

TEXTRON INC  
Form 10-Q  
July 26, 2018  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

[ X ]

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

**For the quarterly period ended June 30, 2018**

**OR**

[ ]

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

**For the transition period from \_\_\_\_ to \_\_\_\_.**

Commission File Number 1-5480

**Textron Inc.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

05-0315468

(I.R.S. Employer Identification No.)

40 Westminister Street, Providence, RI

(Address of principal executive offices)

02903

(Zip code)

(401) 421-2800

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(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 13, 2018, there were 248,410,831 shares of common stock outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****TEXTRON INC.****Consolidated Statements of Operations (Unaudited)**

|  | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|--|---------------------------|-------------------------|--------------------------|-------------------------|
|  | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| <i>(In millions, except per share amounts)</i>           |                           |                         |                          |                         |
| <b>Revenues</b>  |                           |                         |                          |                         |
| Manufacturing revenues                                   | \$ 3,709\$                | 3,586\$                 | 6,989\$                  | 6,661                   |
| Finance revenues   | 17                        | 18                      | 33                       | 36                      |
| Total revenues   | 3,726                     | 3,604                   | 7,022                    | 6,697                   |
| <b>Costs, expenses and other</b>                         |                           |                         |                          |                         |
| Cost of sales  | 3,073                     | 2,996                   | 5,802                    | 5,588                   |
| Selling and administrative expense                       | 370                       | 343                     | 697                      | 652                     |
| Interest expense   | 42                        | 43                      | 83                       | 85                      |
| Special charges  |                           | 13                      |                          | 50                      |
| Other components of net periodic benefit cost (credit)   | (19)                      | (6)                     | (38)                     | (14)                    |
| Total costs, expenses and other                          | 3,466                     | 3,389                   | 6,544                    | 6,361                   |
| Income from continuing operations before income taxes    | 260                       | 215                     | 478                      | 336                     |
| Income tax expense                                       | 36                        | 62                      | 65                       | 83                      |
| <b>Income from continuing operations</b>                 | 224                       | 153                     | 413                      | 253                     |
| Income from discontinued operations, net of income taxes |                           |                         |                          | 1                       |
| <b>Net income</b>  | \$ 224\$                  | 153\$                   | 413\$                    | 254                     |
| <b>Basic earnings per share</b>                          |                           |                         |                          |                         |
| Continuing operations                                    | \$ 0.88\$                 | 0.57\$                  | 1.61\$                   | 0.94                    |
| Discontinued operations                                  |                           |                         |                          |                         |
| <b>Basic earnings per share</b>                          | \$ 0.88\$                 | 0.57\$                  | 1.61\$                   | 0.94                    |
| <b>Diluted earnings per share</b>                        |                           |                         |                          |                         |
| Continuing operations                                    | \$ 0.87\$                 | 0.57\$                  | 1.59\$                   | 0.94                    |
| Discontinued operations                                  |                           |                         |                          |                         |
| <b>Diluted earnings per share</b>                        | \$ 0.87\$                 | 0.57\$                  | 1.59\$                   | 0.94                    |
| <b>Dividends per share</b>                               |                           |                         |                          |                         |
| Common stock   | \$ 0.02\$                 | 0.02\$                  | 0.04\$                   | 0.04                    |

See Notes to the Consolidated Financial Statements.

Table of Contents**TEXTRON INC.****Consolidated Statements of Comprehensive Income (Unaudited)**

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|---|---------------------------|-------------------------|--------------------------|-------------------------|
|   | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| <i>(In millions)</i>  |                           |                         |                          |                         |
| <b>Net income</b>   | \$ 224\$                  | 153\$                   | 413\$                    | 254                     |
| Other comprehensive income (loss), net of taxes:                          |                           |                         |                          |                         |
| Pension and postretirement benefits adjustments, net of reclassifications | 31                        | 23                      | 62                       | 47                      |
| Foreign currency translation adjustments                                  | (69)                      | 42                      | (27)                     | 64                      |
| Deferred gains (losses) on hedge contracts, net of reclassifications      | (4)                       | 4                       | (3)                      | 8                       |
| Other comprehensive income (loss)   | (42)                      | 69                      | 32                       | 119                     |
| <b>Comprehensive income</b>   | \$ 182\$                  | 222\$                   | 445\$                    | 373                     |

See Notes to the Consolidated Financial Statements.

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## TEXTRON INC.

## Consolidated Balance Sheets (Unaudited)

| <i>(Dollars in millions)</i>  | June 30,<br>2018 | December<br>30,<br>2017 |
|---|------------------|-------------------------|
| <b>Assets</b>   |                  |                         |
| <b>Manufacturing group</b>  |                  |                         |
| Cash and equivalents  | \$ 554           | 1,079                   |
| Accounts receivable, net  | 1,121            | 1,363                   |
| Inventories   | 3,925            | 4,150                   |
| Assets of businesses held for sale  | 407              |                         |
| Other current assets  | 763              | 435                     |
| <b>Total current assets</b>   | 6,770            | 7,027                   |
| Property, plant and equipment, less accumulated depreciation<br>and amortization of \$4,097 and \$4,120, respectively | 2,608            | 2,721                   |
| Goodwill  | 2,207            | 2,364                   |
| Other assets  | 1,869            | 2,059                   |
| <b>Total Manufacturing group assets</b>   | 13,454           | 14,171                  |
| <b>Finance group</b>  |                  |                         |
| Cash and equivalents  | 177              | 183                     |
| Finance receivables, net  | 763              | 819                     |
| Other assets  | 164              | 167                     |
| <b>Total Finance group assets</b>   | 1,104            | 1,169                   |
| <b>Total assets</b>   | \$ 14,558        | \$ 15,340               |
| <b>Liabilities and shareholders' equity</b>   |                  |                         |
| <b>Liabilities</b>  |                  |                         |
| <b>Manufacturing group</b>  |                  |                         |
| Short-term debt and current portion of long-term debt   | \$ 9             | 14                      |
| Accounts payable  | 1,147            | 1,205                   |
| Liabilities of businesses held for sale   | 66               |                         |
| Other current liabilities   | 2,175            | 2,441                   |
| <b>Total current liabilities</b>  | 3,397            | 3,660                   |
| Other liabilities   | 1,809            | 2,006                   |
| Long-term debt  | 3,070            | 3,074                   |
| <b>Total Manufacturing group liabilities</b>  | 8,276            | 8,740                   |
| <b>Finance group</b>  |                  |                         |
| Other liabilities   | 111              | 129                     |
| Debt  | 809              | 824                     |
| <b>Total Finance group liabilities</b>  | 920              | 953                     |
| <b>Total liabilities</b>  | 9,196            | 9,693                   |
| <b>Shareholders' equity</b>   |                  |                         |
| Common stock  | 33               | 33                      |
| Capital surplus   | 1,774            | 1,669                   |
| Treasury stock  | (963)            | (48)                    |
| Retained earnings   | 5,861            | 5,368                   |
| Accumulated other comprehensive loss  | (1,343)          | (1,375)                 |
| <b>Total shareholders' equity</b>   | 5,362            | 5,647                   |
| <b>Total liabilities and shareholders' equity</b>   | \$ 14,558        | \$ 15,340               |
| <b>Common shares outstanding</b> <i>(in thousands)</i>  | 248,910          | 261,471                 |

See Notes to the Consolidated Financial Statements.



Table of Contents**TEXTRON INC.****Consolidated Statements of Cash Flows (Unaudited)**

For the Six Months Ended June 30, 2018 and July 1, 2017, respectively

| <i>(In millions)</i>   | <b>Consolidated</b> |              |
|--|---------------------|--------------|
|  | <b>2018</b>         | <b>2017</b>  |
| <b>Cash flows from operating activities</b>  |                     |              |
| Net income   | \$ 413              | 254          |
| Less: Income from discontinued operations  |                     | 1            |
| Income from continuing operations  | 413                 | 253          |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: |                     |              |
| Non-cash items:  |                     |              |
| Depreciation and amortization  | 216                 | 218          |
| Deferred income taxes  | 12                  | 21           |
| Asset impairments  |                     | 21           |
| Other, net   | 61                  | 52           |
| Changes in assets and liabilities:   |                     |              |
| Accounts receivable, net   | (42)                | (125)        |
| Inventories  | (78)                | (61)         |
| Other assets   | (38)                | (33)         |
| Accounts payable   | (22)                | (140)        |
| Other liabilities  | (165)               | (68)         |
| Income taxes, net  | 17                  | 55           |
| Pension, net   | (5)                 | 16           |
| Captive finance receivables, net   | 26                  | 60           |
| Other operating activities, net  | 3                   | (2)          |
| Net cash provided by operating activities of continuing operations                                       | 398                 | 267          |
| Net cash used in operating activities of discontinued operations   | (1)                 | (23)         |
| Net cash provided by operating activities  | 397                 | 244          |
| <b>Cash flows from investing activities</b>  |                     |              |
| Capital expenditures   | (159)               | (161)        |
| Net proceeds from corporate-owned life insurance policies  | 98                  | 22           |
| Net cash used in acquisitions  |                     | (329)        |
| Finance receivables repaid   | 25                  | 24           |
| Other investing activities, net  | 30                  | 34           |
| Net cash used in investing activities  | (6)                 | (410)        |
| <b>Cash flows from financing activities</b>  |                     |              |
| Principal payments on long-term debt and nonrecourse debt  | (34)                | (74)         |
| Proceeds from long-term debt   |                     | 375          |
| Purchases of Textron common stock  | (915)               | (329)        |
| Dividends paid   | (10)                | (11)         |
| Other financing activities, net  | 43                  | 21           |
| Net cash used in financing activities  | (916)               | (18)         |
| Effect of exchange rate changes on cash and equivalents  | (6)                 | 15           |
| <b>Net decrease in cash and equivalents</b>  | <b>(531)</b>        | <b>(169)</b> |
| Cash and equivalents at beginning of period  | 1,262               | 1,298        |
| Cash and equivalents at end of period  | \$ 731              | 1,129        |

See Notes to the Consolidated Financial Statements.



Table of Contents**TEXTRON INC.****Consolidated Statements of Cash Flows (Unaudited) (Continued)**

For the Six Months Ended June 30, 2018 and July 1, 2017, respectively

| <i>(In millions)</i>   | <b>Manufacturing Group</b> |              | <b>Finance Group</b> |             |
|--|----------------------------|--------------|----------------------|-------------|
|  | <b>2018</b>                | <b>2017</b>  | <b>2018</b>          | <b>2017</b> |
| <b>Cash flows from operating activities</b>  |                            |              |                      |             |
| Net income   | \$ 398                     | \$ 245       | \$ 15                | \$ 9        |
| Less: Income from discontinued operations  |                            | 1            |                      |             |
| Income from continuing operations  | 398                        | 244          | 15                   | 9           |
| Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities: |                            |              |                      |             |
| Non-cash items:  |                            |              |                      |             |
| Depreciation and amortization  | 212                        | 211          | 4                    | 7           |
| Deferred income taxes  | 14                         | 22           | (2)                  | (1)         |
| Asset impairments  |                            | 21           |                      |             |
| Other, net   | 60                         | 51           | 1                    | 1           |
| Changes in assets and liabilities:   |                            |              |                      |             |
| Accounts receivable, net   | (42)                       | (125)        |                      |             |
| Inventories  | (80)                       | (60)         |                      |             |
| Other assets   | (39)                       | (30)         | 1                    | (3)         |
| Accounts payable   | (22)                       | (140)        |                      |             |
| Other liabilities  | (162)                      | (62)         | (3)                  | (6)         |
| Income taxes, net  | 28                         | 102          | (11)                 | (47)        |
| Pension, net   | (5)                        | 16           |                      |             |
| Dividends received from Finance group  | 50                         |              |                      |             |
| Other operating activities, net  | 3                          | (2)          |                      |             |
| Net cash provided by (used in) operating activities of continuing operations                                       | 415                        | 248          | 5                    | (40)        |
| Net cash used in operating activities of discontinued operations   | (1)                        | (23)         |                      |             |
| Net cash provided by (used in) operating activities  | 414                        | 225          | 5                    | (40)        |
| <b>Cash flows from investing activities</b>  |                            |              |                      |             |
| Capital expenditures   | (159)                      | (161)        |                      |             |
| Net proceeds from corporate-owned life insurance policies  | 98                         | 22           |                      |             |
| Net cash used in acquisitions  |                            | (329)        |                      |             |
| Finance receivables repaid   |                            |              | 112                  | 158         |
| Finance receivables originated   |                            |              | (61)                 | (74)        |
| Other investing activities, net  | 10                         | 1            | 22                   | 32          |
| Net cash provided by (used in) investing activities  | (51)                       | (467)        | 73                   | 116         |
| <b>Cash flows from financing activities</b>  |                            |              |                      |             |
| Increase in short-term debt  |                            |              |                      |             |
| Principal payments on long-term debt and nonrecourse debt  |                            |              | (34)                 | (74)        |
| Proceeds from long-term debt   |                            | 347          |                      | 28          |
| Purchases of Textron common stock  | (915)                      | (329)        |                      |             |
| Dividends paid   | (10)                       | (11)         | (50)                 |             |
| Other financing activities, net  | 43                         | 21           |                      |             |
| Net cash provided by (used in) financing activities  | (882)                      | 28           | (84)                 | (46)        |
| Effect of exchange rate changes on cash and equivalents  | (6)                        | 15           |                      |             |
| <b>Net increase (decrease) in cash and equivalents</b>   | <b>(525)</b>               | <b>(199)</b> | <b>(6)</b>           | <b>30</b>   |
| Cash and equivalents at beginning of period  | 1,079                      | 1,137        | 183                  | 161         |
| Cash and equivalents at end of period  | \$ 554                     | \$ 938       | \$ 177               | \$ 191      |

See Notes to the Consolidated Financial Statements.

