TEXTRON INC
Form 10-Q
July 29, 2015
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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 July 4, 2015

OR

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

For the transition period from _____ to _____.

Commission File Number 1-5480

Textron Inc.

(Exact name of registrant as specified in its charter)

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

(401) 421-2800

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer [_ü_] Accelerated filer [__] Non-accelerated filer [__] Smaller reporting company [__]

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

As of July 17, 2015, there were 276,421,869 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

TEXTRON INC.

Consolidated Statements of Operations (Unaudited)

(In millions, except per share amounts)	Three Months Ended July 4, 2015	Three Months Ended June 28, 2014	Six Months Ended July 4, 2015	Six Months Ended June 28, 2014
Revenues				
Manufacturing revenues	$ 3,223	$ 3,478	$ 6,274	$ 6,296
Finance revenues	24	27	46	56
Total revenues	3,247	3,505	6,320	6,352
Costs and expenses				
Cost of sales	2,635	2,875	5,144	5,232
Selling and administrative expense	329	353	666	655
Interest expense	42	47	85	94
Acquisition and restructuring costs		20		36
Total costs and expenses	3,006	3,295	5,895	6,017
Income from continuing operations before income taxes	241	210	425	335
Income tax expense	72	65	128	103
Income from continuing operations	169	145	297	232
Loss from discontinued operations, net of income taxes	(2)	(1)	(2)	(3)
Net income	$ 167	$ 144	$ 295	$ 229
Basic earnings per share				
Continuing operations	$ 0.61	$ 0.52	$ 1.07	$ 0.83
Discontinued operations	(0.01)		(0.01)	(0.01)
Basic earnings per share	$ 0.60	$ 0.52	$ 1.06	$ 0.82
Diluted earnings per share				
Continuing operations	$ 0.60	$ 0.51	$ 1.06	$ 0.82
Discontinued operations			(0.01)	(0.01)
Diluted earnings per share	$ 0.60	$ 0.51	$ 1.05	$ 0.81
Dividends per share				
Common stock	$ 0.02	$ 0.02	$ 0.04	$ 0.04

See Notes to the Consolidated Financial Statements.

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TEXTRON INC.

Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended		Six Months Ended	
(In millions)	**July 4, 2015**	**June 28, 2014**	**July 4, 2015**	**June 28, 2014**
Net income	$ 167	$ 144	$ 295	$ 229
Other comprehensive income, net of tax:				
Pension and postretirement benefits adjustments, net of reclassifications	87	27	111	45
Foreign currency translation adjustments	10	2	(46)	(4)
Deferred gains (losses) on hedge contracts, net of reclassifications	4	14	(8)	7
Other comprehensive income	101	43	57	48
Comprehensive income	$ 268	$ 187	$ 352	$ 277

See Notes to the Consolidated Financial Statements.

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TEXTRON INC.

Consolidated Balance Sheets (Unaudited)

(Dollars in millions)	**July 4, 2015**	**January 3, 2015**
Assets		
Manufacturing group		
Cash and equivalents	$ 661	$ 731
Accounts receivable, net	1,163	1,035
Inventories	4,437	3,928
Other current assets	512	579
Total current assets	6,773	6,273
Property, plant and equipment, less accumulated depreciation and amortization of $3,797 and $3,685	2,462	2,497
Goodwill	2,015	2,027
Other assets	2,251	2,279
Total Manufacturing group assets	13,501	13,076
Finance group		
Cash and equivalents	131	91
Finance receivables, net	1,162	1,238
Other assets	154	200
Total Finance group assets	1,447	1,529
Total assets	$ 14,948	$ 14,605
Liabilities and shareholders equity		
Liabilities		
Manufacturing group		
Short-term debt and current portion of long-term debt	$ 263	$ 8
Accounts payable	1,129	1,014
Accrued liabilities	2,671	2,616
Total current liabilities	4,063	3,638
Other liabilities	2,420	2,587
Long-term debt	2,650	2,803
Total Manufacturing group liabilities	9,133	9,028
Finance group		
Other liabilities	242	242
Debt	971	1,063
Total Finance group liabilities	1,213	1,305
Total liabilities	10,346	10,333
Shareholders equity		
Common stock	36	36
Capital surplus	1,535	1,459
Treasury stock	(427)	(340)
Retained earnings	4,907	4,623
Accumulated other comprehensive loss	(1,449)	(1,506)
Total shareholders equity	4,602	4,272
Total liabilities and shareholders equity	$ 14,948	$ 14,605
Common shares outstanding *(in thousands)*	276,342	276,582

See Notes to the Consolidated Financial Statements.

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TEXTRON INC.

