of the remaining non-captive finance receivables. The exit plan is expected to be substantially complete over the next three to five years.

Finance segment revenues decreased $27 million, 46%, in the third quarter of 2011, compared with the third quarter of 2010, primarily attributable to the impact of a $1.6 billion lower average finance receivable balance. Finance segment revenues decreased $100 million, 52%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily attributable to the impact of a $1.9 billion lower average finance receivable balance.

Finance segment loss decreased $27 million, 53%, in the third quarter of 2011, compared with the third quarter of 2010, primarily due to the following factors:

- $26 million in lower provision for loan losses, primarily the result of a decline in the accounts identified as nonaccrual in the non-captive portfolio during the quarter as compared to last year and a specific reserving action taken on one aviation account during 2010; and
- $18 million in lower administrative expenses, primarily due to lower compensation expense associated with a workforce reduction and other cost reductions related to the exit of the non-captive business; partially offset by an
- $11 million reduction in interest margin resulting from the lower average finance receivable portfolio balance.

Finance segment loss decreased $79 million, 44%, in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to the following factors:

- $101 million in lower provision for loan losses, primarily the result of a decline in the accounts identified as nonaccrual in the non-captive portfolio during the first nine months of 2011 as compared to last year; and
- $45 million in lower administrative expenses, primarily due to lower compensation expense associated with a workforce reduction and other cost reductions related to the exit of the non-captive business; partially offset by a

$48 million reduction in interest margin resulting from the lower average finance receivable portfolio balance.

Table of Contents

*Finance Portfolio Quality*

The following table reflects information about the Finance segment s credit performance related to finance receivables held for investment. Finance receivables held for sale are reflected at fair value on the Consolidated Balance Sheets. As a result, finance receivables held for sale are not included in the credit performance statistics below.

| *(Dollars in millions)* | | **October 1, 2011** | | **January 1, 2011** |
|---|---|---|---|---|
| Finance receivables held for investment | $ | 3,302 | $ | 4,213 |
| Nonaccrual finance receivables | $ | 606 | $ | 850 |
| Allowance for losses | $ | 276 | $ | 342 |
| Ratio of nonaccrual finance receivables to finance receivables held for investment | | 18.35% | | 20.17% |
| Ratio of allowance for losses on impaired nonaccrual finance receivables to impaired nonaccrual finance receivables | | 30.44% | | 23.82% |
| Ratio of allowance for losses on finance receivables to nonaccrual finance receivables held for investment | | 45.54% | | 40.30% |
| Ratio of allowance for losses on finance receivables to finance receivables held for investment | | 8.36% | | 8.13% |
| 60+ days contractual delinquency as a percentage of finance receivables held for investment | | 8.33% | | 9.77% |
| 60+ days contractual delinquency | $ | 275 | $ | 411 |
| Repossessed assets and properties | $ | 132 | $ | 157 |
| Operating assets received in satisfaction of troubled finance receivables | $ | 82 | $ | 107 |

At October 1, 2011, finance receivables held for investment included $1.2 billion of non-captive finance receivables, compared with $1.9 billion at the end of 2010. Finance receivables held for sale by the non-captive business totaled $245 million at October 1, 2011, compared with $413 million at the end of 2010.

Nonaccrual finance receivables decreased $244 million, 29%, from the year-end balance, primarily due to reductions of $168 million in the timeshare portfolio, $47 million in the aviation portfolio and $27 million in the other liquidating portfolio. The reduction in the timeshare portfolio was mostly due to the resolution of three significant accounts and cash collections on several other accounts. The decrease in the aviation portfolio was due to a $95 million impact from the resolution of several accounts through cash collections and repossession of collateral, partially offset by new accounts identified as nonaccrual in 2011.

We believe that the percentage of nonaccrual finance receivables generally will remain high as we execute our liquidation plan. The liquidation plan is also likely to result in a slower rate of liquidation for nonaccrual finance receivables. See Note 6 to the Consolidated Financial Statements for more detailed information on the nonaccrual finance receivables by product line, along with a summary of finance receivables held for investment based on our internally assigned credit quality indicators.

## Liquidity and Capital Resources

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron Inc. consolidated with its majority-owned subsidiaries that operate in the Cessna, Bell, Textron Systems and Industrial segments. The Finance group, which also is the Finance segment, consists of TFC, its consolidated subsidiaries and three other finance subsidiaries owned by Textron Inc. We designed this framework to enhance our borrowing power by separating the Finance group. Our Manufacturing group operations include the development, production and delivery of tangible goods and services, while our Finance group provides financial services. Due to the fundamental differences between each borrowing group s activities, investors, rating agencies and analysts use different measures to evaluate each group s performance. To support those evaluations, we present balance sheet and cash flow information for each borrowing group within the Consolidated Financial Statements.

