

Notes to Consolidated Financial Statements

Note 1
Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

Textron is a global, multi-industry company with manufacturing and finance operations primarily in North America, Western Europe, South America and Asia/Pacific. Textron's principal markets are summarized below by segment.

Segment	Principal Markets
Aircraft	<ul style="list-style-type: none"> • Business jets • Commercial and military helicopters • General aviation • Overnight express package carriers • Humanitarian flights, tourism and freight
Fastening Systems	<ul style="list-style-type: none"> • Aerospace • Automotive • Business, electrical and industrial equipment • Non-Auto Transportation • Construction • Electronics
Industrial Products	<ul style="list-style-type: none"> • Golf and turf-care products and specialized industrial vehicles: golf courses, resort communities and municipalities, and commercial and industrial users • Commercial aerospace and defense • Light construction equipment: national rental fleets, independent distributors and rental centers • Power hand tools, test and measurement equipment: construction, maintenance and telecommunications industries
Industrial Components	<ul style="list-style-type: none"> • Automotive equipment: automotive original equipment manufacturers and their suppliers • Fluid and power systems: original equipment manufacturers, distributors and end-users
Finance	<ul style="list-style-type: none"> • Commercial loans and leases

The consolidated financial statements include the accounts of Textron and all of its majority- and wholly owned subsidiaries. Investments in which Textron does not have control, but has the ability to exercise significant influence over the operating and financial policies, are accounted for under the equity method. Textron's share of net earnings and losses from these investments is included in the consolidated statement of operations.

Textron's financings are conducted through two borrowing groups, Textron Finance and Textron Manufacturing. This framework is designed to enhance Textron's borrowing power by separating the Finance segment. Textron Finance consists of Textron Financial Corporation consolidated with its subsidiaries, which are the entities through which Textron operates its Finance segment. Textron Finance finances its operations by borrowing from its own group of external creditors. Certain intercompany transactions between borrowing groups have not been eliminated in the consolidated financial statements. See "Due to Textron Manufacturing" in Note 8 for further details. All other significant intercompany transactions are eliminated.

Textron Manufacturing is Textron Inc., the parent company, consolidated with the entities which operate in the Aircraft, Fastening Systems, Industrial Products and Industrial Components business segments. In January 2002, management responsibility for certain divisions was reorganized to reflect the sale of the Automotive Trim business in December 2001. The former automotive divisions have been included in the Industrial Components segment. All prior period data have been appropriately reclassified.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these statements and accompanying notes. Some of the more significant estimates are made in the areas of receivable and inventory reserves, long-term contracts, goodwill and other intangible assets, securitized transactions and pension and other postretirement benefits. Management's estimates are based

on the facts and circumstances available at the time estimates are made, historical experience, risk of loss, general economic conditions and trends, and management's assessments of the probable future outcome of these matters. Actual results could differ from such estimates.

Certain prior period amounts have been reclassified to conform to the current year presentation.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term, highly liquid securities with original maturities of ninety days or less.

Revenue Recognition

Revenue is generally recognized when products are delivered or services are performed. With respect to aircraft, delivery is upon completion of manufacturing, customer acceptance and the transfer of the risk and rewards of ownership.

Revenue under fixed-price contracts is generally recorded as deliveries are made. Certain long-term fixed-price contracts provide for periodic delivery after a lengthy period of time over which significant costs are incurred or require a significant amount of development effort in relation to total contract volume. Revenues under those contracts and all cost-reimbursement-type contracts are recorded as costs are incurred. Certain contracts are awarded with fixed-price incentive fees. Incentive fees are considered when estimating revenues and profit rates, and are recorded when these amounts are reasonably determined. Long-term contract profits are based on estimates of total sales value and costs at completion. Such estimates are reviewed and revised periodically throughout the contract life. Revisions to contract profits are recorded when the revisions to estimated sales value or costs are made. Estimated contract losses are recorded when identified.

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.

Revenue from certain qualifying non-cancelable aircraft and other product lease contracts are accounted for as sales-type leases. The present value of all payments (net of executory costs and any guaranteed residual values) is recorded as revenue, and the related costs of the product are charged to cost of sales. Generally, this lease financing is through Textron Finance and the associated interest is recorded over the term of the lease agreement using the interest method. Lease financing transactions which do not qualify as sales-type leases are accounted for under the operating method wherein revenue is recorded as earned over the lease period.

Finance revenues include interest on finance receivables which is recognized using the interest method to provide a constant rate of return over the terms of the receivables. Finance revenues also include direct loan origination costs and fees received, which are deferred and amortized over the contractual lives of the respective receivables using the interest method. Unamortized amounts are recognized in revenues when receivables are sold or pre-paid. Accrual of interest income is suspended for accounts that are contractually delinquent by more than three months, unless collection is not doubtful. In addition, detailed reviews of loans may result in earlier suspension if collection is doubtful. Accrual of interest is resumed when the loan becomes contractually current, and suspended interest income is recognized at that time.

Allowance for Losses on Finance Receivables

Provisions for losses on finance receivables are charged to income in amounts sufficient to maintain the allowance at a level considered adequate to cover losses in the existing receivable portfolio. Management evaluates the allowance by examining current delinquencies, the characteristics of the existing accounts, historical loss experience, the value of the underlying collateral and general economic conditions and trends. Finance receivables are charged off when they are deemed to be uncollectible. Finance receivables are written down to the fair value (less estimated costs to sell) of the related collateral at the earlier of the date the collateral is repossessed or when no payment has been received for six months, unless management deems the receivable collectible.

Loan Impairment

Textron Finance periodically evaluates finance receivables, excluding homogeneous loan portfolios and finance leases, for impairment. A loan is considered impaired when it is probable that Textron Finance will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment is measured by comparing the fair value of a loan to its carrying amount. Fair value is based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or, if the loan is collateral dependent, at the fair value of the collateral. If the fair value of the loan is less than its carrying amount, Textron Finance establishes a reserve based on this difference. This evaluation is inherently subjective, as it requires estimates, including the amount and timing of future cash flows expected to be received on impaired loans, that may differ from actual results.

Securitized Transactions

Textron Finance sells or securitizes loans and leases and retains servicing responsibilities and subordinated interests, including interest-only securities, subordinated certificates and cash reserves, all of which are retained interests in the securitized receivables. These retained interests are subordinate to other investors' interests in the securitizations. A gain or loss on the sale of finance receivables depends in part on the previous carrying amount of the finance receivables involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair values at the date of transfer. Retained interests are recorded at fair value as a component of other assets. Textron Finance estimates fair value based on the present value of future expected cash flows using management's best estimates of key assumptions - credit losses, prepayment speeds, forward interest rate yield curves and discount rates commensurate with the risks involved. Textron Finance reviews the fair values of the retained interests quarterly using updated assumptions and compares such amounts with the carrying value of the retained interests. When the carrying value exceeds the fair value of the retained interests and the decline in fair value is determined to be other than temporary, the retained interest is written down to fair value. When a change in the fair value of the retained interest is deemed temporary, any unrealized gains or losses are included in shareholders' equity as a component of accumulated other comprehensive loss (OCL).

Investment Securities

Investments in marketable securities are classified as available for sale and are recorded at fair value as a component of other assets. Unrealized gains and losses on these securities, net of income taxes, are included in shareholders' equity as a component of accumulated OCL. If a decline in the fair value of a marketable security is judged to be other than temporary, the cost basis is written down to fair value with a charge to earnings. Non-marketable equity securities are accounted for under either the cost or equity method of accounting.

Inventories

Inventories are carried at the lower of cost or market. The cost of approximately 71% of inventories is determined using the last-in, first-out method. The cost of remaining inventories, other than those related to certain long-term contracts, are generally valued by the first-in, first-out method. Costs for commercial helicopters are determined on an average cost basis by model considering the expended and estimated costs for the current production release.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and are depreciated primarily using the straight-line method. Land improvements and buildings are depreciated primarily over estimated lives ranging from 5 to 40 years, while machinery and equipment are depreciated primarily over 3 to 15 years. Expenditures for improvements that increase asset values and extend useful lives are capitalized. Expenditures for maintenance and repairs are expensed as incurred.

Goodwill and Other Intangible Assets

Management evaluates the recoverability of goodwill and other intangible assets annually, or more frequently if events or changes in circumstances, such as decline 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. 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.

Derivative Financial Instruments

All derivative instruments are reported on the balance sheet at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in shareholders' equity as a component of comprehensive income (loss) depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value, cash flow or net investment hedge. Upon the adoption of Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities," Textron recorded a cumulative transition adjustment to increase accumulated OCL by approximately \$15 million, net of income taxes, to recognize the fair value of cash flow hedges as of December 31, 2000. The cumulative effect of adoption was not material to the consolidated statement of operations.

Textron is exposed to market risk, primarily from changes in interest rates, currency exchange rates and securities pricing. To manage the volatility relating to these exposures, Textron nets the exposures on a consolidated basis to take advantage of natural offsets. For the residual portion, Textron enters into various derivative transactions pursuant to Textron's policies in such areas as counterparty exposure and hedging practices. Designation is performed on a specific exposure basis to support hedge accounting. Changes in fair value of financial instruments qualifying as fair value hedges are recorded in income, offset in part or in whole by corresponding changes in the fair value of the underlying exposures being hedged. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in OCL net of deferred taxes. Changes in fair value of derivatives not qualifying as hedges are reported in income. Textron does not hold or issue derivative financial instruments for trading or speculative purposes.

Prior to the adoption of SFAS No. 133, changes in market value of contracts that hedged firm foreign currency commitments and intercompany transactions were generally included in the basis of the transactions. Changes in the market value of the contracts that hedged anticipated transactions were generally recognized in net earnings.

