TEXTRON INC
Form 10-Q
April 26, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

**(Mark One)**

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

**For the quarterly period ended March 31, 2012**

**OR**

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

**For the transition period from to .**

**Commission File Number 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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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 x | Accelerated filer ¨ |
| Non-accelerated filer ¨ | Smaller reporting company ¨ |

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

As of April 14, 2012, there were 280,281,049 shares of common stock outstanding.

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**TEXTRON INC.**

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## PART I. FINANCIAL INFORMATION

**Item 1. FINANCIAL STATEMENTS**

### TEXTRON INC.

### Consolidated Statements of Operations (Unaudited)

| *(In millions, except per share amounts)* | Three Months Ended March 31 2012 | April 2, 2011 |
|---|---|---|
| **Revenues** | | |
| Manufacturing revenues | $ 2,795 | $ 2,453 |
| Finance revenues | 61 | 26 |
| Total revenues | 2,856 | 2,479 |
| **Costs, expenses and other** | | |
| Cost of sales | 2,312 | 2,055 |
| Selling and administrative expense | 308 | 304 |
| Provision for losses on finance receivables | 4 | 12 |
| Interest expense | 55 | 62 |
| Total costs, expenses and other | 2,679 | 2,433 |
| Income from continuing operations before income taxes | 177 | 46 |
| Income tax expense | 57 | 15 |
| **Income from continuing operations** | 120 | 31 |
| Loss from discontinued operations, net of income taxes | (2) | (2) |
| **Net income** | $ 118 | $ 29 |
| **Basic earnings per share** | | |
| Continuing operations | $ 0.43 | $ 0.11 |
| Discontinued operations | (0.01) | (0.01) |
| **Basic earnings per share** | $ 0.42 | $ 0.10 |
| **Diluted earnings per share** | | |
| Continuing operations | $ 0.41 | $ 0.10 |
| Discontinued operations | (0.01) | (0.01) |
| **Diluted earnings per share** | $ 0.40 | $ 0.09 |
| **Dividends per share** | | |
| Common stock | $ 0.02 | $ 0.02 |

*See Notes to the consolidated financial statements.*

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**TEXTRON INC.**

**Consolidated Statements of Comprehensive Income (Unaudited)**

| *(In millions)* | Three Months Ended March 31, 2012 | Three Months Ended April 2, 2011 |
|---|---|---|
| Net income | $ 118 | $ 29 |
| Other comprehensive income, net of tax: | | |
| Recognition of prior service cost and unrealized losses on pension and postretirement benefits | 21 | 18 |
| Deferred gains on hedge contracts | 6 | 6 |
| Foreign currency translation and other | (3) | 12 |
| Other comprehensive income | 24 | 36 |
| Comprehensive income | $ 142 | $ 65 |

*See Notes to the consolidated financial statements.*

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**TEXTRON INC.**

**Consolidated Balance Sheets (Unaudited)**

| *(Dollars in millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| **Assets** | | |
| **Manufacturing group** | | |
| Cash and equivalents | $ 628 | $ 871 |
| Accounts receivable, net | 937 | 856 |
| Inventories | 2,593 | 2,402 |
| Other current assets | 1,032 | 1,134 |
| **Total current assets** | 5,190 | 5,263 |
| Property, plant and equipment, less accumulated depreciation and amortization of $3,180 and $3,097 | 2,003 | 1,996 |
| Goodwill | 1,639 | 1,635 |
| Other assets | 1,502 | 1,508 |
| **Total Manufacturing group assets** | 10,334 | 10,402 |
| **Finance group** | | |
| Cash and equivalents | 18 | 14 |
| Finance receivables held for investment, net | 2,174 | 2,321 |
| Finance receivables held for sale | 318 | 418 |
| Other assets | 436 | 460 |
| **Total Finance group assets** | 2,946 | 3,213 |
| **Total assets** | $ 13,280 | $ 13,615 |
| **Liabilities and shareholders equity** | | |
| **Liabilities** | | |
| **Manufacturing group** | | |
| Current portion of long-term debt | $ 464 | $ 146 |
| Accounts payable | 884 | 833 |
| Accrued liabilities | 1,823 | 1,952 |
| **Total current liabilities** | 3,171 | 2,931 |
| Other liabilities | 2,657 | 2,826 |
| Long-term debt | 2,013 | 2,313 |
| **Total Manufacturing group liabilities** | 7,841 | 8,070 |
| **Finance group** | | |
| Other liabilities | 193 | 333 |
| Due to Manufacturing group | 494 | 493 |
| Debt | 1,837 | 1,974 |

| | | |
|---|---|---|
| **Total Finance group liabilities** | 2,524 | 2,800 |
| **Total liabilities** | 10,365 | 10,870 |
| **Shareholders equity** | | |
| Common stock | 35 | 35 |
| Capital surplus | 1,114 | 1,081 |
| Retained earnings | 3,370 | 3,257 |
| Accumulated other comprehensive loss | (1,601) | (1,625) |
| | 2,918 | 2,748 |
| Less cost of treasury shares | 3 | 3 |
| **Total shareholders equity** | 2,915 | 2,745 |
| **Total liabilities and shareholders equity** | $ 13,280 | $ 13,615 |
| **Common shares outstanding** *(in thousands)* | 280,165 | 278,873 |

*See Notes to the consolidated financial statements.*

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**TEXTRON INC.**

**Consolidated Statements of Cash Flows (Unaudited)**

For the Three Months Ended March 31, 2012 and April 2, 2011, respectively

| *(In millions)* | Consolidated 2012 | 2011 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 118 | $ 29 |
| Less: Loss from discontinued operations | (2) | (2) |
| Income from continuing operations | 120 | 31 |
| Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities: | | |
| Non-cash items: | | |
| Depreciation and amortization | 91 | 95 |
| Provision for losses on finance receivables held for investment | 4 | 12 |
| Portfolio losses on finance receivables | 20 | 23 |
| Deferred income taxes | 62 | 79 |
| Other, net | 2 | 21 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (76) | (4) |
| Inventories | (187) | (166) |
| Other assets | (11) | 2 |
| Accounts payable | 48 | 119 |
| Accrued and other liabilities | (368) | (229) |
| Captive finance receivables, net | 42 | 72 |
| Net cash provided by (used in) operating activities of continuing operations | (253) | 55 |
| Net cash used in operating activities of discontinued operations | (1) | (1) |
| Net cash provided by (used in) operating activities | (254) | 54 |
| **Cash flows from investing activities:** | | |
| Finance receivables originated or purchased | (18) | (76) |
| Finance receivables repaid | 154 | 290 |
| Proceeds on receivable sales | 44 | 168 |
| Capital expenditures | (73) | (78) |
| Proceeds from sale of repossessed assets and properties | 18 | 28 |
| Other investing activities, net | (2) | 23 |
| Net cash provided by investing activities | 123 | 355 |
| **Cash flows from financing activities:** | | |
| Increase in short-term debt | | 203 |
| Payments on long-term lines of credit | | (250) |
| Principal payments on long-term and nonrecourse debt | (144) | (417) |
| Proceeds from issuance of long-term debt | 27 | 144 |
| Dividends paid | (5) | (5) |
| Other financing activities, net | 10 | (2) |
| Net cash used in financing activities | (112) | (327) |
| Effect of exchange rate changes on cash and equivalents | 4 | 9 |

| | | |
|---|---|---|
| **Net increase (decrease) in cash and equivalents** | (239) | 91 |
| Cash and equivalents at beginning of period | 885 | 931 |
| Cash and equivalents at end of period | $ 646 | $ 1,022 |

