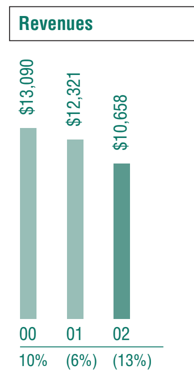
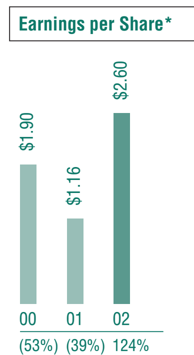
Management's Discussion and Analysis

Results of Operations





*Income from operations – diluted

Textron Inc.

2002 vs. 2001

Revenues decreased to $10.7 billion in 2002 from $12.3 billion in 2001, primarily due to the divestitures of Automotive Trim (Trim), Turbine Engine Components Textron (TECT) and a number of other businesses that contributed $1.7 billion to the decrease. Excluding the divestitures, higher sales in Aircraft and Industrial Components were partially offset by lower sales in Industrial Products and Finance, as more fully discussed in the segment commentary that follows. Income before cumulative effect of change in accounting principle, net of income taxes, was $364 million for 2002 compared to $166 million for 2001. Diluted earnings per share before cumulative effect of change in accounting principle, net of income taxes, were $2.60 in 2002 and $1.16 in 2001. Including the impact of the change in accounting principle, Textron recorded a net loss of $124 million or $0.88 per share for 2002, compared to net income of $166 million or $1.16 per share for 2001. During 2002, Textron recognized pre-tax special charges of $128 million, a net pre-tax gain of $5 million on the sale of businesses and recorded a cumulative effect of change in accounting principle, net of income taxes, of $488 million. In 2001, Textron recognized pre-tax special charges of $437 million and a pre-tax gain of $342 million on the sale of two businesses.

Special charges of $128 million in 2002 included restructuring expense of $90 million and a write-down of $38 million related to Textron's common stock holdings in Collins and Aikman Corp. Special charges of $437 million in 2001 included goodwill and other intangible asset impairment charges of $319 million, restructuring expense of $109 million and e-business investment losses of $9 million.

Textron recorded a net $5 million pre-tax gain on the sale of businesses in 2002. In the second quarter of 2002, a $25 million pre-tax gain was recorded from transactions related to the divestiture of Trim in 2001. In the fourth quarter of 2002, a $20 million pre-tax loss was recorded on the sale of Snorkel and the OmniQuip Textron Inc. holding company to Elwood Holdings, LLC. This transaction created a tax benefit related to the goodwill write-off of OmniQuip Textron Inc. in 2001, at which time only a portion of the tax benefit was realized, resulting in an after-tax gain of $34 million. In 2001, Textron recorded a $342 million gain on the sale of two businesses. In the fourth quarter of 2001, a gain of $339 million was recorded on the sale of Trim to Collins & Aikman Products Co., a subsidiary of Collins & Aikman Corporation (C&A) and, in the third quarter of 2001, a gain of $3 million was recorded on the sale of TECT.

In January 2002, Textron reorganized management responsibility for several divisions which were previously reported in the Automotive and Industrial Products segments into the newly created Industrial Components segment. The Industrial Components segment includes the Fluid Handling Products and Power Transmission Products divisions, the former Automotive divisions and TECT. In addition, management responsibility for Textron Lycoming was transferred to the Aircraft segment.

Effective December 30, 2001, Textron adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets". Under this Statement, goodwill and certain assets with indefinite lives are no longer amortized and must be tested for impairment annually. Textron also adopted the remaining provisions of SFAS No. 141 "Business Combinations" on December 30, 2001, which requires intangible assets that do not meet the new criteria set by this Statement to be classified as goodwill upon adoption. Amortization will continue to be recorded on other intangible assets not classified as goodwill. In 2001, reported pro forma net income excluding amortization of goodwill was $254 million, or $1.78 per diluted share. To reflect the adoption of SFAS No. 142 and the fact that Textron does not include amortization of goodwill in its internal evaluation of segment performance, Textron has recast its segment data for comparability by reclassifying goodwill amortization out of segment profit in prior periods.

During 2002, Textron recorded an after-tax transitional goodwill impairment charge of $488 million, which is reported in the caption "Cumulative effect of change in accounting principle, net of income taxes". This after-tax charge relates to the following segments: $274 million in Industrial Products; $111 million in Industrial Components; $88 million in Fastening Systems; and $15 million in Finance. For Industrial Products, the primary factor resulting in the impairment charge was the difficult economic environment in the telecommunication industry which has experienced a significant decline in demand. This decline has resulted in lower sales and operating margins than originally anticipated with the acqui-

sitions of the InteSys and Tempo businesses. For Industrial Components and Fastening Systems, the primary factor was the decline in demand in certain industries in which these segments operate due to the economic slowdown. The Finance segment's impairment charge was in its franchise finance division and was primarily the result of decreasing loan volumes and an unfavorable securitization market. No impairment charge was appropriate for these segments under the previous goodwill impairment accounting standard, which Textron applied based on undiscounted cash flows.

Segment profit of $835 million in 2002 decreased $91 million from $926 million in 2001 primarily due to low volume manufacturing inefficiencies, the divestitures of Trim and TECT, which contributed $95 million to the decrease, lower results in the Finance segment, changes in sales volume and an unfavorable mix, the cost related to the recall, inspection and customer care program at the aircraft engine business and an increase in reserves for receivables and inventory. These decreases were partially offset by unfavorable 2001 profit adjustments at Bell Helicopter, the benefit of restructuring activities and higher pricing. The preceding items are discussed more fully in the segment commentary that follows.

Corporate expenses and other, net decreased $38 million primarily due to $15 million in lower stock-based compensation and related hedge costs, royalty income of $13 million in 2002 related to the Trim divestiture, lower costs of $5 million as a result of organizational changes made in the third quarter of 2001 and higher income of $4 million related to retirement plans, partially offset by an increase of $7 million in product liability reserves related to exited businesses.

Interest expense, net decreased $54 million primarily due to the benefit of $45 million as a result of a lower level of average debt primarily from the pay down of debt with the proceeds from the divestiture of Trim, the benefit of a lower interest rate environment and the receipt of $5 million for accumulated interest on the preferred shares that C&A repurchased.