Foreign currency denominated assets and liabilities are translated into U.S. dollars with the adjustments from the currency rate changes being recorded in the cumulative translation adjustment account in shareholders' equity until the related foreign entity is sold or substantially liquidated. Foreign currency financing transactions, including currency swaps, are used to effectively hedge long-term investments in foreign operations with the same corresponding currency. Foreign currency gains and losses on the hedge of the long-term investments are recorded in the cumulative translation adjustment account in accumulated OCL with the offset recorded as an adjustment to the non-U.S. dollar financing liability.

Fair Values of Financial Instruments

Fair values of cash and cash equivalents, accounts receivable, accounts payable and variable-rate receivables and debt approximate cost. The estimated fair values of other financial instruments, including debt, equity and risk management instruments, have been determined using available market information and valuation methodologies, primarily discounted cash flow analysis or independent investment bankers. The estimated fair value of nonperforming loans included in finance receivables are based on discounted cash flow analyses using risk-adjusted interest rates or the fair value of the related collateral. Because considerable judgment is required in interpreting market data, the estimates are not necessarily indicative of the amounts that could be realized in a current market.

Stock-Based Compensation

Textron's 1999 Long-Term Incentive Plan (1999 Plan) authorizes awards to key employees. The 1999 Plan and related awards are described more in fully in Note 12. Stock-based compensation awards to employees under the 1999 Plan are accounted for using the intrinsic value method prescribed in APB 25, "Accounting for Stock Issued to Employees" and related Interpretations. No stock-based employee compensation cost related to stock options awards is reflected in net income as all options granted under the 1999 Plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Employee compensation cost related to Textron's performance share program and restricted stock awards is reflected in net income over the awards' vesting period. Textron has entered into cash settlement forward contracts on its common stock to mitigate the impact of stock price fluctuations on compensation expense. The following table illustrates the effect on net income and earnings per share if Textron had applied the fair-value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation.

<i>(In millions, except per share amounts)</i>	2002	2001	2000
Net income (loss), as reported	\$ (124)	\$ 166	\$ 218
Add back: Stock-based employee compensation expense included in reported net income (loss)*	9	22	20
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards*	(40)	(48)	(45)
Pro forma net income (loss)	\$ (155)	\$ 140	\$ 193
Income (loss) per share:			
Basic - as reported	\$ (.90)	\$ 1.17	\$ 1.51
Basic - pro forma	\$ (1.12)	\$.99	\$ 1.34
Diluted - as reported	\$ (.88)	\$ 1.16	\$ 1.49
Diluted - pro forma	\$ (1.10)	\$.98	\$ 1.32

* Net of related cash settlement forward income or expense and related tax effects

Product and Environmental Liabilities

Product liability claims are accrued on the occurrence method based on insurance coverage and deductibles in effect at the date of the incident and management's assessment of the probability of loss when reasonably estimable.

Environmental liabilities are recorded based on the most probable cost, if known, or on the estimated minimum cost, determined on a site-by-site basis. Textron's environmental liabilities are undiscounted and do not take into consideration possible future insurance proceeds or significant amounts from claims against other third parties.

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 of SFAS No. 123 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 characteris-

tics 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.

Note 2

Acquisitions and Dispositions

Acquisitions

During 2001, Textron Manufacturing acquired four companies at a total cost of \$209 million. Textron Manufacturing also made a \$40 million capital contribution to Textron Finance in support of its acquisition of a \$387 million loan portfolio. The largest of Textron Manufacturing's acquisitions was Tempo Research Corporation in the Industrial Products segment.

During 2000, Textron Manufacturing acquired 11 companies and the minority interests of two entities and entered into one joint venture at a total cost of \$121 million, including debt assumed of \$36 million. One of the larger acquisitions was Advantage Molding and Decorating - a leading supplier of injection molded parts, tooling and pad-printed designs.

The purchase method of accounting has been used for all acquisitions during the past three years. Pro forma results of operations have not been presented since these acquisitions are not considered to be material.

Dispositions

On December 26, 2002, Textron sold the Snorkel product line of its OmniQuip business unit and the capital stock of OmniQuip Textron Inc. holding company to Elwood Holdings, LLC and recognized a pre-tax loss of \$20 million with a tax benefit of \$54 million. The tax benefit was related to the writeoff of OmniQuip goodwill in the third quarter of 2001 at which time only a portion of the tax benefit was realized.

On December 20, 2001, Textron completed the sale of its Automotive Trim business to Collins & Aikman Products Company, a subsidiary of Collins & Aikman Corporation (C&A), for \$668 million in cash, non-marketable preferred shares of C&A valued at \$147 million, 18 million shares of C&A common stock valued at \$90 million and a transfer of \$60 million in indebtedness. In addition, Textron Automotive Trim entered into an \$87 million lease agreement whereby equipment used by the Automotive Trim business was retained by Textron and leased back to the business through Textron Financial Corporation. Textron recognized a \$339 million gain on the sale, and received after-tax proceeds of approximately \$582 million, including the transfer of indebtedness. The proceeds were primarily used to repurchase shares and reduce debt. The purchase and sale agreement includes a provision that entitles Textron to an additional cash payment of up to \$125 million to be calculated based on C&A operating results for the five-year period ending 2006.

As a part of the disposition, certain operating leases were transferred to C&A. Textron has guaranteed C&A's payments under these operating leases up to an aggregate amount of \$21 million. Textron is required to make payments under these guarantees upon a default by C&A under the lease agreements. These guarantees expire along with the underlying lease agreements. Textron believes it has sufficient recourse against C&A under the indemnity provisions of the purchase and sale agreement should it be required to make any payments under these guarantees.

In 2002, pursuant to a settlement of post-closing obligations under the purchase and sale agreement for the sale of the Automotive Trim business, Textron received \$110 million from C&A and recorded an additional gain of \$25 million. The transaction included the repurchase of C&A preferred shares and the settlement of all other matters under the purchase and sale agreement. In conjunction with this transaction and following C&A's recapitalization through a share offering, the carrying value of the C&A common stock held by Textron was revised. The C&A common stock was subsequently written down as discussed in Note 15.

In January 2003, Textron sold its 50% interest in an Italian joint venture to C&A for a \$12 million after-tax gain.

Note 3**Finance
Receivables and
Securitizations****Finance Receivables**

Textron Finance provides financial services primarily to the aircraft, golf, vacation interval resort, dealer floorplan and middle market industries under a variety of financing vehicles with various contractual maturities.

Installment contracts and finance leases have initial terms ranging from one to 20 years, and are primarily secured by the financed equipment. Finance leases include residual values expected to be realized at contractual maturity. Distribution finance and revolving loans generally mature within one to five years. Distribution finance receivables are generally secured by the inventory at the financed distributor, while revolving loans are secured by trade receivables, inventory, plant and equipment, and pools of vacation interval notes receivables, pools of residential and recreational land lots and the underlying real property. Golf course mortgages have initial terms ranging from five to seven years with amortization periods from 15 to 25 years. Resort mortgages generally represent construction and inventory loans with terms up to two years. Golf course and resort mortgages are secured by real property and are generally limited to 75% or less of the property's appraised market value at loan origination. Leveraged leases are secured by the ownership of the leased equipment and real property and have initial terms up to 30 years.

At the end of 2002 and 2001, Textron Finance had nonaccrual finance receivables, excluding receivables with recourse to the Manufacturing group, totaling \$182 million and \$114 million, respectively. Approximately \$122 million and \$54 million of these respective amounts were considered impaired, which excludes finance leases and homogeneous loan portfolios. The allowance for losses on finance receivables related to impaired loans was \$33 million and \$11 million at the end of 2002 and 2001, respectively. The average recorded investment in impaired loans during 2002 was \$97 million, compared to \$51 million in 2001.

The following table displays the contractual maturity of the finance receivables. It does not necessarily reflect future cash collections because of various factors including the repayment or refinancing of receivables prior to contractual maturity. Cash collections of finance receivables, excluding proceeds from receivable sales or securitizations, were \$7.7 billion and \$5.8 billion in 2002 and 2001, respectively. The ratio of cash collections (net of finance charges) to average net receivables, excluding distribution finance receivables and revolving loans, was approximately 54% in 2002 and 65% in 2001.

<i>(In millions)</i>	Contractual Maturities					Finance Receivables Outstanding	
	2003	2004	2005	2006	Thereafter	2002	2001
Installment contracts	\$ 275	\$ 234	\$ 187	\$ 166	\$ 966	\$ 1,828	\$ 2,047
Distribution finance	491	188	51	28	34	792	474
Revolving loans	447	208	115	233	363	1,366	1,579
Finance leases	29	54	40	17	207	347	319
Golf course and resort mortgages	55	117	231	144	416	963	813
Leveraged leases	(16)	(19)	22	4	469	460	404
	\$ 1,281	\$ 782	\$ 646	\$ 592	\$ 2,455	5,756	5,636
Less allowance for credit losses						167	144
						\$ 5,589	\$ 5,492

The net investment in finance leases and leveraged leases was as follows:

<i>(In millions)</i>	2002	2001
Finance and leveraged lease receivables, net of nonrecourse debt	\$ 725	\$ 490
Estimated residual values on leased assets	589	589
	1,314	1,079
Unearned income	(507)	(356)
Investment in leases	807	723
Deferred income taxes	(328)	(258)
Net investment in leases	\$ 479	\$ 465

The activity in the allowance for credit losses on finance receivables was as follows:

<i>(In millions)</i>	2002	2001	2000
Balance at the beginning of the year	\$ 144	\$ 116	\$ 113
Provision for losses	139	82	37
Charge-offs	(139)	(82)	(45)
Recoveries	11	8	7
Acquisitions and other	12	20	4
Balance at the end of the year	\$ 167	\$ 144	\$ 116

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. Generally, interest rates on these commitments are not set until the loans are funded; therefore, Textron Finance is not exposed to interest rate changes.

