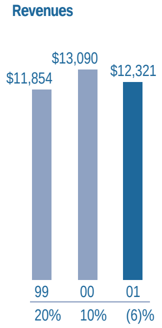
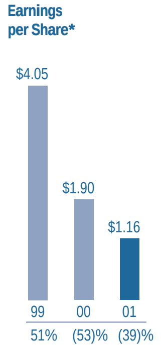
Management's Discussion and Analysis

Results of Operations





*Income from continuing operations – diluted

Textron Inc.

2001 vs. 2000

- Revenues decreased to $12.3 billion in 2001 from $13.1 billion in 2000, primarily due to softening sales in most short-cycle businesses and pricing pressures, partially offset by higher aircraft sales. Net income was $166 million for 2001, down from $218 million in 2000. Diluted earnings per share from continuing operations were $1.16 in 2001 and $1.90 in 2000. During 2001, Textron recognized special charges of $437 million and gains of $342 million on the sale of two divisions. In 2000, Textron recognized $483 million in special charges and recorded a cumulative effect of a change in accounting principle of $59 million (net of tax) for the adoption of EITF consensus on Issue No. 99-5 "Accounting for Pre-Production Costs Related to Long Term Supply Arrangements."

- Special charges of $437 million in 2001 included goodwill and intangible asset impairment write-downs of $319 million, restructuring expense of $81 million, write-downs for fixed asset impairments under the restructuring program of $28 million and e-business investment losses of $9 million.

- Textron recorded $342 million for gains on the sale of two divisions in 2001. In December 2001, Textron recorded a gain of $339 million on the sale of its Automotive Trim business to Collins & Aikman Products Co., a subsidiary of Collins & Aikman Corporation. Under the terms of the sale, Textron received $625 million in cash along with other consideration as disclosed in Note 2 to the consolidated financial statements. In August 2001, Textron recorded a gain of $3 million on the sale of its Turbine Engine Components business.

- At year-end 2001, Textron's reportable segments include Aircraft, Automotive, Fastening Systems, Industrial Products and Finance. During 2001 and 2000, management responsibility for certain divisions was reorganized as described in Note 1 to the consolidated financial statements. All prior period data has been appropriately reclassified. Subsequent to year-end 2001, management responsibility was reorganized to reflect the sale of the Automotive Trim business, and in 2002, Textron will report under the following new segments: Aircraft, Fastening Systems, Industrial Products, Industrial Components and Finance.

- Segment profit of $828 million in 2001 decreased from $1.410 billion in 2000 due to lower sales volumes and pricing pressures at Automotive, Fastening Systems and Industrial Products; lower profit at Bell Helicopter due primarily to reduced profitability on certain military contracts and commercial helicopter programs; manufacturing inefficiencies resulting from reduced production at Fastening Systems and Industrial Products; and $34 million in additional costs related to restructuring included in cost of sales. These negative factors were partially offset by higher Citation business jet volume at Cessna Aircraft, the benefit of restructuring and other cost reduction activities and an increase in syndication and securitization income in the Finance segment.

- Total segment margin decreased to 6.7% in 2001 from 10.8% in 2000 due primarily to lower margins across the manufacturing segments.

- Corporate expenses and other, net decreased $12 million, due primarily to the impact of organizational changes made in 2000.

- Net interest expense for Textron Manufacturing increased $10 million. Interest expense increased $4 million due to a higher level of average debt, primarily as a result of lower cash flow from operations during the first nine months of 2001, partially offset by the benefit of a lower interest rate environment. Interest income decreased $6 million due to the settlement of a note receivable in the fourth quarter 2000.

- Income Taxes – the effective tax rate for 2001 was 54.2% primarily due to the impact of the gain on the sale of the Automotive Trim business in 2001 and the non-tax deductibility of goodwill written-off in 2001. Excluding the impact of these two items, the effective tax rate for 2001 was 35.0%. The effective tax rate for 2000 was also impacted by the non-tax deductibility of goodwill written-off during 2000. Excluding the impact of this goodwill write-off, the effective tax rate for 2000 was 35.5%. The decrease in the annual effective tax rate from 35.5% in 2000 to 35.0% in 2001, was due to the benefit of tax planning initiatives realized in 2001.

- At this time, there are no indications that the weakened economy has begun to recover. Textron anticipates the economy will remain sluggish at least for the first half of 2002. To strengthen operating efficiencies and better align its operations with current economic and market conditions in its manufacturing businesses, Textron expects to continue to incur restructuring charges from its previously announced program throughout 2002.

2000 vs. 1999

- Revenues increased to $13.1 billion in 2000 from $11.9 billion in 1999. Income from continuing operations for 2000 was $277 million, down from $623 million in 1999. Diluted earnings per share from continuing operations were $1.90 and $4.05 for 2000 and 1999, respectively. Net income (including the cumulative effect of a change in accounting principle and special charges) in 2000 was $218 million or $1.49 per share compared to 1999 net income of $2.23 billion or $14.48 per share, which included a gain on the sale of Avco Financial Services (AFS) in January 1999.

- Special charges of $483 million in 2000 include restructuring charges of $17 million, associated with the modernization and consolidation of manufacturing facilities in the Automotive and Industrial Products segments, $349 million for goodwill impairment and $117 million for the write-down of Textron's e-business investment portfolio.

- Segment profit of $1.410 billion increased from $1.201 billion in 1999, as a result of continued improved financial results in Aircraft, Automotive, Industrial Products and Finance, and higher income related to retirement benefits, reflecting a higher expected return on plan assets and revised actuarial estimates.

- Total segment margin increased to 10.8% in 2000 from 10.1% in 1999, due primarily to higher Aircraft and Automotive margins.

- Effective January 2000, Textron implemented the EITF consensus on Issue No. 99-5 "Accounting for Pre-Production Costs Related to Long Term Supply Arrangements." As a result of this, in the first quarter 2000, Textron reported a cumulative effect of a change in accounting principle of $59 million (net of tax), or $0.41 per share related to the adoption of this consensus.

