TEXTRON INC
Form 10-Q
April 26, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from to .

Commission File Number 1-5480

Textron Inc.

(Exact name of registrant as specified in its charter)

Delaware	**05-0315468**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
40 Westminster Street, Providence, RI	**02903**
(Address of principal executive offices)	**(Zip code)**

(401) 421-2800

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

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

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

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

Table of Contents

TEXTRON INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. **FINANCIAL STATEMENTS**

TEXTRON INC.

Consolidated Statements of Operations (Unaudited)

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

See Notes to the consolidated financial statements.

3

Table of Contents

TEXTRON INC.

Consolidated Statements of Comprehensive Income (Unaudited)

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

See Notes to the consolidated financial statements.

4

Table of Contents

TEXTRON INC.

Consolidated Balance Sheets (Unaudited)

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

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

See Notes to the consolidated financial statements.

Table of Contents

TEXTRON INC.

Consolidated Statements of Cash Flows (Unaudited)

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

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

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

See Notes to the consolidated financial statements

Table of Contents

TEXTRON INC.

Consolidated Statements of Cash Flows (Unaudited) (Continued)

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

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

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

See Notes to the consolidated financial statements.

Table of Contents

TEXTRON INC.

Notes to the Consolidated Financial Statements (Unaudited)

Note 1: Basis of Presentation

Our consolidated financial statements include the accounts of Textron Inc. and its majority-owned subsidiaries. We have prepared these unaudited consolidated financial statements in accordance with accounting principles generally accepted in the U.S. for interim financial information. Accordingly, these interim financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. The consolidated interim financial statements included in this quarterly report should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. In the opinion of management, the interim financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for the fair presentation of our consolidated financial position, results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron Inc. consolidated with its majority-owned subsidiaries that operate in the Cessna, Bell, Textron Systems and Industrial segments. The Finance group, which also is the Finance segment, consists of Textron Financial Corporation, its consolidated subsidiaries and three other finance subsidiaries owned by Textron Inc. We designed this framework to enhance our borrowing power by separating the Finance group. Our Manufacturing group operations include the development, production and delivery of tangible goods and services, while our Finance group provides financial services. Due to the fundamental differences between each borrowing group s activities, investors, rating agencies and analysts use different measures to evaluate each group s performance. To support those evaluations, we present balance sheet and cash flow information for each borrowing group within the consolidated financial statements. All significant intercompany transactions are eliminated from the consolidated financial statements, including retail and wholesale financing activities for inventory sold by our Manufacturing group and financed by our Finance group.

Use of Estimates

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

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

Note 2: Retirement Plans

We provide defined benefit pension plans and other postretirement benefits to eligible employees. The components of net periodic benefit cost for these plans are as follows:

	Pension Benefits		Postretirement Benefits Other Than Pensions	
(In millions)	March 31, 2012	April 2, 2011	March 31, 2012	April 2, 2011
Three Months Ended				
Service cost	$ 30	$ 32	$ 2	$ 2
Interest cost	76	82	6	8
Expected return on plan assets	(101)	(98)		
Amortization of prior service cost (credit)	4	4	(3)	(1)

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

Table of Contents

Note 3: Share-Based Compensation

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

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

Stock Options

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

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

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

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

Exercisable at end of period	5,513	$ 29.36	5

Restricted Stock Units

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

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

Table of Contents

Performance Share Units

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

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

Share-Based Compensation Awards

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

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

Note 4: Earnings Per Share

We calculate basic and diluted earnings per share (EPS) based on net income, which approximates income available to common shareholders for each period. Basic EPS is calculated using the two-class method, which includes the weighted-average number of common shares outstanding during the period and restricted stock units to be paid in stock that are deemed participating securities as they provide nonforfeitable rights to dividends. Diluted EPS considers the dilutive effect of all potential future common stock, including stock options, restricted stock units and the shares that could be issued upon the conversion of our convertible notes and upon the exercise of the related warrants. The call options purchased in connection with the issuance of the convertible notes and the capped call transaction entered into in 2011 are excluded from the calculation of diluted EPS as their impact is always anti-dilutive.

