# TEXTRON INC

# FORM 10-Q
(Quarterly Report)

Filed 08/08/05 for the Period Ending 07/02/05

| | |
|---|---|
| Address | 40 WESTMINSTER ST |
| | PROVIDENCE, RI 02903 |
| Telephone | 4014212800 |
| CIK | 0000217346 |
| Symbol | TXT |
| SIC Code | 6162 - Mortgage Bankers and Loan Correspondents |
| Fiscal Year | 01/02 |

# TEXTRON INC

## FORM 10-Q
(Quarterly Report)

## Filed 8/8/2005 For Period Ending 7/2/2005

| | |
|---|---|
| Address | 40 WESTMINSTER ST |
| | PROVIDENCE, Rhode Island 02903 |
| Telephone | 401-421-2800 |
| CIK | 0000217346 |
| Industry | Conglomerates |
| Sector | Conglomerates |
| Fiscal Year | 12/31 |

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal quarter ended July 2, 2005
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-5480

# TEXTRON INC.

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 05-0315468<br>(I.R.S. Employer Identification No.) |

40 Westminster Street, Providence, RI 02903
401-421-2800
*(Address and telephone number of principal executive offices)*

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes _X_ No __

Common stock outstanding at July 30, 2005 - 133,766,934 shares



## PART I. FINANCIAL INFORMATION

**Item 1.** FINANCIAL STATEMENTS

# TEXTRON INC.
## Consolidated Statements of Operations (unaudited)
(Dollars in millions, except per share amounts)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| **Revenues** | | | | |
| Manufacturing revenues | $ 3,041 | $ 2,386 | $ 5,691 | $ 4,589 |
| Finance revenues | 147 | 137 | 288 | 271 |
| Total revenues | 3,188 | 2,523 | 5,979 | 4,860 |
| **Costs, expenses and other** | | | | |
| Cost of sales | 2,495 | 1,936 | 4,644 | 3,754 |
| Selling and administrative | 376 | 342 | 758 | 664 |
| Interest expense, net | 72 | 60 | 141 | 124 |
| Provision for losses on finance receivables | 1 | 14 | 13 | 34 |
| Special charges | 44 | 17 | 104 | 69 |
| Total costs, expenses and other | 2,988 | 2,369 | 5,660 | 4,645 |
| Income from continuing operations before income taxes | 200 | 154 | 319 | 215 |
| Income taxes | (70) | (45) | (110) | (65) |
| **Income from continuing operations** | **130** | **109** | **209** | **150** |
| Discontinued operations, net of income taxes: | | | | |
| Results of operations | - | (9) | - | (13) |
| (Loss) gain on disposition | (7) | - | 40 | - |
| **Net income** | **$ 123** | **$ 100** | **$ 249** | **$ 137** |
| Per common share: | | | | |
| Basic: | | | | |
| Income from continuing operations | $ .97 | $ .79 | $ 1.55 | $ 1.09 |
| Discontinued operations, net of income taxes: | | | | |
| Results of operations | - | (.07) | - | (.10) |
| (Loss) gain on disposition | (.05) | - | .30 | - |
| **Net income** | **$ .92** | **$ .72** | **$ 1.85** | **$ .99** |
| Diluted: | | | | |
| Income from continuing operations | $ .94 | $ .78 | $ 1.51 | $ 1.07 |
| Discontinued operations, net of income taxes: | | | | |
| Results of operations | - | (.07) | - | (.10) |
| (Loss) gain on disposition | (.05) | - | .29 | - |
| **Net income** | **$ .89** | **$ .71** | **$ 1.80** | **$ .97** |
| Average shares outstanding (in thousands): | | | | |
| Basic | 134,603 | 137,749 | 134,866 | 137,618 |
| Diluted | 137,582 | 140,287 | 137,948 | 140,316 |
| Dividends per share: | | | | |
| $2.08 Preferred stock, Series A | $ .52 | $ .52 | $ 1.04 | $ 1.04 |
| $1.40 Preferred stock, Series B | $ .35 | $ .35 | $ .70 | $ .70 |
| Common stock | $ .35 | $ .325 | $ .70 | $ .65 |

*See Notes to the Consolidated Financial Statements.*



**Item 1.** FINANCIAL STATEMENTS (Continued)

**TEXTRON INC.**
**Consolidated Balance Sheets (unaudited)**
(Dollars in millions)

| | July 2, 2005 | January 1, 2005 |
|---|---|---|
| **Assets** | | |
| **Textron Manufacturing** | | |
| Cash and cash equivalents | $ 584 | $ 605 |
| Accounts receivable, less allowance for doubtful accounts of $56 and $64 | 1,315 | 1,211 |
| Inventories | 1,846 | 1,742 |
| Other current assets | 554 | 581 |
| Assets of discontinued operations | 27 | 29 |
| Total current assets | 4,326 | 4,168 |
| Property, plant and equipment, less accumulated depreciation and amortization of $2,708 and $2,652 | 1,842 | 1,922 |
| Goodwill | 1,398 | 1,439 |
| Other intangible assets, net | 41 | 44 |
| Other assets | 1,452 | 1,564 |
| Total Textron Manufacturing assets | 9,059 | 9,137 |
| **Textron Finance** | | |
| Cash | 77 | 127 |
| Finance receivables, net | 5,995 | 5,738 |
| Goodwill | 169 | 169 |
| Other assets | 621 | 704 |
| Total Textron Finance assets | 6,862 | 6,738 |
| Total assets | $ 15,921 | $ 15,875 |
| **Liabilities and Shareholders' Equity** | | |
| **Liabilities** | | |
| **Textron Manufacturing** | | |
| Current portion of long-term debt and short-term debt | $ 24 | $ 433 |
| Accounts payable | 941 | 719 |
| Accrued liabilities | 1,620 | 1,823 |
| Total current liabilities | 2,585 | 2,975 |
| Accrued postretirement benefits other than pensions | 560 | 564 |
| Other liabilities | 1,610 | 1,623 |
| Long-term debt | 1,681 | 1,358 |
| Total Textron Manufacturing liabilities | 6,436 | 6,520 |
| **Textron Finance** | | |
| Other liabilities | 459 | 467 |
| Deferred income taxes | 457 | 453 |
| Debt | 4,965 | 4,783 |
| Total Textron Finance liabilities | 5,881 | 5,703 |
| Total liabilities | 12,317 | 12,223 |

| | | |
|---|---|---|
| **Shareholders' equity** | | |
| Capital stock: | | |
| Preferred stock | 10 | 10 |
| Common stock | 26 | 25 |
| Capital surplus | 1,467 | 1,369 |
| Retained earnings | 5,946 | 5,792 |
| Accumulated other comprehensive loss | (173) | (97) |
| | 7,276 | 7,099 |
| Less cost of treasury shares | 3,672 | 3,447 |
| Total shareholders' equity | 3,604 | 3,652 |
| Total liabilities and shareholders' equity | $ 15,921 | $ 15,875 |
| Common shares outstanding (in thousands) | 133,896 | 135,373 |

*See Notes to the Consolidated Financial Statements.*



**Item 1.** FINANCIAL STATEMENTS (Continued)

**TEXTRON INC.**
**Consolidated Statements of Cash Flows (unaudited)**
(In millions)

| | Six Months Ended | |
|---|---|---|
| | July 2, 2005 | July 3, 2004 |
| **Cash flows from operating activities:** | | |
| Income from continuing operations | $ 209 | $ 150 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 174 | 163 |
| Amortization | 9 | 7 |
| Provision for losses on finance receivables | 13 | 34 |
| Special charges | 104 | 69 |
| Deferred income taxes | 5 | 21 |
| Changes in assets and liabilities excluding those related to acquisitions and divestitures: | | |
| Accounts receivable, net | (142) | (117) |
| Inventories | (124) | (275) |
| Other assets | 87 | 39 |
| Accounts payable | 257 | 234 |
| Accrued liabilities | (118) | 70 |
| Captive finance receivables, net | (46) | 54 |
| Other operating activities, net | 33 | 10 |
| Net cash provided by operating activities of continuing operations | 461 | 459 |
| **Cash flows from investing activities:** | | |
| Finance receivables: | | |
| Originated or purchased | (4,809) | (4,788) |
| Repaid | 4,386 | 4,373 |
| Proceeds from receivables sales and securitization sales | 181 | 186 |

| | | |
|---|---|---|
| Capital expenditures | (145) | (129) |
| Net cash (used) acquired in acquisitions | (23) | 6 |
| Net proceeds from sale of businesses | (1) | 4 |
| Proceeds on sale of property, plant and equipment | 1 | 19 |
| Proceeds on sale of investments | - | 38 |
| Other investing activities, net | 19 | 61 |
| Net cash used by investing activities of continuing operations | (391) | (230) |
| **Cash flows from financing activities:** | | |
| (Decrease) increase in short-term debt | (393) | 62 |
| Proceeds from issuance of long-term debt | 1,551 | 445 |
| Principal payments and retirements of long-term debt | (997) | (668) |
| Proceeds from employee stock ownership plans | 68 | 92 |
| Purchases of Textron common stock | (244) | (71) |
| Dividends paid | (142) | (90) |
| Excess tax benefits related to stock option exercises | 9 | - |
| Net cash used by financing activities of continuing operations | (148) | (230) |
| Effect of exchange rate changes on cash and cash equivalents | (23) | (3) |
| Net cash used by continuing operations | (101) | (4) |
| Net cash provided by discontinued operations | 30 | 32 |
| **Net (decrease) increase in cash and cash equivalents** | (71) | 28 |
| Cash and cash equivalents at beginning of period | 732 | 838 |
| Cash and cash equivalents at end of period | $ 661 | $ 866 |
| **Supplemental schedule of non-cash investing activities:** | | |
| Capital expenditures financed through capital leases | $ 2 | $ 21 |

*See Notes to the Consolidated Financial Statements* .





**TEXTRON INC.**

Notes to the Consolidated Financial Statements (unaudited)

**Note 1: Basis of Presentation**

The consolidated financial statements should be read in conjunction with the financial statements included in Textron's Annual Report on Form 10-K for the year ended January 1, 2005. The consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for the fair presentation of Textron's consolidated financial position at July 2, 2005, and its consolidated results of operations and cash flows for each of 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.

During the fourth quarter of 2004, Textron reached a final decision to sell the remainder of its InteSys operations, and as a result, financial results of this business, net of income taxes, are now reported as discontinued operations. In February 2005, Textron sold the remainder of the InteSys business and recorded an after-tax net gain of approximately $40 million in the first half of 2005.

Textron's financings are conducted through two borrowing groups: Textron Manufacturing and Textron Finance. This framework is designed to enhance Textron's borrowing power by separating the Finance segment. Textron Manufacturing consists of Textron Inc., the parent company, consolidated with the entities that operate in the Bell, Cessna, Fastening Systems and Industrial business segments. Textron Finance consists of Textron's wholly owned commercial finance subsidiary, Textron Financial Corporation, consolidated with its subsidiaries, which are the entities through which Textron operates its Finance segment. Textron Finance obtains financing for its operations by borrowing from its own group of external creditors. All significant intercompany transactions are eliminated, including retail and wholesale financing activities for inventory sold by Textron Manufacturing financed by Textron Finance.

*Reclassifications*

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 Bell, Cessna and Industrial segments. The cash flows related to these captive financing activities are reflected as operating activities (by Textron Manufacturing) and as investing activities (by Textron Finance) based on each group's operations. Historically, Textron's consolidated statement of cash flows has presented a combination of the cash flows of both borrowing groups with no elimination of the captive financing activity. Based on recent views expressed by the staff of the Securities and Exchange Commission about this industry-wide practice followed by companies with captive finance companies, in the fourth quarter of 2004, management elected to change the consolidated classification of these cash flows. Accordingly, the captive financing transactions have been eliminated, and cash from customers and securitizations is recognized in operating activities within the consolidated statement of cash flows when received. Prior period amounts reported in the consolidated statement of cash flows have been reclassified to conform with this presentation; however, the separate cash flow presentation of Textron Manufacturing provided on page 17 is unchanged.