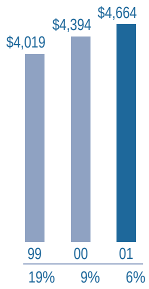
- Textron completed the sale of AFS to Associates First Capital Corporation for $3.9 billion in cash in January 1999 and recorded an after-tax gain of $1.65 billion or $10.70 per share. Textron also recorded an extraordinary loss of $43 million (net of tax) or $0.27 per share on the early retirement of debt in 1999.

- Corporate expenses and other, net increased $21 million due primarily to the impact of organizational changes and costs associated with strategic and e-business initiatives in 2000, partially offset by higher income related to retirement benefits.

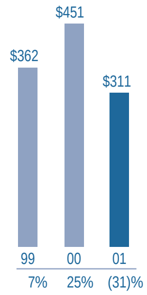
- Net interest expense for Textron Manufacturing increased $123 million. Interest expense increased $102 million due to a higher level of average debt as a result of acquisitions and share repurchases. Interest income for 2000 of $6 million was related to the settlement of a note receivable compared to income of $27 million realized in 1999 as a result of Textron's net investment position during the year.

- Income taxes – the effective income tax rate for 2000 was 50.4% primarily due to the impact of the non-tax deductibility of goodwill written off in the fourth quarter. The impact of the special charges on the effective tax rate was 14.9%. Excluding the tax impact of the special charges, the effective tax rate was 35.5% for 2000 compared to 37.0% in 1999. This reduction is primarily due to the benefit of tax planning initiatives being realized in 2000 and the tax benefit of a contribution of shares granted to Textron in 1999 from Manulife Financial Corporation's initial public offering on their demutualization of Manufacturers Life Insurance Company.

Aircraft
Revenues



Segment
Profit



Aircraft

2001 vs. 2000

The Aircraft segment's revenues increased $270 million, while profit decreased $140 million.

- Cessna Aircraft's revenues increased $229 million due to higher sales of Citation business jets and increased spare parts and service sales. This was partially offset by lower sales of used aircraft and Caravan and single engine piston models that have been adversely affected by the weakening economy. Profit increased $44 million as a result of the higher revenues and improved operating performance, partially offset by a write-down of used aircraft inventory to reflect lower prices in the current market, lower re-sale prices for trade-in aircraft, higher engineering expense for planned program spending related to the Sovereign business jet and the reduced volume of Caravan and single engine piston models.

- Bell Helicopter's revenues increased $41 million primarily due to higher revenue on the V-22 tiltrotor aircraft contract ($54 million) and other sales to the U.S. Government ($25 million) and higher sales of commercial spares ($21 million), partially offset by lower foreign military sales ($74 million). Bell's profit decreased $184 million primarily due to reduced profitability expectations ($124 million) on certain development and production contracts including the Huey and Cobra upgrade contracts, the Model 412 and Model 427 commercial helicopters, and the V-22 Engineering Manufacturing and Development contract. The reduced profitability expectations were based on program reviews in the second half of 2001, and reflect the clarification of several matters including extended development schedules and planned design changes on a number of programs, as well as ongoing development efforts. Profit also decreased due to lower margins on commercial sales, lower income ($17 million in 2001 vs. $30 million in 2000) from a joint venture related to the BA609 program, lower foreign military sales and costs related to outsourcing the manufacture of certain parts. A favorable LIFO inventory reserve adjustment of $8 million from a reduction in LIFO inventories was offset by higher reserves related to receivables and product liability issues.

  In December 2000, the U.S. Marine Corps temporarily restricted the use of their V-22 tiltrotor aircraft pending an investigation by the Department of Defense of a mishap. In April 2001, a Blue Ribbon Panel appointed by the U.S. Secretary of Defense recommended specific changes to the software and hydraulic systems and issued its unanimous recommendation for the continuation of the program. On December 21, 2001, the Department of Defense signed an Acquisition Decision Memorandum that authorizes the V-22 program to proceed with continued low-rate production. The Memorandum requires additional flight testing to ensure that the V-22 can be deployed as a safe, reliable and operationally suitable aircraft. Management expects to finalize contracts in early 2002 for the next two lots which include twenty aircraft. Under the current schedule, Textron plans to return the V-22 to flight in April 2002 for completion of extensive flight testing before returning to operational use in the third quarter of 2003. Textron recognized revenue of $485 million in 2001 and $432 million in 2000 under the V-22 program. Under the current low-rate production level, revenue in 2002 is expected to be comparable to revenue in 2001.

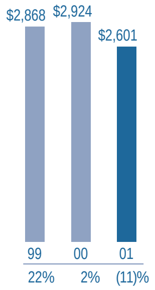
2000 vs. 1999

The Aircraft segment's revenues and profit increased $375 million and $89 million, respectively.

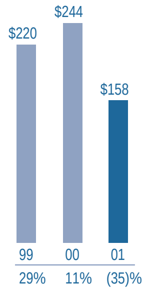
- Cessna Aircraft's revenues increased $342 million due to higher sales of Citation business jets and increased spare parts and service sales. Profit increased $69 million as a result of the higher revenues and improved operating performance, partially offset by higher engineering expense related to the Sovereign business jet.

- Bell Helicopter's revenues increased $33 million as higher foreign military sales ($54 million), higher commercial spares sales ($21 million) and higher revenues on the V-22 tiltrotor aircraft contract ($41 million) were partially offset by lower sales of commercial and other military helicopters ($71 million). Bell's profit increased $20 million due to the higher revenues and higher income related to retirement benefits. This favorable impact was partially offset by the lower income ($30 million in 2000 vs. $37 million in 1999) from a joint venture related to the BA609 program. Product development expense for 2000 increased slightly as higher spending on the BA609 commercial tiltrotor aircraft (net of the benefit of the contribution from a new supplier for the fuselage) was offset by lower spending on other programs.

Automotive
Revenues



Segment
Profit



Automotive

2001 vs. 2000

The Automotive segment's revenues and profit decreased $323 million and $86 million, respectively.