Textron Finance manages finance receivables for a variety of investors, participants and third-party portfolio owners. The total managed and serviced finance receivable portfolio, including owned finance receivables, was \$9.4 billion at the end of 2002 and \$9.3 billion at the end of 2001.

Owned and securitized finance receivables are primarily diversified geographically across the United States, along with 4% held in South America and 9% in other international countries. At December 28, 2002, Textron Finance's most significant collateral concentration was general aviation aircraft, which accounted for 21% of owned and securitized receivables. Textron Finance also has industry concentrations in the golf and vacation interval industries, which each accounted for 15% of owned and securitized receivables at December 28, 2002.

Transactions Between Finance and Manufacturing Groups

A portion of Textron Finance's business involves financing retail purchases and leases for new and used aircraft and equipment manufactured by Textron Manufacturing's Aircraft and Industrial Products segments. In 2002, 2001 and 2000, Textron Finance paid Textron Manufacturing \$1.1 billion, \$1.3 billion, and \$1.4 billion, respectively, relating to the sale of manufactured products to third-parties that were financed by Textron Finance and \$104 million, \$62 million and \$50 million, respectively, for the purchase of operating lease equipment. Operating agreements specify that Textron Finance has recourse to Textron Manufacturing for outstanding balances from these transactions. At year-end 2002 and 2001, the amounts guaranteed by Textron Manufacturing totaled \$562 million and \$652 million, respectively. In addition, Textron Finance has recourse to Textron Manufacturing for an \$87 million lease with C&A and on \$70 million in retained interests in securitizations at the end of 2002 and 2001. Included in the finance receivables guaranteed by Textron Manufacturing are past due loans of \$85 million at the end of 2002 (\$90 million at the end of 2001) that meet the non-accrual criteria but are not classified as non-accrual by Textron Finance due to the guarantee. Textron Finance continues to recognize income on these loans. Concurrently, Textron Manufacturing is charged for their obligation to Textron Finance under the guarantee so that there are no net interest earnings for the loans on a consolidated basis. Textron Manufacturing has established reserves for losses related to these guarantees which are included in other current liabilities.

Securitizations

Textron Finance received proceeds of \$0.9 billion in 2002 and \$1.3 billion in 2001 from the securitization and sale (with servicing rights retained) of finance receivables. Gains from securitized trust sales were approximately \$54 million in 2002 and \$43 million in 2001. At the end of 2002, \$2.6 billion in securitized loans were outstanding with \$78 million in past due loans. Textron Finance has securitized certain receivables generated by Textron Manufacturing for which it has retained full recourse to Textron Manufacturing.

Textron Finance retained subordinated interests in the trusts which are approximately 2% to 10% of the total trust. Servicing fees range from 50 to 200 basis points. During 2002, key economic assumptions used in measuring the retained interests at the date of each securitization included prepayment speeds ranging from 7% to 23%, weighted average lives ranging from 0.3 to 5 years, expected credit losses ranging from 0.3% to 4.5%, and residual cash flows discount rates ranging from 4.7% to 11.5%. At

December 28, 2002, key economic assumptions used in measuring these retained interests were as follows:

<i>(Dollars in millions)</i>	Aircraft Loans	Small Business Loans	Equipment Loans and Leases	Vacation Interval and Land Loans	Distribution Finance Loans
Carrying amount of retained interests in securitizations, net	\$ 89	\$ 58	\$ 47	\$ 40	\$ 89
Weighted-average life (in years)	3.2	1.6	1.8	5.1-5.3	.3
Prepayment speed (annual rate)	22.0%	7.0%	7.0%	15.0-20.0%	—
Expected credit losses (annual rate)	0.4%	4.5%	0.2%	0.5-1.5%	0.3%
Residual cash flows discount rate	6.6%	11.5%	7.4%	9.2-10.0%	5.8%

Hypothetical adverse changes of 10% and 20% to either the prepayment speed, expected credit losses and residual cash flows discount rates assumptions would not have a material impact on the current fair value of the residual cash flows associated with the retained interests. These hypothetical sensitivities should be used with caution as the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption. In reality, changes in one factor may result in another that may magnify or counteract the sensitivities losses, such as increases in market interest rates may result in lower prepayments and increased credit losses.

Note 4
Inventories

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Finished goods	\$ 777	\$ 719
Work in process	811	856
Raw materials	209	377
	1,797	1,952
Less progress payments and customer deposits	186	225
	\$ 1,611	\$ 1,727

Inventories aggregating \$1.1 billion and \$1.0 billion at the end of 2002 and 2001, respectively, were valued by the last-in, first-out (LIFO) method. Had such LIFO inventories been valued at current costs, their carrying values would have been approximately \$228 million and \$188 million higher at those respective dates. The remaining inventories, other than those related to certain long-term contracts, are valued primarily by the first-in, first-out method. Inventories related to long-term contracts, net of progress payments and customer deposits, were \$11 million at the end of 2002 and \$105 million at the end of 2001.

Note 5
**Long-Term
Contracts**

Long-term contract receivables at the end of 2002 and 2001 totaled \$201 million and \$264 million, respectively. This includes \$161 million and \$220 million, respectively, of unbilled costs and accrued profits that had not yet met the contractual billing criteria. Long-term contract receivables do not include significant amounts billed but unpaid due to contractual retainage provisions or subject to collection uncertainty. During the second half of 2001, program reviews on certain long-term development and production contracts indicated reduced profitability expectations resulting in a \$124 million charge to earnings. The reduced profitability expectations reflected the clarification of several matters including extended development schedules and planned design changes on a number of programs, as well as ongoing development efforts.

Note 6
**Long-Term
Assets**

Property, plant and equipment for Textron Manufacturing is comprised of the following:

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Land and buildings	\$ 1,056	\$ 1,011
Machinery and equipment	3,113	2,962
	4,169	3,973
Less accumulated depreciation	2,188	1,929
	\$ 1,981	\$ 2,044

In 2000, Textron adopted the EITF consensus, Issue No. 99-5 “Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements.” This consensus requires that all design and development costs for products sold under long-term supply arrangements be expensed unless there is a contractual guarantee that provides for specific required payments for these costs. Textron reported a cumulative effect of a change in accounting principle of \$59 million, net of tax, upon the adoption.

Note 7
Goodwill and
Other Intangible
Assets

On December 30, 2001, Textron adopted SFAS No. 142, “Goodwill and Other Intangible Assets”, which requires companies to stop amortizing goodwill and certain intangible assets with indefinite useful lives, and requires an annual review for impairment. Upon adoption, Textron discontinued the amortization of goodwill.

Under SFAS No. 142, Textron was required to test all existing goodwill for impairment as of December 30, 2001, on a “reporting unit” basis. The reporting unit represents the operating segment unless, at businesses one level below that operating segment (a “component”), discrete financial information is prepared and is reviewed by segment management, in which case such component is the reporting unit. In certain instances, components of an operating segment have been aggregated and deemed a single reporting unit based on similar economic characteristics of the components. Goodwill is considered to be impaired when the net book value of a reporting unit exceeds its estimated fair value. Fair values were primarily established using a discounted cash flow methodology. When available, comparative market multiples were used to corroborate discounted cash flow results.

As a result of this impairment review of goodwill, Textron recorded an after-tax transitional impairment charge of \$488 million (\$561 million, pre-tax), 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 acquisitions 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 is 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.

Changes in goodwill are summarized below:

<i>(In millions)</i>	Aircraft	Fastening Systems	Industrial Products	Industrial Components	Finance	Total
Balance at December 30, 2000	\$ 333	\$ 497	\$ 798	\$ 577	\$ 216	\$2,421
Acquisitions	—	(2)	184	10	—	192
Dispositions	—	—	—	(181)	—	(181)
Amortization	(11)	(16)	(30)	(21)	(12)	(90)
Impairment charge	—	(2)	(306)	—	—	(308)
Foreign currency translation	—	(4)	—	(5)	—	(9)
Balance at December 29, 2001	322	473	646	380	204	2,025
Reclassification of intangible assets	—	—	41	—	1	42
Transitional impairment charge	—	(100)	(326)	(111)	(24)	(561)
Foreign currency translation	—	17	2	24	—	43
Balance at December 28, 2002	\$ 322	\$ 390	\$ 363	\$ 293	\$ 181	\$ 1,549

Textron also adopted the remaining provisions of SFAS No. 141, “Business Combinations” on December 30, 2001. For goodwill and intangible assets reported in connection with acquisitions made prior to July 1, 2001, these provisions broaden the criteria for recording intangible assets separate from goodwill and require that certain intangible assets that do not meet the new criteria, such as assembled workforce and customer base, be reclassified into goodwill. Upon adoption of these provisions, intangible assets totaling \$42 million, net of related deferred taxes, were reclassified into goodwill within the Industrial Products and Finance segments.

