

TEXTRON INC
Form 10-Q
October 24, 2013
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 28, 2013

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)

Edgar Filing: TEXTRON INC - Form 10-Q

Delaware

(State or other jurisdiction of incorporation or organization)

05-0315468

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

40 Westminster Street, Providence, RI

(Address of principal executive offices)

02903

(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 ☒ 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 ☒ 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 ☒

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 ☒

As of October 11, 2013, there were 281,150,492 shares of common stock outstanding.

Table of Contents

TEXTRON INC.

INDEX

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

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****TEXTRON INC.****Consolidated Statements of Operations (Unaudited)**

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(In millions, except per share amounts)</i>				
Revenues				
Manufacturing revenues	\$ 2,871	\$ 2,936	\$ 8,492	\$ 8,695
Finance revenues	33	64	106	180
Total revenues	2,904	3,000	8,598	8,875
Costs and expenses				
Cost of sales	2,473	2,475	7,193	7,222
Selling and administrative expense	245	264	820	852
Interest expense	41	52	134	160
Total costs and expenses	2,759	2,791	8,147	8,234
Income from continuing operations before income taxes	145	209	451	641
Income tax expense	47	67	124	206
Income from continuing operations	98	142	327	435
Income from discontinued operations, net of income taxes	1	9	4	6
Net income	\$ 99	\$ 151	\$ 331	\$ 441
Basic earnings per share				
Continuing operations	\$ 0.35	\$ 0.51	\$ 1.18	\$ 1.55
Discontinued operations		0.03	0.01	0.02
Basic earnings per share	\$ 0.35	\$ 0.54	\$ 1.19	\$ 1.57
Diluted earnings per share				
Continuing operations	\$ 0.35	\$ 0.48	\$ 1.15	\$ 1.47
Discontinued operations		0.03	0.01	0.02
Diluted earnings per share	\$ 0.35	\$ 0.51	\$ 1.16	\$ 1.49
Dividends per share				
Common stock	\$ 0.02	\$ 0.02	\$ 0.06	\$ 0.06

See Notes to the consolidated financial statements.

Table of Contents

TEXTRON INC.

Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(In millions)</i>				
Net income	\$ 99	\$ 151	\$ 331	\$ 441
Other comprehensive income, net of tax:				
Pension and postretirement benefits adjustments, net of reclassifications	64	21	127	63
Deferred gains/losses on hedge contracts, net of reclassifications	2	8	(11)	5
Foreign currency translation adjustments	12	8	3	(5)
Other comprehensive income	78	37	119	63
Comprehensive income	\$ 177	\$ 188	\$ 450	\$ 504

See Notes to the consolidated financial statements.

Table of Contents**TEXTRON INC.****Consolidated Balance Sheets (Unaudited)**

	September 28, 2013	December 29, 2012
<i>(Dollars in millions)</i>		
Assets		
Manufacturing group		
Cash and equivalents	\$ 444	\$ 1,378
Accounts receivable, net	1,024	829
Inventories	3,220	2,712
Other current assets	501	470
Total current assets	5,189	5,389
Property, plant and equipment, less accumulated depreciation and amortization of \$3,405 and \$3,277	2,163	2,149
Goodwill	1,675	1,649
Other assets	1,499	1,524
Total Manufacturing group assets	10,526	10,711
Finance group		
Cash and equivalents	193	35
Finance receivables held for investment, net	1,436	1,850
Finance receivables held for sale	91	140
Other assets	211	297
Total Finance group assets	1,931	2,322
Total assets	\$ 12,457	\$ 13,033
Liabilities and shareholders' equity		
Liabilities		
Manufacturing group		
Current portion of long-term debt and short-term debt	\$ 104	\$ 535
Accounts payable	1,004	1,021
Accrued liabilities	1,775	1,956
Total current liabilities	2,883	3,512
Other liabilities	2,504	2,798
Long-term debt	1,916	1,766
Total Manufacturing group liabilities	7,303	8,076
Finance group		
Other liabilities	296	280
Debt	1,278	1,686
Total Finance group liabilities	1,574	1,966
Total liabilities	8,877	10,042
Shareholders' equity		
Common stock	37	35
Capital surplus	1,372	1,177
Retained earnings	4,138	3,824
Accumulated other comprehensive loss	(1,651)	(1,770)
	3,896	3,266
Less cost of treasury shares	316	275
Total shareholders' equity	3,580	2,991
Total liabilities and shareholders' equity	\$ 12,457	\$ 13,033
Common shares outstanding (in thousands)	281,071	271,263

See Notes to the consolidated financial statements.

Table of Contents**TEXTRON INC.****Consolidated Statements of Cash Flows (Unaudited)**

For the Nine Months Ended September 28, 2013 and September 29, 2012, respectively

	Consolidated	
	2013	2012
<i>(In millions)</i>		
Cash flows from operating activities		
Net income	\$ 331	\$ 441
Less: Income from discontinued operations	4	6
Income from continuing operations	327	435
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:		
Non-cash items:		
Depreciation and amortization	285	277
Deferred income taxes	74	111
Other, net	38	61
Changes in assets and liabilities:		
Accounts receivable, net	(178)	(56)
Inventories	(443)	(409)
Other assets	(51)	31
Accounts payable	(25)	108
Accrued and other liabilities	(276)	(312)
Income taxes, net	(96)	71
Pension, net	(17)	(57)
Captive finance receivables, net	257	148
Other operating activities, net	2	(6)
Net cash provided by (used in) operating activities of continuing operations	(103)	402
Net cash used in operating activities of discontinued operations	(5)	(5)
Net cash provided by (used in) operating activities	(108)	397
Cash flows from investing activities		
Finance receivables repaid	157	478
Proceeds from sales of receivables and other finance assets	152	184
Capital expenditures	(300)	(314)
Net cash used in acquisitions	(53)	(8)
Other investing activities, net	13	(1)
Net cash provided by (used in) investing activities	(31)	339
Cash flows from financing activities		
Principal payments on long-term and nonrecourse debt	(997)	(474)
Settlement of convertible debt	(215)	(2)
Proceeds from long-term debt	412	88
Increase in short-term debt	96	
Proceeds from settlement of capped call	75	
Dividends paid	(16)	(17)
Other financing activities, net	16	17
Net cash used in financing activities	(629)	(388)
Effect of exchange rate changes on cash and equivalents	(8)	5
Net increase (decrease) in cash and equivalents	(776)	353
Cash and equivalents at beginning of period	1,413	885
Cash and equivalents at end of period	\$ 637	\$ 1,238

See Notes to the consolidated financial statements.

Table of Contents**TEXTRON INC.****Consolidated Statements of Cash Flows (Unaudited) (Continued)**

For the Nine Months Ended September 28, 2013 and September 29, 2012, respectively

<i>(In millions)</i>	Manufacturing Group		Finance Group	
	2013	2012	2013	2012
Cash flows from operating activities				
Net income	\$ 300	\$ 400	\$ 31	\$ 41
Less: Income from discontinued operations	4	6		
Income from continuing operations	296	394	31	41
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:				
Dividends received from Finance Group	30	345		
Capital contribution paid to Finance Group	(1)	(240)		
Non-cash items:				
Depreciation and amortization	271	257	14	20
Deferred income taxes	29	93	45	18
Other, net	69	73	(31)	(12)
Changes in assets and liabilities:				
Accounts receivable, net	(178)	(56)		
Inventories	(459)	(419)		
Other assets	(40)	36	(11)	(5)
Accounts payable	(25)	108		
Accrued and other liabilities	(262)	(284)	(24)	(28)
Income taxes, net	(101)	153	5	(82)
Pension, net	(12)	(57)	(5)	
Other operating activities, net	2	(6)		
Net cash provided by (used in) operating activities of continuing operations	(381)	397	24	(48)
Net cash used in operating activities of discontinued operations	(5)	(5)		
Net cash provided by (used in) operating activities	(386)	392	24	(48)
Cash flows from investing activities				
Finance receivables repaid			558	798
Proceeds from sales of receivables and other finance assets			152	184
Finance receivables originated or purchased			(164)	(194)
Capital expenditures	(300)	(314)		
Net cash used in acquisitions	(53)	(8)		
Other investing activities, net	19	9	40	22
Net cash provided by (used in) investing activities	(334)	(313)	586	810
Cash flows from financing activities				
Principal payments on long-term and nonrecourse debt	(312)	(139)	(685)	(335)
Settlement of convertible debt	(215)	(2)		
Proceeds from long-term debt	150		262	88
Increase in short-term debt	96			
Proceeds from settlement of capped call	75			
Intergroup financing		418		(418)
Capital contributions paid to Finance group			1	240
Dividends paid	(16)	(17)	(30)	(345)
Other financing activities, net	16	17		
Net cash provided by (used in) financing activities	(206)	277	(452)	(770)
Effect of exchange rate changes on cash and equivalents	(8)	5		
Net increase (decrease) in cash and equivalents	(934)	361	158	(8)
Cash and equivalents at beginning of period	1,378	871	35	14
Cash and equivalents at end of period	\$ 444	\$ 1,232	\$ 193	\$ 6

See Notes to the consolidated financial statements.