Income taxes – The effective tax rate for 2002 was 20.4% compared to the federal statutory income tax rate of 35.0%. The lower effective rate was primarily due to the tax impact of 9.5% related to the sale of the Snorkel business and the OmniQuip Textron Inc. holding company, a favorable change in the tax law related to the deductibility of dividends paid on company stock held by an employee stock ownership plan of 3.7% (1.8% of this reduction represents a nonrecurring benefit upon implementation of the new tax law), a benefit of 2.5% for a tax refund as a result of the settlement of a prior year tax dispute and 1.8% related to the benefit from export sales, partially offset by the impact of 2.1% for state income taxes and 1.4% for permanent items related to the divesture of Trim. The effective tax rate for 2001 was 54.2% compared to the federal statutory income tax rate of 35.0%. The higher effective rate was primarily due to the impact of 22.3% for the non-tax deductibility of goodwill written off in 2001, 2.7% for permanent items related to the divesture of Trim and 2.7% for state income taxes, partially offset by 2.9% related to the benefit from export sales.

Outlook

At this time, there are no indications that the weakened economy has begun to recover. Textron anticipates its markets will remain sluggish during 2003. Total revenues are expected to be down about 6%, primarily as a result of lower jet deliveries at Cessna Aircraft. To strengthen operating efficiencies and better align its operations with current economic and market conditions, Textron will continue to incur restructuring charges from its previously announced program through 2004. As a result of strong cost reduction programs, Textron expects to improve segment margins in 2003.

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 before the cumulative effect of change in accounting principle, net of income taxes, were $1.16 in 2001 and $1.90 in 2000. During 2001, Textron recognized special charges of $437 million and a gain of $342 million on the sale of Trim and TECT. In 2000, Textron recognized $483 million in special charges and recorded a cumulative effect of a change in accounting principle, net of income taxes, of $59 million for the adoption of the EITF consensus on Issue No. 99-5 "Accounting for Pre-Production Costs Related to Long Term Supply Arrangements".

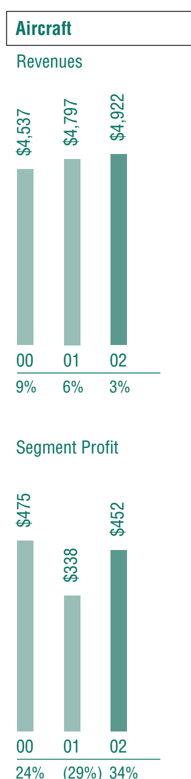
Special charges of $437 million in 2001 included goodwill and other intangible asset impairment charges of $319 million, restructuring expense of $109 million and e-business investment losses of $9 million. Special charges of $483 million in 2000 included goodwill impairment charges of $349 million, e-business investment losses of $117 million and restructuring expenses of $17 million.

Segment profit of $926 million in 2001 decreased $580 million from $1,506 million in 2000 due to lower sales volumes and pricing pressures at Industrial Components, 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 costs related to restructuring incurred in 2001. 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. The preceding items are discussed more fully in the segment commentary that follows.

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

Interest expense, net 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 2000.

Income Taxes - the effective tax rate for 2001 was 54.2% compared to the federal statutory income tax rate of 35.0%. The higher effective rate was primarily due to the impact of 22.3% for the non-tax deductibility of goodwill written off in 2001, 2.7% for permanent items related to the divesture of Trim and 2.7% for state income taxes, partially offset by 2.9% related to the benefit from export sales. The effective tax rate for 2000 was 50.4% compared to the federal statutory income tax rate of 35.0%. The higher effective rate was primarily due to the impact of 19.0% for the non-tax deductibility of goodwill written-off during 2000 and 3.8% for state income taxes, partially offset by 1.9% related to the benefit from export sales.



Aircraft

2002 vs. 2001

The Aircraft segment's revenues and profit increased $125 million and $114 million, respectively.

- Cessna Aircraft's revenues increased $110 million primarily due to higher sales volume of used aircraft of $125 million, higher pricing of $115 million (including the favorable impact of $68 million related to the expiration of lower introductory pricing on certain business jet models), higher spare parts and service sales of $17 million and higher Caravan sales of $9 million. These increases were partially offset by $89 million in lower sales volume of single engine piston aircraft and aircraft engines, lower Citation business jet volume of $49 million and higher trade-in allowances of $15 million for used aircraft. Profit decreased $28 million reflecting cost of $31 million related to the recall, inspection and customer care program at the Lycoming aircraft engine business as described below. Excluding the impact of the above program at Lycoming, profit increased $3 million due to higher pricing of $115 million and the net benefit of $5 million from restructuring activities, partially offset by inflation of $60 million, the impact of $26 million for trade-in allowances and inventory write-downs related to the valuation of used aircraft, an unfavorable sales mix of $19 million (due to higher volume of used aircraft at minimal contribution) and start-up costs of $14 million for the new Sovereign business jet.

In August 2002, the Lycoming aircraft engine business recalled approximately 950 airplane engines to replace potentially faulty crankshafts manufactured by a third party supplier. In conjunction with a Federal Aviation Administration (FAA) directive, aircraft with these engines have been grounded. After detecting a potentially defective crankshaft in an aircraft beyond the group included in the August recall, Lycoming and the FAA mandated inspection of all turbocharged aircraft with engines that use this specific component. This precautionary measure applies to an additional 736 engines, which are being tested in the field within the next 50 hours of operation or within six months, whichever comes first. Lycoming anticipates that only a portion of the crankshafts in the additional engines will need to be replaced. Lycoming has initiated a comprehensive customer care program to replace the defective crankshafts, make any necessary related repairs, and compensate its customers for the loss of use of their aircraft during the recall. Textron is continuing to monitor performance of the crankshafts previously supplied by the third party supplier to ensure that the current recall, inspection and customer care program adequately covers all engines with potentially faulty crankshafts. It is possible that additional engines outside of the current recall could potentially be affected. Lycoming also initiated a program for the inspection and possible replacement of potentially defective zinc-plated bolts manufactured by a third party supplier for use in certain aircraft engines. Textron's reserves for the recall, inspection and customer care program are based on management's best estimate as of December 28, 2002. Actual costs could

vary depending upon the actual experience of the program, recoveries received from third parties or an expansion of the existing program.