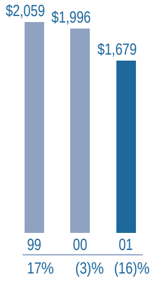
- Trim revenues decreased $263 million primarily due to North American automotive original equipment manufacturer production decreases, customer price reductions and an unfavorable foreign exchange impact resulting from a weaker Brazilian Real, partially offset by the contribution from acquisitions. Profit decreased $84 million primarily due to the lower sales volume, customer price reductions and start-up costs on new programs, partially offset by the benefit of restructuring and other cost containment activities, and the settlement of outstanding customer claims.
- Fuel Systems and Functional Components revenues decreased $60 million primarily as a result of the divestiture of non-core product lines in the fourth quarter of 2000 and the first half of 2001, customer price reductions and the unfavorable impact of foreign exchange, partially offset by higher sales volume. Strong European sales in the first half of 2001, coupled with the success of several customer platforms at Kautex, have mitigated the negative impact from reduced North American volumes. Profit decreased $2 million primarily due to customer price reductions, a $4 million gain in 2000 on the sale of two non-core product lines and the unfavorable impact of foreign exchange, partially offset by the benefit of cost reduction activities and a $7 million gain on the sale of a small product line in 2001.

2000 vs. 1999

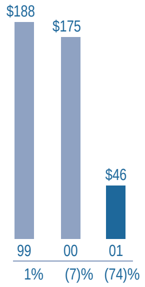
The Automotive segment's revenues and profit increased $56 million and $24 million, respectively. These results were achieved despite North American automotive original equipment manufacturer production decreases in the fourth quarter 2000.

- Trim revenues increased $46 million due to the contribution from acquisitions and major new program launches, partially offset by customer price reductions. Profit increased $13 million due to improved operating performance and the contribution from acquisitions, partially offset by higher petroleum-based resin prices, customer price reductions and higher engineering and design expense to support future programs.
- Fuel Systems and Functional Components revenues increased $10 million as a result of higher sales volume at Kautex, partially offset by the negative impact of foreign exchange and customer price reductions. Profit increased $11 million due to improved operating performance at Kautex and a gain from the sale of two non-core product lines, partially offset by the unfavorable impact of foreign exchange, customer price reductions and higher petroleum-based resin prices.

Fastening Systems
Revenues



Segment
Profit



Fastening Systems

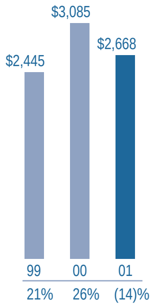
2001 vs. 2000

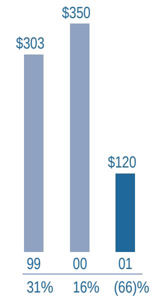
The Fastening Systems segment's revenues and profit decreased $317 million and $129 million, respectively. The revenue and profit decreases were primarily due to depressed market demand in most businesses, customer price reductions and the unfavorable impact of foreign exchange in its European operations, partially offset by the contribution from acquisitions. Profit decreased primarily due to the lower sales, customer price reductions, manufacturing inefficiencies primarily as a result of production decreases to reduce inventory levels and the impact of smaller production lot sizes, a $5 million loss on the divestiture of a non-core product line and a customer warranty issue, partially offset by the benefit of restructuring activities.

2000 vs. 1999

The Fastening Systems segment's revenues and profit decreased $63 million and $13 million, respectively. Revenues decreased due to the unfavorable impact of foreign exchange in its European operations, lower volume in the heavy truck industry and customer price reductions, partially offset by the contribution from acquisitions. Profit decreased as improved operating performance and the benefit from acquisitions were more than offset by the unfavorable impact of customer price reductions, foreign exchange and lower volume in the heavy truck industry. Textron recorded a $128 million goodwill impairment write-down related to this segment, as discussed in the "Special Charges, net" section.

Industrial Products


Industrial Products
Revenues


Segment
Profit

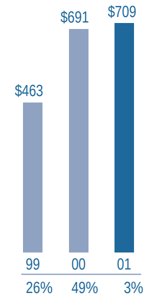
2001 vs. 2000

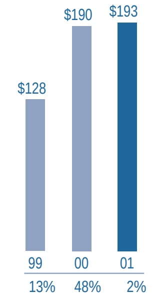
The Industrial Products segment's revenues and profit decreased $417 million and $230 million, respectively. Revenues decreased primarily due to lower sales in most of the segment's businesses reflecting softening demand from the depressed economy, with the largest decreases occurring at OmniQuip, Golf, Turf and Specialty Products, and Fluid and Power and reduced sales due to the divestiture of Turbine Engine Components in the third quarter 2001 ($39 million), partially offset by the contribution from acquisitions. Profit decreased primarily due to the decline in sales volume, other decreases in profit at Golf, Turf and Specialty Products and OmniQuip, and the impact of the divestiture of Turbine Engine Components ($6 million) partially offset by the benefit of restructuring activities and a $5 million gain on the divestiture of a small product line. In addition to lower volumes, the decreases in profit at Golf, Turf and Specialty Products and OmniQuip were primarily caused by manufacturing inefficiencies resulting from reduced production which included the shut-down of certain facilities in an effort to reduce inventory levels, the impact of higher rebates at Golf, Turf and Specialty Products to stimulate retail sales, a write-down of used golf car and other inventories, and an increase in the reserve for receivables. During 2001, Textron recorded an impairment charge at OmniQuip of $317 million, including goodwill of $306 million and intangibles of $11 million, as discussed in the "Special Charges, net" section.

2000 vs. 1999

The Industrial Products segment's revenues and profit increased $640 million and $47 million, respectively. Revenues increased as a result of the contribution from acquisitions, primarily OmniQuip and InteSys Technologies. Profit increased primarily as a result of the contribution from acquisitions and higher income related to retirement benefits, partially offset by lower organic sales and unfavorable operating performance at OmniQuip and Turbine Engine Components. During the fourth quarter 2000, Textron recorded a write-down of Turbine Engine Components goodwill for $178 million, as discussed in the "Special Charges, net" section.