*See Notes to the consolidated financial statements*

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**TEXTRON INC.**

**Consolidated Statements of Cash Flows (Unaudited) (Continued)**

For the Three Months Ended March 31, 2012 and April 2, 2011, respectively

| *(In millions)* | Manufacturing Group 2012 | Manufacturing Group 2011 | Finance Group 2012 | Finance Group 2011 |
|---|---|---|---|---|
| **Cash flows from operating activities:** | | | | |
| Net income (loss) | $ 108 | $ 60 | $ 10 | $ (31) |
| Less: Loss from discontinued operations | (2) | (2) | | |
| Income (loss) from continuing operations | 110 | 62 | 10 | (31) |
| Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used in) operating activities: | | | | |
| Dividends received from Finance Group | 240 | 130 | | |
| Capital contribution paid to Finance Group | (240) | (63) | | |
| Non-cash items: | | | | |
| Depreciation and amortization | 84 | 87 | 7 | 8 |
| Provision for losses on finance receivables held for investment | | | 4 | 12 |
| Portfolio losses on finance receivables | | | 20 | 23 |
| Deferred income taxes | 58 | 66 | 4 | 13 |
| Other, net | 26 | 32 | (24) | (11) |
| Changes in assets and liabilities: | | | | |
| Accounts receivable, net | (76) | (4) | | |
| Inventories | (188) | (169) | | |
| Other assets | (9) | (1) | (2) | |
| Accounts payable | 48 | 119 | | |
| Accrued and other liabilities | (230) | (186) | (138) | (43) |
| Net cash provided by (used in) operating activities of continuing operations | (177) | 73 | (119) | (29) |
| Net cash used in operating activities of discontinued operations | (1) | (1) | | |
| Net cash provided by (used in) operating activities | (178) | 72 | (119) | (29) |
| **Cash flows from investing activities:** | | | | |
| Finance receivables originated or purchased | | | (84) | (125) |
| Finance receivables repaid | | | 262 | 411 |
| Proceeds on receivable sales | | | 44 | 168 |
| Capital expenditures | (73) | (78) | | |
| Proceeds from sale of repossessed assets and properties | | | 18 | 28 |
| Other investing activities, net | | (43) | (1) | 31 |
| Net cash provided by (used in) investing activities | (73) | (121) | 239 | 513 |
| **Cash flows from financing activities:** | | | | |
| Increase in short-term debt | | 203 | | |
| Payments on long-term lines of credit | | | | (250) |
| Intergroup financing | | (60) | | 60 |
| Principal payments on long-term and nonrecourse debt | | (7) | (144) | (410) |
| Proceeds from issuance of long-term debt | | | 27 | 144 |
| Capital contributions paid to Finance group under Support Agreement | | | 240 | 63 |
| Other capital contributions paid to Finance group | | | | 40 |
| Dividends paid | (5) | (5) | (240) | (130) |

| | | | | |
|---|---|---|---|---|
| Other financing activities, net | 9 | (2) | 1 | 1 |
| Net cash provided by (used in) financing activities | 4 | 129 | (116) | (482) |
| Effect of exchange rate changes on cash and equivalents | 4 | 8 | | 1 |
| **Net increase (decrease) in cash and equivalents** | (243) | 88 | 4 | 3 |
| Cash and equivalents at beginning of period | 871 | 898 | 14 | 33 |
| Cash and equivalents at end of period | $ 628 | $ 986 | $ 18 | $ 36 |

*See Notes to the consolidated financial statements.*

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**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 December 31, 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.

*Use of Estimates*

We prepare our financial statements in conformity with generally accepted accounting principles, which require us to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Our estimates and assumptions are reviewed periodically, and the effects of changes, if any, are reflected in the Consolidated Statements of Operations in the period that they are determined.

During the first quarter 2012 and 2011, we changed our estimates of revenues and costs on certain long-term contracts that are accounted for under the percentage-of-completion method of accounting. The changes in estimates increased income from continuing operations before income taxes in the first quarter of 2012 and 2011 by $4 million and $14 million, respectively, ($2 million and $8 million after tax, or $0.01 and $0.03 per diluted share, respectively). For the first quarter of 2012 and 2011, the gross favorable program profit adjustments totaled $17 million and $21 million, respectively, and the gross unfavorable program profit adjustments totaled $13 million and $7 million, respectively.

**Note 2: 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)* | **March 31, 2012** | **April 2, 2011** | **March 31, 2012** | **April 2, 2011** |
| **Three Months Ended** | | | | |
| Service cost | $ 30 | $ 32 | $ 2 | $ 2 |
| Interest cost | 76 | 82 | 6 | 8 |
| Expected return on plan assets | (101) | (98) | | |
| Amortization of prior service cost (credit) | 4 | 4 | (3) | (1) |

| | | | | |
|---|---|---|---|---|
| Amortization of net loss | 29 | 19 | 2 | 3 |
| Net periodic benefit cost | $ 38 | $ 39 | $ 7 | $ 12 |

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**Note 3: Share-Based Compensation**

Share-based compensation expense includes restricted stock, restricted stock units, stock options, stock appreciation rights, performance share units and deferred income plan stock unit awards. The compensation expense we recorded in net income for our share-based compensation plans is as follows:

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| Compensation expense | $ 46 | $ 36 |
| Income tax benefit | (17) | (13) |
| Total net compensation cost included in net income | $ 29 | $ 23 |

*Stock Options*

The stock option compensation cost calculated under the fair value approach is recognized over the vesting period of the stock options. The weighted-average fair value of options granted per share was $10 in both the first quarter of 2012 and 2011. We estimate the fair value of options granted on the date of grant using the Black-Scholes option-pricing model. Expected volatilities are based on implied volatilities from traded options on our common stock, historical volatilities and other factors. We use historical data to estimate option exercise behavior, adjusted to reflect anticipated changes in expected life. The weighted-average assumptions used in our Black-Scholes option-pricing model for awards issued during the respective periods are as follows:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2012** | **April 2, 2011** |
| Dividend yield | 0.3% | 0.3% |
| Expected volatility | 40.0% | 38.0% |
| Risk-free interest rate | 0.8% | 2.4% |
| Expected lives *(in years)* | 5.5 | 5.5 |

At March 31, 2012, our outstanding and exercisable options had an aggregate intrinsic value of $33 million and $26 million, respectively. Stock option activity for the first quarter of 2012 is as follows:

| | **Number of Options** *(In thousands)* | **Weighted-Average Exercise Price** | **Weighted-Average Remaining Contractual Life** *(In years)* |
|---|---|---|---|
| Outstanding at beginning of period | 8,860 | $ 27.68 | 6 |
| Granted | 3,008 | 27.76 | |
| Exercised | (594) | (18.70) | |
| Canceled, expired or forfeited | (396) | (27.96) | |
| Outstanding at end of period | 10,878 | $ 28.18 | 7 |

| | | | |
|---|---|---|---|
| Exercisable at end of period | 5,513 | $ 29.36 | 5 |

*Restricted Stock Units*

The 2012 activity for restricted stock units payable in stock and for restricted stock units payable in cash is provided below:

| | Units Payable in Stock | | Units Payable in Cash | |
|---|---|---|---|---|
| *(Shares in thousands)* | Number of Shares | Weighted-Average Grant Date Fair Value | Number of Shares | Weighted-Average Grant Date Fair Value |
| Outstanding at beginning of year, nonvested | 638 | $ 35.53 | 2,927 | $ 17.33 |
| Granted | 367 | 27.54 | 808 | 27.74 |
| Vested | (218) | (37.89) | (801) | (15.00) |
| Forfeited | (13) | (33.19) | (73) | (19.24) |
| Outstanding at end of period, nonvested | 774 | $ 31.12 | 2,861 | $ 20.88 |