During 2002, Citation business jet deliveries decreased to 307 jets from a record 313 in 2001 resulting in lower business jet volume. The current downturn in the business jet market has caused Cessna to reduce its production for 2003, scheduling about 220 jet deliveries. Cessna has responded to the market downturn by realigning its cost structure to anticipated market demand. Cessna's backlog as of December 28, 2002 includes new Citation business jet models currently under development which are scheduled to begin delivery in 2004. Cessna's wide array of products and its strong backlog, combined with an improved cost structure should put Cessna in a position to grow when its markets recover.

- Bell Helicopter's revenues increased $15 million due to higher revenue of $93 million from the U.S. Government, partially offset by lower commercial sales of $78 million. U. S. Government revenues increased primarily due to higher revenue of $130 million on the V-22 program, partially offset by lower revenue of $25 million on the Huey and Cobra upgrade contracts. Sales in the commercial business primarily reflected lower commercial aircraft sales of $96 million, partially offset by higher commercial spares and service sales of $44 million. Bell's profit increased $142 million primarily as a result of unfavorable 2001 profit adjustments of $149 million, including $124 million related to reduced profitability expectations or losses on certain development and production contracts and $25 million related primarily to receivable and inventory reserve increases. Excluding the 2001 profit adjustments, profit decreased $7 million as a result of lower profit of $30 million in the commercial business, partially offset by higher profit of $13 million in the U.S. Government business and $10 million in cost incurred in 2001 related to outsourcing the manufacture of certain parts. Lower profit of $30 million in the commercial helicopter business primarily reflected reduced pricing of $20 million related to one commercial helicopter model, increased production and warranty costs of $20 million, increased reserves of $15 million related primarily to receivables, lower income of $11 million ($6 million in 2002 vs. $17 million is 2001) from a joint venture partner related to the BA609 program, a lower contribution of $9 million from the decrease in commercial helicopter sales and increased costs of $9 million on a foreign military contract, partially offset by lower product development costs of $30 million and a benefit of $18 million related to the higher spares and service sales.

In December 2000, the U.S. Marine Corps temporarily restricted 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 continuation of the program. As authorized by an Acquisition Decision Memorandum signed by the Department of Defense in December 2001, the V-22 program continues to proceed at low-rate production levels. The V-22 returned to flight operations in May 2002 for extensive flight testing which is a prerequisite for returning to operational use. In August 2002, Bell was awarded a modification to its contract for the next two lots, totaling twenty aircraft, and in January 2003, a contract was awarded for long lead efforts on an additional 11 aircraft.

Revenues under the V-22 low-rate initial production contract are recorded as costs are incurred, primarily due to the significant engineering effort required over a lengthy period of time during the initial development stage in relation to total contract volume. Under the low-rate production releases, Textron continues to manufacture aircraft which may subsequently be modified for engineering changes. Beginning with new production releases in 2003, the development effort will be substantially completed. As a result, revenue on new production releases will be recognized as units are delivered.

2001 vs. 2000

The Aircraft segment's revenues increased $260 million, while profit decreased $137 million.

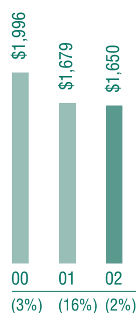
- Cessna Aircraft's revenues increased $219 million due to higher sales volume of Citation business jets of $223 million, higher pricing of $111 million and higher spare parts and service sales of $16 million. These increases were partially offset by lower sales of used aircraft of $47 million, lower sales volume of single engine piston aircraft and aircraft engines of $25 million, higher trade-in allowances of $25 million for used aircraft and lower Caravan sales of $22 million. Profit increased $47 million primarily as a result of higher pricing of $111 million, improved cost performance of $20 million and the contribution of $14 million from the higher volume, partially offset by inflation of $37 million, the impact of $34 million for trade-in allowances and inventory write-downs related to the valuation of used aircraft and higher product development expense of $27 million related to the Sovereign business jet.

- Bell Helicopter's revenues increased $41 million due to higher revenue of $79 million from the U.S. Government, partially offset by lower commercial sales of $38 million. U.S. Government revenues increased primarily due to higher revenue of $54 million on the V-22. Sales in the commercial business primarily

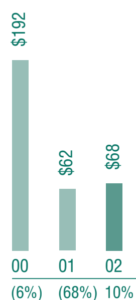
reflected lower foreign military sales of $74 million, partially offset by higher commercial spares and service sales of $21 million. Bell's profit decreased $184 million primarily due to $124 million related to reduced profitability expectations or losses on certain development and production contracts and $25 million related primarily to receivable and inventory reserve increases. 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 higher selling and administrative expense of $24 million, primarily related to hardware and software system upgrades, lower income of $13 million ($17 million in 2001 vs. $30 million in 2000) from a joint venture related to the BA609 program, $10 million of cost related to outsourcing the manufacture of certain parts and the contribution of $9 million from lower foreign military sales, partially offset by a benefit of $10 million related to the higher spares and service sales and a favorable LIFO inventory reserve adjustment of $8 million from a reduction in inventories.

Fastening Systems

Revenues



Segment Profit



Fastening Systems

2002 vs. 2001

The Fastening Systems segment's revenues decreased $29 million, while profit increased $6 million. The revenue decrease was primarily due to the divestiture of non-core product lines of $30 million and customer price reductions of $29 million, partially offset by the favorable impact of foreign exchange of $27 million in the European operations and higher sales volume of $3 million. Profit increased primarily due to the improved cost performance of $40 million and the impact of a $5 million loss on the sale of non-core product lines in 2001, partially offset by customer price reductions of $29 million and a reduced contribution of $11 million from an unfavorable mix.