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**TEXTRON INC.**

**Notes to the Consolidated Financial Statements (Unaudited)**

**Note 1. Basis of Presentation**

Our Consolidated Financial Statements include the accounts of Textron Inc. (Textron) and its majority-owned subsidiaries. We have prepared these unaudited consolidated financial statements in accordance with accounting principles generally accepted in the U.S. for interim financial information. Accordingly, these interim financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. The consolidated interim financial statements included in this quarterly report should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 30, 2017. In the opinion of management, the interim financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for the fair presentation of our consolidated financial position, results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

At the beginning of 2018, we adopted Accounting Standards Update (ASU) No. 2016-15, *Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments*. This standard provides guidance on the classification of certain cash flows and requires companies to classify cash proceeds received from the settlement of corporate-owned life insurance as cash inflows from investing activities. The standard is required to be adopted on a retrospective basis. Prior to adoption of this standard, we classified these proceeds as operating activities in the Consolidated Statements of Cash Flows. Upon adoption, we reclassified \$22 million of net cash proceeds for the first half of 2017 from operating activities to investing activities.

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

*Use of Estimates*

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

**Note 2. Summary of Significant Accounting Policies Update**

Our significant accounting policies are included in Note 1 of our Annual Report on Form 10-K for the year ended December 30, 2017. On December 31, 2017, we adopted ASU No. 2014-09, *Revenue from Contracts with Customers (ASC 606)*. Significant changes to our policies resulting from the adoption are provided below. We adopted ASC 606 using the modified retrospective transition method applied to contracts that were not substantially complete at the end of 2017. We recorded a \$90 million adjustment to increase retained earnings to reflect the cumulative impact of adopting this standard at the beginning of 2018, primarily related to certain long-term contracts our Bell segment has with the U.S. Government that converted to the cost-to-cost method for revenue recognition. The comparative information has not been restated and is reported under the accounting standards in effect for those periods. A reconciliation of the financial statement line items impacted for the three and six months ended June 30, 2018 under ASC 606 to the prior accounting standards is provided in Note 15.

### **Revenue Recognition**

Revenue is recognized when control of the goods or services promised under the contract is transferred to the customer either at a point in time (e.g., upon delivery) or over time (e.g., as we perform under the contract). We account for a contract when it has approval and commitment from both parties, the rights and payment terms of the parties are identified, the contract has commercial substance and collectability of consideration is probable. Contracts are reviewed to determine whether there is one or multiple performance obligations. A performance obligation is a promise to transfer a distinct good or service to a customer and represents the unit of accounting for revenue recognition. For contracts with multiple performance obligations, the expected consideration, or the transaction price, is allocated to each performance obligation identified in the contract based on the relative standalone selling

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price of each performance obligation. Revenue is then recognized for the transaction price allocated to the performance obligation when control of the promised goods or services underlying the performance obligation is transferred. Contract consideration is not adjusted for the effects of a significant financing component when, at contract inception, the period between when control transfers and when the customer will pay for that good or service is one year or less.

*Commercial Contracts*

The majority of our contracts with commercial customers have a single performance obligation as there is only one good or service promised or the promise to transfer the goods or services is not distinct or separately identifiable from other promises in the contract. Revenue is primarily recognized at a point in time, which is generally when the customer obtains control of the asset upon delivery and customer acceptance. Contract modifications that provide for additional distinct goods or services at the standalone selling price are treated as separate contracts.

For commercial aircraft, we contract with our customers to sell fully outfitted fixed-wing aircraft, which may include configuration options. The aircraft typically represents a single performance obligation and revenue is recognized upon customer acceptance and delivery. For commercial helicopters, our customers generally contract with us for fully functional basic configuration aircraft and control is transferred upon customer acceptance and delivery. At times, customers may separately contract with us for the installation of accessories and customization to the basic aircraft. If these contracts are entered into at or near the same time of the basic aircraft contract, we assess whether the contracts meet the criteria to be combined. For contracts that are combined, the basic aircraft and the accessories and customization are typically considered to be distinct, and therefore, are separate performance obligations. For these contracts, revenue is recognized on the basic aircraft upon customer acceptance and transfer of title and risk of loss and on the accessories and customization upon delivery and customer acceptance. We utilize observable prices to determine the standalone selling prices when allocating the transaction price to these performance obligations.

The transaction price for our commercial contracts reflects our estimate of returns, rebates and discounts, which are based on historical, current and forecasted information. Amounts billed to customers for shipping and handling are included in the transaction price and generally are not treated as separate performance obligations as these costs fulfill a promise to transfer the product to the customer. Taxes collected from customers and remitted to government authorities are recorded on a net basis.

We primarily provide standard warranty programs for products in our commercial businesses for periods that typically range from one to five years. These assurance-type programs typically cannot be purchased separately and do not meet the criteria to be considered a performance obligation.

*U.S. Government Contracts*

Our contracts with the U.S. Government generally include the design, development, manufacture or modification of aerospace and defense products as well as related services. These contracts, which also include those under the U.S. Government-sponsored foreign military sales program, accounted for approximately 24% of total revenues in 2017. The customer typically contracts with us to provide a significant service of integrating a complex set of tasks and components into a single project or capability, which often results in the delivery of multiple units. Accordingly, the entire contract is accounted for as one performance obligation. In certain circumstances, a contract may include both production and support services, such as logistics and parts plans, which are considered to be distinct in the context of the contract and represent separate performance obligations. When a contract is separated into more than one performance obligation, we generally utilize the expected cost plus a margin approach to determine the standalone selling prices when allocating the transaction price.

Our contracts are frequently modified for changes in contract specifications and requirements. Most of our contract modifications with the U.S. Government are for goods and services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as part of that existing contract. The effect of these contract modifications on our estimates is recognized using the cumulative catch-up method of accounting.

Contracts with the U.S. Government generally contain clauses that provide lien rights to work-in-process along with clauses that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work-in-process. Due to the continuous transfer of control to the U.S. Government, we recognize revenue over the time that we perform under the contract. Selecting the method to measure progress towards completion requires judgment and is based on the nature of the products or service to be provided. We generally use the cost-to-cost method to measure progress for our contracts because it best depicts the transfer of control to the customer that occurs as we incur costs on our contracts. Under this measure, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the estimated costs at completion of the performance obligation, and revenue is recorded proportionally as costs are incurred.

The transaction price for our contracts represents our best estimate of the consideration we will receive and includes assumptions regarding variable consideration as applicable. Certain of our long-term contracts contain incentive fees or other provisions that can either increase or decrease the transaction price. These variable amounts generally are awarded upon achievement of certain performance metrics, program milestones or cost targets and can be based upon customer discretion. We include estimated amounts



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in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of our anticipated performance and all other information that is reasonably available to us.

Total contract cost is estimated utilizing current contract specifications and expected engineering requirements. Contract costs typically are incurred over a period of several years, and the estimation of these costs requires substantial judgment. Our cost estimation process is based on the professional knowledge and experience of engineers and program managers along with finance professionals. We review and update our projections of costs quarterly or more frequently when circumstances significantly change.

Approximately 80% of our 2017 revenues with the U.S. Government were under fixed-price and fixed-price incentive contracts. Under the typical payment terms of these contracts, the customer pays us either performance-based or progress payments. Performance-based payments represent interim payments of up to 90% of the contract price based on quantifiable measures of performance or on the achievement of specified events or milestones. Progress payments are interim payments of up to 80% of costs incurred as the work progresses. Because the customer retains a small portion of the contract price until completion of the contract, these contracts generally result in revenue recognized in excess of billings, which we present as contract assets in the Consolidated Balance Sheets. Amounts billed and due from our customers are classified in Accounts receivable, net. The portion of the payments retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer. For cost-type contracts, we are generally paid for our actual costs incurred within a short period of time.

**Contract Estimates**

For contracts where revenue is recognized over time, we generally recognize changes in estimated contract revenues, costs and profits using the cumulative catch-up method of accounting. This method recognizes the cumulative effect of changes on current and prior periods with the impact of the change from inception-to-date recorded in the current period. Anticipated losses on contracts are recognized in full in the period in which the losses become probable and estimable.

The impact of cumulative catch-up adjustments on both revenues and segment profit recognized in prior periods totaled \$64 million and \$9 million in the second quarter of 2018 and 2017, respectively. The resulting impact increased income from continuing operations before income taxes by \$64 million and \$9 million, respectively, (\$49 million and \$6 million after tax, or \$0.19 and \$0.02 per diluted share, respectively). For the second quarter of 2018 and 2017, the gross favorable adjustments totaled \$70 million and \$23 million, respectively, and the gross unfavorable adjustments totaled \$6 million and \$14 million, respectively.

In the first half of 2018 and 2017, the impact of cumulative catch-up adjustments on both revenues and segment profit recognized in prior periods totaled \$104 million and \$(3) million, respectively. The resulting impact increased income from continuing operations before income taxes by \$104 million (\$79 million after tax or \$0.30 per diluted share) in the first half of 2018 and decreased income from continuing operations before income taxes by \$3 million (\$2 million after tax or \$0.01 per diluted share) in the first half of 2017. For the first half of 2018 and 2017, the gross favorable adjustments totaled \$126 million and \$43 million, respectively, and the gross unfavorable adjustments totaled \$22 million and \$46 million, respectively. No individual adjustment was material to our Consolidated Statements of Operations for the second quarter and first half of 2018 and 2017.

**Contract Assets and Liabilities**

Contract assets arise from contracts when revenue is recognized over time and the amount of revenue recognized exceeds the amount billed to the customer. These amounts are included in contract assets until the right to payment is no longer conditional on events other than the passage of time. Contract assets are included in Other current assets in the Consolidated Balance Sheet. Contract liabilities, which are primarily included in Other current liabilities, include deposits, largely from our commercial aviation customers, and billings in excess of revenue recognized.

The incremental costs of obtaining a contract with a customer that is expected to be recovered is expensed as incurred when the period to be benefitted is one year or less.

**Accounts Receivable, Net**

Accounts receivable, net includes amounts billed to customers where the right to payment is unconditional. We maintain an allowance for doubtful accounts to provide for the estimated amount of accounts receivable that will not be collected, which is based on an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivable and collateral value, if any.

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**Accounting Pronouncements Not Yet Adopted**

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases*, that requires lessees to recognize all leases with a term greater than 12 months on the balance sheet as right-to-use assets and lease liabilities. Under current accounting guidance, we are not required to recognize assets and liabilities arising from operating leases on the balance sheet. The new standard is effective for our company at the beginning of 2019, using the modified retrospective method of adoption. In 2018, the FASB proposed a change that would permit companies to elect a transitional method that allows for application of the standard at the effective date without adjustment to comparative periods.

We are continuing to review and evaluate our leased assets to assess the impact of adopting the new standard and are implementing changes to our processes, systems and internal controls in order to quantify and account for the standard. Upon adoption, the assets and liabilities on our consolidated balance sheet will materially increase as we recognize the rights and corresponding obligations related to our operating leases. The standard is not expected to materially impact our cash flows or results of operations. We expect to complete our assessment of the impact of adopting this standard in the fourth quarter of 2018.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses*. For most financial assets, such as trade and other receivables, loans and other instruments, this standard changes the current incurred loss model to a forward-looking expected credit loss model, which generally will result in the earlier recognition of allowances for losses. The new standard is effective for our company at the beginning of 2020 with early adoption permitted beginning in 2019. Entities are required to apply the provisions of the standard through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of the standard on our consolidated financial statements.

**Note 3. Business Disposition**

On April 18, 2018, we entered into an agreement to sell the businesses that manufacture and sell the products in our Tools and Test Equipment product line within our Industrial segment to Emerson Electric Co. for a purchase price of \$810 million. We completed this disposition on July 2, 2018 and expect to record an after-tax gain of approximately \$400 million, subject to certain post-closing adjustments, in the third quarter of 2018.