Table of Contents

TEXTRON INC.

Notes to the Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

Our consolidated financial statements include the accounts of Textron Inc. (Textron) 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 29, 2012. 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 (TFC), its consolidated subsidiaries and three other finance subsidiaries owned by Textron. 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 2013 and 2012, 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 included in income from continuing operations before income taxes in the third quarter of 2013 and 2012 were \$4 million and \$(6) million, respectively, (\$2 million and \$(4) million after tax, or \$0.01 and \$(0.02) per diluted share, respectively). For the third quarter of 2013 and 2012, the gross favorable program profit adjustments totaled \$12 million and \$12 million, respectively, and the gross unfavorable program profit adjustments totaled \$8 million and \$18 million, respectively.

The changes in estimates increased income from continuing operations before income taxes in the first nine months of 2013 and 2012 by \$13 million and \$10 million, (\$8 million and \$6 million after tax, or \$0.03 and \$0.02 per diluted share, respectively). For the first nine months of

Edgar Filing: TEXTRON INC - Form 10-Q

2013 and 2012, the gross favorable program profit adjustments totaled \$30 million and \$52 million, respectively, and the gross unfavorable program profit adjustments totaled \$17 million and \$42 million, respectively.

Table of Contents**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	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(In millions)</i>				
Three Months Ended				
Service cost	\$ 33	\$ 30	\$ 1	\$ 2
Interest cost	72	77	5	6
Expected return on plan assets	(104)	(102)		
Amortization of prior service cost (credit)	4	4	(6)	(3)
Amortization of net actuarial loss	46	29	2	2
Net periodic benefit cost	\$ 51	\$ 38	\$ 2	\$ 7
Nine Months Ended				
Service cost	\$ 100	\$ 89	\$ 5	\$ 5
Interest cost	218	229	15	19
Expected return on plan assets	(314)	(305)		
Amortization of prior service cost (credit)	11	12	(11)	(9)
Amortization of net actuarial loss	138	88	5	5
Net periodic benefit cost	\$ 153	\$ 113	\$ 14	\$ 20

Retirement Plan Amendment

During the third quarter of 2013, we amended one of our postretirement benefit plans which triggered a re-measurement of the plan's projected benefit obligation. The discount rate for this plan was increased to 4.50% from 3.75%, while other assumptions remained consistent with year-end assumptions. As a result of the amendment and the revised discount rate, we recorded a reduction in unrealized losses and prior service cost of \$55 million through other comprehensive income in the third quarter of 2013.

Note 3. 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 have been issued upon the conversion of our convertible notes prior to their maturity on May 1, 2013 and upon the exercise of the related warrants.

The dilutive effect of the convertible notes and warrants decreased significantly in 2013 from the 2012 dilutive effect due to the maturity of our convertible notes as described more fully in Note 6. As disclosed in Note 8 of our 2012 Annual Report on Form 10-K, we intended to settle the face value of the notes in cash and the excess of the conversion value over the face value in cash and/or shares of our common stock;

Edgar Filing: TEXTRON INC - Form 10-Q

accordingly, only the shares of our common stock potentially issuable with respect to the excess of the notes' conversion value over the face amount were considered in calculating diluted EPS. The call options purchased in connection with the issuance of the convertible notes and the capped call transaction were excluded from the calculation of diluted EPS as their impact was always anti-dilutive.

The weighted-average shares outstanding for basic and diluted EPS are as follows:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(In thousands)</i>				
Basic weighted-average shares outstanding	281,525	281,813	278,296	280,983
Dilutive effect of:				
Convertible notes and warrants		14,763	6,226	14,219
Stock options and restricted stock units	185	344	221	495
Diluted weighted-average shares outstanding	281,710	296,920	284,743	295,697

Table of Contents

Stock options to purchase 6 million and 5 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for the three and nine months ended September 28, 2013, respectively, as their effect would have been anti-dilutive. Stock options to purchase 5 million and 7 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for the three and nine months ended September 29, 2012, respectively. The effect of these securities would have been anti-dilutive.

Note 4. Accounts Receivable and Finance Receivables**Accounts Receivable**

Accounts receivable is composed of the following:

<i>(In millions)</i>	September 28, 2013	December 29, 2012
Commercial	\$ 708	\$ 534
U.S. Government contracts	340	314
	1,048	848
Allowance for doubtful accounts	(24)	(19)
Total	\$ 1,024	\$ 829

We have unbillable receivables, primarily 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 \$136 million at September 28, 2013 and \$149 million at December 29, 2012.

Finance Receivables

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

<i>(In millions)</i>	September 28, 2013	December 29, 2012
Captive	\$ 1,379	\$ 1,704
Non-captive	210	370
Total finance receivables	1,589	2,074
Less: Allowance for losses	62	84
Less: Finance receivables held for sale	91	140
Total finance receivables held for investment, net	\$ 1,436	\$ 1,850

In the third quarter of 2013, we determined that we no longer had the intent to hold the remaining non-captive loan portfolio for the foreseeable future and, accordingly, transferred \$34 million of the remaining non-captive loans, net of a \$1 million allowance for losses, from the held for investment classification to the held for sale classification.

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 and the financial strength of individual borrowers and guarantors. 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 of principal and interest is doubtful. In addition, we automatically classify accounts as nonaccrual once they are contractually delinquent by more than three months unless collection of principal and interest is not doubtful. Recognition of interest income is suspended for these accounts and all cash collections are used 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

Edgar Filing: TEXTRON INC - Form 10-Q

Table of Contents

finance receivables held for investment that do not meet the watchlist or nonaccrual categories are classified as performing.

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

(In millions)	September 28, 2013				December 29, 2012			
	Performing	Watchlist	Nonaccrual	Total	Performing	Watchlist	Nonaccrual	Total
Captive	\$ 1,173	\$ 101	\$ 105	\$ 1,379	\$ 1,476	\$ 130	\$ 98	\$ 1,704
Non-captive	119			119	185		45	230
Total	\$ 1,292	\$ 101	\$ 105	\$ 1,498	\$ 1,661	\$ 130	\$ 143	\$ 1,934
% of Total	86.3%	6.7%	7.0%		85.9%	6.7%	7.4%	

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:

(In millions)	September 28, 2013					December 29, 2012				
	Less Than 31 Days	31-60 Days	61-90 Days	Over 90 Days	Total	Less Than 31 Days	31-60 Days	61-90 Days	Over 90 Days	Total
	Past Due	Past Due	Past Due	Past Due		Past Due	Past Due	Past Due	Past Due	
Captive	\$ 1,206	\$ 85	\$ 62	\$ 26	\$ 1,379	\$ 1,531	\$ 87	\$ 55	\$ 31	\$ 1,704
Non-captive	119				119	226		1	3	230
Total	\$ 1,325	\$ 85	\$ 62	\$ 26	\$ 1,498	\$ 1,757	\$ 87	\$ 56	\$ 34	\$ 1,934

We had no accrual status loans greater than 90 days past due at September 28, 2013 or December 29, 2012. At September 28, 2013 and December 29, 2012, 60+ days contractual delinquency as a percentage of finance receivables held for investment was 5.87% and 4.65%, respectively.

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, 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 nine months of 2013 and 2012 to finance receivables held for investment were not material.

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. Interest income recognized on impaired loans was not significant in the first nine months of 2013 or 2012.

Table of Contents

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

	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
<i>(In millions)</i>						
September 28, 2013						
Captive	\$ 64	\$ 76	\$ 140	\$ 143	\$ 21	\$ 135
Non-captive						24
Total	\$ 64	\$ 76	\$ 140	\$ 143	\$ 21	\$ 159
December 29, 2012						
Captive	\$ 61	\$ 66	\$ 127	\$ 128	\$ 15	\$ 121
Non-captive	11	33	44	59	12	149
Total	\$ 72	\$ 99	\$ 171	\$ 187	\$ 27	\$ 270

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 \$119 million and \$122 million of leveraged leases at September 28, 2013 and December 29, 2012, respectively, in accordance with authoritative accounting standards.