Upon conversion of our convertible notes, as described in Note 8 of our 2011 Form 10-K, the principal amount would be settled in cash, and the excess of the conversion value, as defined, over the principal amount may be settled in cash and/or shares of our common stock. Therefore, only the shares of our common stock potentially issuable with respect to the excess of the notes conversion value over the principal amount, if any, are considered as dilutive potential common shares for purposes of calculating diluted EPS.

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

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

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

Stock options to purchase 6 million and 4 million shares of common stock outstanding are excluded from our calculation of diluted weighted-average shares outstanding for the three months ended March 31, 2012 and April 2, 2011, respectively, as the exercise prices were greater than the average market price of our common stock for the periods. These securities could potentially dilute earnings per share in the future.

Table of Contents

Note 5: Accounts Receivable and Finance Receivables

Accounts Receivable

Accounts receivable is composed of the following:

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

We have unbillable receivables on U.S. Government contracts that arise when the revenues we have appropriately recognized based on performance cannot be billed yet under terms of the contract. Unbillable receivables within accounts receivable totaled $197 million at March 31, 2012 and $192 million at December 31, 2011.

Finance Receivables

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

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

Credit Quality Indicators and Nonaccrual Finance Receivables

We internally assess the quality of our finance receivables held for investment portfolio based on a number of key credit quality indicators and statistics such as delinquency, loan balance to estimated collateral value, the liquidity position of individual borrowers and guarantors and default rates of our notes receivable collateral in the Timeshare product line. Because many of these indicators are difficult to apply across an entire class of receivables, we evaluate individual loans on a quarterly basis and classify these loans into three categories based on the key credit quality indicators for the individual loan. These three categories are performing, watchlist and nonaccrual.

We classify finance receivables held for investment as nonaccrual if credit quality indicators suggest full collection is doubtful. In addition, we automatically classify accounts as nonaccrual once they are contractually delinquent by more than three months unless collection is not doubtful.

Cash payments on nonaccrual accounts, including finance charges, generally are applied to reduce the net investment balance. We resume the accrual of interest when the loan becomes contractually current through payment according to the original terms of the loan or, if a loan has been modified, following a period of performance under the terms of the modification, provided we conclude that collection of all principal and interest is no longer doubtful. Previously suspended interest income is recognized at that time.

Accounts are classified as watchlist when credit quality indicators have deteriorated as compared with typical underwriting criteria, and we believe collection of full principal and interest is probable but not certain. All other finance receivables held for investment that do not meet the watchlist or nonaccrual categories are classified as performing.

Table of Contents

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

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

We measure delinquency based on the contractual payment terms of our loans and leases. In determining the delinquency aging category of an account, any/all principal and interest received is applied to the most past-due principal and/or interest amounts due. If a significant portion of the contractually due payment is delinquent, the entire finance receivable balance is reported in accordance with the most past-due delinquency aging category.

Finance receivables held for investment by delinquency aging category are summarized in the table below:

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

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

Loan Modifications

Troubled debt restructurings occur when we have either modified the contract terms of finance receivables held for investment for borrowers experiencing financial difficulties or accepted a transfer of assets in full or partial satisfaction of the loan balance. The types of modifications we typically make include extensions of the original maturity date of the contract, extensions of revolving borrowing periods, delays in the timing of required principal payments, deferrals of interest payments, advances to protect the value of our collateral and principal reductions contingent on full repayment prior to the maturity date. The changes effected by modifications made during the first quarter of 2012 to finance receivables held for investment were not material, primarily as a result of the reclassification of the Golf Mortgage finance receivables from the held for investment classification to the held for sale classification at December 31, 2011.

Impaired Loans

We evaluate individual finance receivables held for investment in non-homogeneous portfolios and larger accounts in homogeneous loan portfolios for impairment on a quarterly basis. Finance receivables classified as held for sale are reflected at the lower of cost or fair value and are excluded from these evaluations. A finance receivable is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement based on our review of the credit quality indicators discussed above. Impaired finance receivables include both nonaccrual accounts and accounts for which full collection of principal and interest remains probable, but the account s original terms have been, or are expected to be, significantly modified. If the modification specifies an interest rate equal to or greater than a market rate for a finance receivable with comparable risk, the account is not considered impaired in years subsequent to the modification. There was no significant interest income recognized on impaired loans in the first quarter of 2012 or 2011.