Finance


Finance
Revenues


Segment
Profit

2001 vs. 2000

The Finance segment's revenues and profit increased $18 million and $3 million, respectively. Revenues increased primarily due to higher syndication and securitization income ($68 million in 2001 vs. $37 million in 2000), a $14 million gain from a leveraged lease prepayment, higher servicing fees and higher investment income, partially offset by a lower average yield reflecting the lower interest rate environment. Profit increased primarily due to higher revenue, partially offset by a higher provision for loan losses ($82 million in 2001 vs. $37 million in 2000) as a result of higher charge-offs and higher operating expenses primarily related to managed receivables.

2000 vs. 1999

The Finance segment's revenues and profit increased $228 million and $62 million, respectively. Revenues increased due to a higher level of average receivables ($5.8 billion in 2000 vs. $4.3 billion in 1999), reflecting a balance of both acquisitive and organic growth, a higher yield on receivables and higher syndication and securitization income ($37 million in 2000 vs. $14 million in 1999). Profit increased as the benefit of the higher revenues was partially offset by higher expenses related to managed receivables and a higher provision for loan losses.

Special Charges, Net and Other Costs Related to Restructuring

2001 vs. 2000

Textron recorded $437 million in special charges in 2001 in comparison to $483 million in 2000. Special charges in 2001 included $319 million in goodwill and intangible asset impairment write-downs, $81 million in restructuring expense, $28 million in fixed asset impairment write-downs, and $9 million in write-downs of e-business investments. In 2000, special charges included $349 million in goodwill impairment write-downs, $17 million in restructuring expense, and $117 million in an impairment charge related to e-business investments.

In the fourth quarter of 2000, Textron initiated its restructuring program to strengthen operating efficiencies and better align its operations with current economic and market conditions. Projects include reducing overhead and closing, consolidating and downsizing manufacturing facilities, reducing corporate and segment personnel, consolidating operations and exiting non-core product lines throughout Textron. The restructuring program costs and savings have been driven primarily from efforts within the Industrial Products and Fastening Systems segments. Under the restructuring program, Textron's workforce has been reduced by approximately 5,700 employees through December 29, 2001, including approximately 2,400 in Industrial Products, 1,600 in Fastening Systems, 900 in Automotive, 600 in Aircraft and 200 in Finance and Corporate. Excluding Textron Automotive Trim, total headcount reductions have been approximately 5,000. Through the consolidations, Textron is closing 59 facilities, including 30 manufacturing plants representing over 2.2 million square feet of manufacturing floor space. As of December 29, 2001, 44 facilities have been closed primarily in the Industrial Products and Fastening Systems segments.

In 2001, restructuring expenses of $81 million were incurred in Industrial Products ($27 million), Fastening Systems ($25 million), Automotive ($14 million), Aircraft ($5 million), Finance ($3 million) and Corporate ($7 million). In conjunction with the restructuring efforts, Textron recorded write-downs for fixed asset impairment of $28 million in Fastening Systems ($18 million), Industrial Products ($7 million) and Automotive ($3 million). In 2001, Textron also incurred $34 million in costs related to restructuring in Aircraft ($10 million), Industrial Products ($12 million), Fastening Systems ($8 million) and Automotive ($4 million), which have been included in segment profit.

Under the expanded restructuring program, Textron expects to incur total special charges and costs related to restructuring, excluding goodwill write-downs, of at least $325 million, of which $160 million has been expended at year-end 2001. The program includes an additional workforce reduction of approximately 2,300 and should be substantially completed by the end of 2002. Excluding Textron Automotive Trim, Textron expects a total reduction of approximately 7,300 employees, representing approximately 12% of Textron's global workforce since the restructuring was first announced. Restructuring savings, excluding projects at Textron Automotive Trim, were $124 million in 2001 and are expected to be at least $225 million in 2002 and $250 million in 2003.

During the third quarter of 2001, Textron performed a long-lived asset impairment review as a result of certain impairment indicators being identified. These key impairment indicators included OmniQuip's operating performance against plan despite restructuring efforts to improve operating efficiencies and streamline operations. Additionally, the strategic review process completed in August 2001 confirmed that the economic and market conditions combined with the saturation of light construction equipment handlers in the market had negatively impacted the projected operating results for the foreseeable future. The impairment calculation resulted in a third quarter impairment charge in the Industrial Products segment of $317 million, including goodwill of $306 million and other intangible assets of $11 million. OmniQuip has approximately $107 million in remaining long-lived assets which are deemed substantially recoverable.

Textron continues to address and execute strategic initiatives to enhance the overall profitability of OmniQuip. Through December 29, 2001, OmniQuip's workforce has been reduced by over 700 employees, along with the closure of five facilities including one plant.

2000 vs. 1999

Textron recorded $483 million in special charges, net in 2000 in comparison to a $1 million net gain in 1999. In 2000, special charges included $349 million in goodwill impairment write-downs, $17 million in restructuring expense, and $117 million in an impairment charge related to e-business investments. The restructuring expense of $17 million was associated with the modernization and consolidation of manufacturing facilities in the Automotive ($2 million) and Industrial Products ($15 million) segments.

In conjunction with the initiation of the 2000 restructuring program and Textron's fourth quarter multi-year financial planning process, management identified certain indicators of potential impairment of long-lived assets including goodwill. As a result, Textron performed an impairment review which identified impaired goodwill of $194 million in Industrial Products, $128 million in Fastening Systems and $27 million in Automotive, resulting in an aggregate write-down of $349 million. The largest portions of the goodwill charge were at Turbine Engine Components ($178 million) and Flexalloy ($96 million).

During the end of 2000, the value of Textron's e-business investment portfolio had fallen substantially. Textron determined that this decline in value was other than temporary and recorded a pre-tax charge of $117 million to write-down the portfolio to the current fair value.

In 1999, Textron recorded special charges of $18 million related to restructuring activities. The charges included severance costs, asset impairments and other exit related costs associated with the cost reduction efforts and plant closures in the former Industrial segment, and headcount reductions in the Aircraft segment. These restructuring expenses were offset by a $19 million gain as a result of shares granted to Textron from Manulife Financial Corporation's initial public offering on their demutualization of Manufacturers Life Insurance Company.