The impact of the reclassification of these cash flows from continuing operations between investing and operating activities, on a consolidated basis, for the six months ended July 3, 2004 is as follows:

| *(In millions* ) | As Reported | As Reclassified |
|---|---|---|
| Net cash provided by operating activities | $ 389 | $ 459 |
| Net cash used by investing activities | $(160) | $(230) |



**Note 2: Inventories**

| *(In millions)* | July 2, 2005 | January 1, 2005 |
|---|---|---|
| Finished goods | $ 675 | $ 643 |
| Work in process | 1,311 | 1,206 |
| Raw materials | 222 | 231 |
| | 2,208 | 2,080 |
| Less progress/milestones payments | 362 | 338 |
| | $ 1,846 | $ 1,742 |

**Note 3: Goodwill and Other Intangible Assets**

The changes in the carrying amount of goodwill by segment are summarized below:

| *(In millions)* | January 1, 2005 | Foreign Currency Translation | Acquisitions | Other | July 2, 2005 |
|---|---|---|---|---|---|
| Bell | $ 101 | $ - | $ 2 | $ - | $ 103 |

| | | | | | |
|---|---|---|---|---|---|
| Cessna | 322 | - | - | - | 322 |
| Fastening Systems | 437 | (20) | - | (1) | 416 |
| Industrial | 579 | (20) | 4 | (6) | 557 |
| Finance | 169 | - | - | - | 169 |
| Total | $1,608 | $ (40) | $ 6 | $(7) | $1,567 |

All of Textron's acquired intangible assets are subject to amortization and are composed of the following as of July 2, 2005:

| *(Dollars in millions)* | Weighted-Average Amortization Period *(In years)* | Gross Carrying Amount | Accumulated Amortization | Net |
|---|---|---|---|---|
| Trademarks | 20 | $ 28 | $ 6 | $ 22 |
| License | 15 | 10 | - | 10 |
| Patents | 8 | 12 | 7 | 5 |
| Other | 5 | 12 | 8 | 4 |
| | | $ 62 | $ 21 | $ 41 |

Amortization expense for the three and six months ended July 2, 2005 totaled $1 million and $2 million, respectively, and is expected to be approximately $3 million for the remainder of 2005. Amortization expense for the three and six months ended July 3, 2004 totaled $1 million and $3 million, respectively.



**Note 4: Accumulated Other Comprehensive Loss and Comprehensive Income**

The components of accumulated other comprehensive loss, net of related taxes, are as follows:

| | Six Months Ended | |
|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 |
| Beginning of period | $ (97) | $(64) |
| Currency translation adjustment | (73) | (20) |
| Net deferred loss on hedge contracts | (6) | (6) |
| Net unrealized loss on marketable equity securities | - | (3) |
| Net deferred gain (loss) on interest-only securities | 3 | (6) |
| Other comprehensive loss | (76) | (35) |
| End of period | $(173) | $(99) |

Other comprehensive loss includes a net income tax benefit of $2 million and a net income tax expense of $1 million for the six months ended July 2, 2005 and July 3, 2004, respectively.

Comprehensive income is summarized below:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Net income | $ 123 | $ 100 | $ 249 | $ 137 |

| | | | | |
|---|---|---|---|---|
| Other comprehensive loss | (38) | (19) | (76) | (35) |
| Comprehensive income | $ 85 | $ 81 | $ 173 | $ 102 |

**Note 5: Earnings per Share**

The dilutive effect of convertible preferred shares and stock options was approximately 2,979,000 and 2,538,000 shares for the three months ended July 2, 2005 and July 3, 2004, respectively, and approximately 3,082,000 and 2,698,000 shares for the six months ended July 2, 2005 and July 3, 2004, respectively. The income available to common shareholders that is used to calculate both basic and diluted earnings per share approximated net income for both periods.

**Note 6: Share-Based Compensation**

*Summary of Share-Based Compensation Plans*

Textron's 1999 Long-Term Incentive Plan (the "Plan") authorizes awards to key employees of Textron in the form of options to purchase Textron shares and restricted stock. Options to purchase Textron shares have a maximum term of ten years, and beginning with 2004 grants, vest ratably over a three-year period. Grants awarded prior to 2004 vested ratably over two years. Restricted stock grants vest one-third each in the third, fourth and fifth year following the grant. The maximum number of shares authorized under the Plan include 17.5 million options to purchase Textron shares and 2 million shares of restricted stock. Textron also provides share-based compensation awards payable in cash, including retention awards to certain executives and performance share units. Payouts under performance share units vary based on certain performance criteria measured over a three-year period. The performance share units vest at the end of three years.

The Deferred Income Plan for Textron Key Executives (the "DIP") provides participants the opportunity to voluntarily defer up to 25% of their base salary and up to 100% of annual and long-term incentive compensation



and other compensation. Elective deferrals may be put into either a stock unit account or an interest bearing account. Textron generally contributes a 10% premium on amounts deferred into the stock unit account. Executives that are eligible to participate in the DIP that have not achieved and/or maintained the required minimum stock ownership level are required to defer annual incentive compensation in excess of 100% of the executive's annual incentive target opportunity into a deferred stock unit account and are not entitled to the 10% premium contribution on the amount deferred. Participants cannot move amounts between the two accounts while actively employed by Textron, and cannot receive distributions until termination of employment.

*Change in Accounting for Share-Based Compensation*

Textron historically has accounted for share-based payments, including stock options issued under its Plan, using the intrinsic value method of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25").

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), "Share-Based Payment" ("SFAS No. 123-R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and supercedes APB No. 25. SFAS No. 123-R requires companies to measure compensation costs for share-based payments to employees, including stock options, at fair value and expense such compensation over the service period beginning with the first interim or annual period after June 15, 2005. In April 2005, the Securities and Exchange Commission delayed the transition date for companies to the first fiscal year beginning after June 15, 2005, effectively delaying Textron's required adoption of SFAS No. 123-R until the first quarter of 2006.

Textron elected to adopt SFAS No. 123-R in the first quarter of 2005 using the modified prospective method. Under this transition method, compensation expense recognized in 2005 includes: a) compensation cost for all stock options and restricted stock granted prior to, but not yet vested as of January 1, 2005, based on the grant-date fair value estimated and recognized in accordance with the provisions of SFAS No. 123, and b) compensation cost for all stock options and restricted stock granted subsequent to January 1, 2005, and all share-based compensation awards accounted for as liabilities, based upon the measurement and recognition provisions of SFAS No. 123-R. For awards granted or modified in 2005 and prospectively, compensation costs for awards with only service conditions that vest ratably are recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award. Compensation costs for awards granted prior to 2005 are recognized using the attribution methods required under SFAS No. 123. Upon adoption, Textron re-measured its share-based compensation awards that are accounted for as liabilities at fair value. The cumulative effect of adoption upon this re-measurement resulted in an increase to net income of approximately $1 million in the first quarter of 2005, which is not considered to be material and is recorded in selling and administrative expense. SFAS No. 123-R requires that the excess tax benefits received related to stock option exercises be presented as financing cash inflows. For the first half of 2005, $9 million of these excess tax benefits have been presented as cash provided by financing activities in the consolidated statement of cash flows.

The compensation expense that has been recorded in income for Textron's share-based compensation plans is as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Compensation expense, net of hedge income or expense | $ 16 | $ 9 | $ 29 | $ 14 |
| Income tax benefit | (7) | (3) | (11) | (5) |
| Net compensation cost | $ 9 | $ 6 | $ 18 | $ 9 |



Share-based compensation costs have been reflected primarily in selling and administrative expenses. For 2005, the expense includes attribution of the fair value of options issued, as well as the portion of previously granted options for which the requisite service was rendered, totaling approximately $5 million and $8 million for the three and six months ended July 2, 2005, respectively.

The net impact of the adoption is as follows:

| | Three Months Ended July 2, 2005 | | Six Months Ended July 2, 2005 | |
|---|---|---|---|---|
| *(In millions, except per share data)* | Upon Adoption of SFAS No. 123-R | If SFAS No. 123-R had not been adopted | Upon Adoption of SFAS No. 123-R | If SFAS No. 123-R had not been adopted |
| Income from continuing operations before income taxes | $200 | $205 | $ 319 | $ 326 |
| Net income | $123 | $126 | $ 249 | $ 254 |
| Basic earnings per share | $ .92 | $ .94 | $1.85 | $1.88 |
| Diluted earnings per share | $ .89 | $ .92 | $1.80 | $1.84 |

*Impact of SFAS No. 123-R Adoption on Prior Periods*

No compensation expense related to stock option grants has been recorded in the consolidated statement of operations for the three and six months ended July 3, 2004, as all of the options granted had an exercise price equal to the market value of the underlying stock on the date of grant. Results for prior periods have not been restated.

The following table illustrates the effect on net income and earnings per share if Textron had applied the fair-value recognition provisions required by SFAS No. 123-R at the beginning of fiscal 2004:

| *(In millions, except per share data)* | Three Months Ended July 3, 2004 | Six Months Ended July 3, 2004 |
|---|---|---|
| **Net income, as reported** | $100 | $137 |
| Add back: Stock-based employee compensation expense included in reported net income* | 6 | 9 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards* | (7) | (14) |
| **Pro forma net income** | $ 99 | $132 |
| Income per share: | | |
| Basic - as reported | $.72 | $ .99 |
| Basic - pro forma | $.72 | $ .96 |
| Diluted - as reported | $.71 | $ .97 |
| Diluted - pro forma | $.70 | $ .94 |

** Net of related taxes and hedge income or expense*



*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 $19 and $17 for the three months ended July 2, 2005 and July 3, 2004, respectively, and $20 and $14 for the six months ended July 2, 2005 and July 3, 2004, respectively. The fair values of options granted are estimated on the date of grant using the Black-Scholes option-pricing model. Expected volatilities are based on implied volatilities from traded options on Textron common stock, historical volatilities and other factors. Textron uses historical data to estimate option exercise behavior, adjusted to reflect anticipated increases in expected life.

The weighted-average assumptions used in Textron's Black-Scholes option-pricing model for awards issued during the respective periods are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Dividend yield | 2% | 2% | 2% | 2% |
| Expected volatility | 25% | 36% | 25% | 37% |
| Risk-free interest rate | 4% | 4% | 4% | 3% |
| Expected lives *(In years)* | 6.0 | 3.7 | 6.0 | 3.7 |

The following table summarizes information related to stock option activity for the respective periods:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Intrinsic value of options exercised | $11 | $16 | $36 | $33 |
| Cash received from option exercises | $21 | $42 | $68 | $92 |

| | | | | |
|---|---|---|---|---|
| Actual tax benefit realized for tax deductions from option exercises | $ 3 | $ 5 | $11 | $10 |

Stock option activity under the Plan during the six months ended July 2, 2005 is as follows :

| | Number of Options *(In thousands)* | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life *(In years)* | Aggregate Intrinsic Value *(In millions)* |
|---|---|---|---|---|
| Outstanding at beginning of year | 9,261 | $52.05 | | |
| Granted | 1,204 | 76.00 | | |
| Exercised | (1,338) | 49.56 | | |
| Canceled, expired or forfeited | (136) | 56.71 | | |
| Outstanding at end of quarter | 8,991 | $55.56 | 6.37 | $187 |
| Exercisable at end of quarter | 6,394 | $53.20 | 5.32 | $148 |

*Restricted Stock*

The fair value of restricted stock is based on the trading price of Textron common stock on the date of grant, less required adjustments to reflect the fair value of the award as dividends are not paid or accrued until the restricted stock vests. The weighted-average grant-date fair value of restricted stock granted in the three months ended



July 2, 2005 and July 3, 2004 was approximately $72 and $59 per share, respectively. The weighted-average grant-date fair value of restricted stock granted in the six months ended July 2, 2005 and July 3, 2004 was approximately $71 and $56 per share, respectively.