	September 28, 2013				December 29, 2012			
	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
<i>(In millions)</i>	Individually	Collectively			Individually	Collectively		
Captive	\$ 140	\$ 1,239	\$ 21	\$ 41	\$ 127	\$ 1,577	\$ 15	\$ 55
Non-captive					44	64	12	2
Total	\$ 140	\$ 1,239	\$ 21	\$ 41	\$ 171	\$ 1,641	\$ 27	\$ 57

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. For larger balance accounts specifically identified as impaired, including large accounts in homogeneous portfolios, a reserve is established based on comparing the expected future cash flows, discounted at the finance receivable's effective interest rate, or the fair value of the underlying collateral if the finance receivable is collateral dependent, to its carrying amount. 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 portfolio 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 for the Captive product line include industry valuation guides, age and physical condition of the collateral, payment history and existence and financial strength of guarantors.

Edgar Filing: TEXTRON INC - Form 10-Q

We also establish an allowance for losses to cover probable but specifically unknown losses existing in the portfolio. For the Captive product line, 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.

Finance receivables held for investment are charged off at the earlier of the date the collateral is repossessed or when no payment has been received for six months, unless management deems the receivable collectible.

Table of Contents

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

<i>(In millions)</i>	Captive		Non-captive		Total
For the nine months ended September 28, 2013					
Beginning balance	\$	70	\$	14	\$ 84
Provision for losses		(6)		(17)	(23)
Charge-offs		(7)		(2)	(9)
Recoveries		5		6	11
Transfers				(1)	(1)
Ending balance	\$	62	\$		\$ 62
For the nine months ended September 29, 2012					
Beginning balance	\$	101	\$	55	\$ 156
Provision for losses		1		(5)	(4)
Charge-offs		(40)		(38)	(78)
Recoveries		8		4	12
Ending balance	\$	70	\$	16	\$ 86

Note 5. Inventories

<i>(In millions)</i>	September 28, 2013	December 29, 2012
Finished goods	\$ 1,374	\$ 1,329
Work in process	2,679	2,247
Raw materials	433	437
	4,486	4,013
Progress/milestone payments	(1,266)	(1,301)
Total	\$ 3,220	\$ 2,712

Note 6. Debt

On October 4, 2013, Textron entered into a senior unsecured revolving credit facility for an aggregate principal amount of \$1.0 billion, of which up to \$100 million is available for the issuance of letters of credit. This facility expires in October 2018 and replaced the existing 4-year facility that was scheduled to expire in March 2015. At September 28, 2013, there were no amounts borrowed against the prior facility.

4.50% Convertible Senior Notes and Related Transactions

On May 1, 2013, our remaining convertible senior notes matured, and we paid the holders of the notes \$215 million in settlement of the face value of the notes. In addition, we issued 8.9 million shares of our common stock to converting holders in settlement of the excess of the conversion value over the face value of the notes; however, after giving effect to the exercise of the related call options and warrants discussed below, the incremental share settlement in excess of the face value of the notes resulted in a 7.4 million net share issuance.

Edgar Filing: TEXTRON INC - Form 10-Q

Concurrently with the pricing of the convertible notes in May 2009, we entered into transactions with two counterparties, pursuant to which we purchased from the counterparties call options to acquire our common stock and sold to the counterparties warrants to purchase our common stock. The call options settled on May 1, 2013, while the warrants settled daily over a 45-day period beginning on February 27, 2013. We acquired 8.9 million shares of our common stock upon the settlement of the call options and issued an aggregate of 7.4 million shares of our common stock in connection with the settlement of the warrants during the first half of 2013. The settlement of the call options and warrants resulted in a \$39 million net increase in treasury stock during 2013.

As disclosed in Note 8 of our 2012 Form 10-K, we previously entered into capped call transactions with the counterparties that covered an aggregate of 28.7 million shares of our common stock as of the end of 2012. The capped calls had a strike price of \$13.125 per share and a cap price of \$15.75 per share, which entitled us to receive the per share value of our stock price in excess of \$13.125 up to a maximum stock price of \$15.75 at the expiration date. Upon expiration of the capped calls, the market price of our common stock exceeded the maximum stock price, and we received \$75 million in cash from the counterparties.

Table of Contents**Note 7. Accrued Liabilities**

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

	Nine Months Ended	
	September 28, 2013	September 29, 2012
<i>(In millions)</i>		
Accrual at the beginning of period	\$ 222	\$ 224
Provision	203	190
Settlements	(210)	(187)
Adjustments to prior accrual estimates	(3)	(2)
Accrual at the end of period	\$ 212	\$ 225

Note 8. Accumulated Other Comprehensive Loss and Other Comprehensive Income

The components of Accumulated Other Comprehensive Loss are presented below:

	Foreign Currency Translation Adjustments	Pension and Postretirement Benefits Adjustments	Deferred Gains/Losses on Hedge Contracts	Accumulated Other Comprehensive Loss
<i>(In millions)</i>				
For the nine months ended September 28, 2013				
Beginning balance	\$ 81	\$ (1,857)	\$ 6	\$ (1,770)
Other comprehensive income before reclassifications	3		(9)	(6)
Amounts reclassified from Accumulated Other Comprehensive Loss		127	(2)	125
Other comprehensive income	3	127	(11)	119
Ending balance	\$ 84	\$ (1,730)	\$ (5)	\$ (1,651)
For the nine months ended September 29, 2012				
Beginning balance	\$ 79	\$ (1,711)	\$ 7	\$ (1,625)
Other comprehensive income before reclassifications	(5)		15	10
Amounts reclassified from Accumulated Other Comprehensive Loss		63	(10)	53
Other comprehensive income	(5)	63	5	63
Ending balance	\$ 74	\$ (1,648)	\$ 12	\$ (1,562)

Table of Contents

The before and after-tax components of Other Comprehensive Income are presented below:

	Pre-Tax Amount	Tax (Expense) Benefit	After-Tax Amount
<i>(In millions)</i>			
For the three months ended September 28, 2013			
Pension and postretirement benefits adjustments:			
Amortization of net actuarial loss*	\$ 48	\$ (18)	\$ 30
Amortization of prior service cost*	(2)	1	(1)
Amendment to postretirement benefit plan	55	(20)	35
Pension and postretirement benefits adjustments, net	101	(37)	64
Deferred gains/losses on hedge contracts:			
Current deferrals	3	(1)	2
Deferred gains/losses on hedge contracts, net	3	(1)	2
Foreign currency translation adjustments	8	4	12
Total	\$ 112	\$ (34)	\$ 78
For the three months ended September 29, 2012			
Pension and postretirement benefits adjustments:			
Amortization of net actuarial loss*	\$ 31	\$ (10)	\$ 21
Amortization of prior service cost*	1	(1)	
Pension and postretirement benefits adjustments, net	32	(11)	21
Deferred gains/losses on hedge contracts:			
Current deferrals	12	(3)	9
Reclassification adjustments		(1)	(1)
Deferred gains/losses on hedge contracts, net	12	(4)	8
Foreign currency translation adjustments	1	7	8
Total	\$ 45	\$ (8)	\$ 37
For the nine months ended September 28, 2013			
Pension and postretirement benefits adjustments:			
Amortization of net actuarial loss*	\$ 143	\$ (51)	\$ 92
Amendment to postretirement benefit plan	55	(20)	35
Pension and postretirement benefits adjustments, net	198	(71)	127
Deferred gains/losses on hedge contracts:			
Current deferrals	(11)	2	(9)
Reclassification adjustments	(3)	1	(2)
Deferred gains/losses on hedge contracts, net	(14)	3	(11)
Foreign currency translation adjustments	6	(3)	3
Total	\$ 190	\$ (71)	\$ 119
For the nine months ended September 29, 2012			
Pension and postretirement benefits adjustments:			
Amortization of net actuarial loss*	\$ 93	\$ (32)	\$ 61
Amortization of prior service cost*	3	(1)	2
Pension and postretirement benefits adjustments, net	96	(33)	63
Deferred gains/losses on hedge contracts:			
Current deferrals	19	(4)	15
Reclassification adjustments	(12)	2	(10)
Deferred gains/losses on hedge contracts, net	7	(2)	5
Foreign currency translation adjustments	(9)	4	(5)
Total	\$ 94	\$ (31)	\$ 63

*These components of other comprehensive income are included in the computation of net periodic pension cost. See Note 13 of our 2012 Annual Report on Form 10-K for additional information.