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*Performance Share Units*

The fair value of share-based compensation awards accounted for as liabilities includes performance share units. The fair value of these awards is based on the trading price of our common stock, less adjustments to reflect that dividends are not paid on these awards, and is remeasured at each reporting period date. The 2012 activity for our performance share units is as follows:

| *(Shares in thousands)* | Number of Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Outstanding at beginning of year, nonvested | 859 | $ 22.98 |
| Granted | 535 | 27.76 |
| Forfeited | (53) | (22.62) |
| Outstanding at end of period, nonvested | 1,341 | $ 24.90 |

*Share-Based Compensation Awards*

The value of the share-based compensation awards that vested and/or were paid during the respective periods is as follows:

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | March 31, 2012 | April 2, 2011 |
| Subject only to service conditions: | | |
| Value of awards vested | $ 30 | $ 34 |
| Intrinsic value of cash awards paid | 21 | 20 |
| Subject to performance conditions: | | |
| Intrinsic value of cash awards paid | 51 | 1 |

**Note 4: 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 EPS 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 EPS 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 call options purchased in connection with the issuance of the convertible notes and the capped call transaction entered into in 2011 are excluded from the calculation of diluted EPS as their impact is always anti-dilutive.

Upon conversion of our convertible notes, as described in Note 8 of our 2011 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.

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

| | Three Months Ended | |
|---|---|---|
| *(In thousands)* | March 31, 2012 | April 2, 2011 |
| Basic weighted-average shares outstanding | 280,022 | 276,358 |

| | | |
|---|---|---|
| Dilutive effect of: | | |
| Convertible notes and warrants | 13,902 | 41,504 |
| Stock options and restricted stock units | 708 | 1,257 |
| Diluted weighted-average shares outstanding | 294,632 | 319,119 |

Stock options to purchase 6 million and 4 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for the three months ended March 31, 2012 and April 2, 2011, respectively, 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.

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**Note 5: Accounts Receivable and Finance Receivables**

**Accounts Receivable**

Accounts receivable is composed of the following:

| *(In millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Commercial | $ 594 | $ 528 |
| U.S. Government contracts | 360 | 346 |
| | 954 | 874 |
| Allowance for doubtful accounts | (17) | (18) |
| | $ 937 | $ 856 |

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 $197 million at March 31, 2012 and $192 million at December 31, 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:

| *(In millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Aviation | $ 1,788 | $ 1,876 |
| Golf Equipment | 61 | 69 |
| Golf Mortgage | 314 | 381 |
| Timeshare | 260 | 318 |
| Structured Capital | 171 | 208 |
| Other liquidating | 34 | 43 |
| Total finance receivables | 2,628 | 2,895 |
| Less: Allowance for losses | 136 | 156 |
| Less: Finance receivables held for sale | 318 | 418 |
| Total finance receivables held for investment, net | $ 2,174 | $ 2,321 |

*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 estimated collateral value, the liquidity position of individual borrowers and guarantors 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 once they 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.

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

| | March 31, 2012 | | | | December 31, 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| *(In millions)* | Performing | Watchlist | Nonaccrual | Total | Performing | Watchlist | Nonaccrual | Total |
| Aviation | $ 1,465 | $ 221 | $ 102 | $ 1,788 | $ 1,537 | $ 214 | $ 125 | $ 1,876 |
| Golf Equipment | 20 | 33 | 8 | 61 | 21 | 37 | 11 | 69 |
| Timeshare | 87 | 4 | 165 | 256 | 89 | 25 | 167 | 281 |
| Structured Capital | 166 | 5 | | 171 | 203 | 5 | | 208 |
| Other liquidating | 19 | | 15 | 34 | 25 | | 18 | 43 |
| Total | $ 1,757 | $ 263 | $ 290 | $ 2,310 | $ 1,875 | $ 281 | $ 321 | $ 2,477 |
| % of Total | 76.0% | 11.4% | 12.6% | | 75.7% | 11.3% | 13.0% | |

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 are summarized in the table below:

| | March 31, 2012 | | | | | December 31, 2011 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(In millions)* | Less Than 31 Days Past Due | 31-60 Days Past Due | 61-90 Days Past Due | Over 90 Days Past Due | Total | Less Than 31 Days Past Due | 31-60 Days Past Due | 61-90 Days Past Due | Over 90 Days Past Due | Total |
| Aviation | $ 1,606 | $ 96 | $ 19 | $ 67 | $ 1,788 | $ 1,705 | $ 66 | $ 37 | $ 68 | $ 1,876 |
| Golf Equipment | 52 | 1 | 3 | 5 | 61 | 53 | 3 | 6 | 7 | 69 |
| Timeshare | 199 | 16 | 3 | 38 | 256 | 238 | 3 | | 40 | 281 |
| Structured Capital | 171 | | | | 171 | 208 | | | | 208 |
| Other liquidating | 26 | | | 8 | 34 | 35 | | | 8 | 43 |
| Total | $ 2,054 | $ 113 | $ 25 | $ 118 | $ 2,310 | $ 2,239 | $ 72 | $ 43 | $ 123 | $ 2,477 |

We had no accrual status loans that were greater than 90 days past due at March 31, 2012 or at December 31, 2011. At March 31, 2012, the 60+ days contractual delinquency as a percentage of finance receivables held for investment was 6.19%, compared with 6.70% at December 31, 2011.

*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. 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. The changes effected by modifications made during the first quarter of 2012 to finance receivables held for investment were not material, primarily as a result of the reclassification of the Golf Mortgage finance receivables from the held for investment classification to the held for sale classification at December 31, 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 quarter of 2012 or 2011.

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A summary of impaired finance receivables, excluding leveraged leases, is provided below:

| *(In millions)* | Recorded Investment: Impaired Loans with No Related Allowance for Credit Losses | Recorded Investment: Impaired Loans with Related Allowance for Credit Losses | Total Impaired Loans | Unpaid Principal Balance | Allowance For Losses On Impaired Loans | Average Recorded Investment |
|---|---|---|---|---|---|---|
| **March 31, 2012** | | | | | | |
| Aviation | $ 39 | $ 70 | $ 109 | $ 113 | $ 21 | $ 124 |
| Golf Equipment | | 2 | 2 | 2 | 1 | 2 |
| Timeshare | 122 | 78 | 200 | 250 | 42 | 213 |
| Other liquidating | 1 | 12 | 13 | 24 | 9 | 15 |
| Total | $ 162 | $ 162 | $ 324 | $ 389 | $ 73 | $ 354 |
| **December 31, 2011** | | | | | | |
| Aviation | $ 47 | $ 92 | $ 139 | $ 142 | $ 39 | $ 146 |
| Timeshare | 170 | 57 | 227 | 288 | 38 | 315 |
| Golf Mortgage | | | | | | 232 |
| Other liquidating | 3 | 12 | 15 | 59 | 9 | 30 |
| Total | $ 220 | $ 161 | $ 381 | $ 489 | $ 86 | $ 723 |

*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 of the underlying collateral, 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.

The evaluation of our portfolios is inherently subjective, as it requires estimates, including the amount and timing of future cash flows expected to be received on impaired finance receivables and the estimated fair value of the underlying collateral, which may differ from actual results. While our analysis is specific to each individual account, critical factors included in this analysis vary by product line and include the following:

*Aviation* - industry valuation guides, physical condition of the aircraft, payment history, and existence and financial strength of guarantors.

*Golf Equipment* - age and condition of the collateral.