The effect on net income of the transitional impairment charge and of excluding goodwill amortization expense is presented below:

<i>(In millions, except per share data)</i>	2002	2001	2000
Income before cumulative effect of change in accounting principle	\$ 364	\$ 166	\$ 277
Add back: amortization*	—	88	92
Adjusted net income before cumulative effect of change in accounting principle	364	254	369
Cumulative effect of change in accounting principle*	(488)	—	(59)
Adjusted net income (loss)	\$ (124)	\$ 254	\$ 310
Basic earnings per share:			
Income before cumulative effect of change in accounting principle	\$ 2.62	\$ 1.17	\$ 1.92
Add back: amortization*	—	.63	.64
Adjusted net income before cumulative effect of change in accounting principle	2.62	1.80	2.56
Cumulative effect of change in accounting principle*	(3.52)	—	(.41)
Adjusted income (loss) per share - basic	\$ (0.90)	\$ 1.80	\$ 2.15
Diluted earnings per share:			
Income before cumulative effect of change in accounting principle	\$ 2.60	\$ 1.16	\$ 1.90
Add back: amortization*	—	.62	.63
Adjusted net income before cumulative effect of change in accounting principle	2.60	1.78	2.53
Cumulative effect of change in accounting principle*	(3.48)	—	(.41)
Adjusted income (loss) per share - diluted	\$ (0.88)	\$ 1.78	\$ 2.12

*Net of income taxes

All of Textron's acquired intangible assets are subject to amortization and are comprised of the following:

	Weighted Average Amortization Period (in years)	December 28, 2002			December 29, 2001		
		Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
<i>(Dollars in millions)</i>							
Trademarks	30	\$ 61	\$ 5	\$ 56	\$ 61	\$ 3	\$ 58
Customer base	12	—	—	—	47	8	39
Patents	8	17	6	11	17	4	13
Workforce	9	—	—	—	20	7	13
Non-compete	3	10	7	3	10	3	7
Other	5	16	3	13	14	—	14
		\$ 104	\$ 21	\$ 83	\$ 169	\$ 25	\$ 144

Amortization expense totaled \$11 million and \$17 million in 2002 and 2001, respectively. Amortization expense for fiscal years 2003, 2004, 2005, 2006, and 2007 is estimated to be approximately \$10 million, \$6 million, \$6 million, \$4 million and \$4 million, respectively.

Note 8**Debt and Credit Facilities**

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Textron Manufacturing:		
Short-term debt:		
Borrowings under or supported by long-term credit facilities*	\$ —	\$ 146
Current portion of long-term debt	25	527
Total short-term debt	25	673
Long-term senior debt:		
Medium-term notes due 2010-2011 (average rate - 9.85%)	17	16
6.750% due 2002	—	500
6.375% due 2004	300	300
5.625% due 2005	308	270
6.375% due 2008	300	300
6.50% due 2012	300	—
6.625% due 2020	241	217
Other long-term debt (average rate - 6.49%)	245	185
	1,711	1,788
Current portion of long-term debt	(25)	(527)
Total long-term debt	1,686	1,261
Total Textron Manufacturing debt	\$ 1,711	\$ 1,934

* The weighted average interest rates on these borrowings, before the effect of interest rate exchange agreements, were 3.2% and 5.6% at year-end 2001 and 2000, respectively. Weighted average interest rates during the years 2002, 2001 and 2000 were 2.5%, 4.3% and 5.7%, respectively.

Textron Manufacturing maintains credit facilities with various banks for both short- and long-term borrowings. 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. The \$500 million facility includes a one-year term out option that can effectively extend its expiration into 2004. At December 28, 2002, none of the lines of credit were used or reserved as support for commercial paper.

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Textron Finance:		
Borrowings under or supported by credit facilities*	\$ 917	\$ 688
6.25% average rate debt; due 2003 to 2009	2,586	1,512
2.16% average rate variable notes; due 2003 to 2007	1,337	1,988
Total Textron Finance debt	\$ 4,840	\$ 4,188

* The weighted average interest rates on these borrowings, before the effect of interest rate exchange agreements, were 1.7%, 2.4% and 6.7% at year-end 2002, 2001 and 2000, respectively. Weighted average interest rates during the years 2002, 2001 and 2000 were 2.1%, 4.1% and 6.4%, respectively.

Textron Finance has bank lines of credit of \$1.5 billion, of which \$500 million expires in 2003 and \$1 billion expires in 2006. Of these lines, \$616 million was not used or reserved as support for commercial paper or bank borrowings. The \$500 million facility includes a one-year term out option that can effectively extend its expiration into 2004. Lending agreements limit Textron Finance's net assets available for dividends and other payments to Textron Manufacturing to approximately \$449 million of Textron Finance's net assets of \$1,020 million at the end of 2002. These lending agreements also contain various restrictive provisions regarding additional debt, minimum net worth, creation of liens and the maintenance of a fixed charges coverage ratio.

The following table shows required payments during the next five years on debt outstanding at the end of 2002. The payment schedule excludes amounts that are payable under or supported by long-term credit facilities.

<i>(In millions)</i>	2003	2004	2005	2006	2007
Textron Manufacturing	\$ 25	\$ 318	\$ 314	\$ 5	\$ 37
Textron Finance	1,069	1,407	199	25	726
	\$ 1,094	\$ 1,725	\$ 513	\$ 30	\$ 763

Textron Manufacturing has agreed to cause Textron Finance to maintain certain minimum levels of financial performance. No payments from Textron Manufacturing were necessary in 2002, 2001 or 2000 for Textron Finance to meet these standards.

Due to Textron Manufacturing

On December 20, 2001, Textron Manufacturing entered into a promissory demand note agreement with Textron Finance. At the end of 2001, \$510 million was outstanding and has not been eliminated on the consolidated balance sheet. This note was repaid in full in January 2002.

Note 9

Derivatives and Other Financial Instruments

Fair Value Interest Rate Hedges

Textron Manufacturing's policy is to manage interest cost using a mix of fixed- and variable-rate debt. To manage this mix in a cost efficient manner, Textron Manufacturing will enter into interest rate swaps to agree to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional principal amount. Since the critical terms of the debt and the interest rate swap match and the other conditions of SFAS No. 133 are met, the hedge is considered perfectly effective. The mark-to-market values of both the fair value hedge instruments and underlying debt obligations are recorded as equal and offsetting unrealized gains and losses in interest expense. In November 2002 and in March 2001, Textron Manufacturing terminated all outstanding interest rate swaps and recognized a gain of \$15 million in each year. Hedge accounting was discontinued at the date of the swap termination. The fair value adjustment on the debt related to the discontinued hedge is being amortized into income over the remaining life of the debt. Textron Manufacturing entered into new swap agreements in November 2002 and had interest rate swaps with a fair value of \$4 million at December 28, 2002.

Textron Finance enters into interest rate swap agreements to mitigate its exposure to interest rate changes by converting certain of its fixed-rate receivables and debt issues to floating rates. The agreements require Textron Finance to make periodic fixed-rate payments in exchange for floating-rate receipts and vice-versa based on specified notional amounts. In 2002, Textron Finance also entered into a foreign currency exchange agreement to convert a ¥6 billion fixed-rate note to a \$45 million variable-rate note. Under this agreement, Textron Finance is required to make U.S. dollar payments based on LIBOR in exchange for fixed receipts of Yen at specified notional amounts. Textron Finance has designated these agreements as fair value hedges. At December 28, 2002, Textron Finance had interest swap agreements with a fair value of \$43 million designated as fair value hedges, compared to a liability of \$6 million at December 29, 2001. Textron Finance's fair value hedges are highly effective resulting in an immaterial net impact to earnings due to hedge ineffectiveness.

Interest rate swap agreements designated as fair value hedges are summarized as follows:

	December 28, 2002			December 29, 2001		
	Notional Amount	Weighted Average Interest Rate	Weighted Average Remaining Term (in Years)	Notional Amount	Weighted Average Interest Rate	Weighted Average Remaining Term (in Years)
<i>(Dollars in millions)</i>						
Textron Manufacturing:						
Variable-pay swaps	\$ 300	4.6%	3.7	\$ —	—	—
Textron Finance:						
Variable-pay swaps-foreign debt	\$ 77	2.3%	.5	\$ 33	2.8%	1.9
Variable-pay swaps - debt	\$ 1,240	2.1%	5.1	\$ 370	1.9%	0.6
Variable-receive swaps - receivables	\$ 219	1.9%	12.1	\$ 97	3.1%	12.0

Cash Flow Interest Rate Hedges

Textron Finance enters into interest rate swap, cap and floor agreements to mitigate its exposure on interest-only securities resulting from securitizations. The swap agreements require Textron Finance to make periodic variable-rate payments in exchange for periodic fixed-rate receipts and vice versa based on specified notional amounts. The cap and floor agreements require the payment of variable-rate amounts based on specified notional amounts if interest rates exceed or fall below specified rates. In 2002, Textron Finance also entered into foreign currency exchange agreements to convert \$107 million of variable-rate notes receivable to C\$170 million of fixed-rate notes receivable to manage foreign currency exposure by matching these notes to Canadian-denominated debt. Under these agreements,

Textron Finance is required to make U.S. dollar payments based on LIBOR in exchange for fixed receipts of Canadian dollars at specified notional amounts with a weighted average interest rate of 6% over a remaining term of 2.1 years.

Textron Finance also utilizes interest rate agreements to protect against the interest rate risk associated with its retained interest in securitized assets. Textron Finance's interest rate swap, cap and floor agreements related to its variable rate interest-only securities are summarized as follows:

	December 28, 2002			December 29, 2001		
	Notional Amount	Weighted Average Interest Rate*	Weighted Average Remaining Term (in Years)	Notional Amount	Weighted Average Interest Rate*	Weighted Average Remaining Term (in Years)
<i>(Dollars in millions)</i>						
LIBOR-based swaps	\$ 407	4.79%	5.1	\$ 371	5.71%	6.5
Prime-based swaps	\$ 77	9.07%	15.9	\$ 112	9.00%	16.7
One-month LIBOR-based cap*	\$ 389	5.43%	—	\$ 337	6.35%	—
Prime-based floor*	\$ 129	8.75%	—	\$ 148	8.73%	—
Six-month LIBOR-based floor*	—	—	—	\$ 12	5.34%	—

* Represents interest cap or floor rate

For cash flow hedges during 2002 and 2001, Textron Finance recorded an after-tax charge of \$4 million and \$11 million, respectively, to accumulated OCL with no impact to the statement of operations. Assuming no changes in interest rates, Textron Finance expects \$9 million of net deferred losses to be reclassified to earnings over the next year to offset interest payments made or received, and expects approximately \$2 million, net of income taxes, to be reclassified to earnings as a result of the amortization of deferred losses related to discontinued hedges. Textron Finance has not incurred or recognized any gains or losses in earnings as the result of the ineffectiveness or the exclusion from its assessment of hedge effectiveness of its cash flow hedges.