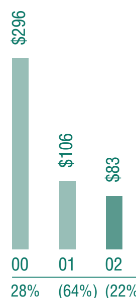
2001 vs 2000

The Fastening Systems segment's revenues and profit decreased $317 million and $130 million, respectively. The revenue decrease was primarily due to lower sales volume of $266 million as a result of depressed market demand in most businesses, customer price reductions of $37 million and the unfavorable impact of foreign exchange of $20 million in the European operations, partially offset by the contribution of $6 million from acquisitions. Profit decreased primarily due to a reduced contribution of $67 million from the lower sales volume, customer price reductions of $37 million, unfavorable cost performance of $11 million, a customer warranty issue of $7 million and a $5 million loss on the sale of a non-core product line. The unfavorable cost performance of $11 million related to low volume manufacturing inefficiencies, primarily as a result of production decreases to reduce inventory levels and the impact of smaller lot sizes, partially offset by the net benefit of restructuring activities of $19 million.

Industrial Products

Revenues

Segment Profit



Industrial Products

2002 vs. 2001

The Industrial Products segment's revenues and profit decreased $133 million and $23 million, respectively. Revenues decreased in most of the segment's businesses primarily due to lower sales of $133 million from depressed markets and the divestiture of non-core product lines of $20 million during 2001, partially offset by higher revenues of $13 million in the aerospace and defense business. Profit decreased primarily due to a reduced contribution of $67 million from the lower sales volume, a $32 million increase in receivable reserves and the nonrecurring impact of a gain of $5 million on the sale of a product line in 2001, partially offset by improved cost performance of $72 million, including the benefit of $49 million from restructuring activities, and the favorable impact of $7 million from losses recorded in 2001 related to divested product lines.

2001 vs. 2000

The Industrial Products segment's revenues and profit decreased $274 million and $190 million, respectively. Revenues decreased in most of the segment's businesses primarily due to lower sales of $349 million from depressed markets, with the largest decreases in the light construction equipment and the golf car and turf care businesses, partially offset by the contribution of $50 million from acquisitions and higher revenues of $27 million in the aerospace and defense business. Profit decreased primarily due to unfavorable cost performance of $102 million and a reduced contribution of $100 million from the lower sales volume, partially offset by the contribution of $9 million from acquisitions and a $5 million gain on the sale of a small product line. The unfavorable cost performance of $102 million, primarily in the light construction, golf car and turf care businesses, was primarily caused by manufacturing inefficiencies of $110 million resulting from reduced production and the shut-down of certain facilities in an effort to reduce inventory levels, a write-down of $16 million of used golf car and other inventories, the impact of $12 million of higher rebates to stimulate sales and an increase of $12 million in the reserve for receiv-

ables, partially offset by the net benefit of $49 million from restructuring activities. 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” section.

Industrial Components

Revenues

Segment Profit

Industrial Components

2002 vs. 2001

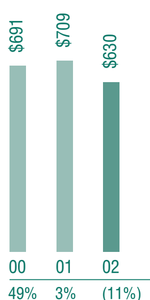
The Industrial Components segment’s revenues and profit decreased $1,547 million and $100 million, respectively. Revenues and profit declined $1.666 billion and $94 million, respectively, due to the divestitures of Trim, TECT and several small product lines in 2001. Excluding the divestitures, revenues increased $119 million while profit decreased $6 million. The revenue increase was primarily due to higher sales volume of $166 million at Kautex, primarily as a result of new product launches and a stronger automotive market, and the favorable impact of foreign exchange of $27 million, partially offset by lower volume of $51 million in the industrial businesses as a result of soft markets and customer price reductions of $23 million. Excluding the divestitures, the profit decrease was primarily due to customer price reductions of $23 million and the nonrecurring impact of a gain of $7 million on the sale of a product line in 2001, partially offset by improved cost performance of $12 million and a contribution of $10 million from the higher volume.

2001 vs. 2000

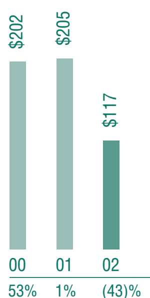
The Industrial Components segment’s revenues and profit decreased $456 million and $126 million, respectively. Revenues decreased due to lower volume of $334 million, primarily due to North American automotive original equipment manufacturer production decreases, the divestiture of non-core product lines of $92 million, customer price reductions of $75 million and the unfavorable impact of foreign exchange of $20 million, partially offset by the contribution from acquisitions of $65 million. Profit decreased due to the reduced contribution of $99 million from the lower sales, customer price reductions of $75 million, the lower contribution of $7 million from the sale of non-core product lines and the unfavorable impact of $6 million from foreign exchange, partially offset by improved cost performance of $52 million and a $7 million gain on the sale of a small product line.

Finance

Revenues



Segment Profit



Finance

2002 vs. 2001

The Finance segment’s revenues and profit decreased $79 million and $88 million, respectively. Revenues decreased primarily due to lower average yields on finance receivables of $95 million (7.7% in 2002, compared to 9.4% in 2001) reflecting the lower interest rate environment, primarily due to reductions in the prime rate, partially offset by $8 million due to higher average finance receivables and higher operating lease revenue of $8 million. Profit decreased due to a higher provision for losses of $57 million ($139 million in 2002 vs. $82 million in 2001), higher operating expenses of $21 million and lower interest margin (7.18% in 2002 and 7.55% in 2001) of $10 million, primarily due to higher relative borrowing costs. The increase in the provision for losses reflects higher net charge-offs of $54 million and the strengthening of the allowance for losses on receivables. Higher net charge-offs reflect increases primarily in liquidating portfolios including syndicated bank loans, principally related to the telecommunication industry, and small business finance. The allowance for losses on receivables as a percentage of total finance receivables was 2.9% at December 28, 2002, compared to 2.6% at December 29, 2001. The increase in operating expenses was primarily related to higher legal and collection expenses of $16 million and higher expenses of $6 million related to growth in managed receivables.

The Finance segment’s nonperforming assets include nonaccrual accounts that are not guaranteed by Textron Manufacturing, for which interest has been suspended, and repossessed assets. During 2002, nonperforming assets increased $84 million to 3.33% of finance assets from 2.13% at December 29, 2001. The significant components of this increase include $35 million in resort finance, $21 million in aircraft finance, $17 million in media finance and $12 million in franchise finance. Textron Finance estimates that nonperforming assets will generally be in the range of 2-4% of finance assets depending on economic conditions. Textron Finance expects modest improvements in portfolio quality as it liquidates certain portfolios. However, a prolonged economic downturn could have a negative effect on the overall portfolio quality. The allowance for losses on receivables as a percentage of nonaccrual finance receivables was 92% at December 28, 2002, compared to 126% at December 29, 2001. The decrease in the percentage represents an increase in nonaccrual finance receivables at December 28, 2002, supported by strong collateral.