Edgar Filing: TEXTRON INC - Form 10-Q

In the third quarter of 2013, we amended one of our postretirement benefit plans which triggered a re-measurement of the plan's projected benefit obligation resulting in a \$55 million reduction in unrealized losses and prior service costs, as discussed in Note 2.

Table of Contents

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.

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 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:

(In millions)	Borrowing Group	Balance Sheet Location	Asset (Liability)	
			September 28, 2013	December 29, 2012
Assets				
Interest rate exchange contracts*	Finance	Other assets	\$ 3	\$ 8
Foreign currency exchange contracts	Manufacturing	Other current assets		9
Total			\$ 3	\$ 17
Liabilities				
Interest rate exchange contracts*	Finance	Other liabilities	\$ (6)	\$ (8)
Foreign currency exchange contracts	Manufacturing	Accrued liabilities	(7)	(5)
Total			\$ (13)	\$ (13)

*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 September 28, 2013. At September 28, 2013 and December 29, 2012, we had interest rate exchange contracts with notional amounts upon which the contracts were based of \$268 million and \$671 million, respectively.

Table of Contents

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 September 28, 2013 and December 29, 2012, we had foreign currency exchange contracts with notional amounts upon which the contracts were based on \$641 million and \$664 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 insignificant in both the first nine months of 2013 and 2012.

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 September 28, 2013, we had a net deferred loss of \$5 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 three and nine months ended September 28, 2013 and September 29, 2012. We do not expect the amount of gains and losses in Accumulated other comprehensive loss that will be reclassified to earnings in the next twelve months to be material.

We hedge our net investment position in major currencies and generate foreign currency interest payments that offset other transactional exposures in these currencies. To accomplish this, we borrow directly in foreign currency and designate a portion of foreign currency debt as a hedge of net investments. We also may utilize currency forwards as hedges of our related foreign net investments. We record changes in the fair value of these contracts in other comprehensive income to the extent they are effective as cash flow hedges. If a contract does not qualify for hedge accounting or is designated as a fair value hedge, changes in the fair value of the contract are recorded in earnings. Currency effects on the effective portion of these hedges, which are reflected in the foreign currency translation adjustment account within other comprehensive income, produced a \$5 million after-tax gain for the first nine months of 2013, resulting in an accumulated net gain balance of \$9 million at September 28, 2013. The ineffective portion of these hedges was insignificant.

Assets Recorded at Fair Value on a Nonrecurring Basis

During the periods ended September 28, 2013 and December 29, 2012, certain assets in the Finance group were measured at fair value on a nonrecurring basis using significant unobservable inputs (Level 3). The table below sets forth the balance of those assets at the end of the period in which a fair value adjustment was taken.

(In millions)	September 28, 2013	December 29, 2012
---------------	-----------------------	----------------------

Edgar Filing: TEXTRON INC - Form 10-Q

Finance receivables held for sale	\$	91	\$	140
Impaired finance receivables		55		72
Other assets		26		76

The following table represents the fair value adjustments recorded for each asset class measured at fair value on a non-recurring basis during the three and nine months ended September 28, 2013 and September 29, 2012.

(In millions)	Gain (Loss)			
	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Finance receivables held for sale	\$ 13	\$ 22	\$ 30	\$ 66
Impaired finance receivables	(3)	(2)	(8)	(9)
Other assets	(5)	(13)	(10)	(45)

Table of Contents*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 September 28, 2013, our finance receivables held for sale included the non-captive loan portfolio. Fair values of each loan in this portfolio were determined based on a combination of discounted cash flow models and recent third-party offers to estimate the price we expect to receive in the principal market for each loan, in an orderly transaction. The cash flow models 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, as well as quantitative assumptions, including discount rates and revenue and earnings multiples, which are used to estimate the value of the underlying collateral. The gains on finance receivables held for sale during the three and nine months ended September 28, 2013 and September 29, 2012 were primarily the result of the payoff of loans in amounts, and sale of loans at prices, in excess of the values established in previous periods.

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 impaired nonaccrual finance receivables secured by aviation assets, the fair values of collateral are determined primarily based on the use of industry pricing guides. Fair value measurements recorded on impaired finance receivables resulted in charges to provision for loan losses and primarily related to initial fair value adjustments.

Other assets

Other assets in the table above primarily include repossessed golf and hotel properties and aviation assets. The fair value of our golf and hotel 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:

	September 28, 2013		December 29, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<i>(In millions)</i>				
Manufacturing group				
Long-term debt, excluding leases	\$ (1,847)	\$ (2,034)	\$ (2,225)	\$ (2,636)
Finance group				
Finance receivables held for investment, excluding leases	1,235	1,194	1,625	1,653
Debt	(1,278)	(1,267)	(1,686)	(1,678)

Fair value for the Manufacturing group debt is determined using market observable data for similar transactions or Level 2 inputs. At September 28, 2013 and December 29, 2012, approximately 29% and 46%, respectively, of the fair value of 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

Edgar Filing: TEXTRON INC - Form 10-Q

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.

Table of Contents**Note 11. Income Tax Expense**

Income tax expense equated to an effective income tax rate of 32.4% and 27.5% for the three and nine months ended September 28, 2013, respectively, compared with the U.S. federal statutory income tax rate of 35%. In the first nine months of 2013, the difference between the effective income tax rate and the statutory income tax rate was primarily due to benefits from income attributable to international operations in countries with lower tax rates and a favorable impact of four percentage points, resulting from the retroactive reinstatement and extension of the Federal Research and Development Tax Credit as part of the American Taxpayer Relief Act of 2012 enacted on January 2, 2013. The difference between the effective income tax rate and the federal statutory income tax rate for the three months ended September 28, 2013 was not significant.

For the three and nine months ended September 29, 2012, the difference between the effective income tax rate and the federal statutory income tax rate was not significant.

Note 12. 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 and certain corporate expenses. The measurement for the Finance segment includes interest income and expense along with intercompany interest expense. Provisions for losses on finance receivables involving the sale or lease of our products are recorded by the selling manufacturing division when our Finance group has recourse to the Manufacturing group.

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

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(In millions)</i>				
REVENUES				
<i>Manufacturing Group</i>				
Cessna	\$ 593	\$ 778	\$ 1,861	\$ 2,210
Bell	1,162	1,075	3,136	3,125
Textron Systems	405	400	1,256	1,166
Industrial	711	683	2,239	2,194
	2,871	2,936	8,492	8,695
<i>Finance Group</i>				
Total revenues	\$ 2,904	\$ 3,000	\$ 8,598	\$ 8,875
SEGMENT OPERATING PROFIT				
<i>Manufacturing Group</i>				
Cessna	\$ (23)	\$ 30	\$ (81)	\$ 59
Bell	131	165	395	462
Textron Systems	35	21	107	96
Industrial	52	38	188	172
	195	254	609	789

Edgar Filing: TEXTRON INC - Form 10-Q

<i>Finance Group</i>	13	28	47	62
Segment profit	208	282	656	851
Corporate expenses and other, net	(34)	(38)	(109)	(105)
Interest expense, net for Manufacturing group	(29)	(35)	(96)	(105)
Income from continuing operations before income taxes	\$ 145	\$ 209	\$ 451	\$ 641

Table of Contents**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Consolidated Results of Operations**

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(Dollars in millions)</i>				
Revenues	\$ 2,904	\$ 3,000	\$ 8,598	\$ 8,875
% change compared with prior period	(3)%		(3)%	
Operating expenses	\$ 2,718	\$ 2,739	\$ 8,013	\$ 8,074
% change compared with prior period	(1)%		(1)%	
Cost of sales	\$ 2,473	\$ 2,475	\$ 7,193	\$ 7,222
% change compared with prior period				
Gross margin percentage of Manufacturing revenues	13.9%	15.7%	15.3%	16.9%
Selling and administrative expenses	\$ 245	\$ 264	\$ 820	\$ 852
% change compared with prior period	(7)%		(4)%	

Revenues

Revenues decreased \$96 million, 3%, in the third quarter of 2013, compared with the corresponding period of 2012, as revenue decreases in the Cessna and Finance segments were partially offset by higher revenues in the Bell, Industrial and Textron Systems segments. The net revenue decrease included the following factors:

- Lower Cessna revenues of \$185 million, primarily due to lower Citation jet volume of \$190 million, lower CitationAir volume of \$27 million and lower pre-owned aircraft volume of \$22 million, partially offset by higher aftermarket volume of \$36 million.
- Lower Finance revenues of \$31 million, primarily attributable to a decrease of \$16 million in revenues related to the resolution of a Timeshare account in 2012 and a \$12 million unfavorable impact from lower average finance receivables.
- Higher Bell revenues of \$87 million, largely due to higher volume of \$51 million in our military programs, primarily due to higher H-1 deliveries and higher V-22 program revenues, and higher commercial revenues of \$36 million, primarily reflecting higher deliveries.
- Higher Industrial segment revenues of \$28 million, primarily the result of a \$12 million impact from acquisitions.
- Higher Textron Systems revenues of \$5 million, primarily due to higher volume of \$30 million in the Weapons and Sensors product line, partially offset by lower volume in the Unmanned Aircraft Systems (UAS) product line of \$18 million and Land & Marine product line of \$11 million.