Key information that is utilized in assessing our liquidity is summarized below:

| *(In millions)* | October 1, 2011 | January 1, 2011 |
|---|---|---|
| ***Manufacturing group*** | | |
| Cash and equivalents | $ 1,517 | $ 898 |
| Debt | 3,062 | 2,302 |
| Shareholders equity | 3,312 | 2,972 |
| Capital (debt plus shareholders equity) | 6,374 | 5,274 |
| Net debt (net of cash and equivalents) to capital | 31.8% | 32.1% |
| Debt to capital | 48.0% | 43.6% |
| ***Finance group*** | | |
| Cash and equivalents | $ 25 | $ 33 |
| Debt | 2,371 | 3,660 |

We believe that our calculations of debt to capital and net debt to capital are useful measures as they provide a summary indication of the level of debt financing (i.e., leverage) that is in place to support our capital structure, as well as to provide an indication of the capacity to add further leverage. We believe that with our existing cash balances, coupled with the continued successful execution of the exit plan for the non-captive portion of the commercial finance business, and cash we expect to generate from our manufacturing operations, we will have sufficient cash to meet our future needs.

We maintain an effective shelf registration statement filed with the Securities and Exchange Commission that allows us to issue an unlimited amount of public debt and other securities. In September 2011, we issued $250 million in 4.625% Notes due 2016 and $250 million in 5.950% Notes due 2021 under this registration statement. In addition, we commenced a cash tender offer for our 4.50% convertible notes, as discussed in Note 8 to the Consolidated Financial Statements. Subsequent to quarter end, we paid $342 million in cash for the portion of the convertible notes tendered. Following the settlement, we had approximately $375 million principal amount of Convertible Notes outstanding.

On March 23, 2011, Textron Inc. entered into a senior unsecured revolving credit facility for an aggregate principal amount of $1.0 billion that expires in March 2015 and replaced the $1.25 billion 5-year facility that was scheduled to expire in April 2012. This facility agreement provides that up to $200 million is available for the issuance of letters of credit in lieu of borrowings. At October 1, 2011, there were no amounts borrowed against the facility, and there were $38 million of letters of credits issued against it. At October 1, 2011, TFC had $400 million of outstanding borrowings against its credit facility, and on October 20, 2011, we repaid all outstanding amounts and elected to terminate the facility.

In the first nine months of 2011, we liquidated $1.1 billion of the Finance group s finance receivables, net of originations. These finance receivable reductions occurred in both the non-captive and captive finance portfolios, but were primarily driven by the non-captive portfolio in connection with our exit plan, including $399 million and

$173 million in the timeshare and golf mortgage product lines, respectively. These reductions resulted from the combination of scheduled finance receivable collections, sales, discounted payoffs, repossession of collateral, charge-offs and impairment charges. At October 1, 2011, $1.5 billion of finance receivables remained in the non-captive portfolio.

**Manufacturing Group Cash Flows**

Cash flows from continuing operations for the Manufacturing group are summarized below:

| | Nine Months Ended | |
|---|---|---|
| *(In millions)* | October 1, 2011 | October 2, 2010 |
| Operating activities | $ 519 | $ 431 |
| Investing activities | (301) | (207) |
| Financing activities | 400 | (1,161) |

Cash flow from operating activities increased in the first nine months of 2011, compared with the corresponding period of 2010, primarily due to higher earnings for the Manufacturing group and $108 million in tax refunds received in 2011, partially offset by $169 million in higher pension contributions. We also made cash payments of $37 million and $34 million in the first nine months of 2011 and 2010, respectively, related to our company-wide restructuring program that was completed at the end of 2010.

We used more cash for investing activities largely due to higher capital expenditures, which totaled $271 million and $134 million in the first nine months of 2011 and 2010, respectively.

In the first nine months of 2011, financing activities primarily consisted of $496 million in proceeds from the issuance of medium-term notes. We used significantly more cash for financing activities in the first nine months of 2010, largely due to the repayment of $1.2 billion on our bank credit lines.