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 of $31 million ($68 million in 2001 vs. $37 million in 2000), a $14 million gain from a leveraged lease prepayment, higher servicing fees of $12 million and higher investment and other income of $20 million, partially offset by a lower average yield of $66 million reflecting the lower interest rate environment. Profit increased primarily due to higher interest margin (7.55% in 2001 vs. 6.17% in 2000) of $82 million primarily due to higher syndication and securitization gains, investment income and other income, partially offset by a higher provision for losses of $45 million ($82 million in 2001 vs. $37 million in 2000) as a result of higher net charge-offs of $29 million, and higher operating expenses of $35 million primarily related to managed receivables.

Special Charges and Other Costs Related to Restructuring

Textron recorded $128 million, $437 million and $483 million in special charges in 2002, 2001 and 2000, respectively. The table below summarizes the special charges which include the write-down of goodwill, other intangibles and investments along with restructuring expenses associated with a) reducing overhead, and closing, consolidating and downsizing manufacturing facilities, b) corporate personnel reductions and c) outsourcing, consolidating operations and exiting non-core product lines.

	Restructuring Expense					
(In millions)	Severance Costs	Facility and Other	Fixed Asset Write-downs	Total	Goodwill, Intangible and Investment Impairment	Total Special Charges
2002						
Aircraft	$ 26	$ —	$ 2	$ 28	$ —	$ 28
Fastening Systems	12	2	4	18	—	18
Industrial Products	13	2	19	34	—	34
Industrial Components	6	1	2	9	—	9
Finance	—	—	—	—	—	—
Corporate	1	—	—	1	38	39
	$ 58	$ 5	$ 27	$ 90	$ 38	$ 128
2001						
Aircraft	$ 6	$ —	$ —	$ 6	$ —	$ 6
Fastening Systems	22	2	18	42	2	44
Industrial Products	16	1	3	20	317	337
Industrial Components	24	—	7	31	—	31
Finance	2	1	—	3	—	3
Corporate	7	—	—	7	9	16
	$ 77	$ 4	$ 28	$ 109	$ 328	$ 437
2000						
Aircraft	$ —	$ —	$ —	$ —	$ —	$ —
Fastening Systems	—	—	—	—	128	128
Industrial Products	7	1	—	8	16	24
Industrial Components	8	—	1	9	205	214
Finance	—	—	—	—	—	—
Corporate	—	—	—	—	117	117
	$ 15	$ 1	$ 1	$ 17	$ 466	$ 483

Restructuring Program

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 corporate and segment workforce reductions, consolidation of facilities primarily in the United States and Europe, rationalization of certain product lines, outsourcing of non-core production activity, the divestiture of non-core businesses and streamlining of sales and administrative overhead. In October 2002, Textron announced an expansion of its restructuring program as part of its strategic effort to improve operating efficiencies, primarily in its industrial businesses. With this expanded program, Textron expects a total reduction of at least 9,500 employees, excluding approximately 700 Trim employees, representing approximately 16% of its global workforce since the restructuring was first announced.

As of December 28, 2002, Textron has reduced its workforce by approximately 8,100 employees, including approximately 2,500 in Industrial Products, 2,000 in Fastening Systems, 2,000 in Industrial Components, 1,400 in Aircraft and 200 in Finance and Corporate. Additionally, 81 facilities, including 36 manufacturing plants with 3.1 million square feet of floor space, have been closed primarily in the Industrial Products, Industrial Components and Fastening Systems segments.

Total program costs, including costs related to restructuring, are estimated at $486 million and include $11 million related to Trim. As of December 28, 2002, $272 million has been incurred including $11 million related to Trim. Restructuring savings were $253 million in 2002 and are expected to be at least $325 million in 2003 and $400 million in 2004.

Other costs related to restructuring, but not accruable under EITF No. 94-3, of $22 million in 2002 and $34 million in 2001 were included in segment profit as incurred. For 2002, costs related to restructuring totaled $8 million in Industrial Products, $6 million in Industrial Components, and $4 million each for Aircraft and Fastening Systems. For 2001, costs related to restructuring totaled $10 million for Aircraft and $8 million each for Fastening Systems, Industrial Products and Industrial Components.

For projects initiated prior to December 28, 2002, the special charges (restructuring costs accruable under EITF No. 94-3) were recorded as each project was formally identified and committed to action. The other costs related to restructuring were recorded in segment profit as incurred. Projects initiated after December 28, 2002, will be accounted for in accordance with SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities”, which delays the recording of costs until they are incurred, with an exception for one-time termination benefits and lease termination costs. Accordingly, all costs related to restructuring will be included in special charges beginning in 2003.

Goodwill, Intangibles and Investment Impairment Special Charges

In the fourth quarter of 2002, Textron recorded a write-down of $38 million ($23 million after-tax) of its holdings in C&A common stock in special charges. Textron acquired this stock as a result of the disposition of the Trim business. During the second half of 2002, the C&A common stock experienced a decline in market value. In December 2002, Moody’s lowered its liquidity rating of C&A. Due to this indicator and the extended length of time and extent to which the market value of the stock was less than the carrying value, Textron determined that the decline in the market value of the stock was other than temporary and wrote down its investment in the stock.

At 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 2001, Textron recorded an additional $6 million impairment charge, and subsequently realized a $3 million net loss on the sale of its remaining e-business securities. Textron had no remaining investments in e-business securities as of December 28, 2002.

During the third quarter of 2001, certain long-lived asset impairment indicators were identified for OmniQuip which caused Textron to perform an impairment review. 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 results for the foreseeable future. The impairment calculation resulted in an impairment charge of $317 million, including goodwill of $306 million and other intangible assets of $11 million.