Restricted stock activity under the Plan during the six months ended July 2, 2005 is as follows:

| *(Shares in thousands)* | Number of Shares | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Outstanding at beginning of year, nonvested | 867 | $49.44 |
| Granted | 346 | 71.14 |
| Forfeited | (41) | 48.56 |
| Outstanding at end of quarter, nonvested | 1,172 | $55.88 |

*Share-Based Compensation Awards Accounted for as Liabilities*

The fair value of share-based compensation awards accounted for as liabilities include performance share units, retention awards and DIP stock unit awards. The fair value of these awards is based on the trading price of Textron common stock, less adjustments to reflect the fair value of the award as dividends are not paid or accrued until vested, re-measured at each reporting period date.

*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 | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Subject only to service conditions: | | | | |
| Value of shares, options or units vested | $ 5 | $ 3 | $ 13 | $ 27 |
| Intrinsic value of cash awards paid | $ 5 | $ 2 | $ 7 | $ 6 |
| Subject to performance vesting conditions: | | | | |
| Value of units vested | $ - | $ - | $ - | $ - |
| Intrinsic value of cash awards paid | $ - | $ - | $25 | $11 |
| Intrinsic value of amounts paid under DIP | $ - | $ 1 | $ 2 | $ 3 |

As of July 2, 2005, $74 million represents the total compensation cost associated with unvested awards subject only to service conditions that has not yet been recognized. Textron expects that this compensation will be recognized over a weighted-average period of approximately 2 years. As of July 2, 2005, $33 million represents the total compensation cost associated with unvested share-based compensation awards subject to performance vesting conditions that has not yet been recognized. Textron expects that this compensation will be recognized over a weighted-average period of approximately 2 years.



**Note 7: Pension Benefits and Postretirement Benefits Other Than Pensions**

The components of net periodic benefit cost for the three months ended July 2, 2005 and July 3, 2004 are as follows:

| *(In millions)* | Pension Benefits | | Postretirement Benefits Other Than Pensions | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Service cost | $ 33 | $ 29 | $ 2 | $ 2 |
| Interest cost | 78 | 72 | 9 | 10 |
| Expected return on plan assets | (104) | (107) | - | - |
| Amortization of prior service cost | 7 | 4 | (1) | (2) |
| Amortization of net loss | 9 | 2 | 3 | 3 |
| Net periodic benefit cost | $ 23 | $ - | $ 13 | $ 13 |

The components of net periodic benefit cost for the six months ended July 2, 2005 and July 3, 2004 are as follows:

| *(In millions)* | Pension Benefits | | Postretirement Benefits Other Than Pensions | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Service cost | $ 69 | $ 58 | $ 5 | $ 4 |
| Interest cost | 153 | 144 | 19 | 20 |
| Expected return on plan assets | (208) | (214) | - | - |
| Amortization of prior service cost | 12 | 8 | (3) | (4) |
| Amortization of net loss | 18 | 4 | 6 | 6 |
| Net periodic benefit cost | $ 44 | $ - | $ 27 | $26 |

For the full year 2005, Textron expects to contribute approximately $22 million to fund its qualified pension plans.



**Note 8: Special Charges**

Special charges are summarized below for the applicable segments:

| | Restructuring Expenses | | | | | C&A | |
|---|---|---|---|---|---|---|---|
| *(In millions)* | Severance Costs | Contract Terminations | Fixed Asset Impairments | Other Associated Costs | Total | Investment Impairments (Gains) | Total Special Charges |
| **Three Months Ended July 2, 2005** | | | | | | | |
| Fastening Systems | $ 1 | $ 1 | $ - | $ 1 | $ 3 | $ - | $ 3 |
| Industrial | 1 | - | - | 1 | 2 | - | 2 |
| Corporate | - | - | - | - | - | 39 | 39 |
| | $ 2 | $ 1 | $ - | $ 2 | $ 5 | $ 39 | $ 44 |
| **Three Months Ended July 3, 2004** | | | | | | | |
| Fastening Systems | $ 11 | $ - | $ - | $ 5 | $16 | $ - | $ 16 |
| Industrial | - | - | - | 1 | 1 | - | 1 |
| Corporate | - | - | - | - | - | - | - |
| | $ 11 | $ - | $ - | $ 6 | $17 | $ - | $ 17 |
| **Six Months Ended July 2, 2005** | | | | | | | |
| Fastening Systems | $ 1 | $ 2 | $ 1 | $ 5 | $ 9 | $ - | $ 9 |
| Industrial | 2 | - | - | 2 | 4 | - | 4 |
| Corporate | - | - | - | - | - | 91 | 91 |
| | $ 3 | $ 2 | $ 1 | $ 7 | $13 | $ 91 | $104 |
| **Six Months Ended July 3, 2004** | | | | | | | |
| Fastening Systems | $24 | $ - | $ 2 | $ 8 | $34 | $ - | $ 34 |
| Industrial | 9 | 36 | (1) | 3 | 47 | - | 47 |
| Corporate | - | - | - | - | - | (12) | (12) |
| | $33 | $36 | $ 1 | $11 | $81 | $(12) | $ 69 |

By the end of 2004, Textron had substantially completed its company-wide restructuring program 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, and the program was expanded in 2001 and in 2002, as part of Textron's strategic effort to improve operating efficiencies. Textron's restructuring program has included corporate and segment direct and indirect workforce reductions, consolidation of facilities, rationalization of certain product lines, outsourcing of non-core production activity, the divestiture of non-core businesses and streamlining of sales and administrative overhead. Since the program was first announced, Textron has reduced its workforce by approximately 11,000 employees from continuing operations, representing approximately 19% of its global workforce, and has closed 110 facilities. As this program winds down in 2005, Textron will continue to make cash payments against its restructuring reserves. During the balance of the year, Textron expects to incur additional expenses of approximately $7 million, primarily in the Fastening Systems and Industrial segments.

The total cost of this restructuring program for continuing operations is expected to be approximately $539 million, including $11 million related to the divested Automotive Trim business ("Trim"). As of July 2, 2005, total program costs incurred of $532 million include $271 million in severance costs, $99 million in asset impairment charges (net of gains on the sale of fixed assets), $56 million in contract termination costs and $106 million in other associated costs. Total program costs incurred for continuing operations through July 2, 2005 include $228 million in the Fastening Systems segment, $217 million in the Industrial segment, $38 million in the Cessna segment, $29 million in the Bell segment, $9 million in the Finance segment and $11 million at Corporate.

An analysis of the restructuring program and related reserve account is summarized below:

| *(In millions)* | Severance Costs | Contract Terminations | Fixed Asset Impairments | Other Associated Costs | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2005 | $ 31 | $ 43 | $ - | $ - | $ 74 |
| Additions | 3 | 2 | 1 | 7 | 13 |
| Non-cash utilization | - | - | (1) | - | (1) |
| Cash paid | (13) | (8) | - | (7) | (28) |
| Balance at July 2, 2005 | $ 21 | $ 37 | $ - | $ - | $ 58 |

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 $58 million is adequate to cover the costs presently accruable and anticipates that actions related to these liabilities will be substantially completed within a twelve-month period.

In connection with the sale of Trim in 2001, Textron acquired preferred stock in Collins & Aikman Products Co., a wholly-owned subsidiary of Collins & Aikman Corporation ("C&A"), and C&A common stock. In March 2005, Textron agreed to sell approximately 60 percent of its preferred stock in Collins & Aikman Products Co. to Heartland Industrial Partners, L.P. ("Heartland") for a combination of cash and other consideration with a total value of approximately $25 million. Heartland also had the option to purchase the remaining preferred shares for an aggregate price of $20 million. Textron recorded a pre-tax impairment charge of approximately $52 million in the first quarter of 2005 to write down the preferred shares to fair market value based on the value determined by the agreement and other market considerations. On May 17, 2005, C&A filed for Chapter 11 bankruptcy protection, effectively terminating Heartland's obligation to purchase the preferred stock. Based on relevant market considerations, Textron recorded a charge of approximately $39 million in the second quarter of 2005 to write-off the remaining book value of its investment in the preferred stock.

During the first quarter of 2004, Textron sold its C&A common stock for cash proceeds of $34 million and recorded a pre-tax gain of $12 million.

**Note 9: 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 sector 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. As a government contractor, Textron is subject to audits, reviews and investigations to determine whether its 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 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.

During 2002, the Lycoming aircraft engine business, in conjunction with the U.S. Federal Aviation Administration ("FAA"), recalled approximately 950 turbocharged airplane engines and mandated the inspection of another 736 engines to replace potentially faulty crankshafts manufactured by a former third-party supplier. Lycoming 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. This program has been completed. Textron has continued to monitor the performance of the crankshafts previously supplied by the former supplier to ensure their continued suitability for their intended use and to ensure that the existing reserves are adequate to cover the costs directly related to potential crankshafts issues that may not specifically be a part of the prior recall program. On July 11, 2005, Lycoming issued a service bulletin covering certain non-turbocharged aircraft engines to replace crankshafts manufactured by the former supplier with new FAA-certified crankshafts. The service bulletin covers approximately 1,100 crankshafts and requires replacement within the earlier of the next 50 hours of operation or six months. An additional $5 million was accrued in the second quarter of 2005, which increased existing reserves to $16 million as of July 2, 2005, to cover costs directly related to potential crankshaft issues, including but not limited to replacement cost under the new service bulletin.

In connection with the recall, the former supplier filed a lawsuit against Lycoming claiming that the former supplier had been wrongly blamed for aircraft engine failures resulting from its crankshaft forging process and that Lycoming's design was the cause of the engine failures. In February 2005, a jury returned a verdict against Lycoming for $86 million in punitive damages, $2.7 million in expert fees and $1.7 million in increased insurance costs. The jury also found that the former supplier's claim that it had incurred $5.3 million in attorneys' fees was reasonable. Judgment was entered on the verdict on March 29, 2005, awarding the former supplier $9.7 million in alleged compensatory damages and attorneys' fees and $86 million in alleged punitive damages. While the ultimate outcome of the litigation cannot be assured, management strongly disagrees with the verdicts and believes that it is probable that they will be reversed through the appellate process.

On September 20, 2004, the former supplier filed for bankruptcy protection and ceased delivering crankshafts to Lycoming. In conjunction with the FAA, Lycoming is in the process of certifying a new supplier for its crankshaft models. During the first half of 2005, FAA approval was received for four of the six crankshaft models requiring certification and the new supplier began production of these crankshafts. Based on the current status of the certification process and the forecasted production requirements, the transition to the new supplier is not expected to have a material impact on Textron's results of operations or financial position.

*Research and Development Arrangements*

In the first quarter of 2005, Bell Helicopter entered into two separate risk-sharing arrangements with commercial participants in the development of the Bell 429 aircraft. The arrangements require contributions from the participants totaling $20 million which are due once the development effort reaches certain pre-determined milestones, as well as in-kind development contributions from one participant.

In the second quarter of 2005, Bell Helicopter entered into two separate risk-sharing arrangements with Canadian governmental organizations. These arrangements, which currently include the 429 aircraft and may potentially include future aircraft in the Modular Affordable Product Line, each require cash contributions of up to CAD115 million from the participants, based on a percentage of qualifying research and development costs incurred.