Textron had minimal exposure to loss from nonperformance by the counterparties to its interest rate swaps at the end of 2002, and does not anticipate nonperformance by counterparties in the periodic settlements of amounts due. Textron currently minimizes this potential for risk by entering into contracts exclusively with major, financially sound counterparties having no less than a long-term bond rating of "A," by continuously monitoring such credit ratings and by limiting exposure with any one financial institution. The credit risk generally is limited to the amount by which the counterparties' contractual obligations exceed Textron's obligations to the counterparty.

Currency Rate Hedging

Textron manufactures and sells its products in a number of countries throughout the world and, as a result, is exposed to movements in foreign currency exchange rates. The primary purpose of Textron's foreign currency hedging activities is to manage the volatility associated with foreign currency purchases of materials, foreign currency sales of its products and other assets and liabilities created in the normal course of business. Textron primarily utilizes forward exchange contracts and purchased options with maturities of no more than 18 months that qualify as cash flow hedges. These are intended to offset the effect of exchange rate fluctuations on forecasted sales, inventory purchases and overhead expenses. The fair value of these instruments at December 28, 2002 was a \$4 million liability. At year-end 2002, \$3 million of after-tax loss was reported in accumulated OCL from qualifying cash flow hedges. This loss is generally expected to be reclassified to earnings in the next 12 months as the underlying transactions occur. Textron Manufacturing also enters into certain foreign currency derivative instruments that do not meet hedge accounting criteria, and are primarily intended to protect against exposure related to inter-company financing transactions and income from international operations. The fair value of these instruments at year-end 2002 and the net impact of the related gains and losses on selling and administrative expense was not material in 2002.

Net Investment Hedging

Textron hedges its net investment position in major currencies and generates foreign currency interest payments, that offset other transactional exposures in these currencies. To accomplish this, Textron borrows directly in foreign currency and designates a portion of foreign currency debt as a hedge of net investments. In addition, certain currency forwards are designated as hedges of Textron's related foreign net investments. Currency effects of these hedges which are reflected in the cumulative translation adjustment account within OCL, produced a \$5 million after-tax gain during 2002, leaving an accumulated net balance of \$47 million.

The table below summarizes, by major currency, Textron Manufacturing's forward exchange contracts in U.S. dollars. The buy and sell amounts represent the U.S. dollar equivalent of commitments to purchase and sell foreign currencies. The foreign currency amounts have been translated into a U.S. dollar equivalent using the exchange rate at the balance sheet date.

	Buy Contracts		Sell Contracts	
	Contract Amount	Unrealized Gain/(Loss)	Contract Amount	Unrealized Gain/(Loss)
<i>(In millions)</i>				
December 28, 2002				
British Pound	\$ 7	\$ —	\$ 1	\$ —
Canadian Dollar	216	(4)	9	—
Euro	97	1	219	—
Other	85	(1)	87	1
Total	\$ 405	\$ (4)	\$ 316	\$ 1
December 29, 2001				
British Pound	\$ 7	\$ —	\$ —	\$ —
Canadian Dollar	217	(7)	23	—
Euro	23	(3)	67	—
Other	106	—	162	—
Total	\$ 353	\$ (10)	\$ 252	\$ —

Stock-based Compensation Hedging

Textron manages the expense related to stock-based compensation awards using cash settlement forward contracts on its common stock. The use of these forward contracts modifies Textron's compensation expense exposure to changes in the stock price with the intent to reduce potential variability. The fair value of these instruments at December 28, 2002 was a \$3 million liability. Gains and losses on these instruments are recorded as an adjustment to compensation expense when the award is charged to expense. These contracts generated expense of \$4 million, \$22 million and \$69 million in 2002, 2001 and 2000, respectively.

Fair Values of Financial Instruments

The carrying amounts and estimated fair values of Textron's financial instruments that are not reflected in the financial statements at fair value as a matter of accounting policy, are as follows:

	December 28, 2002		December 29, 2001	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<i>(In millions)</i>				
Textron Manufacturing:				
Debt	\$ (1,711)	\$ (1,839)	\$ (1,934)	\$ (1,972)
Textron Finance:				
Finance receivables	4,809	4,943	4,795	4,884
Debt	(4,840)	(4,935)	(4,188)	(4,208)

Note 10

Textron Finance - Obligated Mandatorily Redeemable Preferred Securities of Finance Subsidiary Holding Solely Junior Subordinated Debentures

Litchfield Financial Corporation (Litchfield, a subsidiary of Textron Financial Corporation) was acquired by Textron Financial Corporation during 1999. Prior to the acquisition, a trust sponsored and wholly owned by Litchfield issued Series A Preferred Securities to the public (for \$26 million), the proceeds of which were invested by the trust in \$26 million aggregate principal amount of Litchfield's newly issued 10% Series A Junior Subordinated Debentures (Series A Debentures), due 2029. The debentures are the sole asset of the trust. The preferred securities were recorded by Textron Financial Corporation at the fair value of \$29 million as of the acquisition date. The amounts due to the trust under the subordinated debentures and the related income statement amounts have been eliminated in Textron's consolidated financial statements.

The preferred securities accrue and pay cash distributions quarterly at a rate of 10% per annum. The trust's obligation under the Series A Preferred Securities is fully and unconditionally guaranteed by Litchfield. The trust will redeem all of the outstanding Series A Preferred Securities when the Series A Debentures are paid at maturity on June 30, 2029, or otherwise become due. Litchfield will have the right to redeem 100% of the principal plus accrued and unpaid interest on or after June 30, 2004. As a result of its acquisition of Litchfield, Textron Financial Corporation has agreed to make payments to the holders of the Preferred Securities when due, to the extent not paid by or on behalf of the trust or subsidiary.

Note 11**Textron - Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust Holding Solely Textron Junior Subordinated Debt Securities**

In 1996, a trust sponsored and wholly owned by Textron issued preferred securities to the public (for \$500 million) and shares of its common securities to Textron (for \$15.5 million), the proceeds of which were invested by the trust in \$515.5 million aggregate principal amount of Textron's newly issued 7.92% Junior Subordinated Deferrable Interest Debentures, due 2045. The debentures are the sole asset of the trust. The proceeds from the issuance of the debentures were used by Textron for the repayment of long-term borrowings and for general corporate purposes. The amounts due to the trust under the debentures and the related income statement amounts have been eliminated in Textron's consolidated financial statements.

The preferred securities accrue and pay cash distributions quarterly at a rate of 7.92% per annum. Textron has guaranteed, on a subordinated basis, distributions and other payments due on the preferred securities. The guarantee, when taken together with Textron's obligations under the debentures and in the indenture pursuant to which the debentures were issued and Textron's obligations under the Amended and Restated Declaration of Trust governing the trust, provides a full and unconditional guarantee of amounts due on the preferred securities. The preferred securities are mandatorily redeemable upon the maturity of the debentures on March 31, 2045, or earlier to the extent of any redemption by Textron of any debentures. The redemption price in either such case will be \$25 per share plus accrued and unpaid distributions to the date fixed for redemption.

Note 12**Shareholders' Equity****Capital Stock**

Textron has authorization for 15,000,000 shares of preferred stock and 500,000,000 shares of 12.5 cent per share par value common stock. Each share of \$2.08 Preferred Stock (\$23.63 approximate stated value) is convertible into 4.4 shares of common stock and can be redeemed by Textron for \$50 per share. Each share of \$1.40 Preferred Dividend Stock (\$11.82 approximate stated value) is convertible into 3.6 shares of common stock and can be redeemed by Textron for \$45 per share.

Performance Share Units and Stock Options

Textron's 1999 Long-Term Incentive Plan (the "1999 Plan") authorizes awards to key employees of Textron in three forms: (a) options to purchase Textron shares; (b) performance share units and (c) restricted stock. In 2002, Textron's shareholders approved an amendment to the 1999 Plan to revise the maximum number of share awards authorized as follows: (a) 14,000,000 options to purchase Textron shares; (b) 2,000,000 performance units and (c) 500,000 shares of restricted stock.

Pro forma information regarding net income and earnings per share has been determined using the fair value method. For the purpose of developing the pro forma information, the fair values of options granted after 1995 are estimated at the date of grant using the Black-Scholes option-pricing model. The estimated fair values are amortized to expense over the options' vesting period. Using this methodology, net income would have been reduced by \$31 million or \$0.22 per diluted share in 2002, \$26 million or \$0.18 per diluted share in 2001, and \$25 million or \$0.17 per diluted share in 2000.

The assumptions used to estimate the fair value of an option granted in 2002, 2001 and 2000, respectively, are approximately as follows: dividend yield of 3%, 3% and 3%; expected volatility of 36%, 34% and 27%; risk-free interest rates of 4%, 4% and 5%, and weighted average expected lives of 3.7 years in 2002 and 3.5 years in 2001 and 2000. Under these assumptions, the weighted-average fair value of an option to purchase one share granted in 2002, 2001 and 2000 was approximately \$10, \$11 and \$10, respectively.

At the end of 2002, 3,636,000 stock options were available for future grant under the 1999 Plan as amended. Stock option activity is summarized as follows:

	2002		2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
<i>(Shares in thousands)</i>						
Outstanding at beginning of year	10,976	\$ 53.50	12,631	\$ 52.32	8,822	\$ 55.26
Granted	5,135	41.29	315	50.93	4,618	46.31
Exercised	(696)	34.25	(884)	30.20	(440)	30.67
Canceled	(1,275)	57.89	(1,086)	58.01	(369)	76.41
Outstanding at end of year	14,140	\$ 49.62	10,976	\$ 53.50	12,631	\$ 52.32
Exercisable at end of year	9,043	\$ 54.08	8,653	\$ 55.33	7,012	\$ 53.25

Stock options outstanding at the end of 2002 are summarized as follows (shares in thousands):

Range of Exercise Prices	Outstanding	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price	Exercisable	Weighted Average Exercise Price
\$22 - \$40	1,442	3.9	\$ 32.93	1,152	\$ 31.32
\$41 - \$63	9,950	7.9	\$ 45.20	5,143	\$ 48.54
\$64 - \$94	2,748	6.4	\$ 73.97	2,748	\$ 73.97

Reserved Shares of Common Stock

At the end of 2002, common stock reserved for the subsequent conversion of preferred stock and shares reserved for the exercise of stock options were 2,786,000 and 14,140,000, respectively.