Critical Accounting Policies

Recently, the Securities and Exchange Commission (SEC) issued new advice regarding disclosure of critical accounting policies. In response to this advice, we have identified the accounting policies listed below that we believe are most critical to the portrayal of Textron's financial condition and results of operations, and that require management's most difficult, subjective and complex judgments in estimating the effect of inherent uncertainties. This section should be read in conjunction with Note 1 to the consolidated financial statements which includes other significant accounting policies.

Receivable and Inventory Reserves

We evaluate the collectibility of our commercial and finance receivables based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us (e.g., bankruptcy filings, substantial down-grading of credit scores), we record a specific reserve for bad debts for amounts we estimate to be potentially uncollectible. For homogenous loan pools and all other receivables, we recognize reserves for bad debts based on current delinquencies, historical loss experience, the value of underlying collateral and general economic conditions and trends.

In areas where we have significant collateralized finance receivables with large customers such as national rental companies, a single default could have a material impact on Textron if there is a significant decline in the market value of the collateral due to market saturation as a result of numerous companies trying to sell used equipment during an economic recession. We also have receivable and collateral concentrations in aircraft and other equipment that may require additional reserves if the market weakens and becomes saturated with used aircraft and equipment resulting in lower market values. While we believe our reserves are adequate, if economic circumstances change significantly resulting in higher expected defaults or there is an unexpected material adverse change in a major customer's ability to meet its financial obligations to us, our original estimates of the recoverability of amounts due us could be reduced by a significant amount requiring additional reserves.

Long-Term Contracts

We recognize revenue and profit as work on certain government long-term engineering, development and production contracts progresses using the contract method of accounting, which relies on estimates of the total contract cost and revenue. Estimated contract cost and revenue are based on current contract specifications, expected engineering requirements and the achievement of contract milestones, including product deliveries. Since the financial reporting of these contracts depends on estimates, which are assessed periodically during the term of the contract, contract earning rates are subject to revisions as the contract progresses. Revisions in earnings estimates are reflected in the period in which the facts that give rise to the revision become known. Accordingly, favorable changes in estimates result in additional profit recognition, and unfavorable changes in estimates result in the reversal of previously recognized earnings. Any anticipated losses on contracts are charged to earnings when identified. Program earnings could be reduced by a material amount resulting in a charge to income if (a) total estimated contract costs are significantly higher than expected due to changes in customer specifications prior to contract amendment, (b) there is a change in engineering efforts required during the development stage of the contract, or (c) we are unable to meet contract milestones.

Goodwill and Other Intangible Assets

Management periodically evaluates the recoverability of goodwill and other intangible assets whenever events or changes in circumstances, such as declines in sales, earnings or cash flows or material adverse changes in the business climate indicate that the carrying amount of an asset may not be recoverable. Textron's goodwill and other intangible assets are not considered impaired based on management's estimates of future cash flows applying the current accounting standards. The implementation of new accounting standards in this area during 2002 may result in an impairment charge in certain segments. Any impairment charge upon the implementation of these standards would be recorded as a cumulative effect of a change in accounting principle.

Securitized Transactions

Securitized transactions involve the sale of finance receivables to qualified special purpose trusts. While the assets sold are no longer on our balance sheet, our retained interests are included in other assets. Textron Finance retains servicing responsibilities and subordinated interests in the form of interest-only securities, subordinated certificates and cash reserve accounts. Textron continues to be exposed to the credit risk inherent in the securitized receivables because it has provided credit enhancement to the third party investors by its retained interests in the securitization trusts. We estimate the fair value of the retained interests based on the present value of future expected cash flows using our best estimates of credit losses, prepayment speeds, forward interest rate yield curves, and discount rates commensurate with the risks involved. These assumptions are reviewed each quarter, and the retained interests are written down when the carrying value exceeds the fair value and the decline is estimated to be other than temporary. Based on our sensitivity analysis, as discussed in Note 3 to the consolidated financial statements, a 20% adverse change in either the prepayment speed, expected credit losses or the residual cash flows discount rate would not result in a material charge to income.

Pension Benefits

An important element in determining pension income is the expected return on plan assets. We have assumed that the expected long-term rate of return on plan assets will be 9.25%. Over the last ten years, our pension plan assets have earned just under 11%; therefore, we believe that our assumption of future returns is reasonable. The plan assets have earned a rate of return substantially less than 9% in the last two years. Should this trend continue, future pension income will decline.

At the end of each year, we determine the discount rate that reflects the current rate at which the pension liabilities could be effectively settled at the end of the year. This rate should be in line with rates for high quality fixed income investments available for the period to maturity of the pension benefits, and changes as long term interest rates change. At year-end 2001, we determined this rate to be 7.25%. Changes in discount rates over the past three years have not materially affected pension income, and the net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, have been deferred as allowed by SFAS No. 87.

Other Postretirement Benefits

We use various actuarial assumptions including the discount rate and the expected trend in health care costs to estimate the costs and benefit obligations for our retiree health plan. The trend in health care costs is difficult to estimate and it has an important effect on postretirement liabilities. Postretirement benefit plan discount rates are the same as those used by Textron's defined benefit pension plan in accordance with the provisions of SFAS No. 106.

The 2001 health care cost trend rate, which is the weighted average annual projected rate of increase in the per capita cost of covered benefits, was 8%. This rate is assumed to decrease to 5.5% by 2005 and then remain at that level.

Liquidity & Capital Resources

The liquidity and capital resources of Textron’s operations are best understood by separately considering its independent borrowing groups, Textron Manufacturing and Textron Finance. Textron Manufacturing consists of Textron Inc., the parent company, consolidated with the entities which operate in the Aircraft, Automotive, Fastening Systems and Industrial Products business segments, whose financial results are a reflection of the ability to manage and finance the development, production and delivery of tangible goods and services. Textron Finance consists of Textron’s wholly-owned commercial finance subsidiary, Textron Financial Corporation, consolidated with its subsidiaries. The financial results of Textron Financial are a reflection of its ability to provide financial services in a competitive marketplace, at the appropriate pricing, while managing the associated financial risks. The fundamental differences between each borrowing group’s activities result in different measures used by investors, rating agencies and analysts.