At June 30, 2018, the assets and liabilities of these businesses met the criteria to be classified as held for sale, but did not qualify for presentation as a discontinued operation. Accordingly, the assets and liabilities of these businesses are recorded at the lower of the carrying value or fair value, less cost to sell, in the current period, and are each presented on a single line in the Consolidated Balance Sheet. The carrying amounts of the major classes of assets and liabilities classified as held for sale related to this disposition are as follows:

(In millions)  
Assets

June 30,  
2018

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|  |    |     |
|--|----|-----|
| Accounts receivable, net                       | \$ | 71  |
| Inventories                                    |    | 100 |
| Property, plant and equipment, net             |    | 59  |
| Goodwill                                       |    | 153 |
| Other assets                                   |    | 24  |
| <b>Assets of businesses held for sale</b>      | \$ | 407 |
| <b>Liabilities</b>                             |    |     |
| Accounts payable                               | \$ | 30  |
| Other current liabilities                      |    | 25  |
| Other liabilities                              |    | 11  |
| <b>Liabilities of businesses held for sale</b> | \$ | 66  |

Table of Contents**Note 4. Retirement Plans**

In the first quarter of 2018, we adopted ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard requires companies to present only the service cost component of net periodic benefit cost in operating income in the same line as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net periodic benefit cost must be presented separately from service cost and excluded from operating income. In addition, only the service cost component is eligible for capitalization into inventory. The change in the amount capitalized into inventory was applied prospectively. The reclassification of the other components of net periodic benefit cost (credit) to a separate line was applied retrospectively using a practical expedient that permits the usage of amounts previously disclosed in the pension and other postretirement benefit plan note for prior periods. As a result, we reclassified \$(6) million and \$(14) million of other components of net periodic benefit cost (credit) for the second quarter and first half of 2017, respectively, from Cost of sales to a separate line item in the Consolidated Statements of Operations.

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

| <i>(In millions)</i>                               | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|--|---------------------------|-------------------------|--------------------------|-------------------------|
|  | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| <b>Pension Benefits</b>                            |                           |                         |                          |                         |
| Service cost                                       | \$ 27                     | \$ 25                   | \$ 53                    | \$ 50                   |
| Interest cost                                      | 76                        | 81                      | 153                      | 161                     |
| Expected return on plan assets                     | (139)                     | (127)                   | (277)                    | (253)                   |
| Amortization of net actuarial loss                 | 39                        | 34                      | 77                       | 68                      |
| Amortization of prior service cost                 | 3                         | 4                       | 7                        | 8                       |
| Net periodic benefit cost                          | \$ 6                      | \$ 17                   | \$ 13                    | \$ 34                   |
| <b>Postretirement Benefits Other Than Pensions</b> |                           |                         |                          |                         |
| Service cost                                       | \$                        | \$                      | \$ 1                     | \$ 1                    |
| Interest cost                                      | 3                         | 3                       | 5                        | 6                       |
| Amortization of prior service credit               | (1)                       | (2)                     | (3)                      | (4)                     |
| Net periodic benefit cost                          | \$ 2                      | \$ 1                    | \$ 3                     | \$ 3                    |

**Note 5. Earnings Per Share**

We calculate basic and diluted earnings per share (EPS) based on net income, which approximates income available to common shareholders for each period. Basic EPS is calculated using the two-class method, which includes the weighted-average number of common shares outstanding during the period and restricted stock units to be paid in stock that are deemed participating securities as they provide nonforfeitable rights to dividends. Diluted EPS considers the dilutive effect of all potential future common stock, including stock options.

The weighted-average shares outstanding for basic and diluted EPS are as follows:

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| <i>(In thousands)</i>                       | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|---|---------------------------|-------------------------|--------------------------|-------------------------|
|   | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Basic weighted-average shares outstanding   | 253,904                   | 267,114                 | 257,200                  | 268,802                 |
| Dilutive effect of stock options            | 3,273                     | 2,185                   | 3,262                    | 2,274                   |
| Diluted weighted-average shares outstanding | 257,177                   | 269,299                 | 260,462                  | 271,076                 |

Stock options to purchase 1.3 million shares of common stock are excluded from the calculation of diluted weighted-average shares outstanding for both the three and six months ended June 30, 2018, as their effect would have been anti-dilutive. Stock options to purchase 1.7 million shares of common stock are excluded from the calculation of diluted weighted-average shares outstanding for both the three and six months ended July 1, 2017, as their effect would have been anti-dilutive.

Table of Contents**Note 6. Accounts Receivable and Finance Receivables****Accounts Receivable**

Accounts receivable is composed of the following:

| <i>(In millions)</i>  | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|---|--------------------------|----------------------------------|
| Commercial  | \$ 931                   | \$ 1,007                         |
| U.S. Government contracts, including foreign military sales | 215                      | 383                              |
|   | 1,146                    | 1,390                            |
| Allowance for doubtful accounts                             | (25)                     | (27)                             |
| Total   | \$ 1,121                 | \$ 1,363                         |

Upon adoption of ASC 606, unbilled receivables, primarily related to U.S. Government contracts, totaling \$203 million were reclassified from accounts receivable to contract assets or liabilities, depending on the net position of the contract as discussed in Note 15. In addition, \$71 million of accounts receivable, net was reclassified to assets of businesses held for sale at June 30, 2018 as disclosed in Note 3.

**Finance Receivables**

Finance receivables are presented in the following table:

| <i>(In millions)</i>           | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|--------------------------------|--------------------------|----------------------------------|
| Finance receivables            | \$ 792                   | \$ 850                           |
| Allowance for losses           | (29)                     | (31)                             |
| Total finance receivables, net | \$ 763                   | \$ 819                           |

*Credit Quality Indicators and Nonaccrual Finance Receivables*

We internally assess the quality of our finance receivables based on a number of key credit quality indicators and statistics such as delinquency, loan balance to estimated collateral value and the financial strength of individual borrowers and guarantors. Because many of these indicators are difficult to apply across an entire class of receivables, we evaluate individual loans on a quarterly basis and classify these loans into three categories based on the key credit quality indicators for the individual loan. These three categories are performing, watchlist and nonaccrual.

We classify finance receivables as nonaccrual if credit quality indicators suggest full collection of principal and interest is doubtful. In addition, we automatically classify accounts as nonaccrual once they are contractually delinquent by more than three months unless collection of principal and interest is not doubtful. Accrual of interest income is suspended for these accounts and all cash collections are generally applied to reduce the net investment balance. Once we conclude that the collection of all principal and interest is no longer doubtful, we resume the accrual of interest and recognize previously suspended interest income at the time either a) the loan becomes contractually current through payment

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according to the original terms of the loan, or b) if the loan has been modified, following a period of performance under the terms of the modification. Accounts are classified as watchlist when credit quality indicators have deteriorated as compared with typical underwriting criteria, and we believe collection of full principal and interest is probable but not certain. All other finance receivables that do not meet the watchlist or nonaccrual categories are classified as performing.

### *Delinquency*

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



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Finance receivables categorized based on the credit quality indicators and by the delinquency aging category are summarized as follows:

| <i>(Dollars in millions)</i>   | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|--|--------------------------|----------------------------------|
| Performing   | \$ 688\$                 | 733                              |
| Watchlist  | 50                       | 56                               |
| Nonaccrual   | 54                       | 61                               |
| Nonaccrual as a percentage of finance receivables                        | 6.82%                    | 7.18%                            |
| Less than 31 days past due   | \$ 705\$                 | 791                              |
| 31-60 days past due  | 35                       | 25                               |
| 61-90 days past due  | 40                       | 14                               |
| Over 90 days past due  | 12                       | 20                               |
| 60 + days contractual delinquency as a percentage of finance receivables | 6.57%                    | 4.00%                            |

*Impaired Loans*

On a quarterly basis, we evaluate individual finance receivables for impairment in non-homogeneous portfolios and larger balance accounts in homogeneous loan portfolios. A finance receivable is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement based on our review of the credit quality indicators described above. Impaired finance receivables include both nonaccrual accounts and accounts for which full collection of principal and interest remains probable, but the account's original terms have been, or are expected to be, significantly modified. If the modification specifies an interest rate equal to or greater than a market rate for a finance receivable with comparable risk, the account is not considered impaired in years subsequent to the modification. Interest income recognized on impaired loans was not significant in the first half of 2018 or 2017.

A summary of impaired finance receivables, excluding leveraged leases, and the average recorded investment is provided below:

| <i>(In millions)</i>                                | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|---|--------------------------|----------------------------------|
| Recorded investment:                                |                          |                                  |
| Impaired loans with related allowance for losses    | \$ 19\$                  | 24                               |
| Impaired loans with no related allowance for losses | 35                       | 70                               |
| Total   | \$ 54\$                  | 94                               |
| Unpaid principal balance                            | \$ 63\$                  | 106                              |
| Allowance for losses on impaired loans              | 5                        | 6                                |
| Average recorded investment                         | 68                       | 92                               |

A summary of the allowance for losses on finance receivables, based on how the underlying finance receivables are evaluated for impairment, is provided below. The finance receivables reported in this table specifically exclude leveraged leases in accordance with U.S. generally accepted accounting principles.

| <i>(In millions)</i> | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|----------------------|--------------------------|----------------------------------|
|----------------------|--------------------------|----------------------------------|

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|  |    |     |     |
|--|----|-----|-----|
| Allowance based on collective evaluation   | \$ | 24  | 25  |
| Allowance based on individual evaluation   |    | 5   | 6   |
| Finance receivables evaluated collectively |    | 639 | 658 |
| Finance receivables evaluated individually |    | 54  | 94  |

Table of Contents**Note 7. Inventories**

Inventories are composed of the following:

| <i>(In millions)</i>         | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|------------------------------|--------------------------|----------------------------------|
| Finished goods               | \$ 1,725                 | \$ 1,790                         |
| Work in process              | 1,483                    | 2,238                            |
| Raw materials and components | 717                      | 804                              |
| Progress/milestone payments  | 3,925                    | 4,832                            |
| Total                        | \$ 3,925                 | \$ (682)<br>4,150                |

Upon adoption of ASC 606, \$199 million of inventories, net of progress/milestone payments, primarily related to our U.S. Government contracts, were reclassified from inventories to contract assets or liabilities depending on the net position of the contract as discussed in Note 15. In addition, \$100 million of inventories were reclassified to assets of businesses held for sale at June 30, 2018 as disclosed in Note 3.

**Note 8. Warranty Liability**

Changes in our warranty liability are as follows:

| <i>(In millions)</i> | <b>Six Months Ended<br/>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
|----------------------|---|-------------------------|
| Beginning of period  | \$ 164  | \$ 138                  |
| Provision            | 34  | 35                      |
| Settlements          | (39)  | (36)                    |
| Acquisitions         | 1   | 28                      |
| Adjustments*         | 6   | (9)                     |
| End of period        | \$ 166  | \$ 156                  |

\* Adjustments include changes to prior year estimates, new issues on prior year sales, reclassifications to held for sale and currency translation adjustments.

**Note 9. Derivative Instruments and Fair Value Measurements**

We measure fair value at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We prioritize the assumptions that market participants would use in pricing the asset or liability into a

three-tier fair value hierarchy. This fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and the lowest priority (Level 3) to unobservable inputs in which little or no market data exist, requiring companies to develop their own assumptions. Observable inputs that do not meet the criteria of Level 1, which include quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets and liabilities in markets that are not active, are categorized as Level 2. Level 3 inputs are those that reflect our estimates about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. Valuation techniques for assets and liabilities measured using Level 3 inputs may include methodologies such as the market approach, the income approach or the cost approach and may use unobservable inputs such as projections, estimates and management's interpretation of current market data. These unobservable inputs are utilized only to the extent that observable inputs are not available or cost effective to obtain.

#### **Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

We manufacture and sell our products in a number of countries throughout the world, and, therefore, we are exposed to movements in foreign currency exchange rates. We primarily utilize foreign currency exchange contracts with maturities of no more than three years to manage this volatility. These contracts qualify as cash flow hedges and are intended to offset the effect of exchange rate fluctuations on forecasted sales, inventory purchases and overhead expenses. Net gains and losses recognized in earnings and Accumulated other comprehensive loss on cash flow hedges, including gains and losses related to hedge ineffectiveness, were not significant in the periods presented.

Our foreign currency exchange contracts are measured at fair value using the market method valuation technique. The inputs to this technique utilize current foreign currency exchange forward market rates published by third-party leading financial news and data providers. These are observable data that represent the rates that the financial institution uses for contracts entered into at that date; however, they are not based on actual transactions so they are classified as Level 2. At June 30, 2018 and December 30, 2017, we had foreign currency exchange contracts with notional amounts upon which the contracts were based of \$497 million and \$426

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million, respectively. At June 30, 2018, the fair value amounts of our foreign currency exchange contracts were a \$9 million asset and a \$6 million liability. At December 30, 2017, the fair value amounts of our foreign currency exchange contracts were a \$13 million asset and a \$7 million liability.

We hedge our net investment position in major currencies and generate foreign currency interest payments that offset other transactional exposures in these currencies. To accomplish this, we borrow directly in foreign currency and designate a portion of foreign currency debt as a hedge of a net investment. We record changes in the fair value of these contracts in other comprehensive income to the extent they are effective as cash flow hedges. Currency effects on the effective portion of these hedges, which are reflected in the foreign currency translation adjustments within Accumulated other comprehensive loss, were not significant in the periods presented.