Table of Contents

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

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

Allowance for Losses

We maintain the allowance for losses on finance receivables held for investment at a level considered adequate to cover inherent losses in the portfolio based on management s evaluation and analysis by product line. For larger balance accounts specifically identified as impaired, including large accounts in homogeneous portfolios, a reserve is established based on comparing the carrying value with either a) the expected future cash flows, discounted at the finance receivable s effective interest rate; or b) the fair value of the underlying collateral, if the finance receivable is collateral dependent. The expected future cash flows consider collateral value; financial performance and liquidity of our borrower; existence and financial strength of guarantors; estimated recovery costs, including legal expenses; and costs associated with the repossession/foreclosure and eventual disposal of collateral. When there is a range of potential outcomes, we perform multiple discounted cash flow analyses and weight the potential outcomes based on their relative likelihood of occurrence.

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

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

Golf Equipment - age and condition of the collateral.

Timeshare - historical performance of consumer notes receivable collateral, real estate valuations, operating expenses of the borrower, the impact of bankruptcy court rulings on the value of the collateral, legal and other professional expenses and borrower s access to capital.

We also establish an allowance for losses by product line to cover probable but specifically unknown losses existing in the portfolio. For homogeneous portfolios, including Aviation and Golf Equipment, the allowance is established as a percentage of non-recourse finance receivables, which have not been identified as requiring specific reserves. The percentage is based on a combination of factors, including historical loss experience, current delinquency and default trends, collateral values and both general economic and specific industry trends. For non-homogeneous portfolios, such as Timeshare, the allowance is established as a percentage of watchlist balances, as defined on page 11, which represents a combination of assumed default likelihood and loss severity based on historical experience, industry trends and collateral values. In estimating our allowance for losses to cover accounts not specifically identified, critical factors vary by product line and include the following:

13

Table of Contents

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

Golf Equipment - historical loss experience and delinquency trends.

Timeshare - individual loan credit quality indicators such as borrowing base shortfalls for revolving notes receivable facilities, default rates of our notes receivable collateral, borrower s access to capital, historical progression from watchlist to nonaccrual status and estimates of loss severity based on analysis of impaired loans in the product line.

Finance receivables held for investment are written down to the fair value (less estimated costs to sell) of the related collateral when the collateral is repossessed and are charged off when the remaining balance is deemed to be uncollectible.

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

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

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

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

Note 6: Inventories

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

Note 7: Debt

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

Note 8: Accrued Liabilities

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

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

Note 9: Commitments and Contingencies

We are subject to legal proceedings and other claims arising out of the conduct of our business, including proceedings and claims relating to commercial and financial transactions; government contracts; compliance with applicable laws and regulations; production partners; product liability; employment; and environmental, safety and health matters. Some of these legal proceedings and claims seek damages, fines or penalties in substantial amounts or remediation of environmental contamination. As a government contractor, we are subject to audits, reviews and investigations to determine whether our operations are being conducted in accordance with applicable regulatory requirements. Under federal government procurement regulations, certain claims brought by the U.S. Government could result in our being suspended or debarred from U.S. Government contracting for a period of time. On the basis of information presently available, we do not believe that existing proceedings and claims will have a material effect on our financial position or results of operations.

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

Note 10. Derivative Instruments and Fair Value Measurements

We measure fair value at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We prioritize the assumptions that market participants would use in pricing the asset or liability into a three-tier fair value hierarchy. This fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and the lowest priority (Level 3) to unobservable inputs in which little or no market data exist, requiring companies to develop their own assumptions. Observable inputs that do not meet the criteria of Level 1, and include quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets and liabilities in markets that are not active are categorized as Level 2. Level 3 inputs are those that reflect our estimates about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. Valuation

Table of Contents

techniques for assets and liabilities measured using Level 3 inputs may include methodologies such as the market approach, the income approach or the cost approach and may use unobservable inputs such as projections, estimates and management s interpretation of current market data. These unobservable inputs are utilized only to the extent that observable inputs are not available or cost-effective to obtain.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The assets and liabilities that are recorded at fair value on a recurring basis consist primarily of our derivative financial instruments, which are categorized as Level 2 in the fair value hierarchy. The fair value amounts of these instruments that are designated as hedging instruments are provided below:

(In millions)	**Borrowing Group**	**Balance Sheet Location**	**Asset (Liability)**