*Timeshare* - 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 Aviation and Golf Equipment, 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, such as Timeshare, the allowance is established as a percentage of watchlist balances, as defined on page 11, which represents a combination of assumed default likelihood and loss severity based on historical experience, industry trends and collateral values. In estimating our allowance for losses to cover accounts not specifically identified, critical factors vary by product line and include the following:

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*Aviation* - the collateral value of the portfolio, historical default experience and delinquency trends.

*Golf Equipment* - historical loss experience and delinquency trends.

*Timeshare* - 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 when the collateral is repossessed and are charged off when the remaining balance is deemed to be uncollectible.

A rollforward of the allowances for losses on finance receivables held for investment is provided below:

| *(In millions)* | Aviation | Golf Equipment | Golf Mortgage | Timeshare | Other Liquidating | Total |
|---|---|---|---|---|---|---|
| **For the three months ended March 31, 2012** | | | | | | |
| Beginning balance | $ 95 | $ 6 | $ | $ 40 | $ 15 | $ 156 |
| Provision for losses | 2 | | | 3 | (1) | 4 |
| Net charge-offs | (23) | | | (1) | | (24) |
| Ending balance | $ 74 | $ 6 | $ | $ 42 | $ 14 | $ 136 |
| **For the three months ended April 2, 2011** | | | | | | |
| Beginning balance | $ 107 | $ 16 | $ 79 | $ 106 | $ 34 | $ 342 |
| Provision for losses | 11 | | (1) | | 2 | 12 |
| Net charge-offs and transfers | (8) | (3) | (3) | (1) | (1) | (16) |
| Ending balance | $ 110 | $ 13 | $ 75 | $ 105 | $ 35 | $ 338 |

A summary of the allowance for losses on finance receivables that are evaluated on an individual and on a collective basis is provided below. The finance receivables reported in this table specifically exclude $171 million and $279 million of leveraged leases at March 31, 2012 and April 2, 2011, respectively, in accordance with authoritative accounting standards.

| | March 31, 2012 | | | | April 2, 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Finance Receivables Evaluated | | Allowance Based on Individual Evaluation | Allowance Based on Collective Evaluation | Finance Receivables Evaluated | | Allowance Based on Individual Evaluation | Allowance Based on Collective Evaluation |
| *(In millions)* | Individually | Collectively | | | Individually | Collectively | | |
| Aviation | $ 109 | $ 1,679 | $ 21 | $ 53 | $ 164 | $ 1,864 | $ 50 | $ 60 |
| Golf Equipment | 2 | 59 | 1 | 5 | 6 | 186 | 1 | 12 |
| Timeshare | 200 | 56 | 42 | | 368 | 195 | 102 | 3 |
| Golf Mortgage | | | | | 299 | 341 | 45 | 30 |
| Other liquidating | 13 | 21 | 9 | 5 | 38 | 164 | 4 | 31 |
| Total | $ 324 | $ 1,815 | $ 73 | $ 63 | $ 875 | $ 2,750 | $ 202 | $ 136 |

**Note 6: Inventories**

| *(In millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Finished goods | $ 1,210 | $ 1,012 |
| Work in process | 2,233 | 2,202 |
| Raw materials | 418 | 399 |
| | 3,861 | 3,613 |
| Progress/milestone payments | (1,268) | (1,211) |
| | $ 2,593 | $ 2,402 |

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**Note 7: Debt**

At March 31, 2012, the principal amount of our convertible senior notes was $215 million. Our common stock price exceeded the $17.06 per share conversion threshold price set forth for these convertible notes for at least 20 trading days during the 30 consecutive trading days ended March 31, 2012. Accordingly, these notes are convertible at the holder s option through June 30, 2012. We may deliver shares of common stock, cash or a combination of cash and shares of common stock in satisfaction of our obligations upon conversion of the convertible notes. Based on a March 31, 2012 stock price of $27.83, the if converted value exceeds the face amount of the remaining notes by $241 million; however, after giving effect to the exercise of the related outstanding call options and warrants, the incremental cash or share settlement in excess of the face amount would result in either a 7 million net share issuance or a cash payment of $198 million, or a combination of cash and stock, at our option.

**Note 8: 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:

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| Accrual at the beginning of period | $ 224 | $ 242 |
| Provision | 63 | 57 |
| Settlements | (65) | (64) |
| Adjustments to prior accrual estimates | (3) | (6) |
| Accrual at the end of period | $ 219 | $ 229 |

**Note 9: 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.

On February 7, 2012, a lawsuit was filed in the United States Bankruptcy Court, Northern District of Ohio, Eastern Division (Akron) by Brian A. Bash, Chapter 7 Trustee for Fair Finance Company against TFC, Fortress Credit Corp. and Fair Facility I, LLC. TFC provided a revolving line of credit of up to $17.5 million to Fair Finance Company from 2002 through 2007. The complaint alleges numerous counts against TFC, as Fair Finance Company s working capital lender, including receipt of fraudulent transfers and assisting in fraud perpetrated on Fair Finance investors. The Trustee seeks avoidance and recovery of alleged fraudulent transfers in the amount of $316 million as well as damages of $223 million on the other claims. The Trustee also seeks trebled damages on all claims under Ohio law. We are in the process of reviewing the complaint and assessing these claims. We intend to vigorously defend this lawsuit. An estimate of a range of possible loss cannot be made at this time due to the early stage of the litigation.

**Note 10. 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

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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** | **March 31, 2012** | **December 31, 2011** |
| **Assets** | | | | |
| Interest rate exchange contracts* | Finance | Other assets | $ 19 | $ 22 |
| Foreign currency exchange contracts | Manufacturing | Other current assets | 13 | 9 |
| Total | | | $ 32 | $ 31 |
| **Liabilities** | | | | |
| Interest rate exchange contracts* | Finance | Other liabilities | $ (7) | $ (7) |
| Foreign currency exchange contracts | Manufacturing | Accrued liabilities | (4) | (5) |
| Total | | | $ (11) | $ (12) |

** 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 March 31, 2012. At March 31, 2012 and December 31, 2011, we had interest rate exchange contracts with notional amounts upon which the contracts were based of $805 million and $848 million, 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 March 31, 2012 and December 31, 2011, we had foreign currency exchange contracts with notional amounts upon which the contracts were based of $663 million and $645 million, respectively.

*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 quarter of 2012 and 2011.

*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 March 31, 2012, 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-month periods ended March 31, 2012 and April 2, 2011. 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.

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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 $12 million after-tax loss for the first quarter of 2012, resulting in an accumulated net gain balance of $6 million at March 31, 2012. The ineffective portion of these hedges was insignificant.

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

The assets that were measured at fair value on a nonrecurring basis that had fair value measurement adjustments during the first quarter of 2012 and 2011 are presented below. These assets are in the Finance group and were measured using significant unobservable inputs (Level 3).

| | Balance at | | Gain (Loss) Three Months Ended | |
|---|---|---|---|---|
| *(In millions)* | March 31, 2012 | April 2, 2011 | March 31, 2012 | April 2, 2011 |
| Finance receivables held for sale | $ 318 | $ 237 | $ 24 | $ (11) |
| Impaired finance receivables | 92 | 508 | (6) | (33) |
| Repossessed assets and properties | 74 | 54 | (16) | (6) |

*Finance Receivables Held for Sale* Finance receivables held for sale 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 these finance receivables. At March 31, 2012, our finance receivables held for sale primarily include the Golf Mortgage portfolio. Fair value of this portfolio was determined based on the use of discounted cash flow models to estimate the price we expect to receive in the principal market for each loan, or pool of similar loans, in an orderly transaction. The discount rates utilized in these models are derived from prevailing interest rate indices and are based on the nature of the assets, discussions with market participants and our experience in the actual disposition of similar assets. The cash flow models also include the use of qualitative assumptions regarding the borrower s ability to pay and the period of time that will likely be required to restructure and/or exit the account through acquisition of the underlying collateral. We utilize revenue multiples to determine the expected value of the loan collateral. The range of multiples used is based on bids from prospective buyers, inputs from market participants and prices at which sales have been transacted for similar properties.