Textron Inc. provides a support agreement to Textron Finance that requires Textron Inc. to maintain 100% ownership of Textron Finance. The agreement also requires Textron Finance to maintain fixed charge coverage of 125% and consolidated shareholder’s equity of no less than $200 million. Textron Finance’s bank agreements prohibit the termination of the support agreement under any circumstances.

Operating Cash Flows

Textron’s financial position continued to be strong at the end of 2001. During 2001, cash flows from operations was the primary source of funds for the operating needs, dividends and capital expenditures of Textron Manufacturing. The statements of cash flows for each borrowing group detailing the changes in cash balances are on pages 36-37. Textron Manufacturing's operating cash flow includes dividends received from Textron Finance of $51 million and $82 million during 2001 and 2000, respectively.

Financing

Textron Manufacturing’s debt (net of cash) to total capital ratio was 28% at December 29, 2001 down slightly from 29% at December 30, 2000. We have established a financial target of a debt to capital ratio in the high 20% range. Consistent with the analytical methodology used by members of the financial community, leverage of the manufacturing operations excludes the debt of Textron Finance. In addition, the obligated mandatorily redeemable preferred securities are not treated as debt, but are included as capital for the purposes of calculating leverage pursuant to Textron's financial targets. In turn, Textron Finance evaluates its leverage by limiting borrowing so that its leverage will not exceed a ratio of debt to tangible equity of 7.5 to 1. As a result, surplus capital of Textron Finance will be returned to Textron, and additional capital required for growth will be infused or left in the business, assuming Textron Finance's returns are consistent with our standards.

Borrowings have historically been a secondary source of funds for Textron Manufacturing and, along with the collection of finance receivables, are a primary source of funds for Textron Finance. Both Textron Manufacturing and Textron Finance utilize a broad base of financial sources for their respective liquidity and capital needs. Our credit ratings are predominantly a function of our ability to generate operating cash flow and satisfy certain financial ratios. Since high-quality credit ratings provide us with access to a broad base of global investors at an attractive cost, we target a long-term A rating from the independent debt-rating agencies. Our credit ratings remain strong from Standard & Poor’s (Textron Manufacturing: A Long-Term; A1 Short-Term and Textron Finance: A Long-Term; A2 Short-Term). Our credit ratings for Textron Manufacturing and Textron Finance are also strong from Moody’s Investors Service (A3 Long-Term; P2 Short-Term) and Fitch (A Long-Term; F1 Short-Term).

During the second half of 2001, both Textron Manufacturing’s and Textron Finance’s credit ratings were placed on Negative Outlook by all three rating agencies and were downgraded from an A-2 to an A-3 rating by Moody’s Investors Service. The economic environment and its potential impact on the financial performance from the aerospace and financial services industries were listed as contributing factors. While the action of the rating agencies did cause our cost of capital to increase modestly, it did not cause us to lose access to capital. For example, Textron Manufacturing issued $300 million of seven-year term financing at 6.375% in November 2001, and both borrowing groups have continued to issue commercial paper to investors with the revised credit ratings. Although Textron Finance’s borrowing spreads have increased as a result of the downgrades, Textron Finance has not experienced any change in its access to the commercial paper and securitization markets. Additional downgrades in Textron Finance’s ratings could further increase its borrowing spreads or limit its access to the commercial paper, securitization and long-term debt markets.

Short-Term Financing

For liquidity purposes, we maintain sufficient unused lines of credit to support all of our outstanding commercial paper. During 2001, Textron Manufacturing increased its primary committed credit facilities by $600 million to $1.6 billion. Of these primary facilities, $600 million expires in 2002 and $1.0 billion expires in 2003. At December 29, 2001, these facilities remain undrawn, and only $96 million has been reserved as support for commercial paper. Textron Manufacturing's credit facilities contain material adverse change (MAC) clauses at every borrowing along with certain financial covenants. MAC clauses allow financial institutions to withhold future financing if there is a significant change in the business, operations, properties, assets or condition of Textron or any of its subsidiaries, which has a material adverse impact on Textron. There were no material adverse changes during 2001 and we are in compliance with the financial covenants. We expect to renegotiate and extend the maturity of these facilities in the first half of 2002.

Textron Finance has bank line of credit agreements of $1.5 billion, of which $500 million will expire in 2002 and $1.0 billion will expire in 2006. None of these lines of credit were used at December 29, 2001, and the amount not reserved as support for commercial paper totaled $875 million. These facilities contain certain financial covenants that Textron Finance needs to comply with to maintain its ability to borrow under the facilities, but do not include MAC clauses. Textron Finance was in full compliance with these covenants at year-end 2001. We expect to negotiate and extend the maturity of the $500 million facility by the end of the second quarter of 2002.

Textron Manufacturing received approximately $582 million in after-tax proceeds from the sale of the Automotive Trim business, along with other consideration as described in Note 2 to the consolidated financial statements. Approximately $510 million of these proceeds was invested with Textron Finance as a temporary investment under a short-term revolving note agreement. On January 24, 2002, Textron Finance paid off its obligation and terminated this agreement with Textron Manufacturing. The proceeds from the sale will ultimately be deployed to pay for share repurchases and debt retirement.

Textron Finance utilizes the asset securitization market to manage credit exposures and diversify funding sources. During 2001, Textron Finance received proceeds from securitizations of $625 million of floorplan finance receivables (on a revolving basis), $309 million of aircraft finance receivables, $198 million of captive golf and turf finance receivables, $90 million of franchise finance receivables, $56 million of land finance receivables and $19 million of resort receivables. These securitizations provided Textron Finance with an alternate source of financing while maintaining desired debt-to-capital ratios. Textron Finance used the proceeds from the securitizations to retire commercial paper. We anticipate that we will enter into additional securitization transactions in 2002.

Long-Term Financing

At December 29, 2001, Textron Manufacturing had $1.2 billion available under its existing shelf registration statement filed with the SEC. During 2001, Textron Manufacturing's Euro Medium-Term Note facility expired. It is anticipated that this facility will be reactivated early in 2002.