Preferred Stock Purchase Rights

Each outstanding share of Textron common stock has attached to it one-half of a preferred stock purchase right. One preferred stock purchase right entitles the holder to buy one one-hundredth of a share of Series C Junior Participating Preferred Stock at an exercise price of \$250. The rights become exercisable only under certain circumstances related to a person or group acquiring or offering to acquire a substantial block of Textron's common stock. In certain circumstances, holders may acquire Textron stock, or in some cases the stock of an acquiring entity, with a value equal to twice the exercise price. The rights expire in September 2005 but may be redeemed earlier for \$.05 per right.

Income per Common Share

A reconciliation of income from operations and basic to diluted share amounts is presented below.

<i>(Dollars in millions, shares in thousands)</i>	2002		2001		2000	
	Income	Average Shares	Income	Average Shares	Income	Average Shares
Income from operations	\$ 364		\$ 166		\$ 277	
Less: Preferred stock dividends	—		(1)		—	
Basic						
Available to common shareholders	364	138,745	165	141,050	277	143,923
Dilutive effect of convertible preferred stock and stock options	—	1,507	1	1,887	—	2,227
Diluted						
Available to common shareholders and assumed conversions	\$ 364	140,252	\$ 166	142,937	\$ 277	146,150

Accumulated Other Comprehensive Loss (OCL)

<i>(In millions)</i>	Currency Translation Adjustment	Unrealized Gains (Losses) on Securities	Pension Liability Adjustment	Deferred Gains (Losses) on Hedge Contracts	Total
Balance at January 1, 2000	\$ (96)	\$ —	\$ (2)	\$ —	\$ (98)
Change, net of income taxes	(74)	—	—	—	(74)
Net unrealized losses*	—	(59)	—	—	(59)
Reclassification adjustment*	—	59	—	—	59
Balance at December 30, 2000	(170)	—	(2)	—	(172)
Transition adjustment due to change in accounting, net of taxes	—	—	—	(15)	(15)
Change, net of income taxes	(31)	1	—	(17)	(47)
Automotive Trim disposal, net of income taxes	11	—	—	—	11
Net unrealized losses*	—	(6)	—	—	(6)
Reclassification adjustment*	—	6	—	—	6
Balance at December 29, 2001	(190)	1	(2)	(32)	(223)
Change, net of income taxes	78	2	(95)	13	(2)
Net unrealized losses*	—	(25)	—	—	(25)
Reclassification adjustment*	—	25	—	—	25
Balance at December 28, 2002	\$ (112)	\$ 3	\$ (97)	\$ (19)	\$ (225)

* Net of income tax benefit of \$13, \$3 and \$31 for 2002, 2001 and 2000, respectively.

Note 13

Pension Benefits and Postretirement Benefits Other Than Pensions

Textron has defined benefit and defined contribution pension plans that together cover substantially all employees. The costs of the defined contribution plans amounted to approximately \$44 million in 2002, \$48 million in 2001 and \$51 million in 2000. Defined benefits under salaried plans are based on salary and years of service. Hourly plans generally provide benefits based on stated amounts for each year of service. Textron's funding policy is consistent with federal law and regulations. Pension plan assets consist principally of corporate and government bonds and common stocks. Textron offers health care and life insurance benefits for certain retired employees.

The following summarizes the change in the benefit obligation; the change in plan assets; the funded status; and reconciliation to the amount recognized in the balance sheet for the pension and postretirement benefit plans:

<i>(In millions)</i>	Pension Benefits		Postretirement Benefits Other than Pensions	
	December 28, 2002	December 29, 2001	December 28, 2002	December 29, 2001
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 3,908	\$ 3,941	\$ 632	\$ 612
Service cost	99	109	4	6
Interest cost	278	282	45	49
Amendments	12	34	1	(14)
Net effect of acquisitions/dispositions	—	(220)	—	(65)
Plan participants' contributions	4	4	5	5
Actuarial losses	262	28	51	113
Benefits paid	(273)	(258)	(69)	(70)
Foreign exchange rate changes	51	(11)	1	(1)
Curtailements	1	(1)	5	(3)
Benefit obligation at end of year	\$ 4,342	\$ 3,908	\$ 675	\$ 632

	Pension Benefits		Postretirement Benefits Other than Pensions	
	December 28, 2002	December 29, 2001	December 28, 2002	December 29, 2001
<i>(In millions)</i>				
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 4,480	\$ 5,170	\$ —	\$ —
Actual return on plan assets	(275)	(218)	—	—
Employer contributions	23	22	—	—
Plan participants' contributions	4	4	—	—
Net effect of acquisitions/dispositions	—	(229)	—	—
Benefits paid	(273)	(258)	—	—
Foreign exchange rate changes	49	(11)	—	—
Fair value of plan assets at end of year	\$ 4,008	\$ 4,480	\$ —	\$ —
Funded status of the plan	\$ (334)	\$ 572	\$ (675)	\$ (632)
Unrecognized actuarial loss (gain)	892	(133)	77	26
Unrecognized prior service cost (benefit)	151	162	(13)	(20)
Unrecognized transition net asset	(4)	(23)	—	—
Net amount recognized in the balance sheet	\$ 705	\$ 578	\$ (611)	\$ (626)
Amounts recognized in the balance sheet consists of:				
Prepaid benefit cost	\$ 820	\$ 745	\$ —	\$ —
Accrued benefit liability	(270)	(171)	(611)	(626)
Intangible asset	5	2	—	—
Minimum pension liability	150	2	—	—
Net amount recognized in the balance sheet	\$ 705	\$ 578	\$ (611)	\$ (626)

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were \$714 million, \$618 million and \$365 million, respectively, as of year-end 2002, and \$248 million, \$209 million and \$42 million, respectively, as of year-end 2001.

The following summarizes the net periodic benefit cost for the pension benefits and postretirement benefits plans:

	Pension Benefits			Postretirement Benefits Other than Pensions		
	December 28, 2002	December 29, 2001	December 30, 2000	December 28, 2002	December 29, 2001	December 30, 2000
<i>(In millions)</i>						
Components of net periodic benefit cost						
Service cost	\$ 99	\$ 109	\$ 101	\$ 4	\$ 6	\$ 6
Interest cost	278	282	265	45	49	45
Expected return on plan assets	(454)	(454)	(423)	—	—	—
Amortization of unrecognized transition asset	(17)	(17)	(17)	—	—	—
Recognized actuarial (gain)/loss	(16)	(30)	(24)	3	(2)	(8)
Recognized prior service cost	15	20	14	(4)	(6)	(4)
Curtailements	(6)	(6)	—	1	(5)	(1)
Net periodic benefit cost	\$ (101)	\$ (96)	\$ (84)	\$ 49	\$ 42	\$ 38

Recognized actuarial (gain)/loss on net pension benefits is being amortized over a twelve-year period.

Major actuarial assumptions used in accounting for defined benefit pension plans are presented below.

	December 28, 2002	December 29, 2001	December 30, 2000	January 1, 2000
Discount rate	6.75%	7.25%	7.50%	7.50%
Expected rate of return on plan assets	8.90	9.25	9.25	9.25
Annual rate of compensation increase	4.20	4.50	4.80	4.80

Postretirement benefit plan discount rates are the same as those used by Textron's defined benefit pension plans.

The 2002 health care cost trend rate, which is the weighted average annual assumed rate of increase in the per capita cost of covered benefits, was 10% for all retirees. This rate is assumed to decrease to 5% by 2006 and then remain at that level. A one-percentage-point change in assumed health care cost trend rate would have the following effects:

<i>(In millions)</i>	1% Increase	1% Decrease
Effect on total of service and interest cost components	\$ 4	\$ (4)
Effect on postretirement benefit obligation	\$ 55	\$ (47)

Note 14
Income Taxes

Textron files a consolidated federal income tax return for all U.S. subsidiaries and separate returns for foreign subsidiaries.

Income from operations before income taxes and distributions on preferred securities of subsidiary trusts is as follows:

<i>(In millions)</i>	2002	2001	2000
United States	\$ 393	\$ 451	\$ 366
Foreign	97	(32)	245
Total	\$ 490	\$ 419	\$ 611

Income tax expense is summarized as follows:

<i>(In millions)</i>	2002	2001	2000
Federal:			
Current	\$ (13)	\$ 136	\$ 246
Deferred	73	48	(37)
State	15	26	35
Foreign	25	17	64
Income tax expense	\$ 100	\$ 227	\$ 308

The following reconciles the federal statutory income tax rate to the effective income tax rate reflected in the consolidated statements of income:

	2002	2001	2000
Federal statutory income tax rate	35.0%	35.0%	35.0%
Increase (decrease) in taxes resulting from:			
State income taxes	2.1	2.7	3.8
Goodwill	—	22.3	19.0
Permanent items from Automotive Trim disposition	1.4	2.7	—
Settlement of tax court case	(2.5)	—	—
Sale of Snorkel	(9.5)	—	—
ESOP dividends	(3.7)	—	—
Foreign tax rate differential	(0.3)	(0.9)	(2.2)
Export sales benefit	(1.8)	(2.9)	(1.9)
Other, net	(0.3)	(4.7)	(3.3)
Effective income tax rate	20.4%	54.2%	50.4%

The tax effects of temporary differences that give rise to significant portions of Textron's net deferred tax assets and liabilities were as follows:

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Deferred tax assets:		
Self insured liabilities, (including environmental)	\$ 94	\$ 110
Deferred compensation	140	140
Obligation for postretirement benefits	3	44
Investment securities	24	9
Allowance for credit losses	63	49
Amortization of goodwill and other intangibles	22	30
Non-U.S. net operating loss carryforwards	37	34
Other, principally timing of other expense deductions	230	270
Total deferred tax assets	\$ 613	\$ 686
Valuation allowance for deferred tax assets	(26)	(24)
	\$ 587	\$ 662
Deferred tax liabilities:		
Textron Finance transactions, principally leasing	\$ (390)	\$ (387)
Fixed assets, principally depreciation	(146)	(150)
Inventory	(32)	(59)
Currency translation adjustment	(21)	(29)
Total deferred tax liabilities	(589)	(625)
Net deferred tax (liability) asset	\$ (2)	\$ 37

At December 28, 2002 and December 29, 2001, Textron had non-U.S. net operating loss carryforwards for income tax purposes of \$111 million and \$99 million, respectively, of which \$58 million and \$70 million can be carried forward indefinitely and the balance expires at various dates through 2013. A valuation allowance at December 28, 2002 and December 29, 2001, of \$26 million and \$24 million, respectively, has been recognized to offset the related deferred tax assets due to the uncertainty of realizing the benefits of the loss carryforwards.