**Capital Contributions Paid To and Dividends Received From TFC**

Under a Support Agreement between Textron Inc. and TFC, Textron Inc. is required to maintain a controlling interest in TFC. The agreement also requires Textron Inc. to ensure that TFC maintains fixed charge coverage of no less than 125% and consolidated shareholder s equity of no less than $200 million. Cash contributions paid to TFC to maintain compliance with the Support Agreement and dividends paid by TFC to Textron Inc. are detailed below:

| | Nine Months Ended | |
|---|---|---|
| *(In millions)* | October 1, 2011 | October 2, 2010 |
| Dividends paid by TFC to Textron Inc. | $ 179 | $ 355 |
| Capital contributions paid to TFC under Support Agreement | (152) | (228) |

An additional cash contribution of $30 million was paid to TFC on October 11, 2011 as required by the Support Agreement.

Due to the nature of these contributions, we classify these contributions within cash flows used by operating activities for the Manufacturing group in the Consolidated Statement of Cash Flows. Capital contributions to support Finance group growth in the ongoing captive finance business are classified as cash flows from financing activities. The Finance group s loss is excluded from the Manufacturing group s cash flows, while dividends from the Finance group are included within cash flows from operating activities for the Manufacturing group as they represent a return on investment.

**Finance Group Cash Flows**

The cash flows from continuing operations for the Finance group are summarized below:

| | Nine Months Ended | |
|---|---|---|
| | | October 2, |

| *(In millions)* | **October 1, 2011** | **2010** |
| --- | --- | --- |
| Operating activities | $ 22 | $ 68 |
| Investing activities | 1,058 | 1,923 |
| Financing activities | (1,087) | (1,946) |

Cash flow from operating activities decreased in the first nine months of 2011 compared to the corresponding period of 2010, largely due to the settlement of a cross currency interest rate exchange contract and other interest rate exchange contracts for which we paid $3 million in 2011 and received $28 million in net proceeds in 2010.
Cash receipts from the collection of finance receivables continued to exceed finance receivable originations, which resulted in net cash inflow from investing activities in both 2011 and 2010. Finance receivables repaid and proceeds from sales totaled $1.3 billion and $2.5 billion in the first nine months of 2011 and 2010, respectively, while cash outflows for

30

originations declined to $343 million and $662 million, respectively. These decreases were largely driven by the wind down of the non-captive finance receivable portfolio.

In the first nine months of 2011, TFC paid $1.0 billion against the outstanding balance on its bank line of credit; however, cash used for financing activities was lower in 2011 primarily, due to $630 million in long-term debt repayments in the first nine months of 2011, compared with $1.7 billion in the first nine months of 2010. In addition, the Finance group received $295 million in proceeds from the issuance of long-term debt in the first nine months of 2011, largely related to financing under our credit facilities with the Export-Import Bank of the United States and the Export Development Canada Bank, compared with $47 million in the corresponding period of 2010.

TFC borrowed a net amount of $275 million from Textron Inc. with interest in the first nine months of 2011 to pay down maturing debt. As of October 1, 2011 and January 1, 2011, the outstanding balance due to Textron Inc. for these borrowings was $590 million and $315 million, respectively.

**Consolidated Cash Flows**

The consolidated cash flows from continuing operations, after elimination of activity between the borrowing groups, are summarized below:

| | Nine Months Ended | |
|---|---|---|
| *(In millions)* | **October 1, 2011** | **October 2, 2010** |
| Operating activities | $ 663 | $ 767 |
| Investing activities | 648 | 1,338 |
| Financing activities | (700) | (2,997) |

Operating activities generated less cash in 2011 compared with the corresponding period of 2010, primarily due to $254 million related to captive financing, which had lower cash receipts from customers and sales of receivables net of originations, and $169 million in higher pension contributions, which offset higher earnings for the Manufacturing group and $108 million in tax refunds received in 2011.

Cash receipts from the collection of finance receivables continued to outpace finance receivable originations, which was a significant factor in the net cash inflow from investing activities in both 2011 and 2010. Finance receivables repaid and proceeds from sales totaled $941 million and $1.8 billion in the first nine months of 2011 and 2010, respectively, while cash outflows for originations declined to $149 million and $378 million, respectively. These decreases were largely driven by the wind down of the non-captive finance receivable portfolio. We also used more cash for investing activities due to higher capital expenditures, which totaled $271 million and $134 million in the first nine months of 2011 and 2010, respectively.

Cash used for financing activities was lower in 2011 primarily due to $1.2 billion in lower repayments of long-term debt, which totaled $643 million in the first nine months of 2011, compared with $1.9 billion in the first nine months of 2010. In addition, we received proceeds of $791 million in 2011 from the issuance of debt, compared with $47 million in 2010. In the first nine months of 2011, we also began to issue commercial paper again for our short-term financing needs, which provided for an additional $227 million in net proceeds.