**Assets and Liabilities Not Recorded at Fair Value**

The carrying value and estimated fair value of our financial instruments that are not reflected in the financial statements at fair value are as follows:

| <i>(In millions)</i>                  | <b>June 30, 2018</b>  |                             | <b>December 30, 2017</b> |                             |
|---------------------------------------|-----------------------|-----------------------------|--------------------------|-----------------------------|
|                                       | <b>Carrying Value</b> | <b>Estimated Fair Value</b> | <b>Carrying Value</b>    | <b>Estimated Fair Value</b> |
| <b>Manufacturing group</b>            |                       |                             |                          |                             |
| Debt, excluding leases                | \$ (3,004)            | \$ (3,018)                  | \$ (3,007)               | \$ (3,136)                  |
| <b>Finance group</b>                  |                       |                             |                          |                             |
| Finance receivables, excluding leases | 591                   | 615                         | 643                      | 675                         |
| Debt                                  | (809)                 | (787)                       | (824)                    | (799)                       |

Fair value for the Manufacturing group debt is determined using market observable data for similar transactions (Level 2). The fair value for the Finance group debt was determined primarily based on discounted cash flow analyses using observable market inputs from debt with similar duration, subordination and credit default expectations (Level 2). Fair value estimates for finance receivables were determined based on internally developed discounted cash flow models primarily utilizing significant unobservable inputs (Level 3), which include estimates of the rate of return, financing cost, capital structure and/or discount rate expectations of current market participants combined with estimated loan cash flows based on credit losses, payment rates and expectations of borrowers' ability to make payments on a timely basis.

**Note 10. Shareholders' Equity**

A reconciliation of Shareholders' equity is presented below:

| <i>(In millions)</i>         | <b>Common Stock</b> | <b>Capital Surplus</b> | <b>Treasury Stock</b> | <b>Retained Earnings</b> | <b>Accumulated Other Comprehensive Loss</b> | <b>Total Shareholders' Equity</b> |
|------------------------------|---------------------|------------------------|-----------------------|--------------------------|---|-----------------------------------|
| Balance at December 30, 2017 | \$ 33               | \$ 1,669               | \$ (48)               | \$ 5,368                 | \$ (1,375)                                  | \$ 5,647                          |
| Adoption of ASC 606          |                     |                        |                       | 90                       |   | 90                                |

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|                                   |         |         |         |         |           |       |
|-----------------------------------|---------|---------|---------|---------|-----------|-------|
| Balance at December 31, 2017      | 33      | 1,669   | (48)    | 5,458   | (1,375)   | 5,737 |
| Net income                        |         |         |         | 413     |           | 413   |
| Other comprehensive income        |         |         |         |         | 32        | 32    |
| Share-based compensation activity |         | 105     |         |         |           | 105   |
| Dividends declared                |         |         |         | (10)    |           | (10)  |
| Purchases of common stock         |         |         | (915)   |         |           | (915) |
| Balance at June 30, 2018          | \$ 33\$ | 1,774\$ | (963)\$ | 5,861\$ | (1,343)\$ | 5,362 |

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The components of Accumulated other comprehensive loss are presented below:

| <i>(In millions)</i>                                   | <b>Pension and<br/>Postretirement<br/>Benefits<br/>Adjustments</b> | <b>Foreign<br/>Currency<br/>Translation<br/>Adjustments</b> | <b>Deferred<br/>Gains (Losses)<br/>on Hedge<br/>Contracts</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> |
|--|--|---|---|---|
| <b>For the six months ended June 30, 2018</b>          |  |   |   |   |
| Beginning of period                                    | \$ (1,396)\$   | 11\$  | 10\$  | (1,375)   |
| Other comprehensive income before reclassifications    |  | (27)  | (2)   | (29)  |
| Reclassified from Accumulated other comprehensive loss | 62   |   | (1)   | 61  |
| Other comprehensive income                             | 62   | (27)  | (3)   | 32  |
| End of period  | \$ (1,334)\$   | (16)\$  | 7\$   | (1,343)   |
| <b>For the six months ended July 1, 2017</b>           |  |   |   |   |
| Beginning of period                                    | \$ (1,505)\$   | (96)\$  | (4)\$   | (1,605)   |
| Other comprehensive income before reclassifications    |  | 64  | 3   | 67  |
| Reclassified from Accumulated other comprehensive loss | 47   |   | 5   | 52  |
| Other comprehensive income                             | 47   | 64  | 8   | 119   |
| End of period  | \$ (1,458)\$   | (32)\$  | 4\$   | (1,486)   |

The before and after-tax components of Other comprehensive income (loss) are presented below:

| <i>(In millions)</i>                                 | <b>June 30, 2018</b>      |                                      |                             | <b>July 1, 2017</b>       |                                      |                             |
|--|---------------------------|--------------------------------------|-----------------------------|---------------------------|--------------------------------------|-----------------------------|
|  | <b>Pre-Tax<br/>Amount</b> | <b>Tax<br/>(Expense)<br/>Benefit</b> | <b>After-Tax<br/>Amount</b> | <b>Pre-Tax<br/>Amount</b> | <b>Tax<br/>(Expense)<br/>Benefit</b> | <b>After-Tax<br/>Amount</b> |
| <b>Three Months Ended</b>                            |                           |                                      |                             |                           |                                      |                             |
| Pension and postretirement benefits adjustments:     |                           |                                      |                             |                           |                                      |                             |
| Amortization of net actuarial loss*                  | \$ 39\$                   | (9)\$                                | 30\$                        | 34\$                      | (12)\$                               | 22                          |
| Amortization of prior service cost*                  | 2                         | (1)                                  | 1                           | 2                         | (1)                                  | 1                           |
| Pension and postretirement benefits adjustments, net | 41                        | (10)                                 | 31                          | 36                        | (13)                                 | 23                          |
| Deferred gains (losses) on hedge contracts:          |                           |                                      |                             |                           |                                      |                             |
| Current deferrals                                    | (4)                       | 1                                    | (3)                         | 2                         | (1)                                  | 1                           |
| Reclassification adjustments                         | (1)                       |                                      | (1)                         | 4                         | (1)                                  | 3                           |
| Deferred gains (losses) on hedge contracts, net      | (5)                       | 1                                    | (4)                         | 6                         | (2)                                  | 4                           |
| Foreign currency translation adjustments             | (66)                      | (3)                                  | (69)                        | 39                        | 3                                    | 42                          |
| Total  | \$ (30)\$                 | (12)\$                               | (42)\$                      | 81\$                      | (12)\$                               | 69                          |
| <b>Six Months Ended</b>                              |                           |                                      |                             |                           |                                      |                             |
| Pension and postretirement benefits adjustments:     |                           |                                      |                             |                           |                                      |                             |
| Amortization of net actuarial loss*                  | \$ 77\$                   | (18)\$                               | 59\$                        | 68\$                      | (24)\$                               | 44                          |
| Amortization of prior service cost*                  | 4                         | (1)                                  | 3                           | 4                         | (1)                                  | 3                           |
| Pension and postretirement benefits adjustments, net | 81                        | (19)                                 | 62                          | 72                        | (25)                                 | 47                          |
| Deferred gains (losses) on hedge contracts:          |                           |                                      |                             |                           |                                      |                             |
| Current deferrals                                    | (2)                       |                                      | (2)                         | 5                         | (2)                                  | 3                           |

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|   |         |        |      |       |        |     |
|---|---------|--------|------|-------|--------|-----|
| Reclassification adjustments                    | (1)     | (1)    | 6    | (1)   | 5      |     |
| Deferred gains (losses) on hedge contracts, net | (3)     | (3)    | 11   | (3)   | 8      |     |
| Foreign currency translation adjustments        | (26)    | (1)    | (27) | 60    | 4      | 64  |
| Total   | \$ 52\$ | (20)\$ | 32\$ | 143\$ | (24)\$ | 119 |

*\*These components of Other comprehensive income (loss) are included in the computation of net periodic pension cost. See Note 11 of our 2017 Annual Report on Form 10-K for additional information.*



Table of Contents**Note 11. Special Charges**

In 2017, special charges were related to a 2016 restructuring plan and the Arctic Cat acquisition, which included both restructuring, integration and transaction costs. There were no special charges recorded in 2018.

Special charges recorded in 2017 are as follows:

| <i>(In millions)</i>                           | <b>Severance<br/>Costs</b> | <b>Asset<br/>Impairments</b> | <b>Contract<br/>Terminations<br/>and Other</b> | <b>Acquisition<br/>Integration/<br/>Transaction<br/>Costs</b> | <b>Total<br/>Special<br/>Charges</b> |     |
|--|----------------------------|------------------------------|--|---|--------------------------------------|-----|
| <b>For the three months ended July 1, 2017</b> |                            |                              |  |   |                                      |     |
| Industrial                                     | \$                         | \$                           | \$   | 3\$   | 1\$                                  | 4   |
| Textron Aviation                               |                            | 4                            | 7  |   |                                      | 11  |
| Textron Systems                                |                            | 1                            | 4  | (7)   |                                      | (2) |
|  | \$                         | 5\$                          | 11\$   | (4)\$   | 1\$                                  | 13  |
| <b>For the six months ended July 1, 2017</b>   |                            |                              |  |   |                                      |     |
| Industrial                                     | \$                         | 19\$                         | \$   | 6\$   | 4\$                                  | 29  |
| Textron Aviation                               |                            | 5                            | 17   |   |                                      | 22  |
| Textron Systems                                |                            | 1                            | 4  | (6)   |                                      | (1) |
|  | \$                         | 25\$                         | 21\$   | \$  | 4\$                                  | 50  |

Our restructuring reserve activity for the first half of 2018 is summarized below:

| <i>(In millions)</i>         | <b>Severance<br/>Costs</b> | <b>Contract<br/>Terminations<br/>and Other</b> | <b>Total</b> |      |
|------------------------------|----------------------------|--|--------------|------|
| Balance at December 30, 2017 | \$                         | 24\$   | 20\$         | 44   |
| Cash paid                    |                            | (17)   | (6)          | (23) |
| Provision for 2016 Plan      |                            |  | 3            | 3    |
| Reversals                    |                            | (2)  |              | (2)  |
| Balance at June 30, 2018     | \$                         | 5\$  | 17\$         | 22   |

Both plans are substantially completed with approximately half of the remaining cash outlays of \$22 million expected to be paid in the remainder of 2018. Severance costs generally are paid on a lump-sum basis and include outplacement costs, which are paid in accordance with normal payment terms.

**Note 12. Income Taxes**

Our effective tax rate for the second quarter and first half of 2018 was 13.8% and 13.6%, respectively. In the second quarter and first half of 2018, the effective tax rate was lower than the U.S. federal statutory tax rate of 21%, primarily due to a \$25 million benefit recognized upon the reassessment of our reserve for uncertain tax positions based on new information, including interactions with the tax authorities and recent audit settlements. The effective tax rate for the first half of 2018 also reflects benefits recognized from audit settlements in the first quarter of 2018.

*U.S. Tax Reform*

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. Among other things, the Act reduces the U.S. federal corporate tax rate from 35% to 21% and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. We have reasonably estimated the effects of the Act and recorded provisional amounts in the fourth quarter of 2017 to remeasure our U.S. federal deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%, and for the one-time transition tax. The U.S. Government and state tax authorities are expected to continue to issue guidance regarding the Act, which may result in adjustments to our provisional estimates. We are continuing to analyze certain aspects of the Act and may refine our estimates, which could potentially affect the measurement of our net deferred tax assets or give rise to new deferred tax amounts.

In the first half of 2018, we have not recorded any measurement period adjustments to the provisional estimates recorded at the end of 2017. The final determination of the remeasurement of our net deferred tax assets and the transition tax will be completed as additional information becomes available, but no later than one year from the enactment date. Any subsequent adjustments to the provisional amounts will be recorded to current or deferred tax expense in the quarter of 2018 when the analysis is complete.

Table of Contents**Note 13. Commitments and Contingencies**

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

**Note 14. Segment Information**

We operate in, and report financial information for, the following five business segments: Textron Aviation, Bell, Textron Systems, Industrial and Finance. Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit for the manufacturing segments excludes interest expense, certain corporate expenses and special charges. The measurement for the Finance segment includes interest income and expense along with intercompany interest income and expense.