Consolidated Statements of Cash Flows (Unaudited)

For the Six Months Ended July 4, 2015 and June 28, 2014, respectively

	Consolidated	
(In millions)	**2015**	**2014**
Cash flows from operating activities		
Net income	$ 295	$ 229
Less: Loss from discontinued operations	(2)	(3)
Income from continuing operations	297	232
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Non-cash items:		
Depreciation and amortization	220	214
Deferred income taxes	(15)	(14)
Other, net	53	56
Changes in assets and liabilities:		
Accounts receivable, net	(144)	(96)
Inventories	(516)	(279)
Other assets	(24)	16
Accounts payable	123	(98)
Accrued and other liabilities	27	208
Income taxes, net	93	35
Pension, net	40	17
Captive finance receivables, net	53	67
Other operating activities, net	(2)	(5)
Net cash provided by operating activities of continuing operations	205	353
Net cash used in operating activities of discontinued operations	(3)	(2)
Net cash provided by operating activities	202	351
Cash flows from investing activities		
Capital expenditures	(173)	(172)
Net cash used in acquisitions	(34)	(1,550)
Finance receivables repaid	46	58
Other investing activities, net	26	16
Net cash used in investing activities	(135)	(1,648)
Cash flows from financing activities		
Principal payments on long-term and nonrecourse debt	(130)	(121)
Increase in short-term debt	105	
Proceeds from long-term debt	9	1,151
Purchases of Textron common stock	(87)	(150)
Dividends paid	(11)	(11)
Other financing activities, net	21	30
Net cash provided by (used in) financing activities	(93)	899
Effect of exchange rate changes on cash and equivalents	(4)	2
Net decrease in cash and equivalents	(30)	(396)
Cash and equivalents at beginning of period	822	1,211
Cash and equivalents at end of period	$ 792	$ 815

See Notes to the Consolidated Financial Statements.

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TEXTRON INC.

Consolidated Statements of Cash Flows (Unaudited) (Continued)

For the Six Months Ended July 4, 2015 and June 28, 2014, respectively

	Manufacturing Group		Finance Group	
(In millions)	**2015**	**2014**	**2015**	**2014**
Cash flows from operating activities				
Net income	$ 285	$ 222	$ 10	$ 7
Less: Loss from discontinued operations	(2)	(3)		
Income from continuing operations	287	225	10	7
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:				
Non-cash items:				
Depreciation and amortization	215	207	5	7
Deferred income taxes	(6)	(5)	(9)	(9)
Other, net	51	48	2	8
Changes in assets and liabilities:				
Accounts receivable, net	(144)	(96)		
Inventories	(525)	(272)		
Other assets	(34)	16	10	
Accounts payable	123	(98)		
Accrued and other liabilities	33	211	(6)	(3)
Income taxes, net	78	31	15	4
Pension, net	40	17		
Other operating activities, net	(2)	(1)		(4)
Net cash provided by operating activities of continuing operations	116	283	27	10
Net cash used in operating activities of discontinued operations	(3)	(2)		
Net cash provided by operating activities	113	281	27	10
Cash flows from investing activities				
Capital expenditures	(173)	(172)		
Net cash used in acquisitions	(34)	(1,550)		
Finance receivables repaid			181	222
Finance receivables originated			(82)	(97)
Other investing activities, net		(5)	35	14
Net cash provided by (used in) investing activities	(207)	(1,727)	134	139
Cash flows from financing activities				
Principal payments on long-term and nonrecourse debt		(1)	(130)	(120)
Increase in short-term debt	105			
Proceeds from long-term debt		1,093	9	58
Purchases of Textron common stock	(87)	(150)		
Dividends paid	(11)	(11)		
Other financing activities, net	21	30		
Net cash provided by (used in) financing activities	28	961	(121)	(62)
Effect of exchange rate changes on cash and equivalents	(4)	2		
Net increase (decrease) in cash and equivalents	(70)	(483)	40	87
Cash and equivalents at beginning of period	731	1,163	91	48
Cash and equivalents at end of period	$ 661	$ 680	$ 131	$ 135

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 January 3, 2015. In the opinion of management, the interim financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for the fair presentation of our consolidated financial position, results of operations and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

Our financings are conducted through two separate borrowing groups. The Manufacturing group consists of Textron 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 and wholesale financing activities for inventory sold by our Manufacturing group and financed by our Finance group.

Use of Estimates

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

During 2015 and 2014, we changed our estimates of revenues and costs on certain long-term contracts that are accounted for under the percentage-of-completion method of accounting. These changes in estimates increased income from continuing operations before income taxes in the second quarter of 2015 and 2014 by $36 million and $38 million, respectively, ($23 million and $24 million after tax, or $0.08 and $0.09 per diluted share, respectively). For the second quarter of 2015 and 2014, the gross favorable program profit adjustments totaled $40 million and $41 million, respectively, and the gross unfavorable program profit adjustments totaled $4 million and $3 million, respectively. Gross favorable program profit adjustments for the second quarter of 2014 included $16 million related to the settlement of the System Development and Demonstration phase of the Armed Reconnaissance Helicopter (ARH) program, which was terminated in October 2008.

The changes in estimates increased income from continuing operations before income taxes in the first half of 2015 and 2014 by $54 million and $59 million, ($34 million and $37 million after tax, or $0.12 and $0.13 per diluted share, respectively). For the first half of 2015 and 2014, the gross favorable program profit adjustments totaled $73 million and $65 million, respectively, and the gross unfavorable program profit adjustments totaled $19 million and $6 million, respectively. Gross favorable program profit adjustments for the first half of 2014 included $16 million related to the ARH program as described above.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, that outlines a comprehensive five-step revenue recognition model based on the principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved a one-year deferral of the effective date of the standard to the beginning of 2018 for public companies, with an option that would permit companies to adopt the standard as early as the original effective date of 2017. The new standard may be adopted either retrospectively or on a modified retrospective basis whereby it would be applied to new contracts and existing contracts with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to beginning retained earnings at the effective date for those contracts. We are currently evaluating the impacts of adoption on our consolidated financial position, results of operations and related disclosures, along with the implementation approach to be used.