Under a shelf registration statement filed with the SEC, Textron Finance may issue public debt securities in one or more offerings up to a total maximum offering of $3.0 billion. At December 29, 2001, Textron Finance had $3.0 billion available under this facility. During 2001, Textron Finance issued $550 million of floating-rate notes and $300 million of fixed-rate notes that mature in 2003 and 2004, respectively. The proceeds from these issuances were used to refinance maturing commercial paper and long-term debt at par. Through a private issuance in 2001, Textron Finance also entered into a $50 million variable-rate note maturing in 2003.

Other Arrangements

We participate in two joint ventures for the development of certain aircraft. Bell Helicopter has partnered with The Boeing Company in the development of the V-22 tiltrotor and with Agusta in the development of the BA609 and Agusta's AB139. These agreements enable us to share expertise and costs, and ultimately the profits, with our partners in these ventures. We have not guaranteed any debt obligations related to these ventures.

We do have certain other ventures where we have guaranteed an aggregate amount of approximately $85 million. Included in this amount, is our guarantee of one-half of CitationShare's debt and lease obligations up to a maximum of $70 million. At year-end 2001, Textron's portion of the outstanding debt and operating lease commitments covered by this guarantee totaled $25 million. See Note 15 to the consolidated financial statements regarding our joint ventures.

At year-end 2001, Textron Finance had unused commitments to fund new and existing customers under $1.3 billion and $599 million of committed and uncommitted, respectively, revolving lines of credit. Since many of the agreements will not be used to the extent committed or will expire unused, the total commitment amount does not necessarily represent future cash requirements.

Textron Finance has certain contracts that contemplate a capital commitment or the requirement to provide letters of credit should its credit rating drop below a middle to low BBB. The aggregate of the exposure is approximately $55 million.

Textron Manufacturing has entered into an equity forward contract in Textron stock. The contract is intended to hedge the earnings and cash volatility of compensation granted in Textron stock. The forward contract requires annual cash settlement between the counterparties. Settlement is calculated based upon a number of shares multiplied by the difference between the strike price and the actual Textron common stock price. Currently, Textron's forward contract is for approximately two million shares with a strike price of $48.20.

Uses of Capital

Acquisitions by Textron Manufacturing are evaluated on an enterprise basis, so that the capital employed is equal to the price paid for the target company's equity plus any debt assumed. During the past three years, Textron acquired 29 companies, acquired the minority interest of two entities and entered into three joint ventures for an aggregate cost of $1.5 billion, including treasury stock issued for $32 million and $344 million of debt assumed.

Acquisitions of Textron Finance are evaluated on the basis of the amount of Textron Manufacturing capital that Textron would have to set aside so that the acquisition could be levered at a debt to tangible equity ratio with Textron Finance of 7.5 to 1. During the past three years, Textron Finance acquired five companies. The capital required for these acquisitions was $377 million. The actual cost of the acquisitions was $1.6 billion, including debt assumed of $547 million.

Capital spending in 2001 continued at a level consistent with 2000, increasing only slightly to $532 million. Combined capital spending for the past three years totaled $1.6 billion.

In 2001, Textron repurchased 738,000 shares of common stock under its Board authorized share repurchase program for a total cash payment of $47 million.

Textron's Board of Directors approved the annual dividend per common share of $1.30 in 2001. Dividend payments to shareholders in 2001 amounted to $184 million, a decrease of $5 million from 2000.

Financial Risk Management

Interest Rate Risks

Textron's financial results are affected by changes in U.S. and foreign interest rates. As part of managing this risk, Textron enters into interest rate exchange agreements to convert certain variable-rate debt to long-term fixed-rate debt and vice versa. The overall objective of Textron's interest rate risk management is to achieve a prudent balance between floating- and fixed-rate debt. Textron's mix of floating- and fixed-rate debt is continuously monitored by management and is adjusted, as necessary, based on evaluation of internal and external factors. The difference between the rates Textron Manufacturing received and the rates it paid on interest rate exchange agreements did not significantly impact interest expense in 2001 or 2000.

Textron Finance's strategy of matching interest-sensitive assets with interest-sensitive liabilities limits its risk to changes in interest rates and includes entering into interest rate exchange agreements as part of this matching strategy. At year-end 2001, Textron Finance's interest-sensitive assets in excess of interest-sensitive liabilities were $410 million, net of $370 million of variable-rate interest rate exchange agreements on long-term debt and $97 million of variable-rate interest rate exchange agreements on finance receivables. Interest-sensitive assets in excess of interest-sensitive liabilities were $415 million at year-end 2000, net of $150 million of fixed-rate interest rate exchange agreements on long-term debt and $100 million of variable-rate interest rate exchange agreements on finance receivables. The change in net position does not reflect a change in management's match funding strategy. The net impact of these agreements was immaterial in 2001, 2000 and 1999.

Foreign Exchange Risks

Textron's financial results are affected by changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which products are manufactured and/or sold. Textron Manufacturing's primary currency exposures are the European Common Currency (Euro) and the British Pound.

Textron Manufacturing manages its exposures to foreign currency assets and earnings primarily by funding certain foreign currency denominated assets with liabilities in the same currency and, as such, certain exposures are naturally offset. During 2001, Textron Manufacturing primarily used actual foreign currency borrowings for these purposes.

In addition, as part of managing its foreign currency transaction exposures, Textron enters into foreign currency forward exchange and option contracts. These contracts are generally used to fix the local currency cost of purchased goods or services or selling prices denominated in currencies other than the functional currency. The notional amount of outstanding foreign exchange contracts, foreign currency options and currency swaps was approximately $605 million at year-end 2001 and $840 million at year-end 2000.

Quantitative Risk Measures

Textron utilizes a sensitivity analysis to quantify the market risk inherent in its financial instruments. Financial instruments held by Textron that are subject to market risk (interest rate risk, foreign exchange rate risk and equity price risk) include finance receivables (excluding lease receivables), debt (excluding lease obligations), interest rate exchange agreements, foreign exchange contracts, marketable equity securities and marketable security price forward contracts.