Revenues decreased \$277 million, 3%, in the first nine months of 2013, compared with the corresponding period of 2012, as revenue decreases in the Cessna and Finance segments were partially offset by higher revenues in the Textron Systems, Industrial and Bell segments. The net revenue decrease included the following factors:

Edgar Filing: TEXTRON INC - Form 10-Q

- Lower Cessna revenues of \$349 million, primarily due to lower Citation jet volume of \$445 million and CitationAir volume of \$84 million, partially offset by higher pre-owned aircraft volume of \$65 million and higher aftermarket volume of \$55 million.
- Lower Finance revenues of \$74 million, primarily attributable to an unfavorable impact of \$38 million from lower average finance receivables and a decrease of \$25 million in revenues related to the resolution of a Timeshare account in 2012.
- Higher Textron Systems revenues of \$90 million, largely due to higher volume of \$71 million in the Weapons and Sensors product line and higher product and service volume of \$47 million in the UAS product line, partially offset by lower volume of \$33 million in the Land & Marine product line.
- Higher Industrial segment revenues of \$45 million, primarily the result of a \$29 million impact from acquisitions.
- Higher Bell revenues of \$11 million, largely due to higher volume of \$28 million in our military programs, primarily reflecting higher H-1 deliveries, partially offset by lower commercial revenues of \$17 million, largely due to lower aftermarket volume.

Table of Contents

Cost of Sales and Selling and Administrative Expense

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.

Cost of sales as a percentage of manufacturing revenues was 86.1% and 84.3% in the third quarter of 2013 and 2012, respectively, and was 84.7% and 83.1% in the first nine months of 2013 and 2012, respectively. On a dollar basis, cost of sales decreased \$2 million, in the third quarter of 2013, and \$29 million in the first nine months of 2013, compared with the corresponding periods of 2012, primarily due to lower net sales volume. Cost of sales increased approximately \$40 million in the third quarter of 2013 and \$32 million for the first nine months of 2013 primarily due to unfavorable performance at Bell, largely due to manufacturing inefficiencies associated with labor disruptions resulting from negotiations with bargained employees and with the implementation of a new enterprise resource planning system in the first quarter of 2013.

In the third quarter of 2013, gross margin as a percentage of manufacturing revenues decreased 180 basis points largely reflecting lower Citation jet volume at Cessna and unfavorable performance at Bell. In the first nine months of 2013, gross margin as a percentage of manufacturing revenues decreased 160 basis points largely due to the unfavorable impact of higher pre-owned aircraft volume.

Selling and administrative expense decreased \$19 million, 7%, in the third quarter of 2013, compared with the corresponding period of 2012, largely due to a reduction in administrative expense of \$6 million and lower provision for loan losses of \$6 million at the Finance segment, both primarily associated with the non-captive business.

Selling and administrative expense decreased \$32 million, 4%, in the first nine months of 2013, compared with the corresponding period of 2012, primarily due to a reduction in administrative expense of \$22 million and lower provision for loan losses of \$19 million at the Finance segment, both primarily associated with the non-captive business and lower commission expense of \$15 million, largely reflecting lower Citation jet volume at Cessna. These decreases were partially offset by \$28 million in severance costs incurred at Cessna in 2013.

Interest Expense

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
(Dollars in millions)				
Interest expense	\$ 41	\$ 52	\$ 134	\$ 160
% change compared with prior period	(21)%		(16)%	

Interest expense on the Consolidated Statement of Operations includes interest for both the Finance and Manufacturing borrowing groups with interest related to intercompany borrowings eliminated. Interest expense for the Finance segment is included within segment profit and includes intercompany interest.

Edgar Filing: TEXTRON INC - Form 10-Q

Consolidated interest expense decreased \$11 million, 21%, and \$26 million, 16%, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily due to lower average debt outstanding.

Income Taxes

Income tax expense equated to an effective income tax rate of 32.4% and 27.5% in the third quarter and first nine months of 2013, respectively, compared with the U.S. federal statutory income tax rate of 35%. In the first nine months of 2013, the difference between the effective income tax rate and the statutory income tax rate was primarily due to benefits from income attributable to international operations in countries with lower tax rates and a favorable impact of four percentage points, resulting from the retroactive reinstatement and extension of the Federal Research and Development Tax Credit as part of the American Taxpayer Relief Act of 2012 enacted on January 2, 2013.

Backlog

(In millions)	September 28,	December 29,
	2013	2012
Bell	\$ 6,403	\$ 7,469
Textron Systems	2,886	2,919
Cessna	1,072	1,062

Table of Contents

Backlog decreased \$1.1 billion at Bell in the first nine months of 2013 primarily due to deliveries on the V-22 and H-1 programs that exceeded new orders.

U.S. Government Defense Environment

Pursuant to the terms of the Budget Control Act of 2011 (BCA), as amended by the American Taxpayer Relief Act of 2012, a sequestration went into effect on March 1, 2013 resulting in an approximately 8% reduction to the U.S. Department of Defense (DoD) budget for fiscal year 2013. Under the BCA, sequestration also would result in a total of approximately \$500 billion in reduced DoD funding through fiscal year 2021. If Congress does not take legislative action, sequestration will be applied to defense spending in fiscal year 2014 and possibly beyond and the impact will increase as the DoD implements the cuts through future contracts. Considerable uncertainty exists regarding how budget reductions will be applied and what challenges the reductions will present for us and for the defense industry. Although it is difficult to determine specific impacts, especially over the longer term, sequestration, as currently provided for under the BCA, could result in lower revenues, profits and cash flows for our company.

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 and certain corporate expenses. The measurement for the Finance segment includes interest income and expense along with intercompany interest expense.

In our discussion of comparative results for the Manufacturing group, changes in revenues 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 revenues 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 29% of our 2012 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.

Table of Contents

Cessna

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(Dollars in millions)</i>				
Revenues	\$ 593	\$ 778	\$ 1,861	\$ 2,210
Operating expenses	616	748	1,942	2,151
Segment (loss) profit	(23)	30	(81)	59
Profit margin	(3.9)%	3.9%	(4.4)%	2.7%

Cessna Revenues and Operating Expenses

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

	Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
<i>(In millions)</i>		
Volume	\$ (196)	\$ (381)
Acquisitions	7	26
Other	4	6
Total change	\$ (185)	\$ (349)

In the third quarter of 2013, Cessna's revenues decreased \$185 million, 24%, compared with the corresponding period of 2012, primarily due to lower Citation jet volume of \$190 million, reflecting continued softness in the light-to-mid jet market, lower CitationAir volume of \$27 million, largely related to the downsizing of our fractional share business, and lower pre-owned aircraft volume of \$22 million. These decreases were partially offset by higher aftermarket volume of \$36 million, largely due to increased service demand. We delivered 25 Citation jets in the third quarter of 2013, compared with 41 jets in the corresponding period of 2012. During the third quarter of 2013, the portion of Cessna's revenues derived from aftermarket sales and services increased to 41% of Cessna's revenues, compared with 25% in the third quarter of 2012, largely due to the lower Citation jet revenues.

In the first nine months of 2013, Cessna's revenues decreased \$349 million, 16%, compared with the corresponding period of 2012, primarily due to lower Citation jet volume of \$445 million and lower CitationAir volume of \$84 million, largely related to the downsizing of our fractional share business. These decreases were partially offset by higher pre-owned aircraft volume of \$65 million and higher aftermarket volume of \$55 million, largely due to increased service demand. We delivered 77 and 128 Citation business jets in the first nine months of 2013 and 2012, respectively. During the first nine months of 2013, the portion of Cessna's revenues derived from aftermarket sales and services increased to 37% of Cessna's revenues, compared with 27% in the first nine months of 2012, largely due to the lower Citation jet revenues.