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. As a result, Textron performed an impairment review which identified impaired goodwill of $205 million in Industrial Components, $128 million in Fastening Systems and $16 million in Industrial Products, resulting in an aggregate write-down of $349 million. The largest portions of the goodwill charge were at TECT ($178 million) and Flexalloy ($96 million).

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires management to make complex and subjective judgments in the selection and application of accounting policies. The accounting policies 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 are listed below. 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 short-term financial obligations to us (e.g., bankruptcy filings, substantial down-grading of credit scores, geographic economic conditions, etc.), we record a specific reserve for bad debts for amounts we estimate to be potentially uncollectible. Receivables are charged-off when they are deemed uncollectible. For homogenous loan pools and all other receivables, we recognize reserves for bad debts based on current delinquencies, the characteristics of the existing accounts, historical loss experience, the value of underlying collateral and general economic conditions and trends. Finance receivables are written down to the fair value (less estimated costs to sell) of the related collateral at the earlier of the date when the collateral is repossessed or when no payment has been received for six months, unless we deem the receivable collectible.

Reserves on certain finance receivables are determined using estimates of related collateral values based on historical recovery rates and current market conditions. While we have no commercial customers that represent more than 10% of sales in 2002, we do have significant collateralized finance receivables with certain large customers, including national rental companies. Market conditions for used equipment and aircraft inventories could deteriorate if the current depressed economic conditions result in either numerous or several large customer defaults, leading to large quantities of used inventory being offered in the market. Such a deterioration in market conditions would result in lower estimated collateral values, increasing the amount of reserves required on related receivables and used inventories on hand. Based on current market conditions, we believe our reserves are adequate as of December 28, 2002.

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. Contract costs are typically incurred over a period of several years, and the estimation of these costs requires substantial judgments. The cost estimation process is based on the professional knowledge and experience of engineers and program managers along with finance professionals. The duration of the contracts and the technical challenges included in certain contracts affect our ability to estimate costs precisely. As a result, we update our projections of costs at least semiannually or when circumstances significantly change. Adjustments to projected costs are recognized in net earnings when determinable. Favorable changes in estimates result in additional profit recognition, while unfavorable changes in estimates result in the reversal of previously recognized earnings. Any anticipated losses on contracts are charged to earnings when identified. Earnings on long-term contracts 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

Upon the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets", on December 30, 2001, we recorded an after-tax transitional impairment charge of $488 million as discussed in Note 7 to the consolidated financial statements. This new accounting standard requires companies to evaluate goodwill and other intangible assets for impairment on an annual basis. We evaluate the recoverability of goodwill and other intangible assets annually in the fourth quarter, or more frequently if 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 value of an asset might be impaired. We completed our

annual impairment test in the fourth quarter of 2002 using the estimates from our long-term strategic plans. No adjustment was required to the carrying value of our goodwill or other intangible assets based on the analysis performed.

Goodwill is considered to be impaired when the net book value of a reporting unit exceeds its estimated fair value. Fair values are primarily established using a discounted cash flow methodology. The determination of discounted cash flows is based on the businesses' strategic plans and long-range planning forecasts. The revenue growth rates included in the plans are management's best estimates based on current and forecasted market conditions, and the profit margin assumptions are projected by each segment based on the current cost structure and anticipated cost reductions. If different assumptions were used in these plans, the related undiscounted cash flows used in measuring impairment could be different potentially resulting in an impairment charge.

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. We may retain an interest in the transferred assets in the form of interest-only securities, subordinated certificates, cash reserve accounts and servicing rights and obligations. We do not provide legal recourse to third-party investors that purchase interests in our securitizations beyond the credit enhancement inherent in the retained interest-only securities, subordinated certificates and cash reserve accounts. 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 and Other Postretirement Benefits

Assumptions used in determining projected benefit obligations and the fair values of plan assets for our pension plans and other postretirement benefits are evaluated periodically by management in consultation with outside actuaries and investment advisors. Changes in assumptions are based on relevant company data, such as the rate of increase in compensation levels and the long-term rate of return on plan assets. Critical assumptions, such as the discount rate used to measure the benefit obligations, the expected long-term rate of return on plan assets and health care cost projections, are evaluated and updated annually. We have assumed that the expected long-term rate of return on plan assets will be 8.9%. Over the last ten-and twenty-year periods, our pension plan assets have earned in excess of our current assumed long-term rate of return on plan assets.

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. 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 2002, we determined this rate to be 6.75%. Postretirement benefit plan discount rates are the same as those used by our defined benefit pension plan in accordance with the provisions of SFAS No. 106.

In the fourth quarter of 2002, we recorded a non-cash adjustment to equity through other comprehensive loss of $91 million to reflect additional minimum pension liability. Based on our current assumptions, as well as the impact of recent market declines in the value of our pension assets, we estimate that our pension income, excluding curtailment gains, will decline from $95 million in 2002 to approximately $34 million in 2003.

The trend in health care costs is difficult to estimate and it has an important effect on postretirement liabilities. The 2002 health care cost trend rate, which is the weighted average annual projected rate of increase in the per capita cost of covered benefits, was 10%. This rate is assumed to decrease to 5.0% by 2006 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 that operate in the Aircraft, Fastening Systems, Industrial Components 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 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.

Operating Cash Flows

Textron's financial position continued to be strong at the end of 2002. During 2002, cash flows from operations were 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 38 and 39. Management analyzes operating cash flows by tracking Free Cash Flow, which is calculated using net cash provided by operating activities, adding back after-tax cash used for restructuring activities, and proceeds on the sale of fixed assets, then subtracting capital expenditures, including those financed with capital leases.

Financing

Textron Manufacturing's debt (net of cash) to total capital ratio as of December 28, 2002 was 27%, down slightly from 28% at December 29, 2001. Textron Manufacturing has established a target debt-to-capital ratio in the mid to high 20% range. Consistent with the 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 treated as equity capital for the purpose 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 is returned to Textron.