**Captive Financing and Other Intercompany Transactions**

The Finance group finances retail purchases and leases for new and used aircraft and equipment in support of our Manufacturing group, otherwise known as captive financing. In the Consolidated Statements of Cash Flows, cash received from customers or from securitizations is reflected as operating activities when received from third parties. However, in the cash flow information provided for the separate borrowing groups, cash flows related to captive financing activities are reflected based on the operations of each group. For example, when product is sold by our Manufacturing group to a customer and is financed by the Finance group, the origination of the finance receivable is recorded within investing activities as a cash outflow in the Finance group s statement of cash flows. Meanwhile, in the Manufacturing group s statement of cash flows, the cash received from the Finance group on the customer s behalf

is recorded within operating cash flows as a cash inflow. Although cash is transferred between the two borrowing groups, there is no cash transaction reported in the consolidated cash flows at the time of the original financing. These captive financing activities, along with all significant intercompany transactions, are reclassified or eliminated from the Consolidated Statements of Cash Flows.

Table of Contents

Reclassification and elimination adjustments included in the Consolidated Statement of Cash Flows are summarized below:

| *(In millions)* | Nine Months Ended October 1, 2011 | October 2, 2010 |
|---|---|---|
| Reclassifications from investing activities: | | |
| Finance receivable originations for Manufacturing group inventory sales | $ (194) | $ (284) |
| Cash received from customers and sale of receivables | 343 | 687 |
| Other capital contributions made to Finance group | (40) | |
| Other | | (25) |
| Total reclassifications from investing activities | 109 | 378 |
| Reclassifications from financing activities: | | |
| Capital contribution paid by Manufacturing group to Finance group under Support Agreement | 152 | 228 |
| Dividends received by Manufacturing group from Finance group | (179) | (355) |
| Other capital contributions paid to Finance group | 40 | 30 |
| Other | | (13) |
| Total reclassifications from financing activities | 13 | (110) |
| Total reclassifications and adjustments to cash flow from operating activities | $ 122 | $ 268 |

**Forward-Looking Information**

Certain statements in this Quarterly Report on Form 10-Q and other oral and written statements made by us from time to time are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, which may describe strategies, goals, outlook or other non-historical matters, or project revenues, income, returns or other financial measures, often include words such as believe, expect, anticipate, intend , plan, estimate, guidance , project , target , potential , will , should , could , likely or may intended to identify forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update or revise any forward-looking statements. In addition to those factors described herein under RISK FACTORS, among the factors that could cause actual results to differ materially from past and projected future results are the following:

- Changing priorities or reductions in the U.S. Government defense budget, including those related to military operations in foreign countries;
- Changes in worldwide economic or political conditions that impact demand for our products, interest rates or foreign exchange rates;
- Our ability to perform as anticipated and to control costs under contracts with the U.S. Government;
- The U.S. Government s ability to unilaterally modify or terminate its contracts with us for the U.S. Government s convenience or for our failure to perform, to change applicable procurement and accounting policies, or, under certain circumstances, to withhold payment or suspend or debar us as a contractor eligible to receive future contract awards;

Changes in foreign military funding priorities or budget constraints and determinations, or changes in government regulations or policies on the export and import of military and commercial products;
Our Finance segment s ability to maintain portfolio credit quality or to realize full value of receivables and of assets acquired upon foreclosure of receivables;
Textron Financial Corporation s ( TFC ) ability to maintain certain minimum levels of financial performance required under Textron s support agreement with TFC;
Our ability to access the capital markets at reasonable rates;
Performance issues with key suppliers, subcontractors or business partners;
Legislative or regulatory actions impacting our operations or demand for our products;
Our ability to control costs and successfully implement various cost-reduction activities;
The efficacy of research and development investments to develop new products or unanticipated expenses in connection with the launching of significant new products or programs;
The timing of our new product launches or certifications of our new aircraft products;

Our ability to keep pace with our competitors in the introduction of new products and upgrades with features and technologies desired by our customers;

- The extent to which we are able to pass raw material price increases through to customers or offset such price increases by reducing other costs;
- Increases in pension expenses or employee and retiree medical benefits;
- Uncertainty in estimating reserves, including reserves established to address contingent liabilities, unrecognized tax benefits, or potential losses on TFC s receivables;
- Difficult conditions in the financial markets which may adversely impact our customers ability to fund or finance purchases of our products; and
- Continued volatility in the economy resulting in a prolonged downturn in the markets in which we do business.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no significant change in our exposure to market risk during the nine months ended October 1, 2011. For discussion of our exposure to market risk, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk contained in Textron s 2010 Annual Report on Form 10-K.