Cessna's operating expenses decreased \$132 million, 18%, and \$209 million, 10%, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily due to lower sales volume as discussed above. The volume-related decrease in operating expenses in the first nine months of 2013 was partially offset by \$31 million of inflation, largely due to higher pension expense, \$28 million in severance costs and \$28 million of operating costs incurred by service center acquisitions.

Edgar Filing: TEXTRON INC - Form 10-Q

In the first half of 2013, Cessna incurred \$28 million in severance costs in connection with a voluntary separation program offered to qualifying salaried employees and a reduction of certain direct production positions due to an adjustment of our production schedule.

Cessna Segment (Loss) Profit

The following factors contributed to the change in Cessna's segment (loss) profit for the periods:

<i>(In millions)</i>	Q3 2013 versus		YTD 2013 versus	
	Q3 2012		YTD 2012	
Volume	\$	(49)	\$	(94)
Severance costs				(28)
Inflation, net of pricing		(10)		(26)
Other		6		8
Total change	\$	(53)	\$	(140)

Table of Contents

Cessna's segment profit decreased \$53 million and \$140 million in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily due to the impact of lower sales volume as discussed above. Segment profit in the first nine months of 2013 was also impacted by \$28 million in severance costs incurred in the first half of 2013 as described above and \$26 million in inflation, net of pricing, largely due to higher pension expense.

Bell

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(Dollars in millions)</i>				
Revenues				
V-22 program	\$ 442	\$ 430	\$ 1,218	\$ 1,217
Other military	254	215	720	693
Commercial	466	430	1,198	1,215
Total revenues	1,162	1,075	3,136	3,125
Operating expenses	1,031	910	2,741	2,663
Segment profit	131	165	395	462
Profit margin	11.3%	15.3%	12.6%	14.8%

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. During the second quarter of 2013, we signed the second multi-year V-22 contract for production and delivery of 99 units beginning in late 2014 with options for 23 additional aircraft.

Bell Revenues and Operating Expenses

The following factors contributed to the change in Bell's revenues for the periods:

	Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
<i>(In millions)</i>		
Volume	\$ 69	\$ (17)
Other	18	28
Total change	\$ 87	\$ 11

Bell's revenues increased \$87 million, 8%, in the third quarter of 2013, compared with the corresponding period of 2012, due to the following factors:

- \$39 million increase in other military volume, primarily reflecting higher H-1 deliveries. We delivered 7 H-1 aircraft in the third quarter of 2013, compared with 5 aircraft in the third quarter of 2012.

Edgar Filing: TEXTRON INC - Form 10-Q

- \$36 million increase in commercial revenues, primarily due to higher deliveries. Bell delivered 54 aircraft in the third quarter of 2013, compared with 46 aircraft in the third quarter of 2012.
- \$12 million increase in volume related to the V-22 program, primarily due to higher aftermarket volume of \$37 million, reflecting increased support of fielded aircraft, partially offset by the \$27 million impact of lower aircraft deliveries. Bell delivered 10 V-22 aircraft in the third quarter of 2013, compared with 11 aircraft in the third quarter of 2012.

Bell's revenues increased \$11 million, in the first nine months of 2013, compared with the corresponding period of 2012, due to the following factors:

- \$27 million increase in other military volume, primarily reflecting higher H-1 deliveries. We delivered 19 H-1 aircraft in the first nine months of 2013, compared with 18 aircraft in the first nine months of 2012.
- \$17 million decrease in commercial revenues, largely due to lower aftermarket volume, which in part, resulted from the conversion to a new enterprise resource planning system in the first quarter of 2013. Bell delivered 138 aircraft in the first nine months of 2013, compared with 123 aircraft in the first nine months of 2012.
- Revenues for the V-22 program were essentially flat as higher aftermarket volume reflecting increased support of fielded aircraft offset by lower aircraft deliveries. Bell delivered 28 V-22 aircraft in the first nine months of 2013, compared with 30 aircraft in the first nine months of 2012.

Table of Contents

Bell's operating expenses increased \$121 million, 13%, and \$78 million, 3%, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily due to unfavorable performance, largely due to manufacturing inefficiencies associated with labor disruptions resulting from negotiations with bargained employees and with the implementation of a new enterprise resource planning system in the first quarter of 2013. On October 13, 2013, Bell reached a new five-year collective bargaining agreement with the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) and UAW Local 218 which represents these employees.

Bell Segment Profit

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

		Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
(In millions)			
Volume and mix	\$	(5)	\$ (40)
Performance		(40)	(32)
Other		11	5
Total change	\$	(34)	\$ (67)

Bell's segment profit decreased \$34 million, 21%, and \$67 million, 15%, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily due to unfavorable performance, largely due to manufacturing inefficiencies associated with labor disruptions resulting from negotiations with bargained employees and with the implementation of a new enterprise resource planning system in the first quarter of 2013. Segment profit was also impacted by an unfavorable mix of commercial aircraft deliveries.

Textron Systems

	Three Months Ended		Nine Months Ended	
(Dollars in millions)	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues	\$ 405	\$ 400	\$ 1,256	\$ 1,166
Operating expenses	370	379	1,149	1,070
Segment profit	35	21	107	96
Profit margin	8.6%	5.3%	8.5%	8.2%

Textron Systems Revenues and Operating Expenses

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

		Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
(In millions)			
Volume	\$	4	\$ 87

Edgar Filing: TEXTRON INC - Form 10-Q

Other			1		3
Total change		\$	5	\$	90

Revenues at Textron Systems increased \$5 million, 1%, in the third quarter of 2013, compared with the third quarter of 2012, primarily due to higher volume in the Weapons and Sensors product line of \$30 million, partially offset by lower volume in the UAS and Land & Marine product lines of \$18 million and \$11 million, respectively.

Revenues at Textron Systems increased \$90 million, 8%, in the first nine months of 2013, compared with the first nine months of 2012, primarily due to higher volume in the Weapons and Sensors product line of \$71 million and higher product and service volume in the UAS product line of \$47 million, partially offset by lower volume in the Land & Marine product line of \$33 million.

Textron Systems' operating expenses decreased \$9 million, 2%, in the third quarter compared with the corresponding period of 2012, largely due to improved performance across most of the segment's product lines.

Table of Contents

Textron Systems' operating expenses increased \$79 million, 7%, in the first nine months of 2013, compared with the corresponding period of 2012, primarily due to higher sales volume as discussed above.

In the third quarter of 2013, we recorded \$15 million of charges related to the UAS fee-for service program, compared to a \$14 million charge in the third quarter of 2012. The charges in 2013 were related to our estimate of costs to fulfill the options that were exercised by the customer during the third quarter; these options extended the period of performance on the initial task orders under the contracts for one year. We continue to experience unacceptable quality from our engine supplier for this program. Accordingly, we have decided to transition the manufacture of the engine to our Lycoming business, which we believe will allow us to improve performance. Previously, in the third quarter of 2012, we recorded a charge that reflected our estimated loss on the initial task orders under the contracts due to significant start-up issues experienced as we began deployment of the initial task orders, which required us to augment training procedures, add resources and adjust certain estimated costs.

Textron Systems Segment Profit

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

	Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
<i>(In millions)</i>		
Performance	\$ 24	\$ 26
Volume and mix	(8)	(9)
Other	(2)	(6)
Total change	\$ 14	\$ 11

Segment profit at Textron Systems increased \$14 million and \$11 million, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, largely due to favorable performance across most of the segment's product lines primarily due to cost reduction initiatives.

Industrial

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
<i>(Dollars in millions)</i>				
Revenues:				
Fuel Systems and Functional Components	\$ 442	\$ 433	\$ 1,373	\$ 1,393
Other Industrial	269	250	866	801
Total revenues	711	683	2,239	2,194
Operating expenses	659	645	2,051	2,022
Segment profit	52	38	188	172
Profit margin	7.3%	5.6%	8.4%	7.8%

Industrial Revenues and Operating Expenses

Edgar Filing: TEXTRON INC - Form 10-Q

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

<i>(In millions)</i>	Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
Acquisitions	\$ 12	\$ 29
Volume	8	13
Other	8	3
Total change	\$ 28	\$ 45

Industrial segment revenues increased \$28 million, 4%, and \$45 million, 2%, in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily the result of acquisitions. Revenues in the third quarter of 2013 were also impacted by higher volume of \$8 million, primarily in the Fuel Systems and Functional Components product line reflecting higher market demand mostly in Europe and Asia. Revenues in the first nine months of 2013 were impacted by higher volume of \$13 million, primarily in the Other Industrial product lines, mostly due to higher market demand in the Golf, Turf Care and Light Transportation Vehicle product line.