Based on our qualitative assumptions, we separate the loans into three categories for the cash flow models. In the first category, we include loans that we assume will be paid in accordance with the contractual terms of the loan. In the second category, we include loans where we perceive that the borrower has less of an ability to pay, and we assume that the loan will be restructured and resolved typically over a period of one to four years. For the third category, we assume that the borrower will default on the loan and that it will be resolved within an average of 24 months. The fair values of these finance receivables are sensitive to variability in both the quantitative and qualitative assumptions. Changes in the borrower s ability to pay or the period of time required to restructure and/or exit accounts may significantly increase or decrease the fair value of these finance receivables, and, to a lesser extent, fluctuations in discount rates and/or revenue multiples could also change the fair value of these finance receivables.

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*Impaired Finance Receivables* Impaired nonaccrual finance receivables represent assets recorded at fair value on a nonrecurring basis since the measurement of required reserves on our impaired finance receivables is significantly dependent on the fair value of the underlying collateral. For our Aviation impaired nonaccrual finance receivables, fair values of collateral are determined based on the use of industry pricing guides. Our Timeshare impaired nonaccrual finance receivables largely consist of notes receivable loans to developers of resort properties which are collateralized by pools of consumer notes receivable. Fair values of collateral are estimated using cash flow models incorporating estimates of credit losses in the consumer notes pools and the developer s ability to mitigate losses through the repurchase or replacement of defaulted notes. Fair value measurements recorded on impaired finance receivables resulted in charges to provision for loan losses and primarily related to initial fair value adjustments.

*Repossessed assets and properties* Repossessed assets and properties in the table above primarily include both golf properties and aviation assets at March 31, 2012. The fair value of our golf properties is determined based on the use of discounted cash flow models, bids from prospective buyers or inputs from market participants. The fair value of our aviation assets is largely determined based on the use of industry pricing guides. If the carrying amount of these assets is higher than their estimated fair value, we record a corresponding charge to income for the difference.

**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:

| | March 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| *(In millions)* | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| **Manufacturing group** | | | | |
| Long-term debt, excluding leases | $ (2,348) | $ (2,757) | $ (2,328) | $ (2,561) |
| **Finance group** | | | | |
| Finance receivables held for investment, excluding leases | 1,890 | 1,819 | 1,997 | 1,848 |
| Debt | (1,837) | (1,778) | (1,974) | (1,854) |

Fair value for the Manufacturing group debt is determined using market observable data for similar transactions or Level 2 inputs. At March 31, 2012 and December 31, 2011, approximately 42% and 53%, respectively, of the fair value of term debt for the Finance group was determined based on observable market transactions (Level 1). 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 (Level 2). Fair value estimates for finance receivables held for investment were determined based on internally developed discounted cash flow models primarily utilizing significant unobservable inputs (Level 3), which include 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 expectations of borrowers ability to make payments on a timely basis.

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**Note 11: 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 | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| **REVENUES** | | |
| *Manufacturing group* | | |
| Cessna | $ 669 | $ 556 |
| Bell | 994 | 749 |
| Textron Systems | 377 | 445 |
| Industrial | 755 | 703 |
| | 2,795 | 2,453 |
| *Finance group* | 61 | 26 |
| Total revenues | $ 2,856 | $ 2,479 |
| **SEGMENT OPERATING PROFIT** | | |
| *Manufacturing group* | | |
| Cessna | $ (6) | $ (38) |
| Bell | 145 | 91 |
| Textron Systems | 35 | 53 |
| Industrial | 73 | 61 |
| | 247 | 167 |
| *Finance group* | 12 | (44) |
| Segment profit | 259 | 123 |
| Corporate expenses and other, net | (47) | (39) |
| Interest expense, net for Manufacturing group | (35) | (38) |
| Income from continuing operations before income taxes | $ 177 | $ 46 |

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

**Consolidated Results of Operations**

**Revenues**

| | Three Months Ended | |
|---|---|---|
| *(Dollars in millions)* | **March 31, 2012** | **April 2, 2011** |
| Revenues | $ 2,856 | $ 2,479 |
| % change compared with prior period | 15% | |

Revenues increased $377 million, 15%, in the first quarter of 2012, compared with the corresponding period of 2011. This increase was due to revenue increases in the Bell, Cessna, Industrial and Finance segments that were partially offset by lower revenues in the Textron Systems segment. The net revenue increase included the following factors:

Higher Bell revenues of $245 million, largely due to higher commercial aircraft volume and higher volume in our military programs, which included more deliveries of V-22 and H-1 aircraft.

Higher Cessna revenues of $113 million, primarily due to higher Citation jet volume.

Increased Industrial segment revenues of $52 million, primarily due to higher volume, mostly reflecting higher market demand in the Fuel Systems and Functional Components and Golf and Turf Care product lines.

Higher Finance revenues of $35 million as favorable adjustments, largely related to the non-captive business, offset a decline in revenues attributable to lower average finance receivables of $1.4 billion.

Lower Textron Systems revenues of $68 million, primarily due to $86 million in lower volume in the Unmanned Aircraft Systems (UAS), Mission Support and Other, and Land & Marine product lines, partially offset by higher volume in the Weapons and Sensors product line, largely due to higher international Sensor Fuzed Weapon volume.

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

| | Three Months Ended | |
|---|---|---|
| *(Dollars in millions)* | **March 31, 2012** | **April 2, 2011** |
| Operating expenses | $ 2,620 | $ 2,359 |
| % change compared with prior period | 11% | |
| Cost of sales | $ 2,312 | $ 2,055 |
| % change compared with prior period | 13% | |
| Gross margin percentage of Manufacturing revenues | 17.3% | 16.2% |
| Selling and administrative expenses | $ 308 | $ 304 |
| % change compared with prior period | 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.

Consolidated manufacturing cost of sales as a percentage of Manufacturing revenues was 82.7% and 83.8% in the first quarter of 2012 and 2011, respectively. On a dollar basis, consolidated manufacturing cost of sales increased $257 million, 13%, in the first quarter of 2012, compared with the first quarter of 2011, principally due to higher sales volume in the Bell, Cessna and Industrial segments. In the first quarter of 2012, gross margin increased as a percentage of Manufacturing revenues primarily due to favorable product mix at Bell and improved leverage on higher volume at the Bell, Cessna and Industrial segments.

On a consolidated basis, selling and administrative expense increased $4 million, 1%, to $308 million in the first quarter of 2012, compared with the first quarter of 2011. Share-based compensation expense increased $10 million in the first quarter of 2012 over the corresponding period of 2011, reflecting changes in our stock price. This increase was offset by a $10 million reduction in operating expense at the Finance segment, largely reflecting liquidations within the non-captive commercial finance portfolio.