Each of the participants under these arrangements is entitled to payments from Bell Helicopter, with the commercial participants also entitled to discounts, based on future sales of the 429 aircraft. In addition, there are certain requirements related to production of future 429 aircraft in Canada and one of the commercial participants is entitled to perform certain manufacturing functions for the 429 aircraft. Based on the development activities completed and costs incurred in the current and prior periods through July 2, 2005, $20 million has been recorded in income related to these arrangements.

**Note 10: Arrangements with Off-Balance Sheet Risk**

Bell Helicopter and AgustaWestland North America Inc. ("AWNA") formed the AgustaWestlandBell Limited Liability Company ("AWB LLC") in January 2004 for the joint design, development, manufacture, sale, customer training and product support of the US101 helicopter and certain variations and derivatives thereof, to be offered and sold to departments or agencies of the U.S. Government.

In March 2005, AWB LLC received a $1.2 billion cost reimbursement-type subcontract from Lockheed Martin for the System Design and Development ("SDD") phase of the U.S. Marine Corps Marine 1 Helicopter Squadron

(VXX) Program. On March 11, 2005, Bell Helicopter guaranteed to Lockheed Martin the due and prompt performance by AWB LLC of all its obligations under this subcontract, provided that Bell Helicopter's liability under the guaranty shall not exceed 49% of AWB LLC's aggregate liability to Lockheed Martin under the subcontract. AgustaWestland N.V., AWNA's parent company, has guaranteed the remaining 51% to Lockheed Martin. Bell Helicopter and AgustaWestland N.V. have entered into cross-indemnification agreements in which each party indemnifies the other related to any payments required under these agreements that result from the indemnifying party's workshare under any subcontracts received.

For 2005, AWB LLC's maximum obligation is 20% of the total contract value, which equates to $232 million based on the current contract value of $1.2 billion. In 2006, AWB LLC's maximum obligation increases to 40%, or $464 million, and thereafter increases to 50%, or $580 million. Accordingly, the maximum amount of Bell Helicopter's liability under the guarantee will be $114 million in 2005, $227 million in 2006 and $284 million thereafter through completion.

In connection with the disposition of Trim, certain operating leases were transferred and assigned to C&A. Textron has guaranteed C&A's payments under these operating leases and certain environmental matters up to an aggregate remaining amount of approximately $24 million. Textron is required to make payments under these guarantees upon default by C&A. In May 2005, the U.S. subsidiary of C&A filed for Chapter 11 bankruptcy protection, and in July 2005 the European subsidiaries filed a group-wide administration order in the United Kingdom, effectively reducing Textron's ability to seek recourse from C&A under the indemnity provisions of the purchase and sale agreement, should a default occur. Textron has not received any default notices related to these leases, and management believes C&A will continue to make payments. Management will continue to monitor C&A's performance and Textron's reserves related to this matter.

As disclosed under the caption "Guarantees" in Note 16 to the Consolidated Financial Statements in Textron's 2004 Annual Report on Form 10-K, Textron has issued or is party to certain other guarantees. As of July 2, 2005, there have been no material changes to these other guarantees.

**Note 11: Textron Manufacturing Statements of Cash Flows**

The Statements of Cash Flows for Textron Manufacturing are provided on page 17 and include cash flows from the manufacturing businesses along with distributions received from Textron Finance. Textron's Consolidated Statements of Cash Flows are provided on page 4, and exclude all significant intercompany transactions and captive financing transactions as further discussed in Note 1 to the Consolidated Financial Statements.



**Note 11: Textron Manufacturing Statements of Cash Flows (Continued)**

| | Six Months Ended | |
|---|---|---|
| *(Unaudited) (In millions)* | July 2, 2005 | July 3, 2004 |
| **Cash flows from operating activities:** | | |
| Income from continuing operations | $ 209 | $ 150 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Earnings of Textron Finance less than distributions to Textron Manufacturing | 46 | 22 |
| Depreciation | 157 | 145 |
| Amortization | 4 | 1 |
| Special charges | 104 | 69 |
| Deferred income taxes | - | (1) |
| Changes in assets and liabilities excluding those related to acquisitions and divestitures: | | |

| | | |
|---|---|---|
| Accounts receivable, net | (142) | (117) |
| Inventories | (118) | (282) |
| Other assets | 60 | 28 |
| Accounts payable | 248 | 238 |
| Accrued liabilities | (149) | 167 |
| Other operating activities, net | 33 | 15 |
| Net cash provided by operating activities of continuing operations | 452 | 435 |
| **Cash flows from investing activities:** | | |
| Capital expenditures | (141) | (124) |
| Net cash (used) acquired in acquisitions | (23) | 6 |
| Net proceeds from sale of businesses | (1) | 4 |
| Proceeds on sale of property, plant and equipment | 11 | 27 |
| Proceeds on the sale of investments | - | 38 |
| Net cash used by investing activities of continuing operations | (154) | (49) |
| **Cash flows from financing activities:** | | |
| Increase in short-term debt | - | 4 |
| Proceeds from issuance of long-term debt | 401 | - |
| Principal payments and retirements of long-term debt | (418) | (52) |
| Proceeds from employee stock ownership plans | 68 | 92 |
| Purchases of Textron common stock | (244) | (71) |
| Dividends paid | (142) | (90) |
| Excess tax benefits related to stock option exercises | 9 | - |
| Net cash used by financing activities of continuing operations | (326) | (117) |
| Effect of exchange rate changes on cash and cash equivalents | (23) | (3) |
| Net cash (used) provided by continuing operations | (51) | 266 |
| Net cash provided by discontinued operations | 30 | 32 |
| **Net (decrease) increase in cash and cash equivalents** | (21) | 298 |
| Cash and cash equivalents at beginning of period | 605 | 481 |
| Cash and cash equivalents at end of period | $ 584 | $ 779 |
| **Supplemental schedule of non-cash investing activities:** | | |
| Capital expenditures financed through capital leases | $ 2 | $ 21 |



**Note 12: Segment Information**

Textron reports under the following segments: Bell, Cessna, Fastening Systems, Industrial and Finance. Textron evaluates segment operating performance based on segment profit. Segment profit for the Manufacturing segment does not include interest, certain corporate expenses, special charges and gains and losses from the disposition of significant business units. The measurement for the Finance segment includes both interest income and expense, and excludes special charges. Provisions for losses on finance receivables involving the sale or lease of Textron products are recorded by the selling manufacturing division when the Finance segment has recourse to the Manufacturing segment.

A summary of continuing operations by segment is provided below:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| **REVENUES** | | | | |

| | | | | |
|---|---|---|---|---|
| MANUFACTURING: | | | | |
| Bell | $ 786 | $ 587 | $ 1,402 | $ 1,094 |
| Cessna | 910 | 500 | 1,623 | 918 |
| Fastening Systems | 521 | 494 | 1,042 | 991 |
| Industrial | 824 | 805 | 1,624 | 1,586 |
| | 3,041 | 2,386 | 5,691 | 4,589 |
| FINANCE | 147 | 137 | 288 | 271 |
| Total revenues | $ 3,188 | $ 2,523 | $ 5,979 | $ 4,860 |
| **SEGMENT OPERATING PROFIT** | | | | |
| MANUFACTURING: | | | | |
| Bell | $ 83 | $ 71 | $ 158 | $ 123 |
| Cessna | 121 | 44 | 208 | 66 |
| Fastening Systems | 11 | 24 | 5 | 44 |
| Industrial | 58 | 57 | 113 | 105 |
| | 273 | 196 | 484 | 338 |
| FINANCE | 44 | 36 | 77 | 67 |
| Segment profit | 317 | 232 | 561 | 405 |
| Special charges | (44) | (17) | (104) | (69) |
| Segment operating income | 273 | 215 | 457 | 336 |
| Corporate expenses and other, net | (50) | (36) | (91) | (71) |
| Interest expense, net | (23) | (25) | (47) | (50) |
| Income from continuing operations before income taxes | $ 200 | $ 154 | $ 319 | $ 215 |



## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESUL OF OPERATIONS

### Business Overview

Textron Inc. is a multi-industry company that leverages its global network of businesses to provide customers with innovative solutions and services in five business segments: Bell, Cessna, Fastening Systems, Industrial and Finance. Textron is known around the world for its powerful brands spanning the business jet, aerospace and defense, fastening systems, plastic fuel systems, golf car and turf-care markets, among others.

We experienced strong revenue growth and order intake in most of our businesses in the first half of 2005. Backlog in the aircraft businesses increased to approximately $8.6 billion due to innovative new product offerings and continued economic improvements. Fastening Systems has been able to reach new pricing agreements with its customers, which have compensated for higher steel costs in the second quarter. In addition, our Finance segment experienced significant improvement in portfolio credit quality with lower charge-offs and delinquencies and a decrease in nonperforming assets.

The increased sales volume in the first half of 2005 was the primary contributor to our improved performance, enabling us to overcome inflation of $193 million (including a $76 million increase in steel costs), higher pension costs of $44 million and higher costs in North American Fastening Systems plants as discussed in the segment analysis. Textron's transformation activities continue to drive improved performance. We expect that continued execution of our transformation strategy through Integrated Supply Chain and Textron Six Sigma, including Lean Manufacturing activities, will drive performance improvements and expand manufacturing margins.

### Consolidated Results of Operations

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Revenue | $3,188 | $2,523 | $5,979 | $4,860 |
| Segment profit | 317 | 232 | 561 | 405 |

**Revenues**

Revenues increased $665 million in the second quarter of 2005, compared with 2004, primarily due to higher manufacturing volume of $512 million, higher pricing of $70 million, favorable foreign exchange of $34 million and additional revenue of $38 million at CitationShares, which we began consolidating at the end of the second quarter of 2004. In addition, the Finance segment's revenues increased by $10 million primarily due to higher average finance receivables, partially offset by lower prepayment, syndication and securitization gains and other charges.

Revenues increased $1.1 billion in the first half of 2005, compared with 2004, primarily due to higher manufacturing volume of $819 million, higher pricing of $127 million, favorable foreign exchange of $81 million and additional revenue of $78 million at CitationShares, which we began consolidating at the end of the second quarter of 2004. In addition, the Finance segment's revenues increased by $17 million primarily due to higher average finance receivables, partially offset by lower prepayment, syndication and securitization gains and other charges.



**Segment Profit**

Segment profit increased $85 million in the second quarter of 2005, compared with 2004, primarily due to the $129 million impact of higher net sales volume, mainly in the commercial aircraft businesses, and higher pricing of $70 million, partially offset by inflation of $97 million.

Segment profit increased $156 million in the first half of 2005, compared with 2004, primarily due to the $226 million impact of higher net sales volume, mainly in the commercial aircraft businesses and higher pricing of $127 million, partially offset by inflation of $193 million.

**Corporate Expenses**

Corporate expenses increased $14 million in the second quarter of 2005, compared with 2004, primarily due to $6 million for corporate initiatives, $5 million for higher pension and compensation costs and $2 million for the corporate portion of stock-based compensation expense recorded under a newly adopted accounting standard (see Recently Announced Accounting Pronouncements on page 32).

Corporate expenses increased $20 million in the first half of 2005, compared with 2004, primarily due to $8 million for corporate initiatives, $5 million for higher pension and compensation costs and $3 million for the corporate portion of stock-based compensation expense recorded under a newly adopted accounting standard.