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. As of December 28, 2002, 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 commercial paper and long-term debt credit ratings were downgraded from a P1 to P2 and from an A-2 to A-3, respectively, by Moody's Investors Service and both companies were placed on Negative Outlook by all three ratings agencies. 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 actions of the rating agencies caused our cost of capital to increase, it did not result in any loss of access to capital. Textron did not experience any commercial paper or long-term debt credit rating downgrades in 2002. Further downgrades in Textron's ratings could increase borrowing spreads or limit its access to the commercial paper, securitization and long-term debt markets. In addition, Textron Finance's $1.5 billion revolving bank line of credit agreements contain certain financial covenants that Textron Finance needs to comply with to maintain its ability to borrow under the facilities. Textron Finance was in full compliance with such covenants at December 28, 2002.

Textron believes that it has adequate credit facilities and access to credit markets to meet its long-term financing needs.

Short-Term Financing

For liquidity purposes, we maintain sufficient unused lines of credit to support our outstanding commercial paper. None of these lines of credit were used at December 28, 2002. Textron Manufacturing has a primary revolving credit facility for $1.5 billion, of which $500 million will expire in 2003 and $1 billion will expire in 2007. Textron Finance has bank lines of credit of $1.5 billion, of which $500 million expires in 2003 and $1 billion expires in 2006. At December 28, 2002, the lines of credit not reserved as support for commercial paper totaled $1.5 billion and $616 million for Textron Manufacturing and Textron Finance, respectively. Both $500 million facilities include one-year term out options that can effectively extend their expiration into 2004.

Textron Finance utilizes the asset securitization market to manage asset exposures and diversify funding sources. During the year, Textron Finance received net proceeds from the securitizations of $299 million of aircraft finance receivables, $185 of small business finance receivables (on a revolving basis), $150 million of distribution finance receivables (on a revolving basis), $131 million of resort finance receivables and $127 million of golf equipment receivables. These securitizations provided Textron Finance with an alternate source of liquidity. Textron Finance used the proceeds from the securitizations to retire commercial paper. In connection with the outstanding $229 million revolving securitization of small business finance receivables, Textron Finance is obligated to repurchase a certain class of loans if Textron Finance's credit rating drops below BBB. These loans amounted to $41 million at December 28, 2002. Textron Finance has no other repurchase obligations in connection with any other securitization transactions. Textron Finance anticipates that it will enter into additional securitization transactions in 2003.

Long-Term Financing

During 2002, Textron Manufacturing issued $300 million in medium-term notes under Textron Inc.'s existing shelf registration filed with the Securities and Exchange Commission, leaving $900 million available under this registration statement. The proceeds from the issuances are expected to be used for general corporate purposes. Textron Manufacturing also paid off $500 million of maturing notes in 2002 with a combination of cash and proceeds from commercial paper issuances.

Under a shelf registration statement filed with the Securities and Exchange Commission, Textron Finance may issue public debt securities in one or more offerings up to a total maximum offering of $3 billion. Under this facility, Textron Finance issued $1.9 billion of term notes during 2002, primarily in U.S. and Canadian markets, that mature in 2003 through 2009. The proceeds from the issuances were used to refinance maturing commercial paper and long-term debt at par. At December 28, 2002, Textron Finance had $1.1 billion available under this facility. Through private issuances in 2002, Textron Finance also entered into $170 million of variable-rate notes maturing in 2004.

Off-Balance Sheet and 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 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 $91 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 2002, Textron's portion of the outstanding debt and operating lease commitments covered by this guarantee totaled $30 million. See Note 16 to the consolidated financial statements regarding our joint ventures.

At December 28, 2002, Textron Finance had unused commitments to fund new and existing customers under $1.5 billion of committed revolving lines of credit and $1.0 billion of uncommitted 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. As a result of the sale of an equipment portfolio in 2001, Textron Finance retained a contingent recourse liability that had a balance of $17 million at December 28, 2002. In the event Textron Finance's credit rating drops below a low BBB, Textron Finance is required to pledge related equipment residuals of $9 million with a letter of credit up to $8 million.

Textron Manufacturing has entered into a forward contract in Textron common stock. The contract is intended to hedge the earnings and cash volatility of stock-based incentive compensation indexed to Textron stock. The forward contract requires annual cash settlement between the counterparties. Settle-

ment is calculated based upon a number of shares multiplied by the difference between the strike price and the prevailing Textron common stock price. In 2002, Textron Manufacturing's primary forward contract was for approximately two million shares with a strike price of $49.09. In December 2002, Textron Manufacturing paid $12 million in advance of the settlement date for this contract of January 9, 2003. This prepayment reduced the remaining liability for this contract to approximately $3 million at December 28, 2002. In January 2003, Textron Manufacturing entered into a new forward contract for approximately 2.4 million shares at a strike price of $44.88.

Dispositions

In December 2001, 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. An additional $110 million was received in 2002 pursuant to the settlement of post-closing obligations and the repurchase of C&A preferred shares. The proceeds from this sale were primarily used to repurchase Textron common stock and reduce debt.

In December 2002, Textron Manufacturing sold the Snorkel product line of its OmniQuip business unit and the capital stock of the OmniQuip Textron Inc. holding company for a pre-tax loss of $20 million with a tax benefit of $54 million. The tax benefit was primarily due to the write-off of OmniQuip goodwill in the third quarter of 2001 at which time only a portion of the tax benefit was realized. Approximately $100 million is expected to be collected in 2003 due to this transaction, and the cash will be used for general operating purposes.

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 fifteen companies, acquired the minority interest of two entities and entered into one joint venture for an aggregate cost of $333 million and assumed debt of $38 million.

Acquisitions by 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 leveraged at a debt-to-tangible equity ratio with Textron Finance of 7.5 to 1. During the past three years, Textron Finance acquired one significant loan portfolio for $387 million.

Capital spending in 2002 decreased to $319 million, which includes $23 million of expenditures purchased through capital leases, from $532 million in 2001. This decrease was primarily due to the sale of the Automotive Trim business in 2001 along with a planned decrease in capital spending. Aggregate capital spending for the past three years totaled $1.4 billion.

In fiscal 2002, Textron repurchased 5,734,000 shares of common stock under its Board authorized share repurchase program for a total cash payment of $248 million.

Textron's Board of Directors approved the annual dividend per common share of $1.30 in 2002. Dividend payments to shareholders in 2002 of $182 million were $2 million less than amounts paid in 2001, primarily due to share repurchases.