Deferred income taxes have not been provided for the undistributed earnings of foreign subsidiaries, which approximated \$618 million at the end of 2002. Management intends to reinvest those earnings for an indefinite period, except for distributions having an immaterial tax effect. If foreign subsidiaries' earnings were distributed, 2002 taxes, net of foreign tax credits, would be increased by approximately \$89 million.

Note 15
Special Charges

<i>(In millions)</i>	Restructuring Expense			Total	Goodwill, Intangible and Investment Impairments	Total Special Charges
	Severance Costs	Facility and Other	Fixed Asset Write-downs			
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

To improve returns at core businesses and to complete the integration of certain acquisitions, Textron approved and committed to a restructuring program in the fourth quarter of 2000 based upon targeted cost reductions which was expanded in 2001. In October 2002, Textron announced a further expansion of its restructuring program as part of its strategic effort to improve operating efficiencies, primarily in its industrial business. Textron's restructuring program includes 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.

Under this restructuring program, Textron has reduced its workforce by approximately 8,100 employees and has closed 81 facilities, including 36 manufacturing plants, primarily in the Industrial Products, Industrial Components and Fastening Systems segments.

Restructuring costs that have been accrued in accordance with EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity," and related asset impairment charges are included in special charges on the consolidated statement of operations. An analysis of the special charges for restructuring and related reserve accounts is summarized below:

<i>(In millions)</i>	Asset Impairments	Severance	Facilities & Other	Total
Charges	\$ 1	\$ 15	\$ 1	\$ 17
Cash paid	—	(1)	—	(1)
Non-cash utilization	(1)	—	—	(1)
Balance at December 30, 2000	—	14	1	15
Additions	28	79	4	111
Reserves deemed unnecessary	—	(2)	—	(2)
Non-cash utilization	(28)	(4)	—	(32)
Cash paid	—	(56)	(2)	(58)
Balance at December 29, 2001	—	31	3	34
Additions	27	65	6	98
Reserves deemed unnecessary	—	(7)	(1)	(8)
Non-cash utilization	(27)	—	—	(27)
Cash paid	—	(65)	(4)	(69)
Balance at December 28, 2002	\$ —	\$ 24	\$ 4	\$ 28

Severance costs are generally paid on a monthly basis over the severance period granted to each employee or on a lump sum basis when required. Severance costs include outplacement costs which are paid in accordance with normal payment terms. Facilities and other costs represent lease termination costs and facility and plant clean-up costs. Lease termination costs are generally paid upon exiting the facility or over the remaining lease term and facility and plant clean-up costs are paid in accordance with normal payment terms.

The specific restructuring measures and associated estimated costs are based on Textron's best judgment under prevailing circumstances. Textron believes that the restructuring reserve balance of \$28 million is adequate to carry out the restructuring activities formally identified and committed to as of December 28, 2002 and anticipates that all actions related to these liabilities will be completed within a twelve-month period.

Textron also incurred costs related to restructuring that have not been included in special charges and are included in segment profit only as incurred. While these costs are incremental and directly related to the restructuring program, they are expensed as incurred as they do not meet EITF Issue No. 94-3 criteria for accrual.

Costs related to restructuring that are reflected in the consolidated statement of operations include the following:

<i>(In millions)</i>	2002	2001
Cost of sales:		
Outsourcing operations	\$ 4	\$ 9
Plant rearrangement and inventory disposal	4	9
Other	2	4
	10	22
Selling and administrative expenses:		
Machinery, equipment and inventory relocation	7	6
Employee replacement, relocation and related	3	5
Other	2	1
	12	12
Total	\$ 22	\$ 34

Goodwill and Other Intangible Assets

In conjunction with Textron's restructuring activities and review of long-lived assets, Textron wrote down goodwill and other intangible assets by \$319 million in 2001 and \$349 million in 2000. For 2001, the impairment charge was primarily related to goodwill and other intangible assets at OmniQuip within the Industrial Products segment. For 2000, Textron recognized impairment charges for goodwill only of \$205 million in Industrial Components primarily related to Turbine Engine Components Textron (TECT), \$128 million in Fastening Systems primarily related to Flexalloy, and \$16 million in Industrial Products. See Note 7 regarding the after-tax transitional impairment charge of \$488 million reported under the caption "Cumulative effect of change in accounting principle, net of income taxes" in 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 undiscounted cash flow projections performed were less than the carrying amount of OmniQuip's long-lived assets indicating that there was an impairment. Textron used a discounted pre-tax cash flow calculation in determining the fair value of the long-lived assets utilizing the multi-year forecast to project future cash flows and a risk-based rate of 11%. The calculation resulted in an impairment charge of \$317 million, including goodwill of \$306 million and other intangible assets of \$11 million.

In 2000, a similar calculation was performed when indicators of potential impairment of long-lived assets were identified in connection with multi-year financial planning, as well as the initiation of the current restructuring program. Based on the indicators, Textron performed an impairment review for the applicable operating units. Key indicators with respect to TECT were deteriorating margins and its inability to generate new contracts that had resulted in a significantly decreased revenue base. Key indicators for Flexalloy were its performance against plan and the negative effect on its vendor-managed business model by other supply-chain competitors. The business is dependent upon large customers, and the service level for larger customers cannot be easily replicated over a large number of smaller customers without significant additional investment. Also, the synergies within Fastening Systems, which were initially viewed to be significant due to Textron's existing market share, were considerably less than anticipated. Accordingly, future cash flow projections were not expected to achieve the level of growth originally anticipated at the time of Flexalloy's acquisition. Using a risk-based rate of 11%, the impairment calculation resulted in a fourth quarter 2000 write down of goodwill for TECT of \$178 million, Flexalloy of \$96 million and \$75 million related to other operating units.

Investments

During the second half of 2002, the C&A common stock owned by Textron experienced a decline in market value. Textron acquired this stock as a result of the disposition of the Trim business. 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. The write-down resulted in a pre-tax loss of \$38 million which is included in special charges.

During 2001, Textron recorded a \$6 million impairment charge related to its e-business securities, and subsequently realized a \$3 million net loss on the sale of its remaining e-business securities. In 2000, Textron recorded an impairment charge of \$117 million related to these investment securities when it was determined that the decline in market value was other than temporary. These charges are included in special charges on the consolidated statement of operations. Textron had no remaining investments in e-business securities as of December 28, 2002.

Note 16

Joint Ventures

In the normal course of business, Textron has entered into various joint venture agreements. At December 28, 2002 and December 29, 2001, other assets includes \$35 million and \$37 million, respectively, attributable to investments in unconsolidated joint ventures. Textron accounts for its interest in these ventures under the equity method of accounting. Since Textron's equity in income (loss) from joint ventures is not material, this amount is reported in cost of sales rather than as a separate line item. Textron's loss from unconsolidated joint ventures totaled \$10 million each year for 2002 and 2001, and \$2 million in 2000.

Textron has entered into an agreement with Agusta to share certain costs and profits for the joint design, development, manufacture, marketing, sale, customer training and product support of Bell Agusta Aerospace's BA609 and AB139. These programs are currently in the development stage, and only certain marketing costs are being charged to the venture. Bell Helicopter's share of the development costs are being charged to earnings as a period expense. Bell Helicopter has also partnered with The Boeing Company in the development and production of the V-22 tiltrotor aircraft.

Textron has also entered into a joint venture with TAG Aviation USA, Inc. to sell fractional share interests in small business jets. During 2002, 2001 and 2000, Textron recorded revenue of \$101 million, \$38 million and \$26 million, respectively, for the sale of aircraft to this venture through arm's length transactions. Profit on these sales is initially deferred then recognized on a pro-rata basis as fractional share interests are sold to third parties. Textron has guaranteed one-half of the venture's debt and lease obligations up to a maximum of \$70 million. At December 28, 2002, Textron's portion of the outstanding debt and operating lease commitments covered by this guarantee totaled \$30 million. Textron would be required to make payments under these guarantees if the joint venture defaults under the related debt agreements.

While Textron has several other joint venture agreements that have external financing arrangements, Textron has only guaranteed approximately \$21 million in debt obligations related to these ventures. Textron would be required to make payments under these guarantees if a joint venture defaults under the debt agreements.

Note 17

Commitments and Contingencies

Textron is subject to legal proceedings and other claims arising out of the conduct of Textron's business, including proceedings and claims relating to private transactions, government contracts, production partners, product liability, employment, and environmental, safety and health matters. Some of these legal proceedings and claims seek damages, fines or penalties in substantial amounts or remediation of environmental contamination. Under federal government procurement regulations, certain claims brought by the U.S. Government could result in Textron's suspension or debarment from U.S. Government contracting for a period of time. On the basis of information presently available, Textron believes that these proceedings and claims will not have a material effect on Textron's financial position or results of operations.