Our revenues by segment, along with a reconciliation of segment profit to income from continuing operations before income taxes, are included in the table below:

|   | Three Months Ended |                 | Six Months Ended |                 |
|---|--------------------|-----------------|------------------|-----------------|
|   | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| <i>(In millions)</i>                                  |                    |                 |                  |                 |
| <b>Revenues</b>                                       |                    |                 |                  |                 |
| Textron Aviation                                      | \$ 1,276\$         | 1,171\$         | 2,286\$          | 2,141           |
| Bell  | 831                | 825             | 1,583            | 1,522           |
| Textron Systems                                       | 380                | 477             | 767              | 893             |
| Industrial  | 1,222              | 1,113           | 2,353            | 2,105           |
| Finance   | 17                 | 18              | 33               | 36              |
| Total revenues  | \$ 3,726\$         | 3,604\$         | 7,022\$          | 6,697           |
| <b>Segment Profit</b>                                 |                    |                 |                  |                 |
| Textron Aviation                                      | \$ 104\$           | 54\$            | 176\$            | 90              |
| Bell  | 117                | 112             | 204              | 195             |
| Textron Systems                                       | 40                 | 42              | 90               | 62              |
| Industrial  | 80                 | 82              | 144              | 158             |
| Finance   | 5                  | 5               | 11               | 9               |
| Segment profit  | 346                | 295             | 625              | 514             |
| Corporate expenses and other, net                     | (51)               | (31)            | (78)             | (58)            |
| Interest expense, net for Manufacturing group         | (35)               | (36)            | (69)             | (70)            |
| Special charges                                       |                    | (13)            |                  | (50)            |
| Income from continuing operations before income taxes | \$ 260\$           | 215\$           | 478\$            | 336             |



Table of Contents**Note 15. Revenues***Disaggregation of Revenues*

Our revenues disaggregated by major product type for the three and six months ended June 30, 2018 are presented below:

| <i>(In millions)</i>                       | <b>Three<br/>Months<br/>Ended</b> | <b>Six<br/>Months<br/>Ended</b> |
|--|-----------------------------------|---------------------------------|
| Aircraft                                   | \$ 877\$                          | 1,511                           |
| Aftermarket parts and services             | 399                               | 775                             |
| <b>Textron Aviation</b>                    | <b>1,276</b>                      | <b>2,286</b>                    |
| Military aircraft and support programs     | 533                               | 1,020                           |
| Commercial helicopters, parts and services | 298                               | 563                             |
| <b>Bell</b>                                | <b>831</b>                        | <b>1,583</b>                    |
| Unmanned systems                           | 161                               | 331                             |
| Marine and land systems                    | 69                                | 161                             |
| Simulation, training and other             | 150                               | 275                             |
| <b>Textron Systems</b>                     | <b>380</b>                        | <b>767</b>                      |
| Fuel systems and functional components     | 627                               | 1,282                           |
| Specialized vehicles                       | 475                               | 823                             |
| Tools and test equipment                   | 120                               | 248                             |
| <b>Industrial</b>                          | <b>1,222</b>                      | <b>2,353</b>                    |
| <b>Finance</b>                             | <b>17</b>                         | <b>33</b>                       |
| Total revenues                             | \$ 3,726\$                        | 7,022                           |

Our revenues by customer type and geographic location for the three and six months ended June 30, 2018 are presented below:

| <i>(In millions)</i>        | <b>Textron<br/>Aviation</b> | <b>Bell</b> | <b>Textron<br/>Systems</b> | <b>Industrial</b> | <b>Finance</b> | <b>Total</b> |
|-----------------------------|-----------------------------|-------------|----------------------------|-------------------|----------------|--------------|
| <b>Three months ended</b>   |                             |             |                            |                   |                |              |
| <b>Customer type:</b>       |                             |             |                            |                   |                |              |
| Commercial                  | \$ 1,191\$                  | 291\$       | 107\$                      | 1,215\$           | 17\$           | 2,821        |
| U.S. Government             | 85                          | 540         | 273                        | 7                 |                | 905          |
| Total revenues              | \$ 1,276\$                  | 831\$       | 380\$                      | 1,222\$           | 17\$           | 3,726        |
| <b>Geographic location:</b> |                             |             |                            |                   |                |              |
| United States               | \$ 914\$                    | 543\$       | 297\$                      | 590\$             | 7\$            | 2,351        |
| International               | 362                         | 288         | 83                         | 632               | 10             | 1,375        |
| Total revenues              | \$ 1,276\$                  | 831\$       | 380\$                      | 1,222\$           | 17\$           | 3,726        |
| <b>Six months ended</b>     |                             |             |                            |                   |                |              |
| <b>Customer type:</b>       |                             |             |                            |                   |                |              |
| Commercial                  | \$ 2,164\$                  | 543\$       | 234\$                      | 2,339\$           | 33\$           | 5,313        |
| U.S. Government             | 122                         | 1,040       | 533                        | 14                |                | 1,709        |
| Total revenues              | \$ 2,286\$                  | 1,583\$     | 767\$                      | 2,353\$           | 33\$           | 7,022        |
| <b>Geographic location:</b> |                             |             |                            |                   |                |              |
| United States               | \$ 1,579\$                  | 1,052\$     | 584\$                      | 1,086\$           | 14\$           | 4,315        |
| International               | 707                         | 531         | 183                        | 1,267             | 19             | 2,707        |
| Total revenues              | \$ 2,286\$                  | 1,583\$     | 767\$                      | 2,353\$           | 33\$           | 7,022        |

*Remaining Performance Obligations*

Our remaining performance obligations, which is the equivalent of our backlog, represent the expected transaction price allocated to our contracts that we expect to recognize as revenue in future periods when we perform under the contracts. These remaining obligations include amounts that have been formally appropriated under contracts with the U.S. Government, and exclude unexercised contract options and potential orders under ordering-type contracts such as Indefinite Delivery, Indefinite Quantity contracts. At June 30, 2018, we had \$8.2 billion in remaining performance obligations of which we expect to recognize revenues of approximately 67% through 2019, an additional 19% through 2021, and the balance thereafter.

*Contract assets and liabilities*

Assets and liabilities related to our contracts with customers are reported on a contract-by-contract basis at the end of each reporting period. At June 30, 2018, contract assets and liabilities totaled \$405 million and \$1.1 billion, respectively. Upon adoption of ASC 606 on December 31, 2017, contract assets and liabilities related to our contracts with customers were \$429 million and \$1.0 billion,

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respectively. During the second quarter and first half of 2018, we recognized \$377 million and \$699 million, respectively, in revenues that were included in the contract liability balance at the adoption date.

*Reconciliation of ASC 606 to Prior Accounting Standards*

The amount by which each financial statement line item is affected in 2018 as a result of applying the new accounting standard as discussed in Note 2 is presented below:

| <i>(In millions)</i>                  | June 30, 2018 |                                   |                        |
|---------------------------------------|---------------|-----------------------------------|------------------------|
|                                       | As Reported   | Effect of the adoption of ASC 606 | Under Prior Accounting |
| <b>Consolidated Balance Sheets</b>    |               |                                   |                        |
| Accounts receivable, net              | \$ 1,121      | \$ 163                            | \$ 1,284               |
| Inventories                           | 3,925         | 209                               | 4,134                  |
| Other current assets                  | 763           | (413)                             | 350                    |
| Property, plant and equipment, net    | 2,608         | 6                                 | 2,614                  |
| Other assets                          | 1,869         | 40                                | 1,909                  |
| Total Manufacturing group assets      | 13,454        | 5                                 | 13,459                 |
| Total assets                          | 14,558        | 5                                 | 14,563                 |
| Other current liabilities             | 2,175         | 127                               | 2,302                  |
| Total Manufacturing group liabilities | 8,276         | 127                               | 8,403                  |
| Total liabilities                     | 9,196         | 127                               | 9,323                  |
| Retained earnings                     | 5,861         | (122)                             | 5,739                  |
| Total shareholders' equity            | 5,362         | (122)                             | 5,240                  |

| <i>(In millions, except per share amounts)</i>         | Three Months Ended |                                   |                        | Six Months Ended |                                   |                        |
|--|--------------------|-----------------------------------|------------------------|------------------|-----------------------------------|------------------------|
|  | As Reported        | Effect of the adoption of ASC 606 | Under Prior Accounting | As Reported      | Effect of the adoption of ASC 606 | Under Prior Accounting |
| <b>Consolidated Statements of Operations</b>           |                    |                                   |                        |                  |                                   |                        |
| Manufacturing revenues                                 | \$ 3,709           | \$ (25)                           | \$ 3,684               | \$ 6,989         | \$ (246)                          | \$ 6,743               |
| Total revenues   | 3,726              | (25)                              | 3,701                  | 7,022            | (246)                             | 6,776                  |
| Cost of sales  | 3,073              | (5)                               | 3,068                  | 5,802            | (203)                             | 5,599                  |
| Income from continuing operations before income taxes  | 260                | (20)                              | 240                    | 478              | (43)                              | 435                    |
| Income tax expense                                     | 36                 | (5)                               | 31                     | 65               | (11)                              | 54                     |
| Income from continuing operations                      | 224                | (15)                              | 209                    | 413              | (32)                              | 381                    |
| Net income   | 224                | (15)                              | 209                    | 413              | (32)                              | 381                    |
| Basic earnings per share - continuing operations       | \$ 0.88            | \$ (0.06)                         | \$ 0.82                | \$ 1.61          | \$ (0.13)                         | \$ 1.48                |
| Diluted earnings per share - continuing operations     | 0.87               | (0.06)                            | 0.81                   | 1.59             | (0.13)                            | 1.46                   |
| <b>Consolidated Statements of Comprehensive Income</b> |                    |                                   |                        |                  |                                   |                        |
| Other comprehensive income (loss)                      | \$ (42)            | \$ (15)                           | \$ (57)                | \$ 32            | \$ (32)                           | \$ 413                 |
| Comprehensive income                                   | 182                | (15)                              | 167                    | 445              | (32)                              | 413                    |

|  | Six Months Ended |  |                              |
|--|------------------|--|------------------------------|
|  | As Reported      | June 30, 2018<br>Effect of the<br>adoption of<br>ASC 606 | Under<br>Prior<br>Accounting |
| <i>(In millions)</i>   |                  |  |                              |
| <b>Consolidated Statements of Cash flows</b>                       |                  |  |                              |
| Net income   | \$ 413           | \$(32)   | 381                          |
| Income from continuing operations                                  | 413              | (32)   | 381                          |
| Deferred income taxes  | 12               | (11)   | 1                            |
| Accounts receivable, net   | (42)             | 40   | (2)                          |
| Inventories  | (78)             | (10)   | (88)                         |
| Other assets   | (38)             | (28)   | (66)                         |
| Other liabilities  | (165)            | 41   | (124)                        |
| Net cash provided by operating activities of continuing operations | 398              |  | 398                          |



Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Consolidated Results of Operations**

|   | Three Months Ended |                 |             | Six Months Ended |                 |             |
|---|--------------------|-----------------|-------------|------------------|-----------------|-------------|
|   | June 30,<br>2018   | July 1,<br>2017 | %<br>Change | June 30,<br>2018 | July 1,<br>2017 | %<br>Change |
| <i>(Dollars in millions)</i>                      |                    |                 |             |                  |                 |             |
| Revenues  | \$ 3,726           | \$ 3,604        | 3%          | \$ 7,022         | \$ 6,697        | 5%          |
| Cost of sales                                     | 3,073              | 2,996           | 3%          | 5,802            | 5,588           | 4%          |
| Selling and administrative expense                | 370                | 343             | 8%          | 697              | 652             | 7%          |
| Gross margin percentage of Manufacturing revenues | 17.1%              | 16.5%           |             | 17.0%            | 16.1%           |             |

An analysis of our consolidated operating results is set forth below. A more detailed analysis of our segments' operating results is provided in the Segment Analysis section on pages 23 to 28.

At the beginning of 2018, we adopted Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (ASC 606)* using the modified retrospective transition method applied to contracts that were not substantially complete at the end of 2017. We recorded a \$90 million adjustment to increase retained earnings to reflect the cumulative impact of adopting this standard at the beginning of 2018, primarily related to certain long-term contracts our Bell segment has with the U.S. Government that converted to the cost-to-cost method for revenue recognition. Revenues in 2018 for our U.S. Government contracts are primarily recognized as costs are incurred, while revenues for 2017 were primarily recognized as units were delivered. The comparative information has not been restated and is reported under the accounting standards in effect for those periods. A reconciliation of the financial statement line items impacted for the three and six months ended June 30, 2018 under ASC 606 to the prior accounting standards is provided in Note 15 to the Consolidated Financial Statements.

**Revenues**

Revenues increased \$122 million, 3%, in the second quarter of 2018, compared with the second quarter of 2017, largely driven by increases in the Industrial, Textron Aviation and Bell segments, partially offset by lower revenues at the Textron Systems segment. The net revenue increase included the following factors:

- Higher Industrial revenues of \$109 million, primarily due to higher volume of \$75 million across all of the segment's product lines and a favorable impact of \$27 million from foreign exchange, primarily related to the Euro.
- Higher Textron Aviation revenues of \$105 million, primarily due to higher volume and mix of \$76 million, largely the result of higher commercial turboprop volume, and favorable pricing of \$29 million.

- Higher Bell revenues of \$6 million, primarily due to higher commercial revenues of \$35 million, partially offset by lower military revenues of \$29 million.
- Lower Textron Systems revenues of \$97 million, largely reflecting lower volume, primarily due to the discontinuance of our sensor-fuzed weapon product in 2017 and lower volume of \$54 million in the Marine and Land Systems product line.