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**Backlog**

| (In millions) | Three Months Ended March 31, 2012 | December 31, 2011 |
|---|---|---|
| Bell | $ 7,133 | $ 7,346 |
| Cessna | 1,722 | 1,889 |
| Textron Systems | 1,440 | 1,337 |

**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 31% of our 2011 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**

| (Dollars in millions) | Three Months Ended March 31, 2012 | April 2, 2011 |
|---|---|---|
| Revenues | $ 669 | $ 556 |
| Operating expenses | 675 | 594 |
| Segment loss | (6) | (38) |
| Profit margin | (1)% | (7)% |

**Cessna Revenues and Operating Expenses**

The following factors contributed to the change in Cessna s revenues from the prior year quarter:

| (In millions) | 2012 versus 2011 |
|---|---|

| | | |
|---|---|---|
| Volume | $ | 111 |
| Other | | 2 |
| Total change | $ | 113 |

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In the first quarter of 2012, Cessna s revenues increased $113 million, 20%, compared with the corresponding period of 2011, primarily due to higher Citation business jet volume, which had a $75 million impact, and higher aftermarket volume of $24 million primarily due to higher part sales. We delivered 38 Citation jets in the first quarter of 2012, compared with 31 jets in the corresponding period of 2011. During the first quarter of 2012, the portion of Cessna s revenues derived from aftermarket sales and services represented 30% of Cessna s revenues, compared with 31% in the first quarter of 2011.

Cessna s operating expenses increased by $81 million, 14%, in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to higher sales volume, which resulted in a $61 million increase in direct material costs and a $22 million increase in manufacturing overhead.

**Cessna Segment Profit**

The following factors contributed to the change in Cessna s segment profit from the prior year quarter:

| *(In millions)* | 2012 versus 2012 versus 2011 |
|---|---|
| Volume | $ 26 |
| Other | 6 |
| Total change | $ 32 |

Cessna s segment profit increased $32 million in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to higher volume of $26 million as described above.

**Bell**

| *(Dollars in millions)* | 2012 versus Three Months Ended March 31, 2012 | 2012 versus April 2, 2011 |
|---|---|---|
| Revenues: | | |
| V-22 program | $ 396 | $ 358 |
| Other military | 249 | 170 |
| Commercial | 349 | 221 |
| Total revenues | 994 | 749 |
| Operating expenses | 849 | 658 |
| Segment profit | 145 | 91 |
| Profit margin | 15% | 12% |

Bell manufactures helicopters, tiltrotor aircraft, and related spare parts and provides services for military and 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.

**Bell Revenues and Operating Expenses**

The following factors contributed to the change in Bell s revenues from the prior year quarter:

| *(In millions)* | 2012 versus 2011 |
|---|---|
| Volume | $ 241 |
| Other | 4 |
| Total change | $ 245 |

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Bell s revenues increased $245 million, 33%, in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to higher volume, which included the following factors:

$124 million increase in commercial volume, largely related to higher deliveries. Bell delivered 30 commercial aircraft in the first quarter of 2012, compared with 15 aircraft in the first quarter of 2011.

$79 million increase in other military volume, primarily reflecting higher H-1 deliveries. We delivered 7 H-1 aircraft in the first quarter of 2012, compared with 4 aircraft in the first quarter of 2011.

$38 million increase in volume related to the V-22 program, primarily reflecting higher aircraft deliveries. Bell delivered 10 V-22 aircraft in the first quarter of 2012, compared with 9 deliveries in the first quarter of 2011.

Bell s operating expenses increased $191 million, 29%, in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to higher sales volume as discussed above.

**Bell Segment Profit**

The following factors contributed to the change in Bell s segment profit from the prior year quarter:

| *(In millions)* | **2012 versus 2011** |
|---|---|
| Volume and mix | $ 57 |
| Other | (3) |
| Total change | $ 54 |

Bell s segment profit increased $54 million, 59%, in the first quarter of 2012, compared with the first quarter of 2011, primarily due to higher volume, as described above, and favorable mix in our commercial aircraft business.

**Textron Systems**

| | **Three Months Ended** | |
|---|---|---|
| *(Dollars in millions)* | **March 31, 2012** | **April 2, 2011** |
| Revenues | $ 377 | $ 445 |
| Operating expenses | 342 | 392 |
| Segment profit | 35 | 53 |
| Profit margin | 9% | 12% |

**Textron Systems Revenues and Operating Expenses**

The following factors contributed to the change in Textron Systems revenues from the prior year quarter:

| *(In millions)* | **2012 versus 2011** |
|---|---|

| | | |
|---|---|---|
| Volume | $ | (69) |
| Other | | 1 |
| Total change | $ | (68) |

Revenues at Textron Systems decreased $68 million, 15%, in the first quarter of 2012, compared with the first quarter of 2011, primarily due to lower volume reflecting the following changes:

Lower UAS volume of $47 million, largely due to lower system deliveries.

Lower Mission Support and Other product line volume of $22 million, primarily due to the completion of certain intelligence and communications contracts in the first quarter of 2011.

Lower Land & Marine volume of $17 million, primarily related to lower Armored Security Vehicle deliveries.

Higher Weapons and Sensors revenues of $19 million, largely due to higher international Sensor Fuzed Weapon volume.

Textron Systems operating expenses decreased $50 million, 13%, in the first quarter of 2012, compared with the first quarter of 2011, primarily due to the lower volume.

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**Textron Systems Segment Profit**

The following factors contributed to the change in Textron Systems segment profit from the prior year quarter:

| *(In millions)* | 2012 versus 2011 |
|---|---|
| Volume and mix | $ (24) |
| Other | 6 |
| Total change | $ (18) |

Segment profit at Textron Systems decreased $18 million, 34%, in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to the impact of lower volume described above and the mix of contracts delivered in the period. Unfavorable mix relates to lower margin ASV vehicle contracts delivered in the current period compared with the prior year, as well as a shift to lower margin UAS contracts.

**Industrial**

| | Three Months Ended | |
|---|---|---|
| *(Dollars in millions)* | March 31, 2012 | April 2, 2011 |
| Revenues: | | |
| Fuel Systems and Functional Components | $ 492 | $ 471 |
| Other Industrial | 263 | 232 |
| Total revenues | 755 | 703 |
| Operating expenses | 682 | 642 |
| Segment profit | 73 | 61 |
| Profit margin | 10% | 9% |

**Industrial Revenues and Operating Expenses**

The following factors contributed to the change in Industrial s revenues from the prior year quarter:

| *(In millions)* | 2012 versus 2011 |
|---|---|
| Volume | $ 58 |
| Foreign exchange | (12) |
| Other | 6 |
| Total change | $ 52 |

Industrial segment revenues increased $52 million, 7%, in the first quarter of 2012, compared with the corresponding period of 2011. Volume increased largely due to a $36 million increase in the Fuel Systems and Functional Components product line, reflecting higher automotive industry demand, and $22 million in the Other Industrial product lines, largely related to the Golf and Turf Care product line reflecting higher market demand. The unfavorable foreign exchange impact was primarily related to the weakening of the euro, which primarily impacted the Fuel Systems and Functional Components product line.

Operating expenses for the Industrial segment increased $40 million, 6%, in the first quarter of 2012, compared with the corresponding period of 2011, largely due to $48 million in higher direct material costs due to higher sales volume. Operating expenses were also impacted by cost

inflation of $12 million primarily due to higher commodity and material component costs, which were partially offset by a favorable foreign exchange impact of $10 million, largely due to the weakening of the euro.

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**Industrial Segment Profit**

The following factors contributed to the change in Industrial s segment profit from the prior year quarter:

| *(In millions)* | 2012 versus 2011 |
|---|---|
| Volume | $ 11 |
| Other | 1 |
| Total change | $ 12 |

Segment profit for the Industrial segment increased $12 million, 20%, in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to an $11 million impact from higher volume as described above.