**Special Charges**

Special charges are summarized below:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Restructuring | $ 5 | $ 17 | $ 13 | $ 81 |
| Gain on sale of C&A common stock | - | - | - | (12) |
| C&A investment impairment | 39 | - | 91 | - |

| | | | | |
|---|---|---|---|---|
| Total special charges | $ 44 | $ 17 | $ 104 | $ 69 |

*Restructuring Program*

By the end of 2004, Textron had substantially completed its company-wide restructuring program 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, and the program was expanded in 2001 and in 2002, as part of Textron's strategic effort to improve operating efficiencies. Textron's restructuring program has included corporate and segment direct and indirect workforce reductions, consolidation of facilities, rationalization of certain product lines, outsourcing of non-core production activity, the divestiture of non-core businesses and streamlining of sales and administrative overhead. Since the program was first announced, Textron has reduced its workforce by approximately 11,000 employees from continuing operations, representing approximately 19% of its global workforce, and has closed 110 facilities. As this program winds down in 2005, Textron will continue to make cash payments against its restructuring reserves. During the balance of the year, Textron expects to incur additional expenses of approximately $7 million, primarily in the Fastening Systems and Industrial segments.



The total cost of this restructuring program for continuing operations is expected to be approximately $539 million, including $11 million related to the divested Automotive Trim business ("Trim"). As of July 2, 2005, total program costs incurred of $532 million include $271 million in severance costs, $99 million in asset impairment charges (net of gains on the sale of fixed assets), $56 million in contract termination costs and $106 million in other associated costs. Total program costs incurred for continuing operations through July 2, 2005 include $228 million in the Fastening Systems segment, $217 million in the Industrial Segment, $38 million in the Cessna segment, $29 million in the Bell segment, $9 million in the Finance segment and $11 million at Corporate.

*C&A Investment Impairment and Gain*

In connection with the sale of Trim in 2001, Textron acquired preferred stock in Collins & Aikman Products Co., a wholly-owned subsidiary of Collins & Aikman Corporation ("C&A"), and C&A common stock. In March 2005, Textron agreed to sell approximately 60 percent of its preferred stock in Collins & Aikman Products Co. to Heartland Industrial Partners, L.P. ("Heartland") for a combination of cash and other consideration with a total value of approximately $25 million. Heartland also had the option to purchase the remaining preferred shares for an aggregate price of $20 million. Textron recorded a pre-tax impairment charge of approximately $52 million in the first quarter of 2005 to write down the preferred shares to fair market value based on the value determined by the agreement and other market considerations. On May 17, 2005, C&A filed for bankruptcy protection, effectively terminating Heartland's obligation to purchase the preferred stock. Based on relevant market considerations, Textron recorded a charge of approximately $39 million in the second quarter of 2005 to write-off the remaining book value of its investment in the preferred stock.

In the first quarter of 2004, Textron sold its C&A common stock for cash proceeds of $34 million and recorded a pre-tax gain of $12 million.

**Share-Based Compensation**

During the first quarter of 2005, Textron elected to adopt the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), "Share-Based Payments" ("SFAS No. 123-R"), using the modified prospective method. The adoption resulted in recognition of share-based compensation expense related primarily to the expensing of stock options of approximately $5 million and $7 million for the three and six months ended July 2, 2005, respectively, including the net impact of the cumulative effect of adoption of approximately $1 million in the first quarter. For the full year, we expect to recognize share-based compensation expense related to stock options of approximately $18 million ($13 million after taxes).

**Income Taxes**

A reconciliation of the federal statutory income tax rate to the effective income tax rate from continuing operations is provided below:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Federal statutory income tax rate | 35.0% | 35.0% | 35.0% | 35.0% |
| Increase (decrease) in taxes resulting from: | | | | |
| State income taxes | (0.4) | 2.0 | 0.4 | 2.0 |
| C&A impairment valuation allowance | 8.4 | - | 8.4 | - |
| Special foreign dividend | 1.0 | - | 0.6 | - |
| Foreign tax rate differential | (5.8) | (2.1) | (5.8) | (2.1) |
| ESOP dividends | (1.1) | (1.7) | (1.1) | (1.7) |
| Export sales benefit | (1.1) | (1.0) | (1.1) | (1.0) |
| Other, net | (1.0) | (3.0) | (1.9) | (2.0) |
| Effective income tax rate | 35.0% | 29.2% | 34.5% | 30.2% |

The effective income tax rate from continuing operations for the second half of 2005 is expected to be approximately 29%.

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law and includes a deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. In the first quarter of 2005, Textron repatriated approximately $200 million in cash from foreign subsidiaries, for which the related tax expense of $11 million was recognized in the fourth quarter of 2004. Textron intends to repatriate approximately $245 million in additional cash from foreign subsidiaries in the second half of 2005, and has recognized a related tax expense of $2 million in the second quarter of 2005. The tax expense related to dividend repatriation may be reduced or increased in future periods due to changes in key assumptions such as applicable law or business conditions.

**Discontinued Operations**

In February 2005, Textron sold the remainder of its InteSys business, which was classified as discontinued operations during the fourth quarter of 2004. In connection with the transaction, Textron recorded an after-tax net gain of approximately $40 million in the first half of 2005.

**Outlook**

We expect continued strength in revenues for 2005 in most of our businesses. At Bell, the expected annual revenue increase in 2005 over 2004 is primarily related to higher V-22 revenue from new production releases (recorded as units are delivered), which is expected to more than offset lower engineering- and development-based revenues (recorded as costs are incurred). At Cessna, we expect an increase in 2005 annual revenue over 2004 due to higher sales of jets based on our current production schedule. At Fastening Systems, we expect that new customer pricing agreements that became effective in the first quarter of 2005 will allow us to offset higher steel costs throughout the year, based on current steel prices. Additionally, we expect improved operating performance within Fastening Systems resulting from the stabilization of manufacturing operations for the balance of the year. Overall segment profit and margins for the year are expected to increase over 2004 as we continue to realize the benefits of our transformation initiatives.



**Segment Analysis**

**Bell**

| | Three Months Ended | Six Months Ended |
|---|---|---|

| (In millions) | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
|---|---|---|---|---|
| Revenue | $786 | $587 | $1,402 | $1,094 |
| Segment profit | 83 | 71 | 158 | 123 |

**Bell Revenues**

The Bell segment's revenues increased $199 million in the second quarter of 2005, compared with 2004, due to higher revenue of $190 million in the U.S. Government businesses and $9 million in the commercial businesses. The increase in U.S. Government revenue was primarily due to higher V-22 revenue of $166 million and higher volume of armored security vehicles of $16 million. The increase in V-22 revenue reflects the delivery of six Lot 7 aircraft (recorded as units are delivered). Commercial revenues increased primarily due to higher aircraft sales of $40 million and higher spares volume of $12 million, partially offset by lower international military sales of $48 million (reflecting lower deliveries under a model 412 contract, partially offset by higher volume of $20 million for armored security vehicles).

The Bell segment's revenues increased $308 million in the first half of 2005, compared with 2004, due to higher revenue of $180 million in the U.S. Government businesses and $128 million in the commercial businesses. The increase in U.S. Government revenue was primarily due to higher V-22 revenue of $89 million, higher air-launched weapons sales of $40 million, higher volume of armored security vehicles of $20 million and increased demand for military spares of $8 million. The higher V-22 revenue reflects the delivery of six Lot 7 aircraft (recorded as units are delivered). Commercial revenues increased primarily due to higher aircraft sales of $50 million, higher international military sales of $42 million (largely due to higher volume of armored security vehicles and model 412 deliveries) and higher spares volume of $23 million.

**Bell Segment Profit**

Segment profit increased $12 million in the second quarter of 2005, compared with 2004 due to higher profit of $20 million in the U.S. Government businesses, partially offset by lower profit of $8 million in the commercial businesses. Increased profit in the U.S. Government businesses was largely due to higher V-22 profit of $13 million, primarily related to higher revenue. Commercial profit decreased primarily due to the $8 million impact of lower international military sales volume, the impact of a $6 million favorable warranty settlement in 2004 and a $5 million warranty provision related to Lycoming aircraft engine crankshafts, as discussed below. These decreases were partially offset by $6 million in lower net engineering expense, as increased engineering expenses were more than offset by $18 million recorded in income related to risk-sharing agreements with new co-development partners, as discussed in Note 9 to the consolidated financial statements. Bell continues to invest in research and development and expects gross spending to increase in 2005, while continuing to realize benefits from existing risk-sharing agreements with its co-development partners.

On July 11, 2005, Lycoming issued a service bulletin covering certain non-turbocharged aircraft engines to replace crankshafts manufactured by a former third-party supplier. The service bulletin covers approximately 1,100 crankshafts and requires replacement within the earlier of the next 50 hours of operation or six months. As of July 2, 2005, reserves to cover costs directly related to potential crankshaft issues, including the replacement



cost under the new service bulletin, totaled $16 million. See Note 9 to the consolidated financial statements for additional information.

Segment profit increased $35 million in the first half of 2005, compared with 2004, due to higher profit of $22 million in the commercial businesses and $13 million in the U.S. Government businesses. Commercial profit increased primarily due to the $34 million impact of higher international military sales volume and $14 million of higher spares volume, partially offset by $19 million of higher selling and administrative expense, a favorable warranty settlement of $6 million in 2004 and the $5 million warranty reserve related to Lycoming aircraft engine crankshafts. In addition, commercial profit reflected a $2 million increase in net engineering expense, as increased engineering expenses were largely offset by $20 million recorded in income related to risk-sharing agreements with new co-development partners, as discussed in Note 9 to the consolidated financial statements. Profit in the U.S. Government businesses increased primarily due to higher profit on spares of $6 million and higher V-22 profit of $5 million due to higher revenue.

Backlog at Bell was $3.9 billion at the end of the second quarter, compared with $3.8 billion at year-end 2004.

**Cessna**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Revenue | $910 | $500 | $1,623 | $918 |
| Segment profit | 121 | 44 | 208 | 66 |

**Cessna Revenues**

The Cessna segment's revenues increased $410 million in the second quarter of 2005, compared with 2004, primarily due to higher volume of $355 million across all product lines, an increase related to the consolidation of CitationShares of $38 million and higher pricing of $17 million. Citation business jet customer deliveries were 67 in the second quarter of 2005, compared with 35 jets in the second quarter of 2004, and represented $277 million of the increased sales volume. Single engine aircraft deliveries reached 199 in the second quarter of 2005, compared with 61 aircraft in the second quarter of 2004, representing $43 million of the increased sales volume.

The Cessna segment's revenues increased $705 million in the first half of 2005, compared with 2004, primarily due to higher Citation business jet volume of $516 million, an increase related to the consolidation of CitationShares of $78 million, higher single engine aircraft volume of $42 million, higher Caravan volume of $41 million and higher pricing of $31 million. These increases were partially offset by lower used aircraft sales of $23 million. Citation business jet customer deliveries were 122 in the first half of 2005, compared with 69 jets in the first half of 2004.

**Cessna Segment Profit**

Segment profit increased $77 million in the second quarter of 2005, compared with 2004, largely due to the $91 million impact from higher volume across all product lines and $17 million of higher pricing, partially offset by $25 million of inflation.

Segment profit increased $142 million in the first half of 2005, compared with 2004, largely due to the $172 million impact from higher volume across all product lines and $31 million of higher pricing, partially offset by $47 million of inflation.



Backlog at Cessna was $5.8 billion at the end of the second quarter, compared with $5.3 billion at year-end 2004.

**Fastening Systems**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Revenue | $521 | $494 | $1,042 | $991 |
| Segment profit | 11 | 24 | 5 | 44 |

**Fastening Systems Revenues**

The Fastening Systems segment's revenues increased $27 million in the second quarter of 2005, compared with 2004, primarily due to higher pricing related to steel price recoveries of $33 million and favorable foreign exchange of $15 million, partially offset by lower volume of $21 million, largely the result of soft demand in the automotive market.