Table of Contents

Operating expenses for the Industrial segment increased \$14 million, 2%, in the third quarter of 2013, compared with the corresponding period of 2012, largely due to the impact from acquisitions. Lower operating expenses of \$15 million resulting from improved performance associated with the Fuel Systems and Functional Components product line, were offset mostly by the impact of higher volume.

Operating expenses for the Industrial segment increased \$29 million, 1%, in the first nine months of 2013, compared with the corresponding period of 2012, largely due to the impact from acquisitions. Lower operating expenses of \$29 million resulting from improved performance associated with the Fuel Systems and Functional Components product line, were offset by inflation of \$21 million primarily due to higher material costs and compensation expense, and the impact of higher volume.

Industrial Segment Profit

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

	Q3 2013 versus Q3 2012	YTD 2013 versus YTD 2012
<i>(In millions)</i>		
Performance	\$ 15	\$ 29
Volume	3	(2)
Inflation, net of pricing	(2)	(13)
Other	(2)	2
Total change	\$ 14	\$ 16

Segment profit for the Industrial segment increased \$14 million, 37%, in the third quarter of 2013, compared with the corresponding period of 2012, primarily due to improved performance of \$15 million, largely associated with the Fuel Systems and Functional Components product line.

Segment profit for the Industrial segment increased \$16 million, 9%, in the first nine months of 2013, compared with the corresponding period of 2012, primarily due to improved performance of \$29 million, largely associated with the Fuel Systems and Functional Components product line. This improvement was partially offset by a \$13 million unfavorable impact from inflation, net of pricing, primarily in the Fuel Systems and Functional Components product line.

Finance

	Three Months Ended		Nine Months Ended	
<i>(In millions)</i>	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenues	\$ 33	\$ 64	\$ 106	\$ 180
Segment profit	13	28	47	62

Finance segment revenues decreased \$31 million and \$74 million in the third quarter and first nine months of 2013, respectively, compared with the corresponding periods of 2012, primarily attributable to an unfavorable impact of \$12 million and \$38 million, respectively, from lower

Edgar Filing: TEXTRON INC - Form 10-Q

average finance receivables of \$802 million and \$908 million, respectively. Revenues during the third quarter and first nine months of 2013 were also lower by \$16 million and \$25 million, respectively, due to the resolution of a Timeshare account that returned to accrual status in 2012.

Finance segment profit decreased \$15 million in both the third quarter and first nine months of 2013, compared with the corresponding periods of 2012, primarily resulting from the resolution of a Timeshare account as discussed above and an unfavorable impact of \$6 million and \$20 million, respectively, from lower average finance receivables. These decreases were partially offset by lower administrative expenses of \$6 million and \$22 million, respectively, and lower provision for loan losses of \$6 million and \$19 million, respectively, largely related to the downsizing of the non-captive business.

Table of Contents

Finance Portfolio Quality

The following table reflects information about the Finance segment's credit performance related to finance receivables held for investment. The credit performance statistics below do not include finance receivables held for sale.

	September 28, 2013	December 29, 2012
<i>(Dollars in millions)</i>		
Finance receivables	\$ 1,498	\$ 1,934
Nonaccrual finance receivables	105	143
Allowance for losses	62	84
Ratio of nonaccrual finance receivables to finance receivables	7.01%	7.39%
Ratio of allowance for losses on impaired nonaccrual finance receivables to impaired nonaccrual finance receivables	20.57%	21.24%
Ratio of allowance for losses on finance receivables to nonaccrual finance receivables	59.05%	58.74%
Ratio of allowance for losses on finance receivables to finance receivables	4.14%	4.34%
60+ days contractual delinquency as a percentage of finance receivables	5.87%	4.65%
60+ days contractual delinquency	\$ 88	\$ 90
Repossessed assets and properties	51	81

Liquidity and Capital Resources

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron 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. 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:

	September 28, 2013	December 29, 2012
<i>(Dollars in millions)</i>		
Manufacturing group		
Cash and equivalents	\$ 444	\$ 1,378
Debt	2,020	2,301
Shareholders' equity	3,580	2,991
Capital (debt plus shareholders' equity)	5,600	5,292
Net debt (net of cash and equivalents) to capital	31%	24%
Debt to capital	36%	44%
Finance group		
Cash and equivalents	\$ 193	\$ 35
Debt	1,278	1,686

Edgar Filing: TEXTRON INC - Form 10-Q

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 we will have sufficient cash to meet our future needs, based on our existing cash balances, the cash we expect to generate from our manufacturing operations and other available funding alternatives, as appropriate.

On October 4, 2013, Textron entered into a senior unsecured revolving credit facility for an aggregate principal amount of \$1.0 billion, of which up to \$100 million is available for the issuance of letters of credit. This facility expires in October 2018 and replaced the existing 4-year facility that was scheduled to expire in March 2015. At September 28, 2013, there were no amounts borrowed against the prior 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.

Table of Contents**Manufacturing Group Cash Flows**

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

	Nine Months Ended	
	September 28, 2013	September 29, 2012
<i>(In millions)</i>		
Operating activities	\$ (381)	\$ 397
Investing activities	(334)	(313)
Financing activities	(206)	277

Cash flows from operating activities decreased \$778 million during the first nine months of 2013, compared with the corresponding period of 2012, largely due to working capital requirements as well as \$98 million of lower income from continuing operations and \$76 million of lower net dividends from the Finance group. Significant changes in working capital included a \$240 million net use of cash attributable to net taxes received/paid between the periods as net tax payments were \$179 million in the first nine months of 2013, while net tax refunds were \$61 million in the first nine months of 2012. Other changes in working capital included uses of cash attributable to a \$133 million decrease in accounts payable and a \$122 million increase in accounts receivable, largely due to an increase in commercial deliveries at Bell, as well as the use of approximately \$230 million more in cash to fund inventory growth at Bell, which were partially offset by \$189 million of cash provided by customer deposits at Bell, primarily as a result of the timing of receipts in relation to production activities. The change in inventory growth at Bell between the periods largely reflects a buildup of costs in excess of billings on military contracts of approximately \$135 million and an increase in production stock, military spares and commercial inventories of approximately \$95 million, which were both in support of future military and commercial deliveries and, to a lesser extent, as a result of the conversion to a new enterprise resource planning system in the first quarter of 2013.

Working capital requirements improved by \$186 million during the third quarter of 2013, compared with the corresponding period of 2012, and we expect continued improvement during the last quarter of the year resulting in positive cash flows from operating activities for the full year as we deliver higher volumes at Bell and Cessna.

Investing cash flows in the first nine months of 2013 and 2012 primarily included capital expenditures of \$300 million and \$314 million, respectively. Cash flows from investing activities also included \$53 million of cash used in acquisitions of a business within our Industrial segment and two service centers in the first half of 2013.

In the first nine months of 2013, financing activities primarily consisted of the repayment of \$527 million of outstanding debt, including the settlement of our convertible notes, which was partially offset by proceeds of \$246 million from long-term debt and the issuance of commercial paper. In the second quarter of 2013, we entered into a \$150 million variable-rate term loan agreement maturing in May 2016. In addition, we began to issue commercial paper for our short-term financing needs in 2013 and ended the period with \$96 million outstanding. In the first nine months of 2012, we generated cash from financing activities largely due to the receipt of \$418 million from the Finance group in payment of a portion of its intergroup borrowing, partially offset by the repayment of \$141 million of outstanding debt.

Capital Contributions Paid To and Dividends Received From TFC

Edgar Filing: TEXTRON INC - Form 10-Q

Under a Support Agreement between Textron and TFC, Textron is required to maintain a controlling interest in TFC. The agreement also requires Textron 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 are detailed below:

	Nine Months Ended	
	September 28, 2013	September 29, 2012
(In millions)		
Dividends received by Textron	\$ 30	\$ 345
Capital contributions paid by Textron under Support Agreement		(240)

During 2013, we also made a \$1 million capital contribution to TFC to fund the repurchase of a portion of TFC's 6% Fixed-to-Floating Rate Junior Subordinated Notes.