**Finance**

| | Three Months Ended | |
|---|---|---|
| *(Dollars in millions)* | March 31, 2012 | April 2, 2011 |
| Revenues | $ 61 | $ 26 |
| Segment profit (loss) | 12 | (44) |

Our plan to exit the non-captive commercial finance business of our Finance segment is being effected through a combination of orderly liquidation and selected sales. Depending on market conditions, we expect continued progress in liquidating the remaining $779 million in the non-captive portfolio over the next several years.

Finance segment revenues increased $35 million in the first quarter of 2012, compared with the first quarter of 2011, primarily attributable to the following factors:

$26 million due to $11 million in net favorable valuation adjustments in the first quarter of 2012 related to the Golf Mortgage finance receivables held for sale and owned assets, compared with $15 million in unfavorable valuation adjustments in the first quarter of 2011.

$14 million of lower portfolio losses, primarily associated with the Aviation and Timeshare portfolios.

$7 million increase due to the resolution of one significant Timeshare account that returned to accrual status in the first quarter of 2012.

These increases were partially offset by a $15 million decrease attributable to lower average finance receivables of $1.4 billion.

Finance segment profit increased $56 million in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to the following factors:

$26 million attributable to changes in valuation adjustments as discussed above.

$14 million in lower portfolio losses as discussed above.

$10 million in lower administrative expense primarily associated with the exit of the non-captive business.

$8 million in lower provision for loan losses mostly related to specific reserving actions taken on several Aviation accounts during the first quarter of 2011.

$7 million increase due to the resolution of one significant Timeshare account as discussed above.

These increases were partially offset by a $7 million reduction in net interest margin attributable to lower average finance receivables.

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*Finance Portfolio Quality*

The following table reflects information about the Finance segment s credit performance related to finance receivables held for investment:

| *(Dollars in millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Finance receivables | $ 2,310 | $ 2,477 |
| Nonaccrual finance receivables | 290 | 321 |
| Allowance for losses | 136 | 156 |
| Ratio of nonaccrual finance receivables to finance receivables | 12.55% | 12.96% |
| Ratio of allowance for losses on impaired nonaccrual finance receivables to impaired nonaccrual finance receivables | 26.58% | 28.52% |
| Ratio of allowance for losses on finance receivables to nonaccrual finance receivables | 46.90% | 48.60% |
| Ratio of allowance for losses on finance receivables to finance receivables | 5.89% | 6.30% |
| 60+ days contractual delinquency as a percentage of finance receivables | 6.19% | 6.70% |
| 60+ days contractual delinquency | 143 | 166 |
| Repossessed assets and properties | 201 | 199 |

Finance receivables held for sale are reflected at the lower of cost or fair value on the Consolidated Balance Sheets and are not included in the credit performance statistics above. Finance receivables held for sale in the non-captive portfolio totaled $318 million at March 31, 2012, compared with $418 million at the end of 2011.

Nonaccrual finance receivables decreased $31 million, 10%, from the year-end balance, primarily due to the resolution of several Aviation accounts through repossession of collateral and cash collections, partially offset by new accounts identified as nonaccrual in 2012.

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 5 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:

| *(Dollars in millions)* | March 31, 2012 | December 31, 2011 |
|---|---|---|
| **Manufacturing group** | | |
| Cash and equivalents | $ 628 | $ 871 |
| Debt | 2,477 | 2,459 |
| Shareholders equity | 2,915 | 2,745 |
| Capital (debt plus shareholders equity) | 5,392 | 5,204 |
| Net debt (net of cash and equivalents) to capital | 38.8% | 36.6% |
| Debt to capital | 45.9% | 47.3% |

| | | |
|---|---|---|
| **Finance group** | | |
| Cash and equivalents | $ 18 | $ 14 |
| Debt | 1,837 | 1,974 |

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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, along with the cash we expect to generate from our manufacturing operations, we will have sufficient cash to meet our future needs.

In 2011, Textron Inc. entered into a senior unsecured revolving credit facility that expires in March 2015 for an aggregate principal amount of $1.0 billion, up to $200 million of which is available for the issuance of letters of credit. At March 31, 2012, there were no amounts borrowed against the facility. We also 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.

**Manufacturing Group Cash Flows**

Cash flows from continuing operations for the Manufacturing group as presented in our Consolidated Statement of Cash Flows are summarized below:

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| Operating activities | $ (177) | $ 73 |
| Investing activities | (73) | (121) |
| Financing activities | 4 | 129 |

Cash flow from operating activities used more cash in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to $128 million in higher pension contributions in the first quarter of 2012 and a $67 million impact due to the excess of dividends received from the Finance group, net of capital contributions in the first quarter of 2011. In addition, more cash was used for working capital requirements, largely due to lower receipts at Bell for the H-1 program primarily due to the timing of payments and $27 million received in the first quarter of 2011 related to the settlement of a request for equitable adjustment, and a decrease in accounts payable related to the timing of payments.

Investing cash flows in the first quarter of 2012 and 2011 primarily included capital expenditures of $73 million and $78 million, respectively. We generated less cash from financing activities in the first quarter of 2012, primarily due to the issuance of $203 million in commercial paper in the first quarter of 2011.

*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:

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| Dividends paid by TFC to Textron Inc. | $ 240 | $ 130 |
| Capital contributions paid to TFC under Support Agreement | (240) | (63) |

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 net income (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**

In the first quarter of 2012, we liquidated $267 million 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 $67 million and $58 million in the Golf Mortgage and Timeshare product lines, respectively. Depending on market conditions, we expect continued progress in liquidating the remaining $779 million in the non-captive portfolio over the next several years.

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

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | March 31, 2012 | April 2, 2011 |
| Operating activities | $ (119) | $ (29) |
| Investing activities | 239 | 513 |
| Financing activities | (116) | (482) |

The Finance group used more cash for operating activities largely due to $111 million in taxes paid in the first quarter of 2012, compared with less than $1 million paid in the corresponding period of 2011. The 2012 tax payment was primarily attributable to a 2008 settlement with the Internal Revenue Service related to the challenge of tax deductions we took in prior years for certain leveraged lease transactions.

Cash receipts from the collection of finance receivables continued to outpace finance receivable originations, which resulted in net cash inflow from investing activities in both quarters. Finance receivables repaid and proceeds from sales totaled $306 million and $579 million in the first quarter of 2012 and 2011, respectively, while cash outflows for originations declined to $84 million in the first quarter of 2012 from $125 million in the first quarter of 2011. These decreases were largely driven by the wind down of the non-captive finance receivable portfolio.

Cash used for financing activities in the first quarter of 2012 largely related to $144 million in long-term and nonrecourse debt payments, compared with $410 million in the first quarter of 2011. In the first quarter of 2011, the Finance group made a discretionary payment of $250 million on its bank line of credit and borrowed $60 million from Textron Inc. with interest to pay down its maturing debt. As of March 31, 2012 and December 31, 2011, the outstanding balance due to Textron Inc. for these borrowings was $490 million.

The Finance group received $27 million in proceeds from the issuance of long-term debt in the first quarter of 2012, compared with $144 million in the first quarter of 2011.

**Consolidated Cash Flows**

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

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | March 31, 2012 | April 2, 2011 |
| Operating activities | $ (253) | $ 55 |
| Investing activities | 123 | 355 |
| Financing activities | (112) | (327) |

Cash flow from operating activities used more cash in the first quarter of 2012, compared with the corresponding period of 2011, primarily due to $128 million in higher pension contributions and an increase in cash used for working capital requirements, largely due to lower receipts at Bell for the H-1 program primarily due to the timing of payments and $27 million received in the first quarter of 2011 related to the settlement of a request for equitable adjustment, and a decrease in accounts payable related to the timing of payments. Working capital also decreased due to lower cash receipts, net of originations, in the captive financing business.