Revenues increased \$325 million, 5%, in the first half of 2018, compared with the first half of 2017, largely driven by increases in the Industrial, Textron Aviation and Bell segments, partially offset by lower revenues at the Textron Systems segment. The net revenue increase included the following factors:

- Higher Industrial revenues of \$248 million, primarily due to higher volume of \$109 million across all of the segment's product lines, a favorable impact of \$79 million from foreign exchange, primarily related to the Euro, and the impact from the Arctic Cat acquisition of \$49 million.
- Higher Textron Aviation revenues of \$145 million, primarily due to higher volume and mix of \$93 million, largely the result of higher commercial turboprop volume, and favorable pricing of \$52 million.
- Higher Bell revenues of \$61 million, largely due to higher military revenues.
- Lower Textron Systems revenues of \$126 million, largely reflecting lower volume, primarily due to the discontinuance of our sensor-fuzed weapon product in 2017.

#### **Cost of Sales and Selling and Administrative Expense**

Cost of sales increased \$77 million, 3%, and \$214 million, 4%, in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017, largely due to higher net volume described above and an unfavorable foreign exchange impact largely within our Industrial segment. In the first half of 2018, cost of sales also included an increase related to the Arctic Cat acquisition. Gross margin as a percentage of Manufacturing revenues increased 60 and 90 basis points in the second quarter and first half of 2018, respectively, primarily due to improved margins at the Textron Aviation segment, reflecting higher volume and mix and favorable pricing. The first half of 2018 was also impacted by improved margins at the Textron Systems segment largely

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due to a 2017 unfavorable program adjustment for the TAPV program, partially offset by lower margin at the Industrial segment, which included the impact from the Arctic Cat acquisition.

Selling and administrative expense increased \$27 million, 8%, and \$45 million, 7%, in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017, primarily due to higher share-based compensation expense. The first half of 2018 also reflected higher selling and administrative expenses at the Bell segment.

**Income Taxes**

Our effective tax rate for the second quarter and first half of 2018 was 13.8% and 13.6%, respectively. In the second quarter and first half of 2018, the effective tax rate was lower than the U.S. federal statutory tax rate of 21%, primarily due to a \$25 million benefit recognized upon the reassessment of our reserve for uncertain tax positions based on new information, including interactions with the tax authorities and recent audit settlements. The effective tax rate for the first half of 2018 also reflects benefits recognized from audit settlements in the first quarter of 2018.

**Backlog**

Our backlog is summarized below:

| <i>(In millions)</i> | <b>June 30,<br/>2018</b> | <b>December<br/>30,<br/>2017</b> |
|----------------------|--------------------------|----------------------------------|
| Bell                 | \$ 5,482                 | \$ 4,598                         |
| Textron Aviation     | 1,563                    | 1,180                            |
| Textron Systems      | 1,178                    | 1,406                            |
| Total backlog        | \$ 8,223                 | \$ 7,184                         |

Bell's backlog increased \$884 million in the first half of 2018. New contracts received in excess of revenues recognized totaled \$1.6 billion, which primarily reflected an increase of \$2.2 billion for Bell's portion of a third multi-year V-22 contract for the production and delivery of 58 units along with related supplies and services through 2024. This was partially offset by a decrease of approximately \$760 million upon the adoption of ASC 606 at the beginning of 2018, largely resulting from the acceleration of revenues upon conversion to the cost-to-cost method of revenue recognition.

Backlog at Textron Aviation increased \$383 million in the first half of 2018 as a result of orders in excess of deliveries and an increase of approximately \$170 million upon the adoption of ASC 606. Textron Systems backlog decreased \$228 million in the first half of 2018 as revenues recognized exceeded new contracts.

At June 30, 2018, backlog includes amounts that have been formally appropriated under contracts with the U.S. Government and certain other agreements that meet the contract criteria under ASC 606 that had previously been excluded from backlog. For both periods, backlog excludes unexercised contract options and potential orders under ordering-type contracts such as Indefinite Delivery, Indefinite Quantity contracts.

**Segment Analysis**

We operate in, and report financial information for, the following five business segments: Textron Aviation, Bell, Textron Systems, Industrial and Finance. Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit for the manufacturing segments excludes interest expense, certain corporate expenses and special charges. The measurement for the Finance segment includes interest income and expense along with intercompany interest income and expense. Operating expenses for the Manufacturing segments include cost of sales, selling and administrative expense and other components of net periodic benefit cost/(credit), and exclude certain corporate expenses and special charges.

In our discussion of comparative results for the Manufacturing group, changes in revenues and segment profit typically are expressed for our commercial business in terms of volume, pricing, foreign exchange and acquisitions, while changes in segment profit may be expressed in terms of mix, inflation and cost performance. Volume changes in revenues for our commercial business represent increases or decreases in the number of units delivered or services provided. Pricing represents changes in unit pricing. Foreign exchange is the change resulting from translating foreign-denominated amounts into U.S. dollars at exchange rates that are different from the prior period. Revenues generated by acquired businesses are reflected in Acquisitions for a twelve-month period. For segment profit, mix represents a change due to the composition of products and/or services sold at different profit margins. Inflation represents higher material, wages, benefits, pension service cost or other costs. Performance reflects an increase or decrease in research and development, depreciation, selling and administrative costs, warranty, product liability, quality/scrap, labor efficiency, overhead, non-service pension cost/(credit), product line profitability, start-up, ramp up and cost-reduction initiatives or other manufacturing inputs.

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Approximately 24% of our 2017 revenues were derived from contracts with the U.S. Government, including those under the U.S. Government-sponsored foreign military sales program. For our segments that contract with the U.S. Government, changes in revenue related to these contracts are expressed in terms of volume. Revenues in 2018 for our U.S. Government contracts are primarily recognized as costs are incurred, while revenues for 2017 were primarily recognized as units were delivered. Changes in segment profit are typically expressed in terms of volume and performance, which includes cumulative catch-up adjustments associated with a) revisions to the transaction price that may reflect contract modifications or changes in assumptions related to award fees and other variable consideration or b) changes in the total estimated costs at completion due to improved or deteriorated operating performance.

**Textron Aviation**

|                                | Three Months Ended |                 | Six Months Ended |                 |
|--------------------------------|--------------------|-----------------|------------------|-----------------|
|                                | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| <i>(Dollars in millions)</i>   |                    |                 |                  |                 |
| Revenues:                      |                    |                 |                  |                 |
| Aircraft                       | \$ 877             | \$ 775          | \$ 1,511         | \$ 1,374        |
| Aftermarket parts and services | 399                | 396             | 775              | 767             |
| Total revenues                 | 1,276              | 1,171           | 2,286            | 2,141           |
| Operating expenses             | 1,172              | 1,117           | 2,110            | 2,051           |
| Segment profit                 | 104                | 54              | 176              | 90              |
| Profit margin                  | 8.2%               | 4.6%            | 7.7%             | 4.2%            |

**Textron Aviation Revenues and Operating Expenses**

The following factors contributed to the change in Textron Aviation's revenues for the periods:

|                      |    | Q2 2018<br>versus<br>Q2 2017 | YTD 2018<br>versus<br>YTD 2017 |
|----------------------|----|------------------------------|--------------------------------|
| <i>(In millions)</i> |    |                              |                                |
| Volume and mix       | \$ | 76                           | 93                             |
| Pricing              |    | 29                           | 52                             |
| Total change         | \$ | 105                          | 145                            |

Textron Aviation's revenues increased \$105 million, 9%, and \$145 million, 7%, in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017. The increase in revenues was primarily due to higher volume and mix of \$76 million and \$93 million, respectively, largely related to higher commercial turboprop volume, and favorable pricing of \$29 million and \$52 million, respectively. We delivered 48 Citation jets and 47 commercial turboprops in the second quarter of 2018, compared with 46 Citation jets and 33 commercial turboprops in the second quarter of 2017. We delivered 84 Citation jets and 76 commercial turboprops in the first half of 2018, compared with 81 Citation jets and 53 commercial turboprops in the first half of 2017.

Textron Aviation's operating expenses increased \$55 million, 5%, and \$59 million, 3%, in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017, largely due to higher volume described above.

**Textron Aviation Segment Profit**

The following factors contributed to the change in Textron Aviation's segment profit for the periods:

|                           |    | <b>Q2 2018</b> | <b>YTD 2018</b> |
|---------------------------|----|----------------|-----------------|
|                           |    | <b>versus</b>  | <b>versus</b>   |
|                           |    | <b>Q2 2017</b> | <b>YTD 2017</b> |
| <i>(In millions)</i>      |    |                |                 |
| Volume and mix            | \$ | 33\$           | 48              |
| Pricing, net of inflation |    | 20             | 29              |
| Performance               |    | (3)            | 9               |
| Total change              | \$ | 50\$           | 86              |

Segment profit at Textron Aviation increased \$50 million and \$86 million in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017, primarily due to higher volume and mix described above and a favorable impact from pricing, net of inflation, of \$20 million and \$29 million, respectively.

Table of Contents**Bell**

|  | Three Months Ended |                 | Six Months Ended |                 |
|--|--------------------|-----------------|------------------|-----------------|
|  | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| <i>(Dollars in millions)</i>               |                    |                 |                  |                 |
| Revenues:                                  |                    |                 |                  |                 |
| Military aircraft and support programs     | \$ 533             | \$ 562          | 1,020            | 965             |
| Commercial helicopters, parts and services | 298                | 263             | 563              | 557             |
| Total revenues                             | 831                | 825             | 1,583            | 1,522           |
| Operating expenses                         | 714                | 713             | 1,379            | 1,327           |
| Segment profit                             | 117                | 112             | 204              | 195             |
| Profit margin                              | 14.1%              | 13.6%           | 12.9%            | 12.8%           |

Bell's military revenues include two major U.S. Government programs for the V-22 tiltrotor aircraft and the H-1 helicopter, which are both in the production stage and represent a significant portion of Bell's revenues from the U.S. Government.

**Bell Revenues and Operating Expenses**

The following factors contributed to the change in Bell's revenues for the periods:

| <i>(In millions)</i> |    | Q2 2018 | YTD 2018 |
|----------------------|----|---------|----------|
|                      |    | versus  | versus   |
|                      |    | Q2 2017 | YTD 2017 |
| Volume and mix       | \$ | 2       | 53       |
| Other                |    | 4       | 8        |
| Total change         | \$ | 6       | 61       |

Bell's revenues increased \$6 million, in the second quarter of 2018, compared with the second quarter of 2017, largely due to higher commercial revenues of \$35 million, partially offset by a \$29 million decrease in military revenues. We delivered 57 commercial helicopters in the second quarter of 2018, compared with 21 commercial helicopters in the second quarter of 2017.

In the first half of 2018, Bell's revenues increased \$61 million, 4%, compared with the first half of 2017, largely due to higher military revenues of \$55 million and higher commercial revenues of \$6 million. We delivered 103 commercial helicopters in the first half of 2018, compared with 48 commercial helicopters in the first half of 2017.

Bell's operating expenses were largely unchanged in the second quarter of 2018, compared with the second quarter of 2017, as improved performance on military programs described below was largely offset by unfavorable performance associated with certain commercial aircraft programs and higher selling and administrative costs.

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Bell's operating expenses increased \$52 million, 4%, in the first half of 2018, compared with the first half of 2017, primarily due to higher volume and mix described above, higher selling and administrative costs and unfavorable performance associated with certain commercial aircraft programs, partially offset by improved performance on military programs described below.

### Bell Segment Profit

The following factors contributed to the change in Bell's segment profit for the periods:

|                       |    | Q2 2018 | YTD 2018 |
|-----------------------|----|---------|----------|
|                       |    | versus  | versus   |
|                       |    | Q2 2017 | YTD 2017 |
| <i>(In millions)</i>  |    |         |          |
| Volume and mix        | \$ | 4\$     | 17       |
| Performance and other |    | 1       | (8)      |
| Total change          | \$ | 5\$     | 9        |

Bell's segment profit increased \$5 million, 4%, in the second quarter of 2018, compared with the second quarter of 2017. Performance and other included \$26 million of improved performance on military programs reflecting retirements of risk related to cost estimates, partially offset by the mix of lower margin contract revenues. Performance and other also included unfavorable performance associated with certain commercial programs and higher selling and administrative costs.

Bell's segment profit increased \$9 million, 5%, in the first half of 2018, compared with the first half of 2017, primarily due to higher volume and mix described above, partially offset by an unfavorable impact of \$8 million from performance and other. Performance and other included \$31 million of improved performance on military programs reflecting retirements of risk related to cost estimates,



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partially offset by the mix of lower margin contract revenues. Performance and other also included higher selling and administrative costs and unfavorable performance associated with certain commercial aircraft programs.