## Item 4. CONTROLS AND PROCEDURES

We have carried out an evaluation, under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer (CEO) and our Executive Vice President and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Act)) as of the end of the fiscal quarter covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the fiscal quarter ended October 1, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

# PART II. OTHER INFORMATION

## Item 1. LEGAL PROCEEDINGS

As previously reported in Textron s Annual Report on Form 10-K for the fiscal year ended January 2, 2010, on August 13, 2009, a purported shareholder class action lawsuit was filed in the United States District Court in Rhode Island against Textron, its then Chairman and former Chief Executive Officer and its former Chief Financial Officer. The suit, filed by the City of Roseville Employees Retirement System, alleged that the defendants violated the federal securities laws by making material misrepresentations or omissions related to Cessna and Textron Financial Corporation (TFC). The complaint sought unspecified compensatory damages. In December 2009, the Automotive Industries Pension Trust Fund was appointed lead plaintiff in the case. On February 8, 2010, an amended class action complaint was filed with the Court. The amended complaint named as additional defendants TFC and three of its present and former officers. On April 6, 2010, the court entered a stipulation agreed to by the parties in which plaintiffs voluntarily dismissed, without prejudice, certain causes of action in the amended complaint. On April 9, 2010, all defendants moved to dismiss the remaining counts of the amended complaint, and on August 24, 2011, the Court granted the motion to dismiss on behalf of all defendants without leave to amend and entered judgment in favor of all defendants. On September 23, 2011, plaintiffs filed a notice of appeal of the dismissal with the First Circuit Court of Appeals, which is currently pending.

As previously reported in Textron s Annual Report on Form 10-K for the fiscal year ended January 2, 2010, on August 21, 2009, a purported class action lawsuit was filed in the United States District Court in Rhode Island by Dianne Leach, an alleged participant in the Textron Savings Plan. Six additional substantially similar class action lawsuits were subsequently filed by other individuals. The complaints varyingly name Textron and certain present and former employees, officers and directors as defendants. These lawsuits allege that the defendants violated the United States Employee Retirement Income Security Act (ERISA) by imprudently permitting participants in the Textron Savings Plan to invest in Textron common stock. The complaints seek equitable relief and unspecified compensatory damages. On February 2, 2010, an amended class action complaint was filed consolidating the seven previous lawsuits into a single complaint. On March 19, 2010, all defendants moved to dismiss the consolidated amended complaint,

and on September 6, 2011, the Court granted the motion to dismiss in part and denied the motion in part. Specifically, the Court ruled that plaintiffs failed to plead sufficient allegations to support any claim that defendants made material misrepresentations that would be actionable under ERISA, but permitted the

remainder of the Amended Complaint to survive the pleadings stage. On September 20, 2011, all defendants moved for partial reconsideration of the Court s decision not to dismiss the Amended Complaint. The motion for reconsideration is still pending.

As previously reported in Textron s Annual Report on Form 10-K for the fiscal year ended January 2, 2010, on November 18, 2009, a purported derivative lawsuit was filed by John D. Walker in the United States District Court of Rhode Island against certain present and former officers and directors of Textron. The suit alleged violations of the federal securities laws consistent with the Roseville action described above, as well as breach of fiduciary duties, waste of corporate assets and unjust enrichment. On February 16, 2010, all defendants moved to dismiss the derivative complaint, and on September 13, 2011, the Court granted the motion to dismiss on behalf of all defendants without leave to amend and entered judgment in favor of all defendants.

Textron believes that these lawsuits are without merit and intends to defend them vigorously.

**Item 6. EXHIBITS**

| | |
|---|---|
| 12.1 | Computation of ratio of income to fixed charges of Textron Inc. Manufacturing Group |
| 12.2 | Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101 | The following materials from Textron Inc. s Quarterly Report on Form 10-Q for the quarterly period ended October 1, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows and (iv) Notes to the Consolidated Financial Statements. |

SIGNATURES

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

| | |
|---|---|
| | TEXTRON INC. |
| Date: October 28, 2011 | /s/ Richard L. Yates |
| | Richard L. Yates<br>Senior Vice President and Corporate Controller<br>(principal accounting officer) |

**Table of Contents**

## LIST OF EXHIBITS

12.1 Computation of ratio of income to fixed charges of Textron Inc. Manufacturing Group

12.2 Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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