The Fastening Systems segment's revenues increased $51 million in the first half of 2005, compared with 2004, primarily due to higher pricing related to steel price recoveries of $60 million and favorable foreign exchange of $33 million, partially offset by lower volume of $41 million, largely the result of soft demand in the automotive market.

**Fastening Systems Segment Profit**

Segment profit decreased $13 million in the second quarter of 2005, compared with 2004, primarily due to inflation of $38 million (including $29 million in higher steel costs) and the impact of lower volume of $5 million, partially offset by higher pricing of $33 million.

Segment profit decreased $39 million in the first half of 2005, compared with 2004, primarily due to inflation of $80 million (including $62 million in higher steel costs), unfavorable cost performance of $14 million as discussed below, and the impact of lower volume of $9 million, partially offset by higher pricing of $60 million.

As part of the restructuring efforts at Fastening Systems in 2004, certain manufacturing operations were consolidated in North America. During the first half of 2005, operating inefficiencies and higher than expected ramp-up costs were incurred as a result of these consolidations. Management has taken significant actions to stabilize these operations resulting in a reduction in costs incurred in the second quarter compared with the first quarter. Management expects continued performance improvements at these facilities in the second half of 2005.

**Industrial**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Revenue | $824 | $805 | $1,624 | $1,586 |
| Segment profit | 58 | 57 | 113 | 105 |

**Industrial Revenues**

The Industrial segment's revenues increased $19 million in the second quarter of 2005, compared with 2004, primarily due to higher combined volume at E-Z-GO, Fluid & Power and Greenlee of $38 million, favorable foreign exchange of $20 million and higher pricing of $10 million, partially offset by lower combined sales



volume at Kautex and Jacobsen of $50 million. Sales volume was lower at Kautex largely due to model changeovers.

The Industrial segment's revenues increased $38 million in the first half of 2005, compared with 2004, primarily due to higher combined volume at E-Z-GO, Fluid & Power and Greenlee of $55 million, favorable foreign exchange of $48 million and higher pricing of $14 million, partially offset by lower combined sales volume at Kautex and Jacobsen of $75 million and the impact of the divestiture of a non-core product line during the second quarter of 2004 of $12 million. Sales volume was lower at Kautex largely due to model changeovers.

**Industrial Segment Profit**

Segment profit increased $1 million in the second quarter of 2005, compared with 2004, primarily due to improved cost performance of $12 million, higher pricing of $10 million and favorable foreign exchange of $3 million, partially offset by inflation of $23 million.

Segment profit increased $8 million in the first half of 2005, compared with 2004, primarily due to improved cost performance of $38 million, higher pricing of $14 million and favorable foreign exchange of $6 million, partially offset by inflation of $45 million.

**Finance**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 | July 2, 2005 | July 3, 2004 |
| Revenue | $147 | $137 | $288 | $271 |
| Segment profit | 44 | 36 | 77 | 67 |

**Finance Revenues**

The Finance segment's revenues increased $10 million in the second quarter of 2005, compared with 2004. The increase was primarily due to higher finance charges and discounts of $25 million, partially offset by $9 million in lower prepayment, syndication and securitization gains and $6 million in investment impairment charges related to assets acquired through bankruptcy or repossession of collateral related to troubled loans. The increase in finance charges and discounts was largely due to the higher interest rate environment which accounted for approximately $22 million of the increase and $18 million related to higher average finance receivables of $995 million, partially offset by lower receivable pricing of $15 million largely due to competitive pressures. The increase in average finance receivables was related to core portfolio growth, partially offset by reductions in the liquidating portfolios.

The Finance segment's revenues increased $17 million in the first half of 2005, compared with 2004. The increase was primarily due to higher finance charges and discounts of $35 million, partially offset by $13 million in lower prepayment, syndication and securitization gains and $6 million in impairment charges related to assets acquired through bankruptcy or repossession of collateral related to troubled loans. The increase in finance charges and discounts was largely due to the higher interest rate environment which accounted for approximately $50 million of the increase and $33 million related to higher average finance receivables of $890 million, partially offset by lower receivable pricing of $48 million largely due to competitive pressures. The increase in average finance receivables was related to core portfolio growth, partially offset by reductions in the liquidating portfolios.

**Finance Segment Profit**

Segment profit increased $8 million in the second quarter of 2005, compared with 2004, primarily due to a $13 million reduction in the provision for loan losses as a result of improved portfolio quality, partially offset by lower



net interest margin of $7 million as the benefit from higher average finance receivables was more than offset by lower other income.

Segment profit increased $10 million in the first half of 2005, compared with 2004, primarily due to an $21 million reduction in the provision for loan losses as a result of improved portfolio quality, partially offset by lower net interest margin of $7 million, as the benefit from higher average finance receivables was more than offset by lower other income, and a $4 million increase in selling and administrative expenses.

**Finance Portfolio Quality**

The following table presents information about the credit quality of the Finance segment's portfolio:

| *(In millions, except for ratios)* | July 2, 2005 | January 1, 2005 |
|---|---|---|
| Nonperforming assets | $127 | $140 |
| Ratio of nonperforming assets to total finance assets | 1.92% | 2.18% |
| Allowance for losses on finance receivables recorded on balance sheet | $ 99 | $ 99 |
| Ratio of allowance for losses on receivables to nonaccrual finance receivables | 94.7% | 83.7% |
| 60+ days contractual delinquency as a percentage of finance receivables | 1.08% | 1.47% |

The Finance segment has continued to experience improvements in portfolio quality as indicated by improved credit quality measures and a lower provision for losses ($13 million in the first half of 2005, compared with $34 million in 2004). The improvements in credit quality were evident through lower nonperforming asset levels and 60+ days contractual delinquency. Net charge-offs in the first half of 2005 were $13 million compared with $44 million in 2004.

Textron Finance's nonperforming assets include nonaccrual accounts that are not guaranteed by Textron Manufacturing for which interest has been suspended, as well as repossessed assets. Nonperforming assets by business are as follows:

| *(In millions)* | July 2, 2005 | January 1, 2005 |
|---|---|---|
| Resort finance | $ 38 | $ 53 |
| Golf finance | 19 | 26 |
| Aircraft finance | 11 | 12 |
| Asset-based lending | 9 | 7 |
| Distribution finance | 5 | 5 |
| Other | 45 | 37 |
| Total nonperforming assets | $127 | $140 |

Textron Finance experienced improvement in its nonperforming assets with a $21 million decrease attributable to its core businesses in the first half of 2005, largely related to improved general economic conditions. This decrease was partially offset by a $8 million increase in its non-core businesses within the Other line primarily related to one customer in media finance. Overall, we expect relative stability in portfolio quality during the remainder of 2005.

Textron Finance has recourse to Textron Manufacturing for equipment leases with the U.S. and Canadian subsidiaries of Collins & Aikman Corporation ("C&A"). At July 2, 2005, these leases had outstanding balances of $59 million and $17 million, respectively. During the second quarter of 2005, the U.S. subsidiary of C&A filed for Chapter 11 bankruptcy protection. Textron Manufacturing has classified these leases as impaired.



Management believes Textron Manufacturing's reserves are adequate to cover potential collateral shortfalls related to these leases.

**Special Charges by Segment**

Special charges are more fully discussed on pages 20 and 21 and are summarized below by segment:

| | Restructuring Expenses | | | | | C&A | |
|---|---|---|---|---|---|---|---|
| *(In millions)* | Severance Costs | Contract Terminations | Fixed Asset Impairments | Other Associated Costs | Total | Investment Impairments (Gains) | Total Special Charges |
| **Three Months Ended July 2, 2005** | | | | | | | |
| Fastening Systems | $ 1 | $ 1 | $ - | $ 1 | $ 3 | $ - | $ 3 |
| Industrial | 1 | - | - | 1 | 2 | - | 2 |
| Corporate | - | - | - | - | - | 39 | 39 |
| | $ 2 | $ 1 | $ - | $ 2 | $ 5 | $ 39 | $ 44 |
| **Three Months Ended July 3, 2004** | | | | | | | |
| Fastening Systems | $ 11 | $ - | $ - | $ 5 | $16 | $ - | $ 16 |
| Industrial | - | - | - | 1 | 1 | - | 1 |
| Corporate | - | - | - | - | - | - | - |
| | $ 11 | $ - | $ - | $ 6 | $17 | $ - | $ 17 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Six Months Ended July 2, 2005** | | | | | | | |
| Fastening Systems | $ 1 | $ 2 | $ 1 | $ 5 | $ 9 | $ - | $ 9 |
| Industrial | 2 | - | - | 2 | 4 | - | 4 |
| Corporate | - | - | - | - | - | 91 | 91 |
| | $ 3 | $ 2 | $ 1 | $ 7 | $13 | $ 91 | $104 |
| **Six Months Ended July 3, 2004** | | | | | | | |
| Fastening Systems | $ 24 | $ - | $ 2 | $ 8 | $34 | $ - | $ 34 |
| Industrial | 9 | 36 | (1) | 3 | 47 | - | 47 |
| Corporate | - | - | - | - | - | (12) | (12) |
| | $ 33 | $ 36 | $ 1 | $ 11 | $81 | $(12) | $ 69 |

## Liquidity and Capital Resources

Textron's financings are conducted through two borrowing groups: Textron Manufacturing and Textron Finance. This framework is designed to enhance Textron's borrowing power by separating the Finance segment. Textron Manufacturing consists of Textron Inc., the parent company, consolidated with the entities that operate in the Bell, Cessna, Fastening Systems and Industrial business segments, whose financial results are a reflection of the ability to manage and finance the development, production and delivery of tangible goods and services. Textron Finance consists of Textron's wholly owned commercial finance subsidiary, Textron Financial Corporation, consolidated with its subsidiaries. The financial results of Textron Finance are a reflection of its ability to provide financial services in a competitive marketplace, at appropriate pricing, while managing the associated financial risks. The fundamental differences between each borrowing group's activities result in different measures used by investors, rating agencies and analysts.

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 Bell, Cessna and Industrial segments. The cash flows related to these captive financing activities are reflected as operating activities (by Textron Manufacturing) and as



investing activities (by Textron Finance) based on each group's operations. These captive financing transactions have been eliminated and cash from customers or from securitizations is recognized in operating activities within the Consolidated Statement of Cash Flows when received. The Consolidated Statements of Cash Flows for Textron Inc. are provided on page 4 and the Statements of Cash Flows for Textron Manufacturing are provided on page 17.

Textron Manufacturing's debt (net of cash)-to-capital ratio as of July 2, 2005 was 23.7%, compared with 24.5% at January 1, 2005. Textron Manufacturing's gross debt-to-capital ratio as of July 2, 2005 was 32.1%, compared with 32.9% at January 1, 2005. Textron Manufacturing has a long-term gross debt-to-capital ratio target in the mid-thirties.

For liquidity purposes, Textron Manufacturing and Textron Finance have a policy of maintaining sufficient unused lines of credit to support their outstanding commercial paper. Textron Manufacturing's primary revolving credit facility consists of a $1.3 billion 5-year credit agreement that expires in March 2010. Textron Finance is permitted to borrow under this facility. Textron Finance also has bank lines of credit of $1.5 billion, of which $500 million expires in July 2006 and $1.0 billion expires in 2010. The $500 million facility includes a one-year term out option, effectively extending its expiration into 2007. Neither Textron Manufacturing nor Textron Finance had used these lines of credit at July 2, 2005 or at January 1, 2005. At July 2, 2005, the lines of credit not reserved as support for commercial paper or letters of credit were $1.2 billion for Textron Manufacturing and $581 million for Textron Finance, compared with $1.2 billion and $187 million, respectively, at January 1, 2005.

At July 2, 2005, Textron Finance had $1.7 billion in debt and $370 million in other liabilities that are due within the next twelve months.