**Textron Systems**

|                              | Three Months Ended |              | Six Months Ended |              |
|------------------------------|--------------------|--------------|------------------|--------------|
|                              | June 30, 2018      | July 1, 2017 | June 30, 2018    | July 1, 2017 |
| <i>(Dollars in millions)</i> |                    |              |                  |              |
| Revenues                     | \$ 380             | \$ 477       | \$ 767           | \$ 893       |
| Operating expenses           | 340                | 435          | 677              | 831          |
| Segment profit               | 40                 | 42           | 90               | 62           |
| Profit margin                | 10.5%              | 8.8%         | 11.7%            | 6.9%         |

**Textron Systems Revenues and Operating Expenses**

The following factors contributed to the change in Textron Systems revenues for the periods:

|                      |    | Q2 2018 | YTD 2018 |
|----------------------|----|---------|----------|
|                      |    | versus  | versus   |
| <i>(In millions)</i> |    | Q2 2017 | YTD 2017 |
| Volume               | \$ | (98)\$  | (128)    |
| Other                |    | 1       | 2        |
| Total change         | \$ | (97)\$  | (126)    |

Revenues at Textron Systems decreased \$97 million, 20%, in the second quarter of 2018, compared with the second quarter of 2017, largely due to lower volume of \$98 million. The lower volume was primarily due to the discontinuance of our sensor-fuzed weapon product in 2017 and lower volume of \$54 million in the Marine and Land Systems product line largely resulting from lower TAPV deliveries.

In the first half of 2018, revenues at Textron Systems decreased \$126 million, 14%, compared with the first half of 2017, largely due to lower volume of \$128 million, primarily due to the discontinuance of our sensor-fuzed weapon product in 2017.

Textron Systems operating expenses decreased \$95 million, 22%, in the second quarter of 2018, compared with the second quarter of 2017, primarily due to lower net volume described above. In the first half of 2018, operating expenses decreased \$154 million, 19%, compared with the first half of 2017, primarily due to lower volume described above and the impact from an unfavorable program adjustment recorded in the first quarter of 2017 described below.

**Textron Systems Segment Profit**

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The following factors contributed to the change in Textron Systems segment profit for the periods:

| <i>(In millions)</i>  | <b>Q2 2018<br/>versus<br/>Q2 2017</b> | <b>YTD 2018<br/>versus<br/>YTD 2017</b> |
|-----------------------|---------------------------------------|---|
| Performance and other | \$ 11                                 | \$ 48                                   |
| Volume and mix        | (13)                                  | (20)                                    |
| Total change          | \$ (2)                                | \$ 28                                   |

Textron Systems segment profit decreased \$2 million, 5%, in the second quarter of 2018, compared with the second quarter of 2017, primarily due to lower net volume as described above, partially offset by favorable performance and other of \$11 million.

Textron Systems segment profit increased \$28 million, 45%, in the first half of 2018, compared with the first half of 2017, primarily due to favorable performance and other of \$48 million, partially offset by lower net volume described above. Performance and other includes an unfavorable program adjustment recorded in the first quarter of 2017 of \$24 million related to the TAPV program, which experienced inefficiencies resulting from production issues.

Table of Contents**Industrial**

| <i>(Dollars in millions)</i>           | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|--|---------------------------|-------------------------|--------------------------|-------------------------|
|  | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Revenues:                              |                           |                         |                          |                         |
| Fuel Systems and Functional Components | \$ 627                    | \$ 591                  | \$ 1,282                 | \$ 1,194                |
| Other Industrial                       | 595                       | 522                     | 1,071                    | 911                     |
| Total revenues                         | 1,222                     | 1,113                   | 2,353                    | 2,105                   |
| Operating expenses                     | 1,142                     | 1,031                   | 2,209                    | 1,947                   |
| Segment profit                         | 80                        | 82                      | 144                      | 158                     |
| Profit margin                          | 6.6%                      | 7.4%                    | 6.1%                     | 7.5%                    |

**Industrial Revenues and Operating Expenses**

The following factors contributed to the change in Industrial s revenues for the periods:

| <i>(In millions)</i> |    | <b>Q2 2018<br/>versus<br/>Q2 2017</b> | <b>YTD 2018<br/>versus<br/>YTD 2017</b> |
|----------------------|----|---------------------------------------|---|
| Volume               | \$ | 75                                    | 109                                     |
| Foreign exchange     |    | 27                                    | 79                                      |
| Acquisitions         |    |                                       | 49                                      |
| Other                |    | 7                                     | 11                                      |
| Total change         | \$ | 109                                   | 248                                     |

Industrial segment revenues increased \$109 million, 10%, in the second quarter of 2018, compared with the second quarter of 2017, primarily due to higher volume of \$75 million across all of the segment s product lines and a favorable impact of \$27 million from foreign exchange, primarily related to the strengthening of the Euro against the U.S. dollar.

In the first half of 2018, Industrial segment revenues increased \$248 million, 12%, compared with the first half of 2017, primarily due to higher volume of \$109 million across all of the segment s product lines, a favorable impact of \$79 million from foreign exchange, primarily related to the strengthening of the Euro against the U.S. dollar, and the impact of \$49 million from the acquisition of Arctic Cat on March 6, 2017.

Operating expenses for the Industrial segment increased \$111 million, 11%, and \$262 million, 13%, in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017, primarily due to additional operating expenses from higher volume described above and the impact from foreign exchange. The increase in operating expenses in the first half of 2018 also reflected additional operating expenses from the Arctic Cat acquisition.

**Industrial Segment Profit**

The following factors contributed to the change in Industrial s segment profit for the periods:

| <i>(In millions)</i>  | <b>Q2 2018<br/>versus<br/>Q2 2017</b> | <b>YTD 2018<br/>versus<br/>YTD 2017</b> |
|-----------------------|---------------------------------------|---|
| Performance and other | \$ (1)\$                              | (8)                                     |
| Volume and mix        | (1)                                   | (6)                                     |
| Total change          | \$ (2)\$                              | (14)                                    |

Segment profit for the Industrial segment decreased \$2 million, 2%, in the second quarter of 2018, compared with the second quarter of 2017, despite the higher revenues, primarily due to the mix of products sold in the period.

Segment profit for the Industrial segment decreased \$14 million, 9%, in the first half of 2018, compared with the first half of 2017, reflecting additional operating expenses from Arctic Cat in the first half of 2018 due to the timing of the acquisition and the seasonality of the outdoor powersports business. The unfavorable volume and mix was primarily due to the mix of products sold in the period.

On April 18, 2018, we entered into a definitive agreement to sell the businesses that manufacture and sell the products in our Tools and Test Equipment product line within our Industrial segment to Emerson Electric Co. We completed the disposition of these businesses on July 2, 2018.

Table of Contents**Finance**

| <i>(In millions)</i> | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|----------------------|---------------------------|-------------------------|--------------------------|-------------------------|
|                      | <b>June 30,<br/>2018</b>  | <b>July 1,<br/>2017</b> | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Revenues             | \$ 17\$                   | 18\$                    | 33\$                     | 36                      |
| Segment profit       | 5                         | 5                       | 11                       | 9                       |

Finance segment revenues and profit were largely unchanged in the second quarter and first half of 2018, respectively, compared with the corresponding periods of 2017. The following table reflects information about the Finance segment's credit performance related to finance receivables.

| <i>(Dollars in millions)</i>  | <b>December</b>          |                     |
|---|--------------------------|---------------------|
|   | <b>June 30,<br/>2018</b> | <b>30,<br/>2017</b> |
| Finance receivables   | \$ 792\$                 | 850                 |
| Nonaccrual finance receivables  | 54                       | 61                  |
| Ratio of nonaccrual finance receivables to finance receivables          | 6.82%                    | 7.18%               |
| 60+ days contractual delinquency  | \$ 52\$                  | 34                  |
| 60+ days contractual delinquency as a percentage of finance receivables | 6.57%                    | 4.00%               |

**Liquidity and Capital Resources**

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron consolidated with its majority-owned subsidiaries that operate in the Textron Aviation, Bell, Textron Systems and Industrial segments. The Finance group, which also is the Finance segment, consists of Textron Financial Corporation and its consolidated subsidiaries. We designed this framework to enhance our borrowing power by separating the Finance group. Our Manufacturing group operations include the development, production and delivery of tangible goods and services, while our Finance group provides financial services. Due to the fundamental differences between each borrowing group's activities, investors, rating agencies and analysts use different measures to evaluate each group's performance. To support those evaluations, we present balance sheet and cash flow information for each borrowing group within the Consolidated Financial Statements.

Key information that is utilized in assessing our liquidity is summarized below:

| <i>(Dollars in millions)</i>                      | <b>December</b>          |                     |
|---|--------------------------|---------------------|
|   | <b>June 30,<br/>2018</b> | <b>30,<br/>2017</b> |
| <b>Manufacturing group</b>                        |                          |                     |
| Cash and equivalents                              | \$ 554\$                 | 1,079               |
| Debt  | 3,079                    | 3,088               |
| Shareholders' equity                              | 5,362                    | 5,647               |
| Capital (debt plus shareholders' equity)          | 8,441                    | 8,735               |
| Net debt (net of cash and equivalents) to capital | 32%                      | 26%                 |

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|                      |    |     |     |
|----------------------|----|-----|-----|
| Debt to capital      |    | 36% | 35% |
| <b>Finance group</b> |    |     |     |
| Cash and equivalents | \$ | 177 | 183 |
| Debt                 |    | 809 | 824 |

We believe that our calculations of debt to capital and net debt to capital are useful measures as they provide a summary indication of the level of debt financing (i.e., leverage) that is in place to support our capital structure, as well as to provide an indication of the capacity to add further leverage. We believe that we will have sufficient cash to meet our future needs, based on our existing cash balances, the cash we expect to generate from our manufacturing operations and other available funding alternatives, as appropriate.

Textron has a senior unsecured revolving credit facility that expires in September 2021 for an aggregate principal amount of \$1.0 billion, of which up to \$100 million is available for the issuance of letters of credit. At June 30, 2018, there were no amounts borrowed against the facility. We also maintain an effective shelf registration statement filed with the Securities and Exchange Commission that allows us to issue an unlimited amount of public debt and other securities.

Table of Contents**Manufacturing Group Cash Flows**

Cash flows from continuing operations for the Manufacturing group as presented in our Consolidated Statements of Cash Flows are summarized below:

| <i>(In millions)</i> |    | Six Months Ended |                 |
|----------------------|----|------------------|-----------------|
|                      |    | June 30,<br>2018 | July 1,<br>2017 |
| Operating activities | \$ | 415\$            | 248             |
| Investing activities |    | (51)             | (467)           |
| Financing activities |    | (882)            | 28              |

Cash flows from operating activities increased \$167 million during the first half of 2018, compared with the first half of 2017, primarily reflecting higher earnings and a dividend of \$50 million received from the Finance group in the first quarter of 2018.

Investing cash flows included capital expenditures of \$159 million and \$161 million in the first half of 2018 and 2017, respectively, partially offset by net proceeds received from corporate-owned life insurance policies of \$98 million and \$22 million, respectively. In the first half of 2017, investing activities also reflected a \$316 million aggregate cash payment, including the repayment of debt and net of cash acquired, for the Arctic Cat acquisition.

In the first half of 2018, cash flows used in financing activities primarily included \$915 million of cash paid to repurchase an aggregate of 14.6 million shares of our outstanding common stock under a prior 2017 share repurchase authorization and a new 2018 share repurchase authorization as disclosed below. In the first half of 2017, cash flows from financing activities primarily included proceeds from long-term debt of \$347 million, partially offset by \$329 million of cash paid to repurchase an aggregate of 7.0 million shares of our outstanding common stock under a 2017 share repurchase authorization.

On April 16, 2018, our Board of Directors authorized the repurchase of up to 40 million shares of our common stock. This repurchase plan is sufficient for repurchases related to the disposition of the Tools and Test product line as disclosed in Note 3 to the Consolidated Financial Statements, as well as to continue our practice of repurchasing shares to offset the impact of dilution from stock-based compensation and benefit plans, and for opportunistic capital management purposes. The new authorization replaced the previous plan, approved in January 2017, which was nearing completion.

**Finance Group Cash Flows**

Cash flows from continuing operations for the Finance group as presented in our Consolidated Statements of Cash Flows are summarized below:

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| <i>(In millions)</i> |    | <b>Six Months Ended</b>  |                         |
|----------------------|----|--------------------------|-------------------------|
|                      |    | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Operating activities | \$ | 5\$                      | (40)                    |
| Investing activities |    | 73                       | 116                     |
| Financing activities |    | (84)                     | (46)                    |

The Finance group's cash flows used in operating activities included net tax payments of \$48 million for the first half of 2017. Cash flows from investing activities primarily included collections on finance receivables totaling \$112 million and \$158 million in the first half of 2018 and 2017, respectively, partially offset by finance receivable originations of \$61 million and \$74 million, respectively. Financing activities in the first half of 2018 reflected a dividend payment of \$50 million to the Manufacturing group. In addition, cash flows used for financing activities included payments on long-term and nonrecourse debt of \$34 million and \$74 million in the first half of 2018 and 2017, respectively.