Table of Contents

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 Statements 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 is excluded from the Manufacturing group's cash flows, while dividends from the Finance group are included within cash flows from operating activities for the Manufacturing group as they represent a return on investment.

Finance Group Cash Flows

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

	Nine Months Ended	
	September 28, 2013	September 29, 2012
(In millions)		
Operating activities	\$ 24	\$ (48)
Investing activities	586	810
Financing activities	(452)	(770)

The Finance group generated cash from operating activities in the first nine months of 2013, primarily due to changes in net taxes received/paid. Net tax refunds were \$33 million in the first nine months of 2013, while net tax payments were \$85 million in the first nine months of 2012. Net tax payments in 2012 were primarily attributable to a settlement related to the Internal Revenue Service's challenge of tax deductions claimed in prior years for certain leveraged lease transactions.

Cash flows from investing activities primarily included collections on finance receivables and proceeds from sales of finance receivables and other finance assets totaling \$710 million and \$982 million in the first nine months of 2013 and 2012, respectively, partially offset by finance receivable originations of \$164 million and \$194 million in the first nine months of 2013 and 2012, respectively.

Cash used for financing activities in the first nine months of 2013 largely related to the repayment of \$685 million of long-term and nonrecourse debt, compared with \$335 million in the first nine months of 2012. The payments in the first nine months of 2013 were partially offset by \$262 million in proceeds from long-term debt. In the second quarter of 2013, we borrowed \$200 million under a variable-rate term loan agreement maturing in May 2016. Cash used for financing activities in the first nine months of 2012 also included the repayment of \$418 million to the Manufacturing group in settlement of a portion of its intergroup borrowings.

Consolidated Cash Flows

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

	Nine Months Ended	
	September 28, 2013	September 29, 2012
(In millions)		
Operating activities	\$ (103)	\$ 402

Edgar Filing: TEXTRON INC - Form 10-Q

Investing activities	(31)	339
Financing activities	(629)	(388)

Cash flows from operating activities decreased \$505 million during the first nine months of 2013, compared with the corresponding period of 2012, largely due to working capital requirements and \$108 million of lower income from continuing operations. Significant changes in working capital included a \$122 million net use of cash attributable to net taxes received/paid between the periods as net tax payments were \$146 million and \$24 million in the first nine months of 2013 and 2012, respectively. Other changes in working capital included uses of cash attributable to a \$133 million decrease in accounts payable and a \$122 million increase in accounts receivable, largely due to an increase in commercial deliveries at Bell, as well as the use of approximately \$230 million more in cash to fund inventory growth at Bell, which were partially offset by \$189 million of cash provided by customer deposits at Bell, primarily as a result of the timing of receipts in relation to production activities.

Cash flows from investing activities in the first nine months of 2013 and 2012 primarily included capital expenditures of \$300 million and \$314 million, respectively, and collections on finance receivables and proceeds from sales of finance receivables and other finance assets totaling \$309 million and \$662 million, respectively. Cash flows from

Table of Contents

investing activities also included \$53 million of cash used in acquisitions of a business within our Industrial segment and two service centers in the first half of 2013.

In the first nine months of 2013, financing activities primarily consisted of the repayment of \$1.2 billion of outstanding debt, including the settlement of our convertible notes, partially offset by proceeds from long-term debt of \$412 million and the issuance of commercial paper. In addition, we began to issue commercial paper for our short-term financing needs in 2013 and ended the period with \$96 million outstanding. In the first nine months of 2012, cash from financing activities included the repayment of \$476 million of outstanding debt.

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 Statements of Cash Flows are summarized below:

	Nine Months Ended	
	September 28, 2013	September 29, 2012
<i>(In millions)</i>		
Reclassifications from investing activities:		
Finance receivable originations for Manufacturing group inventory sales	\$ (144)	\$ (172)
Cash received from customers and sale of receivables and other finance assets	401	320
Other	26	10
Total reclassifications from investing activities	283	158
Reclassifications from financing activities:		
Capital contribution paid by Manufacturing group to Finance group	1	240
Dividends received by Manufacturing group from Finance group	(30)	(345)
Total reclassifications from financing activities	(29)	(105)
Total reclassifications and adjustments to cash flow from operating activities	\$ 254	\$ 53

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 35 through 38 in our 2012 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 first nine months of 2013 and 2012.

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

Table of Contents

efficiencies and the achievement of contract milestones, including product deliveries, technical requirements, or schedule.

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 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 aggregate gross amount of all program profit adjustments that are included within segment profit are presented below.

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
(In millions)				
Gross favorable	\$ 12	\$ 12	\$ 30	\$ 52
Gross unfavorable	(8)	(18)	(17)	(42)
Net adjustments	\$ 4	\$ (6)	\$ 13	\$ 10

Forward-Looking Information

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

- Interruptions in the U.S. Government's ability to fund its activities and/or pay its obligations;
- Changing priorities or reductions in the U.S. Government defense budget, including those related to military operations in foreign countries;
- Our ability to perform as anticipated and to control costs under contracts with the U.S. Government;
- The U.S. Government's ability to unilaterally modify or terminate its contracts with us for its convenience or for our failure to perform, to change applicable procurement and accounting policies, or, under certain circumstances, to withhold payment or suspend or debar us as a contractor eligible to receive future contract awards;

Edgar Filing: TEXTRON INC - Form 10-Q

- Changes in foreign military funding priorities or budget constraints and determinations, or changes in government regulations or policies on the export and import of military and commercial products;
- Volatility in the global economy or changes in worldwide political conditions that adversely impact demand for our products;
- Volatility in interest rates or foreign exchange rates;
- Risks related to our international business, including establishing and maintaining facilities in locations around the world and relying on joint venture partners, subcontractors, suppliers, representatives, consultants and other business partners in connection with international business, including in emerging market countries;
- Our Finance segment's ability to maintain portfolio credit quality or to realize full value of receivables and of assets acquired upon foreclosure of receivables;
- Performance issues with key suppliers or subcontractors;
- Legislative or regulatory actions, both domestic and foreign, impacting our operations or demand for our products;

Table of Contents

- Our ability to control costs and successfully implement various cost-reduction activities;
- The efficacy of research and development investments to develop new products or unanticipated expenses in connection with the launching of significant new products or programs;
- The timing of our new product launches or certifications of our new aircraft products;
- Our ability to keep pace with our competitors in the introduction of new products and upgrades with features and technologies desired by our customers;
- Increases in pension expense or employee and retiree medical benefits;
- Difficult conditions in the financial markets which may adversely impact our customers' ability to fund or finance purchases of our products; and
- Continued demand softness or volatility in the markets in which we do business.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no significant change in our exposure to market risk during the fiscal quarter ended September 28, 2013. For discussion of our exposure to market risk, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk contained in Textron's 2012 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, President 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 September 28, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

As previously reported, plaintiffs in a purported class action lawsuit in the United States District Court in Rhode Island alleged that the company and certain of its present and former employees, officers and directors had violated the United States Employee Retirement Income Security Act by imprudently permitting participants in the Textron Savings Plan to invest in Textron common stock. As reported in Textron's Annual Report on Form 10-K for the fiscal year ended December 29, 2012, on December 13, 2012, as a result of a mediation process overseen by an independent mediator, the parties reached an agreement in principle, subject to settlement documentation and court approval, to settle the plaintiffs' claims for an immaterial amount. Because this is a class action, settlements of this type are subject to preliminary and final review by the Court with an opportunity for class members to respond to the proposed settlement and object if they so desire. On August 21, 2013, the Court entered an order preliminarily approving the settlement, certifying a settlement class, and approving the form and manner of class notice. Neither Textron nor any of the other defendants in the settlement admitted any wrongdoing with respect to the allegations in the case.

Table of Contents

Item 6. EXHIBITS

- 12.1 Computation of ratio of income to fixed charges of Textron Inc. Manufacturing Group
- 12.2 Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 The following materials from Textron Inc. s Quarterly Report on Form 10-Q for the quarterly period ended September 28, 2013, 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) the Notes to the Consolidated Financial Statements.

SIGNATURES

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

TEXTRON INC.

Date: October 24, 2013

/s/ Richard L. Yates
Richard L. Yates
Senior Vice President and Corporate Controller
(principal accounting officer)

Table of Contents

LIST OF EXHIBITS

12.1	Computation of ratio of income to fixed charges of Textron Inc. Manufacturing Group
12.2	Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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 September 28, 2013, 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) the Notes to the Consolidated Financial Statements.