**Operating Cash Flows**

| | Six Months Ended | |
|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 |
| Textron Manufacturing | $452 | $435 |
| Textron Finance | $146 | $ 21 |
| Consolidated | $461 | $459 |

In the Consolidated Statements of Cash Flows, cash provided by operating cash flows was relatively consistent with the prior period as the increase in operating cash flows at Textron Finance was largely offset by a decrease in net captive financing activity. The decrease in net captive financing activity relates to a $40 million decrease in the first half of 2005 when finance receivable originations exceeded cash collections and proceeds from receivable sales and securitizations, compared with a $70 million increase in the first half of 2004 when more cash was collected in comparison to finance receivable originations. Textron Finance's operating cash flows increased $125 million primarily due to the timing of payments of accrued interest and other liabilities and an income tax payment of $60 million in the first quarter of 2004.

Dividends received by Textron Manufacturing from Textron Finance of $97 million in the first half of 2005 and $67 million in the first half of 2004 have been eliminated from the consolidated operating cash flows.

**Investing Cash Flows**

| | Six Months Ended | |
|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 |
| Textron Manufacturing | $(154) | $ (49) |
| Textron Finance | $(277) | $(111) |
| Consolidated | $(391) | $(230) |



In the Consolidated Statements of Cash Flows, the decrease in investing cash flows was driven by decreases at both Textron Finance and Textron Manufacturing. At Textron Finance, the decrease was primarily due to a $98 million increase in finance receivable originations, net of cash collections. This decrease in cash flows related to finance receivable originations, net of cash collections, was offset on a consolidated basis after reclassification adjustments to operating cash flows, for net captive financing activity of $40 million in the first half of 2005 and $(70) million in the first half of 2004, increased investing cash flows. The decrease at Textron Manufacturing was primarily due to the $38 million in proceeds received in the first quarter of 2004 for the sale of C&A common stock and $23 million used to acquire the assets of US Helicopter, Inc. and the minority interest in a Japanese joint venture in the first half of 2005. In addition, Textron Manufacturing's capital expenditures increased to $141 million in the first half of 2005, compared with $124 million in the first half of 2004.

**Financing Cash Flows**

| | Six Months Ended | |
|---|---|---|
| *(In millions)* | July 2, 2005 | July 3, 2004 |
| Textron Manufacturing | $(326) | $(117) |
| Textron Finance | $ 81 | $(180) |
| Consolidated | $(148) | $(230) |

In the Consolidated Statements of Cash Flows, the decrease in cash used by financing activities principally reflected a net increase in debt outstanding at Textron Finance to fund asset growth and additional purchases of Textron common stock made by Textron Manufacturing in the first half of 2005, partially offset by a $24 million decrease in proceeds from the exercise of stock options. Dividends paid by Textron Finance to Textron Manufacturing of $97 million in the first half of 2005 and $67 million in the first half of 2004 have been eliminated from the consolidated financing cash flows. The increase in these dividends in 2005 was due to excess capital that resulted from liquidating non-core portfolios and increased profitability at Textron Finance.

*Principal Payments on Long-Term Debt*

In the first half of 2005 and 2004, Textron Manufacturing made principal payments of $418 million and $52 million, respectively. The increase during the first half of 2005 for Textron Manufacturing was due to EUR 300 million of debt that matured. This debt was refinanced with EUR 300 million 3.875% notes that mature in March 2013. In the first half of 2005 and 2004, Textron Finance made principal payments of $579 million and $616 million, respectively.

*Stock Repurchases*

In the first half of 2005 and 2004, Textron repurchased 3,171,428 and 1,302,600 shares of common stock, respectively, under its Board authorized share repurchase programs for an aggregate cost of $239 million and $71 million, respectively.

*Dividends*

Textron's Board of Directors approved a quarterly dividend per common share of $0.35 in first and second quarters of 2005 compared with $.325 in first and second quarters of 2004. Dividend payments to shareholders totaled $142 million and $90 million in the first half of 2005 and 2004, respectively. The significant increase in the dividend payments in 2005 reflects the fourth quarter 2004 dividend that was paid in the first quarter of 2005, while for the corresponding prior year period, the fourth quarter dividend was paid in the fourth quarter.



**Capital Resources**

Under a shelf registration statement filed with the Securities and Exchange Commission, Textron Finance may issue public debt securities in one or more offerings up to a total maximum offering of $4 billion. Under this registration statement, Textron Finance issued $1.1 billion of term debt and 130 million of CAD term debt during the first half of 2005. The proceeds from these issuances were used to repay short-term debt. At July 2, 2005, Textron Finance had $2.1 billion available under this registration statement. Under a shelf registration statement filed with the Securities and Exchange Commission, Textron Manufacturing may issue public debt securities in one or more offerings up to a total maximum offering of $2.0 billion. As discussed earlier, EUR 300 million 3.875% notes were issued under this registration statement during the first half of 2005. At July 2, 2005, Textron Manufacturing had $1.6 billion available under this registration statement.

**Off-Balance Sheet Arrangements**

Textron Manufacturing enters into a forward contract in Textron common stock on an annual basis. The contract is intended to hedge the cash volatility of stock-based incentive compensation indexed to Textron common stock. The forward contract requires an annual cash settlement between the counter parties based upon a number of shares multiplied by the difference between the strike price and the prevailing Textron common stock price. A cash payment of approximately $25 million was received in January 2005 upon the settlement of the contract held at year-end. As of July 2, 2005, the contract was for approximately 1.8 million shares with a strike price of $70.80. The market price of Textron's common stock closed at $76.40 on July 2, 2005, resulting in a receivable of $10 million.

Textron Finance sells finance receivables utilizing both securitizations and whole-loan sales. As a result of these transactions, finance receivables are removed from the balance sheet and the proceeds received are used to reduce the recorded debt levels. Despite the reduction in the recorded balance sheet position, Textron Finance generally retains a subordinated interest in the finance receivables sold through securitizations, which may affect operating results through periodic fair value adjustments. Textron Finance utilizes these off-balance sheet financing arrangements (primarily asset-backed securitizations) to further diversify funding alternatives. These arrangements are an important source of funding that provided net proceeds from continuing operations of $227 million in the first half of 2005, compared with $248 million of proceeds in the corresponding period of 2004.

*Guarantees*

Bell Helicopter and AgustaWestland North America Inc. ("AWNA") formed the AgustaWestlandBell Limited Liability Company ("AWB LLC") in January 2004 for the joint design, development, manufacture, sale, customer training and product support of the US101 helicopter and certain variations and derivatives thereof, to be offered and sold to departments or agencies of the U.S. Government.

In March 2005, AWB LLC received a $1.2 billion cost reimbursement-type subcontract from Lockheed Martin for the System Design and Development ("SDD") phase of the U.S. Marine Corps Marine 1 Helicopter Squadron (VXX) Program. On March 11, 2005, Bell Helicopter guaranteed to Lockheed Martin the due and prompt performance by AWB LLC of all its obligations under this subcontract, provided that Bell Helicopter's liability under the guaranty shall not exceed 49% of AWB LLC's aggregate liability to Lockheed Martin under the subcontract. AgustaWestland N.V., AWNA's parent company, has guaranteed the remaining 51% to Lockheed Martin. Bell Helicopter and AgustaWestland N.V. have entered into cross-indemnification agreements in which each party indemnifies the other related to any payments required under these agreements that result from the indemnifying party's workshare under any subcontracts received.



For 2005, AWB LLC's maximum obligation is 20% of the total contract value, which equates to $232 million based on the current contract value of $1.2 billion. In 2006, AWB LLC's maximum obligation increases to 40%, or $464 million, and thereafter increases to 50%, or $580 million. Accordingly, the maximum amount of Bell Helicopter's liability under the guarantee will be $114 million in 2005, $227 million in 2006 and $284 million thereafter through completion.

In connection with the disposition of Trim, certain operating leases were transferred and assigned to C&A. Textron has guaranteed C&A's payments under these operating leases and certain environmental matters up to an aggregate remaining amount of approximately $24 million. Textron is required to make payments under these guarantees upon default by C&A. In May 2005, the U.S. subsidiary of C&A filed for Chapter 11 bankruptcy protection, and in July 2005 the European subsidiaries filed a group-wide administration order in the United Kingdom, effectively reducing Textron's ability to seek recourse from C&A under the indemnity provisions of the purchase and sale agreement, should a default occur. Textron has not received any default notices related to these leases, and management believes C&A will continue to make payments. Management will continue to monitor C&A's performance and Textron's reserves related to this matter.

As disclosed under the caption "Guarantees" in Note 16 to the Consolidated Financial Statements in Textron's 2004 Annual Report on Form 10-K, Textron has issued or is party to certain other guarantees. As of July 2, 2005, there have been no material changes to these other guarantees.

**Critical Accounting Policies**

*Goodwill*

We evaluate the recoverability of goodwill annually in the fourth quarter or more frequently if events or changes in circumstances, such as declines in sales, earnings or cash flows or material adverse changes in the business climate, indicate that the carrying value of an asset might be impaired. 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 with a discounted cash flow methodology using assumptions consistent with market participants, which are confirmed with market multiples where available. The determination of discounted cash flows is based on the businesses' strategic plans and long-range planning forecasts. The revenue growth rates included in the plans are management's best estimates based on current and forecasted market conditions, and the profit margin assumptions are projected by each reporting unit based on the current cost structure and anticipated net cost reductions. If different assumptions were used in these plans, the related undiscounted cash flows used in measuring impairment could be different, potentially resulting in an impairment charge.

During the first half of 2005, our Fastening Systems segment has experienced declining sales volumes and margins, primarily due to soft demand in the North American automotive market, a lag in the recovery of higher steel costs and temporary inefficiencies associated with the consolidation of manufacturing operations in North America related to restructuring. We will continue to evaluate business climate trends, but currently believe these conditions to be temporary and not long-term indicators of reduced future cash flows that would necessitate a re-evaluation of the fair value estimates used in our assessment of goodwill.

**Recently Announced Accounting Pronouncements**

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), "Share-Based Payment" ("SFAS No. 123-R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and supercedes APB No. 25. SFAS No. 123-R requires companies to measure compensation costs for share-based payments to employees, including stock options, at fair value and expense such compensation over the service period beginning with the first interim or annual period after June 15,



2005. In April 2005, the Securities and Exchange Commission delayed the transition date for companies to the first fiscal year beginning after June 15, 2005, effectively delaying Textron's required adoption of SFAS No. 123-R until the first quarter of 2006.

Textron elected to adopt SFAS No. 123-R in the first quarter of 2005 using the modified prospective method. Under this transition method, compensation expense recognized in 2005 includes: a) compensation cost for all stock options and restricted stock granted prior to, but not yet vested as of January 1, 2005, based on the grant-date fair value estimated and recognized in accordance with the provisions of SFAS No. 123, and b) compensation cost for all stock options and restricted stock granted subsequent to January 1, 2005, and all share-based compensation awards accounted for as liabilities, based upon the measurement and recognition provisions of SFAS No. 123-R. For awards granted or modified in 2005 and prospectively, compensation costs for awards with only service conditions that vest ratably are recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award. Compensation costs for awards granted prior to 2005 are recognized using the attribution methods required under SFAS No. 123. Upon adoption, Textron re-measured its share-based compensation awards that are accounted for as liabilities at fair value. The cumulative effect of adoption upon this re-measurement resulted in an increase to net income of approximately $1 million in the first quarter of 2005, which is not considered to be material and is recorded in selling and administrative expense.