Presented below is a sensitivity analysis of the fair value of Textron's financial instruments entered into for purposes other than trading at year-end. The following table illustrates the hypothetical change in the fair value of the financial instruments at year-end assuming a 10% decrease in interest rates, a 10% strengthening in exchange rates against the U.S. dollar and a 10% decrease in the quoted market prices of applicable marketable equity securities. The estimated fair value of the financial instruments was determined by discounted cash flow analysis and by independent investment bankers. This sensitivity analysis is most likely not indicative of actual results in the future.

		2001			2000	
(In millions)	**Carrying Value**	**Fair Value**	**Hypothetical Change in Fair Value**	Carrying Value	Fair Value	Hypothetical Change in Fair Value
Interest Rate Risk						
Textron Manufacturing:						
Debt	**$(1,934)**	**$(1,972)**	**$(29)**	$(2,061)	$(2,105)	$ (31)
Interest rate swaps	**–**	**–**	**–**	–	8	9
Textron Finance:						
Finance receivables	**4,795**	**4,884**	**4**	4,767	4,840	31
Interest rate swaps – receivables	**(8)**	**(8)**	**1**	–	6	5
Debt	**(4,188)**	**(4,208)**	**(36)**	(4,667)	(4,688)	(33)
Interest rate swaps – debt	**3**	**3**	**1**	–	(17)	(10)
Foreign Exchange Rate Risk						
Textron Manufacturing:						
Debt	**(661)**	**(655)**	**(66)**	(1,101)	(1,113)	(111)
Foreign exchange contracts	**(7)**	**(7)**	**(26)**	3	3	22
Textron Finance:						
Debt	**(32)**	**(32)**	**(3)**	(32)	(32)	(5)
Equity Price Risk						
Textron Manufacturing:						
Available for sale securities	**90**	**90**	**(9)**	16	16	(2)
Marketable security price forward contracts	**(11)**	**(11)**	**(8)**	(26)	(26)	(8)

Other Matters

Environmental

As with other industrial enterprises engaged in similar businesses, Textron is involved in a number of remedial actions under various federal and state laws and regulations relating to the environment which impose liability on companies to clean up, or contribute to the cost of cleaning up, sites on which their hazardous wastes or materials were disposed or released. Expenditures to evaluate and remediate contaminated sites approximated $14 million, $11 million and $16 million in 2001, 2000 and 1999, respectively. Textron currently projects that expenditures for remediation will range between $8 million and $15 million for each of the years 2002 and 2003.

Textron's accrued estimated environmental liabilities are based on assumptions which are subject to a number of factors and uncertainties. Circumstances which can affect the accruals' reliability and precision include identification of additional sites, environmental regulations, level of cleanup required, technologies available, number and financial condition of other contributors to remediation, and the time period over which remediation may occur. Textron believes that any changes to the accruals that may result from these factors and uncertainties will not have a material effect on Textron's financial position or results of operation. Textron estimates that its accrued environmental remediation liabilities will likely be paid over the next five to ten years.

Backlog

Textron's commercial backlog was $6.5 billion and $8.5 billion at the end of 2001 and 2000, respectively, and U.S. Government backlog was $1.0 billion at the end of 2001 and $1.4 billion at the end of 2000. Backlog for the Aircraft segment was approximately 85% and 84% of Textron's commercial backlog at the end of 2001 and 2000, respectively, and 68% and 74% of Textron's U.S. Government backlog at the end of 2001 and 2000, respectively.

Foreign Military Sales

Certain Textron products are sold through the Department of Defense's Foreign Military Sales Program. In addition, Textron sells directly to select foreign military organizations. Sales under these programs totaled approximately 1.2% of Textron's consolidated revenue in 2001 (0.4% in the case of foreign military sales and 0.8% in the case of direct sales) and 1.7% in 2000 (1.0% and 0.7%, respectively). Such sales include military and commercial helicopters, armored vehicles, turrets, and spare parts and in 2001, were made primarily to the countries of Taiwan (32%), El Salvador (21%), Colombia (13%), Botswana (4%), Pakistan (4%), Saudi Arabia (4%), Canada (3%) and Germany (3%). All sales are made in full compliance with all applicable laws and in accordance with Textron's code of conduct.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill, along with intangible assets deemed to have indefinite lives, will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Also, business combinations initiated after June 30, 2001 must be accounted for using the purchase method of accounting.

Textron will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of the Statement, excluding Automotive Trim, would have resulted in an increase in net income of $81 million in 2001. During 2002, Textron will perform the first of the required impairment tests of goodwill and indefinite lived intangible assets as of December 30, 2001 and has not yet determined what the effect of these tests will be on Textron's results of operations and financial position.

In August 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” SFAS No. 144 requires that one accounting model be used for long-lived assets to be disposed of by sale. Discontinued operations will be measured similar to other long-lived assets classified as held for sale at the lower of its carrying amount or fair value less cost to sell. Future operating losses will no longer be recognized before they occur. SFAS No. 144 also broadens the presentation of discontinued operations to include a component of an entity when operations and cash flows can be clearly distinguished. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. At this time, adoption of this Statement is not expected to have a material effect on Textron’s results of operations or financial position.

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Forward-looking Information: Certain statements in this release and other oral and written statements made by Textron from time to time, are forward-looking statements, including those that discuss strategies, goals, outlook or other non-historical matters; or project revenues, income, returns or other financial measures. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements, including the following: (a) the extent to which Textron is able to achieve savings from its restructuring plans (b) changes in worldwide economic and political conditions that impact interest and foreign exchange rates, (c) the occurrence of work stoppages and strikes at key facilities of Textron or Textron’s customers or suppliers, (d) government funding and program approvals affecting products being developed or sold under government programs, (e) cost and delivery performance under various program and development contracts, (f) successful implementation of supply chain and other cost-reduction programs, (g) the timing of certifications of new aircraft products, (h) the occurrence of further downturns in customer markets to which Textron products are sold or supplied, (i) Textron’s ability to offset, through cost reductions, raw material price increases and pricing pressure brought by original equipment manufacturer customers and (j) Textron Financial’s ability to maintain credit quality and control costs.