In August 2002, Lycoming 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 will be 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. 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 recorded \$31 million in its Aircraft segment related to these matters. 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. 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 current program, recoveries received from third parties or an expansion of the existing program.

In the ordinary course of business, Textron enters into letters of credit and other similar arrangements with financial institutions. The letters of credit typically serve as a guarantee of payment or performance to certain third parties in accordance with specified terms and conditions. Management knows of no event of default that would require Textron to satisfy these guarantees at the end of 2002.

In addition to its financing relationship with Textron Finance, OmniQuip also utilizes third-party finance institutions to provide wholesale financing to certain of its customers. While these finance receivables are not reflected on Textron's balance sheet, the finance institutions generally have recourse to OmniQuip and may require OmniQuip to repurchase equipment related to customer defaults. OmniQuip generally obtains a secured interest in any equipment repurchased. The balance of this portfolio at December 28, 2002 and December 29, 2001 was \$47 million and \$57 million, respectively.

Textron has a number of guaranteed minimum resale value contracts associated with certain past aircraft sales. These guarantees require Textron to make possible future payments to a customer in the event that the fair value of an aircraft falls below a minimum guaranteed amount, or stipulate a minimum value upon the trade-in for a new replacement aircraft. The agreements generally include operating restrictions such as maximum usage over the guarantee period or minimum maintenance requirements. The amount of resale value guaranteed at December 28, 2002 was approximately \$160 million. The estimated fair values of the guaranteed aircraft prevailing at December 28, 2002 were greater than the amount of Textron's guarantees. In addition, for aircraft representing \$117 million of the guaranteed amounts, Textron has \$97 million in residual value insurance coverage that would reimburse Textron if the guaranteed value falls below the insured level. The guarantee contracts expire as follows: \$98 million in 2003, \$37 million in 2004, \$5 million in 2005, \$3 million in 2006, and \$17 million in 2012. Of the related residual value insurance, \$78 million expires in 2003 and \$19 million expires in 2004.

Leases

Rental expense approximated \$92 million, \$103 million and \$101 million in 2002, 2001 and 2000, respectively. Future minimum rental commitments for noncancellable operating leases in effect at the end of 2002 approximated \$70 million for 2003; \$54 million for 2004; \$38 million for 2005; \$28 million for 2006; \$22 million for 2007; and a total of \$198 million thereafter.

Environmental Remediation

Textron's accrued estimated environmental liabilities are based upon currently available facts, existing technology and presently enacted laws and regulations and 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. Accrued liabilities relate to disposal costs, U.S. Environmental Protection Agency oversight costs, legal fees and operating and maintenance costs for both currently and formerly owned or operated facilities. 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. Based upon information currently available, Textron estimates potential environmental liabilities to be in the range of \$38 million to \$138 million. At the end of 2002, environmental reserves of approximately \$80 million, of which \$17 million are classified as current liabilities, have been established to address these specific estimated potential liabilities. Textron estimates that its accrued environmental remediation liabilities will likely be paid over the next five to ten years.

Note 18

Supplemental Financial Information

Accrued Liabilities

Textron Manufacturing's accrued liabilities are comprised of the following:

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Customer deposits	\$ 193	\$ 279
Warranty and product maintenance contracts	301	257
Salaries, wages and employer taxes	237	212
Contract reserves	153	113
Other	453	547
Total accrued liabilities	\$ 1,337	\$ 1,408

Warranty and Product Maintenance Contracts

Textron provides limited warranty and product maintenance programs, including parts and labor, for certain products for periods ranging from one to five years. Textron estimates the costs that may be incurred under these programs and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect this liability include the number of products sold, historical and anticipated rates of warranty claims and cost per claim. Textron periodically assesses the adequacy of its recorded warranty and product maintenance liabilities and adjusts the amounts as necessary.

Changes in Textron's warranty and product maintenance liability in 2002 and 2001 are as follows:

<i>(In millions)</i>	December 28, 2002	December 29, 2001
Accrual at beginning of year	\$ 257	\$ 241
Provision	170	162
Settlement	(161)	(142)
Adjustments to pre-existing liabilities	35	(4)
Accrual at end of year	\$ 301	\$ 257

For 2002, the adjustments to pre-existing liabilities include \$31 million in costs for the recall, inspection and customer care program at Lycoming described in Note 17.

Research and Development Costs

Company-funded research and development costs include amounts for company-initiated programs, the cost sharing portions of customer-initiated programs, and losses incurred on customer-initiated programs. Textron also carries out research and development under contracts with others, primarily the U.S. Government. A significant portion of company-initiated programs include independent research and development related to government products and services which is recoverable through overhead cost allowances.

Company-funded and customer-funded research and development costs are as follows:

<i>(In millions)</i>	2002	2001	2000
Company-funded	\$ 207	\$ 366	\$ 307
Customer-funded	379	323	414
Total research and development	\$ 586	\$ 689	\$ 721

Note 19 Segment Reporting

Textron has five reportable segments: Aircraft, Fastening Systems, Industrial Products, Industrial Components and Finance. See Note 1 for principal markets and pages 16 through 17 for products of Textron's segments.

Textron's reportable segments are strategically aligned based on the manner in which Textron manages its various operations. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1. Textron evaluates segment performance based on segment profit. Segment profit for Textron Manufacturing excludes interest expense, certain corporate expenses, special charges and gains and losses from the disposition of significant business units. Textron Finance includes interest income, interest expense and distributions on preferred securities of Finance subsidiary trust and excludes special charges as part of segment profit. 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. Provisions for losses on finance receivables involving the sale or lease of Textron products are recorded by the selling manufacturing division.

The Aircraft segment is comprised of two product groups: fixed-wing aircraft and rotor aircraft. Fixed-wing aircraft revenues were \$3,286 million, \$3,176 million and \$2,956 million in 2002, 2001 and 2000, respectively. Rotor aircraft revenues were \$1,636 million, \$1,621 million and \$1,581 million in 2002, 2001 and 2000, respectively. The Industrial Products segment primarily includes defense systems, golf car and turf care equipment and electrical and telecommunication products. Defense systems revenues were \$488 million, \$490 million and \$470 million in 2002, 2001 and 2000, respectively. Golf car and turf care equipment revenues were \$732 million, \$738 million and \$823 million in 2002, 2001 and 2000, respectively, and electrical and telecommunications products revenues were \$341 million, \$430 million and \$454 million, respectively.

(In millions)	Revenues			Segment Profit		
	2002	2001	2000	2002	2001	2000
Aircraft	\$ 4,922	\$ 4,797	\$ 4,537	\$ 452	\$ 338	\$ 475
Fastening Systems	1,650	1,679	1,996	68	62	192
Industrial Products	1,841	1,974	2,248	83	106	296
Industrial Components	1,615	3,162	3,618	115	215	341
Finance	630	709	691	117	205	202
	\$10,658	\$12,321	\$13,090	835	926	1,506
Special charges				(128)	(437)	(483)
Segment operating income				707	489	1,023
Gain on sale of businesses, net				5	342	—
Goodwill amortization				—	(98)	(96)
Corporate expenses and other, net				(114)	(152)	(164)
Interest expense, net				(108)	(162)	(152)
Income before income taxes and distribution on preferred securities				\$ 490	\$ 419	\$ 611

(In millions)	Assets			Property, Plant and Equipment Expenditures		
	2002	2001	2000	2002	2001	2000
Aircraft	\$ 2,857	\$ 2,848	\$ 2,612	\$ 106	\$ 175	\$ 157
Fastening Systems	1,451	1,541	1,770	43	61	108
Industrial Products	1,484	1,886	2,089	91	93	98
Industrial Components	1,394	1,375	2,563	48	180	146
Finance	6,654	6,464	6,131	17	18	14
Corporate	3,287	4,119	3,351	14	5	4
Eliminations	(1,622)	(2,181)	(2,146)	—	—	—
	\$15,505	\$16,052	\$16,370	\$ 319	\$ 532	\$ 527

(In millions)	Amortization			Depreciation		
	2002	2001	2000	2002	2001	2000
Aircraft	\$ —	\$ 11	\$ 10	\$ 116	\$ 116	\$ 107
Fastening Systems	4	16	18	70	78	82
Industrial Products	11	48	32	69	60	56
Industrial Components	—	21	27	54	123	116
Finance	10	22	15	28	19	17
Corporate	2	(4)	10	4	4	4
	\$ 27	\$ 114	\$ 112	\$ 341	\$ 400	\$ 382

Geographic Data

Presented below is selected financial information by geographic area of Textron's operations:

(In millions)	Revenues*			Property, Plant and Equipment**		
	2002	2001	2000	2002	2001	2000
United States	\$ 7,138	\$ 8,022	\$ 8,569	\$ 1,434	\$ 1,502	\$ 1,791
Canada	383	692	798	63	78	127
Latin America and Mexico	526	826	790	28	45	121
Germany	611	613	584	198	183	165
Asia and Australia	412	518	603	41	12	13
United Kingdom	324	367	385	108	98	145
France	260	311	352	86	80	79
Other	1,004	972	1,009	73	90	164
	\$10,658	\$12,321	\$13,090	\$ 2,031	\$ 2,088	\$ 2,605

* Revenues are attributed to countries based on the location of the customer.

** Property, plant and equipment is based on the location of the asset.

Revenues include sales to the U.S. Government of \$1.3 billion in 2002 and \$1.2 billion in both 2001 and 2000. Revenues also include sales to DaimlerChrysler, primarily through the Automotive Trim Business, of \$1.4 billion and \$1.5 billion in 2001 and 2000, respectively.