**Consolidated Cash Flows**

The consolidated cash flows from continuing operations, after elimination of activity between the borrowing groups, are summarized below:

| <i>(In millions)</i> |    | <b>Six Months Ended</b>  |                         |
|----------------------|----|--------------------------|-------------------------|
|                      |    | <b>June 30,<br/>2018</b> | <b>July 1,<br/>2017</b> |
| Operating activities | \$ | 398\$                    | 267                     |
| Investing activities |    | (6)                      | (410)                   |
| Financing activities |    | (916)                    | (18)                    |



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In the first half of 2018, consolidated cash flows from operating activities increased \$131 million, compared with the first half of 2017, primarily reflecting higher earnings, partially offset by a decrease in cash flows of \$34 million related to captive financing activities.

Investing cash flows included capital expenditures of \$159 million and \$161 million in the first half of 2018 and 2017, respectively, partially offset by net proceeds received from corporate-owned life insurance policies of \$98 million and \$22 million, respectively. In the first half of 2017, investing activities also reflected a \$316 million aggregate cash payment, including the repayment of debt and net of cash acquired, for the Arctic Cat acquisition.

Financing activities in the first half of 2018 primarily included \$915 million in cash paid to repurchase an aggregate of 14.6 million shares of our outstanding common stock under a prior 2017 share repurchase authorization and a new 2018 share repurchase authorization as discussed above. In the first half of 2017, cash flows used in financing activities primarily included share repurchases of \$329 million and payments on long-term debt and nonrecourse debt of \$74 million, partially offset by proceeds from long-term debt of \$375 million.

**Captive Financing and Other Intercompany Transactions**

The Finance group provides financing primarily to purchasers of new and pre-owned Textron Aviation aircraft and Bell helicopters manufactured by our Manufacturing group, otherwise known as captive financing. In the Consolidated Statements of Cash Flows, cash received from customers is reflected as operating activities when received from third parties. However, in the cash flow information provided for the separate borrowing groups, cash flows related to captive financing activities are reflected based on the operations of each group. For example, when product is sold by our Manufacturing group to a customer and is financed by the Finance group, the origination of the finance receivable is recorded within investing activities as a cash outflow in the Finance group's statement of cash flows. Meanwhile, in the Manufacturing group's statement of cash flows, the cash received from the Finance group on the customer's behalf is recorded within operating cash flows as a cash inflow. Although cash is transferred between the two borrowing groups, there is no cash transaction reported in the consolidated cash flows at the time of the original financing. These captive financing activities, along with all significant intercompany transactions, are reclassified or eliminated from the Consolidated Statements of Cash Flows.

Reclassification adjustments included in the Consolidated Statements of Cash Flows are summarized below:

| <i>(In millions)</i>  |    | <b>Six Months Ended</b> |                |
|---|----|-------------------------|----------------|
|   |    | <b>June 30,</b>         | <b>July 1,</b> |
|   |    | <b>2018</b>             | <b>2017</b>    |
| Reclassification adjustments from investing activities:                 |    |                         |                |
| Cash received from customers  | \$ | 87\$                    | 134            |
| Finance receivable originations for Manufacturing group inventory sales |    | (61)                    | (74)           |
| Other   |    | 2                       | (1)            |
| Total reclassification adjustments from investing activities            |    | 28                      | 59             |
| Reclassification adjustments from financing activities:                 |    |                         |                |
| Dividends received by Manufacturing group from Finance group            |    | (50)                    |                |
| Total reclassification adjustments to operating activities              | \$ | (22)\$                  | 59             |

Critical Accounting Estimates Update

Our Consolidated Financial Statements are prepared in conformity with U.S. generally accepted accounting principles, which require us to make estimates and assumptions that affect the amounts reported in the financial statements. The accounting estimates that we believe are most critical to the portrayal of our financial condition and results of operations are reported in Item 7 of our Annual Report on Form 10-K for the year ended December 30, 2017. In the first quarter of 2018, we adopted ASC 606, as discussed in Note 2 to the Consolidated Financial Statements. Significant changes to our critical accounting estimates as a result of the adoption of this standard are provided below.

#### **Revenue Recognition**

A substantial portion of our revenues is related to long-term contracts with the U.S. Government, including those under U.S. Government-sponsored foreign military sales program, for the design, development, manufacture or modification of aerospace and defense products as well as related services. Due to the continuous transfer of control to the U.S. Government, we recognize revenue over the time that we perform under the contract. Selecting the method to measure progress towards completion requires judgment and is based on the nature of the products or service to be provided. We generally use the cost-to-cost method to measure progress for our contracts because it best depicts the transfer of control to the customer that occurs as we incur costs on our contracts. Under this measure, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the estimated costs at completion of the performance obligation, and revenue is recorded proportionally as costs are incurred.

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Approximately 80% of our 2017 revenues with the U.S. Government were under fixed-price and fixed-price incentive contracts. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss.

The transaction price for our contracts represents our best estimate of the consideration we expect to receive and includes assumptions regarding variable consideration as applicable. Certain of our long-term contracts contain incentive fees or other provisions that can either increase or decrease the transaction price. These variable amounts generally are awarded upon achievement of certain performance metrics, program milestones or cost targets and can be based upon customer discretion. We include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of our anticipated performance, historical performance and all other information that is reasonably available to us.

Due to the number of years it may take to complete many of our contracts and the scope and nature of the work required to be performed on those contracts, the estimation of total transaction price and costs at completion is complicated and subject to many variables and, accordingly, is subject to change. In estimating total costs at completion, we are required to make numerous assumptions related to the complexity of design and related development work to be performed; engineering requirements; product performance; subcontractor performance; availability and cost of materials; labor productivity, availability and cost; overhead and capital costs; manufacturing efficiencies; the length of time to complete the contract (to estimate increases in wages and prices for materials); and costs of satisfying offset obligations, among other variables. Our cost estimation process is based on the professional knowledge and experience of engineers and program managers along with finance professionals. We review and update our cost projections quarterly or more frequently when circumstances significantly change. When estimates of total costs to be incurred on a contract exceed estimates of total sales to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

At the outset of each contract, we estimate an initial profit booking rate considering the risks surrounding our ability to achieve the technical requirements (e.g., a newly-developed product versus a mature product), schedule (e.g., the number and type of milestone events), and costs by contract requirements in the initial estimated costs at completion. Profit booking rates may increase during the performance of the contract if we successfully retire risks surrounding the technical, schedule, and cost aspects of the contract. Conversely, the profit booking rate may decrease if we are not successful in retiring the risks; and, as a result, our estimated costs at completion increase. All of the estimates are subject to change during the performance of the contract and, therefore, may affect the profit booking rate. Increases or decreases in profit booking rates are recognized in the current period and reflect the inception-to-date effect of such changes. Changes in our profit booking rate due to changes in our estimate of the total expected costs, along with changes in the transaction price, are generally recognized on a cumulative catch-up method of accounting. This method recognizes the cumulative effect of changes on current and prior periods with the impact of the change from inception-to-date recorded in the current period. The impact of our gross cumulative catch-up adjustments on revenue and segment profit recognized in prior periods is presented below:

|                      | Three Months Ended |                 | Six Months Ended |                 |
|----------------------|--------------------|-----------------|------------------|-----------------|
|                      | June 30,<br>2018   | July 1,<br>2017 | June 30,<br>2018 | July 1,<br>2017 |
| <i>(In millions)</i> |                    |                 |                  |                 |
| Gross favorable      | \$ 70\$            | 23\$            | 126\$            | 43              |
| Gross unfavorable    | (6)                | (14)            | (22)             | (46)            |
| Net adjustments      | \$ 64\$            | 9\$             | 104\$            | (3)             |

No individual adjustment was material to our Consolidated Statements of Operations for the three and six months ended June 30, 2018 and July 1, 2017. Due to the significance of judgment in the estimation process described above, it is likely that materially different revenues and/or cost of sales amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. Our earnings could be reduced by a material amount resulting in a charge to earnings if (a) total estimated contract costs are significantly higher than expected due

to changes in customer specifications prior to contract amendment, (b) total estimated contract costs are significantly higher than previously estimated due to cost overruns or inflation, (c) there is a change in engineering efforts required during the development stage of the contract or (d) we are unable to meet contract milestones.

### **Forward-Looking Information**

Certain statements in this Quarterly Report on Form 10-Q and other oral and written statements made by us from time to time are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, which may describe strategies, goals, outlook or other non-historical matters, or project revenues, income, returns or other financial measures, often include words such as believe, expect, anticipate, intend, plan, estimate, guidance, project, target, potential, will, sh may and similar expressions intended to identify forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. Given

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these uncertainties, you should not place undue reliance on these forward-looking statements. 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. In addition to those factors described in our 2017 Annual Report on Form 10-K under Risk Factors, among the factors that could cause actual results to differ materially from past and projected future results are the following:

- Interruptions in the U.S. Government's ability to fund its activities and/or pay its obligations;
- Changing priorities or reductions in the U.S. Government defense budget, including those related to military operations in foreign countries;
- Our ability to perform as anticipated and to control costs under contracts with the U.S. Government;
- The U.S. Government's ability to unilaterally modify or terminate its contracts with us for the U.S. Government's convenience or for our failure to perform, to change applicable procurement and accounting policies, or, under certain circumstances, to withhold payment or suspend or debar us as a contractor eligible to receive future contract awards;
- Changes in foreign military funding priorities or budget constraints and determinations, or changes in government regulations or policies on the export and import of military and commercial products;
- Volatility in the global economy or changes in worldwide political conditions that adversely impact demand for our products;
- Volatility in interest rates or foreign exchange rates;
- Risks related to our international business, including establishing and maintaining facilities in locations around the world and relying on joint venture partners, subcontractors, suppliers, representatives, consultants and other business partners in connection with international business, including in emerging market countries;
- Our Finance segment's ability to maintain portfolio credit quality or to realize full value of receivables;
- Performance issues with key suppliers or subcontractors;
- Legislative or regulatory actions, both domestic and foreign, impacting our operations or demand for our products;
- Our ability to control costs and successfully implement various cost-reduction activities;
- The efficacy of research and development investments to develop new products or unanticipated expenses in connection with the launching of significant new products or programs;
- The timing of our new product launches or certifications of our new aircraft products;
- Our ability to keep pace with our competitors in the introduction of new products and upgrades with features and technologies desired by our customers;

- Pension plan assumptions and future contributions;
- Demand softness or volatility in the markets in which we do business;
- Cybersecurity threats, including the potential misappropriation of assets or sensitive information, corruption of data or operational disruption;
- Difficulty or unanticipated expenses in connection with integrating acquired businesses;
- The risk that acquisitions do not perform as planned, including, for example, the risk that acquired businesses will not achieve revenues and profit projections;
- The impact of changes in tax legislation (including the recently enacted Tax Cuts and Jobs Act); and
- Risks related to the timing and scope of future repurchases of our common stock.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There has been no significant change in our exposure to market risk during the fiscal quarter ended June 30, 2018. For discussion of our exposure to market risk, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk contained in Textron's 2017 Annual Report on Form 10-K.

**Item 4. Controls and Procedures**

We performed an evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2018. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, under the supervision of our Chairman, President and Chief Executive Officer (CEO) and our Executive Vice President and Chief Financial Officer (CFO). Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures were operating and effective as of June 30, 2018.

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following provides information about our second quarter 2018 repurchases of equity securities that are registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended:

| <b>Period</b> <i>(shares in thousands)</i> | <b>Total<br/>Number of<br/>Shares<br/>Purchased *</b> | <b>Average Price<br/>Paid per Share<br/>(excluding<br/>commissions)</b> | <b>Total Number of<br/>Shares Purchased as<br/>part of Publicly<br/>Announced Plans *</b> | <b>Maximum<br/>Number of Shares<br/>that may yet be<br/>Purchased under<br/>the 2018 Plan*</b> |
|--|---|---|---|--|
| April 1, 2018 – May 5, 2018                | 2,600   | \$ 62.80  | 2,600   | 37,800   |
| May 6, 2018 – June 2, 2018                 | 3,125   | 65.59   | 3,125   | 34,675   |
| June 3, 2018 – June 30, 2018               | 3,012   | 67.26   | 3,012   | 31,663   |
| <b>Total</b>                               | <b>8,737</b>  | <b>\$ 65.34</b>   | <b>8,737</b>  |  |

\* On April 16, 2018, Textron's Board of Directors authorized a new share repurchase plan under which Textron is authorized to repurchase up to 40 million shares of Textron common stock. This plan replaced the previous plan, approved in January 2017, which was nearing completion. Under the 2017 plan, 400,000 shares were repurchased during the period April 1, 2018 through April 15, 2018, with the remainder purchased pursuant to the new plan. The new plan has no expiration date.

**Item 6. Exhibits**

- 12.1 Computation of ratio of income to fixed charges of Textron Inc. Manufacturing Group
- 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 Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 The following materials from Textron Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Balance Sheets, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements.





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**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.

Date: July 26, 2018

TEXTRON INC.

/s/ Mark S. Bamford  
Mark S. Bamford  
Vice President and Corporate Controller  
(principal accounting officer)

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