Cash receipts from the collection of finance receivables continued to outpace finance receivable originations, which resulted in net cash inflow from investing activities in both quarters. Finance receivables repaid and proceeds from sales totaled $198 million and $458 million in the first quarter of 2012 and 2011, respectively, while cash outflows for originations declined to $18 million in the first quarter of 2012 from $76 million in the first quarter of 2011. These decreases were largely driven by the wind down of the non-captive finance receivable portfolio.

Total cash used for financing activities was lower in 2012 primarily due to lower repayments of long-term debt of $144 million in the first quarter of 2012, compared with $417 million in the first quarter of 2011. In addition, TFC made a $250 million discretionary payment against the outstanding balance on its bank line of credit during the first quarter of 2011. These payments were partially offset by the issuance of $203 million in commercial paper and $144 million in long-term debt in the first quarter of 2011.

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**Captive Financing and Other Intercompany Transactions**

The Finance group finances retail purchases and leases for new and used aircraft and equipment manufactured by our Manufacturing group, otherwise known as captive financing. In the Consolidated Statements of Cash Flows, cash received from customers or from the sale of receivables 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.

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

| | Three Months Ended | |
|---|---|---|
| *(In millions)* | **March 31, 2012** | **April 2, 2011** |
| Reclassifications from investing activities: | | |
| Finance receivable originations for Manufacturing group inventory sales | $ (66) | $ (49) |
| Cash received from customers and sale of receivables | 108 | 121 |
| Other capital contributions made to Finance group | 1 | (40) |
| Other | | 5 |
| Total reclassifications from investing activities | 43 | 37 |
| Reclassifications from financing activities: | | |
| Capital contribution paid by Manufacturing group to Finance group under Support Agreement | 240 | 63 |
| Dividends received by Manufacturing group from Finance group | (240) | (130) |
| Other capital contributions made to Finance group | | 40 |
| Other | | 1 |
| Total reclassifications from financing activities | | (26) |
| Total reclassifications and adjustments to cash flow from operating activities | $ 43 | $ 11 |

**Critical Accounting Estimates**

The accounting policies that we believe are most critical to the portrayal of our financial condition and results of operations are disclosed on pages 36 through 40 in our 2011 Annual Report on Form 10-K. The following section provides an update of the year-end disclosure for long-term contracts to include program profit adjustments made during the quarter.

**Long-Term Contracts**

We make a substantial portion of our sales to government customers pursuant to long-term contracts. These contracts require development and delivery of products over multiple years and may contain fixed-price purchase options for additional products. We account for these long-term contracts under the percentage-of-completion method of accounting. Under this method, we estimate profit as the difference between total estimated revenues and cost of a contract. The percentage-of-completion method of accounting involves the use of various estimating techniques to project costs at completion and, in some cases, includes estimates of recoveries asserted against the customer for changes in specifications. Due to the size, length of time and nature of many of our contracts, the estimation of total contract costs and revenues through completion is complicated and subject to many variables relative to the outcome of future events over a period of several years. We are required to make numerous assumptions and estimates relating to items such as expected engineering requirements, complexity of design and related development costs, performance of subcontractors, availability and cost of materials, labor productivity and cost, overhead and capital costs, manufacturing efficiencies and the achievement of contract milestones, including product deliveries.

At the outset of each contract, we estimate the initial profit booking rate. The initial profit booking rate of each contract considers risks surrounding the ability to achieve the technical requirements (for example, a newly-developed product versus a mature product), schedule (for example, the number and type of milestone events), and costs by contract

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requirements in the initial estimated costs at completion. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule, and costs aspects of the contract. Likewise, the profit booking rate may decrease if we are not successful in retiring the risks; and, as a result, our estimated costs at completion increase. All of the estimates are subject to change during the performance of the contract and, therefore, may affect the profit booking rate. When adjustments are required, any changes from prior estimates are recognized using the cumulative catch-up method with the impact of the change from inception-to-date recorded in the current period. The following table sets forth the aggregate gross amount of all program profit adjustments that are included within segment profit for the first quarter of 2012 and 2011:

| *(In millions)* | **2012** | **2011** |
|---|---|---|
| Gross favorable | $ 17 | $ 21 |
| Gross unfavorable | (13) | (7) |
| Net adjustments | $ 4 | $ 14 |

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

There has been no significant change in our exposure to market risk during the fiscal quarter ended March 31, 2012. For discussion of our exposure to market risk, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk contained in Textron s 2011 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 March 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

**Item 5. OTHER INFORMATION**

(a) The Annual Meeting of Shareholders of Textron Inc. was held on April 25, 2012 in Providence, Rhode Island. Of the 279,811,899 shares outstanding as of the record date, 254,726,347 shares (approximately 91%) were present or represented by proxy at the meeting.

The results of the voting on the matters submitted to the shareholders are as follows:

1. The following persons were elected to serve as directors until the next annual shareholders meeting and received the votes listed:

| | For | Against | Abstain | Broker Non-Vote |
|---|---|---|---|---|
| Scott C. Donnelly | 223,680,515 | 5,603,225 | 3,082,476 | 22,360,131 |
| James T. Conway | 223,760,667 | 5,497,372 | 3,108,177 | 22,360,131 |
| Lawrence K. Fish | 222,094,905 | 7,086,686 | 3,184,625 | 22,360,131 |
| Paul E. Gagné | 205,575,473 | 23,596,200 | 3,194,543 | 22,360,131 |
| Dain M. Hancock | 219,234,538 | 9,957,554 | 3,174,124 | 22,360,131 |
| Lloyd G. Trotter | 220,071,941 | 9,095,334 | 3,198,941 | 22,360,131 |

The following directors have terms of office which continued after the meeting: Class II expiring in 2013: Kathleen M. Bader, R. Kerry Clark, Ivor J. Evans, Lord Powell of Bayswater KCMG and James L. Ziemer.

2. The advisory (non-binding) resolution to approve the compensation of our named executive officers, as disclosed in our proxy statement, was approved by the following vote:

| For | Against | Abstain | Broker Non-Vote |
|---|---|---|---|
| 211,743,037 | 15,683,111 | 4,940,068 | 22,360,131 |

3. The material terms of the performance goals under the Textron Inc. Short-Term Incentive Plan was approved by the following vote:

| For | Against | Abstain | Broker Non-Vote |
|---|---|---|---|
| 218,507,701 | 10,791,716 | 3,066,799 | 22,360,131 |

4. The material terms of the performance goals under the Textron Inc. 2007 Long-Term Incentive Plan was approved by the following vote:

| For | Against | Abstain | Broker Non-Vote |
|---|---|---|---|
| 217,825,020 | 11,437,960 | 3,103,236 | 22,360,131 |

5. The appointment of Ernst & Young LLP by the Audit Committee as Textron s independent registered public accounting firm for 2012 was ratified by the following vote:

| For | Against | Abstain | Broker Non-Vote |
|---|---|---|---|
| 248,730,063 | 3,753,414 | 2,242,870 | 0 |

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**Item 6. EXHIBITS**

| | |
|---|---|
| 10.1 | Textron Inc. 2007 Long-Term Incentive Plan (Amended and Restated as of April 28, 2010) |
| 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 March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Cash Flows and (v) 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: April 26, 2012

/s/ Richard L. Yates
Richard L. Yates

Senior Vice President and Corporate Controller

(principal accounting officer)

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**LIST OF EXHIBITS**

| | |
|---|---|
| 10.1 | Textron Inc. 2007 Long-Term Incentive Plan (Amended and Restated as of April 28, 2010) |
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| 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 March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Cash Flows and (v) Notes to the Consolidated Financial Statements. |