Adoption of SFAS No. 123-R resulted in recognition of stock option costs in the current period. The stock option costs are included primarily in selling and administrative expense and totaled approximately $5 million and $8 million for the three and six months ended July 2, 2005, respectively. In accordance with the modified prospective method, prior periods have not been restated. No compensation expense related to stock option grants has been recorded in the consolidated statement of operations for the three and six months ended July 3, 2004, as all of the options granted had an exercise price equal to the market value of the underlying stock on the date of grant. For the full year, we expect to recognize share-based compensation costs related to stock options of approximately $18 million ($13 million after taxes).

As of July 2, 2005, $74 million represents the total compensation cost associated with unvested awards subject only to service conditions that has not yet been recognized. Textron expects that this compensation will be recognized over a weighted-average period of approximately 2 years. As of July 2, 2005, $33 million represents the total compensation cost associated with unvested share-based compensation awards subject to performance vesting conditions that has not yet been recognized. Textron expects that this compensation will be recognized over a weighted-average period of approximately 2 years.

SFAS No. 123-R requires that the excess tax benefits received related to stock option exercises be presented as financing cash inflows. For the first half of 2005, $9 million of these excess tax benefits have been presented as cash provided by financing activities in the consolidated statement of cash flows.

The valuation of stock options requires numerous assumptions. Textron determines the fair value of each option as of the date of grant using the Black-Scholes option-pricing model. This model requires inputs for the expected volatility of Textron's common stock price, expected life of the option, and expected dividend yield, among others. In addition, we estimate the number of options expected to eventually vest. Expected volatility estimates are based on implied volatilities from traded options on Textron common stock, historical volatilities, and other factors. Textron uses historical data to estimate option exercise behavior, adjusted to reflect anticipated increases in expected life.

See Note 6 to the Consolidated Financial Statements for additional details.



## Foreign Exchange Risks

Textron's financial results are affected by changes in foreign currency exchange rates and economic conditions in the foreign markets in which products are manufactured and/or sold. For the first half of 2005, the impact of foreign exchange rate changes from the first half of 2004 increased revenues by approximately $81 million (2%) and increased segment profit by approximately $6 million (2%).

*Forward-looking Information: Certain statements in this quarterly report on Form 10-Q and other oral and written statements made by Textron from time to time are forward-looking statements, including those that discuss strategies, goals, outlook or other non-historical matters; or project revenues, income, returns or other financial measures. These forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update or revise any forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements, including the following: (a) the extent to which Textron is able to achieve savings from its restructuring plans; (b) uncertainty in estimating the amount and timing of restructuring charges and related costs; (c) changes in worldwide economic and political conditions that impact interest and foreign exchange rates; (d) the occurrence of work stoppages and strikes at key facilities of Textron or Textron's customers or suppliers; (e) Textron's ability to perform as anticipated and to control costs under contracts with the U.S. Government; (f) the U.S. Government's ability to unilaterally modify or terminate its contracts with Textron for the Government's convenience or for Textron's failure to perform, to change applicable procurement and accounting policies, and, under certain circumstances, to suspend or debar Textron as a contractor eligible to receive future contract awards; (g) changes in national or international funding priorities and government policies on the export and import of military and commercial products; (h) the adequacy of cost estimates for various customer care programs including servicing warranties; (i) the ability to control costs and successful implementation of various cost reduction programs; (j) the timing of certifications of new aircraft products; (k) the occurrence of slowdowns or downturns in customer markets in which Textron products are sold or supplied or where Textron Financial offers financing; (l) changes in aircraft delivery schedules or cancellation of orders; (m) the impact of changes in tax legislation; (n) the extent to which Textron is able to pass the cost of inflation, including raw material price increases, through to customers or offset such price increases by reducing other costs; (o)Textron's ability to offset, through cost reductions, pricing pressure brought by original equipment manufacturer customers; (p) Textron's ability to realize full value of receivables and investments in securities; (q) the availability and cost of insurance; (r) increases in pension expenses related to lower than expected asset performance or changes in discount rates; (s) Textron Financial's ability to maintain portfolio credit quality; (t) Textron Financial's access to debt financing at competitive rates; (u) uncertainty in estimating contingent liabilities and establishing reserves to address such contingencies; (v) performance of acquisitions; and (w) the efficacy of research and development investments to develop new products.*



## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no significant change in Textron's exposure to market risk during the first half of 2005. Fo discussion of Textron's exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosur About Market Risk contained in Textron's 2004 Annual Report on Form 10-K.

## Item 4. CONTROLS AND PROCEDURES

We have carried out an evaluation, under the supervision and with the participation of our managemer including our Chairman, President and Chief Executive Officer (the "CEO") and our Executive Vice Preside and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of our disclosu controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act ( 1934, as amended (the "Act")) as of the end of the fiscal quarter covered by this report. Based upon th evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in providir reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or subm under the Act is recorded, processed, summarized and reported within the time periods specified in tl Securities and Exchange Commission's rules and forms, and (b) such information is accumulated ar communicated to our management, including our CEO and CFO, as appropriate to allow timely decisior regarding required disclosure.

During the second quarter of 2005, there were several changes in internal control over financial reporting (a defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or a reasonably likely to materially affect, our internal control over financial reporting. Our Bell Helicopter divisic implemented SAP software for its general ledger and consolidation systems, effectively modifying the way w record certain accounting transactions at the division. Bell Helicopter also transferred its accounts payab processing to a shared service center on SAP during the quarter. Concurrently, Bell Helicopter experience personnel turnover in the financial reporting department. We believe that appropriate actions have been take during the quarter to address the controls affected by these changes to ensure the accurate preparation of tl consolidated financial statements.

In the first quarter of 2005, there was one change in internal control over financial reporting (as defined i Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely t materially affect, our internal control over financial reporting. On January 2, 2005, Textron engaged a thir party service provider to assume operational oversight and maintenance of its information technolog infrastructure. As of July 2, 2005, there has been no material change in Textron's internal control over financi reporting related to this contract; however, the transfer of operational oversight to the third-party servic provider is expected to result in material changes to Textron's internal control over financial reporting relate to its information technology infrastructure later in 2005. We believe that we have taken appropriate actions t ensure that effective internal controls over financial reporting associated with the transfer will continue to b maintained during the transition period.

Other than as set forth above, there were no other changes in Textron's internal control over financial reportir during the fiscal quarter ended July 2, 2005 that have materially affected, or are reasonably likely to material affect, our internal control over financial reporting.



## PART II. OTHER INFORMATION

### Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

**ISSUER REPURCHASES OF EQUITY SECURITIES**

| | Total Number of Shares Purchased | Average Price Paid per Share (Excluding Commissions) | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Shares that May Yet Be Purchased Under the Plan |
|---|---|---|---|---|
| Month 1 (April 3, 2005 - May 7, 2005) | 47,600 | $76.75 | 47,600 | 7,277,472 |
| Month 2 (May 8, 2005 - June 4, 2005) | 656,300 | $76.89 | 656,300 | 6,621,172 |
| Month 3 (June 5, 2005 - | | | | |

| | | | | |
|---|---|---|---|---|
| July 2, 2005) | 796,100 | $76.55 | 796,100 | 5,825,072 |
| Total | 1,500,000 | $76.71 | 1,500,000 | |

These shares were purchased, or are available, pursuant to a plan that was announced on October 21, 2004 authorizing the repurchase of up to 12 million shares of common stock. The plan has no expiration date.



**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At Textron's annual meeting of shareholders held on April 27, 2005, the following items were voted upon:

1. The following persons were elected to serve as directors in Class III for three year terms expiring in 2008 and received the votes listed.

| Name | For | Withheld |
|---|---|---|
| H. Jesse Arnelle | 114,207,079 | 5,438,745 |
| Paul E. Gagné | 111,604,811 | 8,041,013 |
| Dain M. Hancock | 116,011,660 | 3,634,164 |
| Thomas B. Wheeler | 114,535,785 | 5,110,039 |

The following directors have terms of office which continued after the meeting: Kathleen M. Bader, Lewis B. Campbell, R. Kerry Clark, Ivor J. Evans, Lawrence K. Fish, Joe T. Ford, Lord Powell of Bayswater KCMG, Brian H. Rowe.

2. The appointment of Ernst & Young LLP as Textron's independent auditors for 2005 was ratified by the following vote:

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 114,732,446 | 3,517,962 | 1,395,416 | 0 |

3. A shareholder proposal relating to Board Chair and CEO Separation was approved by the following vote:

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 51,229,278 | 48,351,484 | 2,022,990 | 18,042,072 |

4. A shareholder proposal relating to Performance-Based Options was rejected by the following vote:

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 48,463,606 | 51,310,177 | 1,829,969 | 18,042,072 |



**Item 6. EXHIBITS**

12.1 Computation of ratio of income to fixed charges of Textron Manufacturing

12.2 Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350



SIGNATURES

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

TEXTRON INC.

Date: August 8, 2005

/s/R. L. Yates

R. L. Yates
Senior Vice President and Corporate Controller
(principal accounting officer)



**LIST OF EXHIBITS**

The following exhibits are filed as part of this report on Form 10-Q:

Name of Exhibit

12.1 Computation of ratio of income to fixed charges of Textron Manufacturing

12.2 Computation of ratio of income to fixed charges of Textron Inc. including all majority-owned subsidiaries

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350

EXHIBIT 12.1

**TEXTRON MANUFACTURING**

**COMPUTATION OF RATIO OF INCOME TO FIXED CHARGES**

**(unaudited)**

(In millions, except ratio)

Six Months

| | | Ended July 2, 2005 |
|---|---|---|
| Fixed charges: | | |
| Interest expense | $ | 51 |
| Estimated interest portion of rents | | 16 |
| Total fixed charges | $ | 67 |
| Income: | | |
| Income from continuing operations before income taxes | $ | 319 |
| Dividends in excess of pre-tax income of Textron Finance | | 20 |
| Fixed charges | | 67 |
| Adjusted income | $ | 406 |
| Ratio of income to fixed charges | | 6.06 |

EXHIBIT 12.2

**TEXTRON INC.**
**INCLUDING ALL MAJORITY-OWNED SUBSIDIARIES**

**COMPUTATION OF RATIO OF INCOME TO FIXED CHARGES**

**(unaudited)**

(In millions, except ratio)

| | | Six Months Ended July 2, 2005 |
|---|---|---|
| Fixed charges: | | |
| Interest expense | $ | 147 |
| Estimated interest portion of rents | | 17 |
| Total fixed charges | $ | 164 |
| Income: | | |
| Income from continuing operations before income taxes | $ | 319 |
| Fixed charges | | 164 |
| Adjusted income | $ | 483 |
| Ratio of income to fixed charges | | 2.95 |

Exhibit 31.1

**Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)**

I, Lewis B. Campbell, Chairman, President and Chief Executive Officer of Textron Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Textron Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2005

/s/Lewis B. Campbell
Lewis B. Campbell
Chairman, President and Chief Executiv
Officer

Exhibit 31.2

**Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)**

I, Ted R. French, Executive Vice President and Chief Financial Officer of Textron Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Textron Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2005

/s/Ted R. French
Ted R. French
Executive Vice President and Chief Financial Officer

EXHIBIT 32.1

**TEXTRON INC.**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Textron Inc. (the "Company") on Form 10-Q for the period ended July 2, 2005 as filed with the Securities and Exchange Commission on the Date hereof (the "Report"), I, Lewis B. Campbell, Chairman, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Textron Inc.

Date: August 8, 2005

/s/ Lewis B. Campbell

Lewis B. Campbell

Chairman, President and Chief Executive Officer

EXHIBIT 32.2

**TEXTRON INC.**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Textron Inc. (the "Company") on Form 10-Q for the period ended July 2, 2005 as filed with the Securities and Exchange Commission on the Date hereof (the "Report"), I, Ted R. French, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Textron Inc.

Date: August 8, 2005

/s/ Ted R. French

Ted R. French

Executive Vice President and Chief Financial Officer