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 swap 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 swap agreements did not significantly impact interest expense in 2002 or 2001.

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 swap agreements. At December 28, 2002, interest-sensitive assets in excess of interest-sensitive liabilities were $629 million, net of $1.4 billion of interest rate swap agreements on long-term debt and $219 million of interest rate swap agreements on finance receivables. Interest-sensitive assets in excess of interest-sensitive liabilities were $410 million at December 29, 2001, net of $370 million of interest rate swap agreements on long-term debt and $97 million of interest rate swap agreements on finance receivables. The increase in interest

rate swap agreements was directly related to the conversion of fixed-rate debt to variable-rate debt at the time of issuance. The change in net position does not reflect a change in management's match funding strategy.

Foreign Exchange Risks

Textron's financial results are affected by changes in foreign currency exchange rates and 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 Sterling. Textron's results of operations were not materially affected by foreign exchange exposures in 2002 or 2001.

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 2002, Textron Manufacturing primarily used borrowings denominated in Euro and British Pound Sterling 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 $721 million at the end of 2002 and $605 million at the end of 2001.

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 swap 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.

			2002			2001
(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	$(1,711)	$(1,839)	$ (31)	$(1,934)	$(1,972)	$(29)
Interest rate swaps	4	4	3	—	—	—
Textron Finance:						
Finance receivables	4,809	4,943	21	4,795	4,884	4
Interest rate swaps - receivables	(21)	(21)	(5)	(8)	(8)	(1)
Debt	(4,840)	(4,935)	(62)	(4,188)	(4,208)	(36)
Interest rate swaps - debt	67	67	9	3	3	1
Foreign Exchange Rate Risk						
Textron Manufacturing:						
Debt	(631)	(662)	(66)	(661)	(655)	(66)
Foreign currency exchange contracts	(4)	(4)	(21)	(7)	(7)	(26)
Equity Price Risk						
Textron Manufacturing:						
Available for sale securities	30	30	(3)	90	90	(9)
Marketable security price forward contracts	(3)	(3)	(9)	(11)	(11)	(8)

** Asset or (liability)*

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 that impose liability on companies to clean up, or contribute to the cost of cleaning up, sites on which hazardous wastes or materials were disposed or released. Expenditures to evaluate and remediate contaminated sites approximated $16 million, $14 million and $11 million in 2002, 2001 and 2000, respectively. Textron currently projects that expenditures for remediation will range between $12 million and $17 million for each of the years 2003 and 2004.

Textron's accrued estimated environmental liabilities are based on assumptions that are subject to a number of factors and uncertainties. Circumstances that 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 operations. 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 $6.1 billion and $6.5 billion at the end of 2002 and 2001, respectively, and U.S. Government backlog was $1.6 billion at the end of 2002 and $1.0 billion at the end of 2001. Backlog for the Aircraft segment was approximately 85% of Textron's commercial backlog at the end of 2002 and 2001, and 65% and 68% of Textron's U.S. Government backlog at the end of 2002 and 2001, respectively. Included in commercial backlog is approximately $500 million related to firm orders from CitationShares, Textron's joint venture with TAG Aviation USA, Inc., discussed in Note 16.

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 2.1% of Textron's consolidated revenue in 2002 (0.1% in the case of foreign military sales and 2.0% in the case of direct sales) and 1.2% in 2001 (0.4% and 0.8%, respectively). Such sales include military and commercial helicopters, armored vehicles, turrets, and spare parts. In 2002, these sales were made primarily to the countries of Saudi Arabia (20%), United Kingdom (16%), Mexico (15%) and Venezuela (10%). 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 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" and requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Costs related to restructuring that were not accruable under EITF No. 94-3, were previously recorded by Textron in segment profit as incurred. Beginning in 2003, Textron will include all costs related to restructuring, for which this Statement applies, in special charges. The adoption of this Statement is not expected to have a material effect on Textron's results of operations or financial position.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). Along with new disclosure requirements, FIN 45 requires guarantors to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee. This differs from the current practice to record a liability only when a loss is probable and reasonably estimable. The recognition and measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 is not expected to have a material effect on Textron's results of operations or financial position. Textron has adopted the disclosure provisions as of December 28, 2002.

In December 2002, the FASB issued SFAS No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure” which amended SFAS No. 123, “Accounting for Stock-Based Compensation”. This Statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. It also amends the disclosure provisions to require prominent disclosure about the effects on reported net income of an entity’s accounting policy decisions with respect to stock-based employee compensation. The provisions of this Statement are to be applied to financial statements for fiscal years ending after December 15, 2002. As permitted by the Statement, Textron does not plan to adopt the fair value recognition provisions at this time. Textron has adopted the disclosure provisions of this Statement as of December 28, 2002.

In January 2003, the FASB issued Interpretation No. 46 “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. Management is currently evaluating the impact of the adoption of FIN 46 and does not anticipate that it will have a material effect on Textron’s results of operations or financial position.

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Forward-looking Information: Certain statements in this Annual Report 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) uncertainty in estimating the amount and timing of restructuring charges and related costs, (c) changes in worldwide economic and political conditions that impact interest and foreign exchange rates, (d) the occurrence of work stoppages and strikes at key facilities of Textron or Textron’s customers or suppliers, (e) government funding and program approvals affecting products being developed or sold under government programs, (f) cost and delivery performance under various program and development contracts, (g) the adequacy of cost estimates for various customer care programs including servicing warranties, (h) the ability to control costs and successful implementation of various cost reduction programs, (i) the timing of certifications of new aircraft products, (j) the occurrence of further downturns in customer markets to which Textron products are sold or supplied or where Textron Financial offers financing, (k) Textron’s ability to offset, through cost reductions, raw material price increases and pricing pressure brought by original equipment manufacturer customers, (l) the availability and cost of insurance, (m) pension plan income falling below current forecasts, (n) Textron Financial’s ability to maintain portfolio credit quality, (o) Textron Financial’s access to debt financing at competitive rates; and (p) uncertainty in estimating contingent liabilities and establishing reserves tailored to address such contingencies.