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Note 2. Retirement Plans

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

	Three Months Ended		Six Months Ended	
(In millions)	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Pension Benefits				
Service cost	$ 29	$ 27	$ 59	$ 54
Interest cost	82	85	163	164
Expected return on plan assets	(121)	(117)	(242)	(228)
Amortization of prior service cost	4	4	8	8
Amortization of net actuarial loss	39	28	78	56
Curtailment and other charges	6		6	
Net periodic benefit cost	$ 39	$ 27	$ 72	$ 54
Postretirement Benefits Other Than Pensions				
Service cost	$ 1	$ 1	$ 2	$ 2
Interest cost	4	5	8	10
Expected return on plan assets				
Amortization of prior service credit	(6)	(5)	(12)	(11)
Amortization of net actuarial loss				1
Net periodic benefit cost (credit)	$ (1)	$ 1	$ (2)	$ 2

In April 2015, our Bell segment announced cost reduction actions that resulted in a headcount reduction of approximately 12% of the Bell workforce. We determined that a curtailment had occurred in Bell s pension plan as a result of this reduction, which triggered a remeasurement of the projected benefit obligation. We remeasured Bell s pension plan incorporating a 50 basis-point increase in the discount rate to 4.75%, while other assumptions remained consistent with year-end. The remeasurement reduced our unrealized losses by approximately $98 million which was recorded in other comprehensive income in the second quarter.

Note 3. 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. In addition, diluted EPS for the three and six months ended June 28, 2014 includes the impact of the initial delivery of shares under an Accelerated Share Repurchase agreement (ASR), which was settled in December 2014 as disclosed in Note 9 of our 2014 Annual Report on Form 10-K.

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

(In thousands)	**Three Months Ended** July 4, 2015	**Three Months Ended** June 28, 2014	**Six Months Ended** July 4, 2015	**Six Months Ended** June 28, 2014
Basic weighted-average shares outstanding	277,715	280,280	277,808	280,715
Dilutive effect of:				
Stock options	2,220	2,042	2,216	2,072
ASR		442		312
Diluted weighted-average shares outstanding	279,935	282,764	280,024	283,099

Stock options to purchase 2 million and 1 million of common shares outstanding are excluded from the calculation of diluted weighted average shares outstanding for the three and six months ended July 4, 2015, respectively, as their effect would have been anti-dilutive. For both the three and six months ended June 28, 2014, stock options to purchase 2 million of common shares outstanding are excluded from the calculation of diluted weighted average shares, as their effect would have been anti-dilutive.

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Note 4. Accounts Receivable and Finance Receivables

Accounts Receivable

Accounts receivable is composed of the following:

(In millions)		**July 4, 2015**		**January 3, 2015**
Commercial	$	894	$	765
U.S. Government contracts		300		300
		1,194		1,065
Allowance for doubtful accounts		(31)		(30)
Total	$	1,163	$	1,035

We have unbillable receivables, primarily on U.S. Government contracts, that arise when the revenues we have appropriately recognized based on performance cannot be billed yet under terms of the contract. Unbillable receivables within accounts receivable totaled $150 million at July 4, 2015 and $151 million at January 3, 2015.

Finance Receivables

Finance receivables are presented in the following table:

(In millions)		**July 4, 2015**		**January 3, 2015**
Finance receivables*	$	1,216	$	1,289
Allowance for losses		(54)		(51)
Total finance receivables, net	$	1,162	$	1,238

** Includes finance receivables held for sale of $33 million and $35 million at July 4, 2015 and January 3, 2015, respectively.*

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. Recognition of interest income is suspended for these accounts and all cash collections are used to reduce the net investment balance. We resume the accrual of interest when the loan becomes contractually current through payment according to the original terms of the loan or, if a loan has been modified, following a period of performance under the terms of the modification, provided we conclude that collection of all principal and interest is no longer doubtful. Previously suspended interest income is recognized at that time. Accounts are classified as watchlist when credit quality indicators have deteriorated as compared with typical underwriting criteria, and we believe collection of full principal and interest is probable but not certain. All other finance receivables that do not meet the watchlist or nonaccrual categories are classified as performing.

Finance receivables categorized based on the credit quality indicators discussed above are summarized as follows:

(In millions)	**July 4, 2015**	**January 3, 2015**
Performing	$ 1,014	$ 1,062
Watchlist	72	111
Nonaccrual	97	81
Total	$ 1,183	$ 1,254
Nonaccrual as a percentage of finance receivables	8.20%	6.46%

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 by delinquency aging category are summarized in the table below:

(In millions)	July 4, 2015	January 3, 2015
Less than 31 days past due	$ 1,016	$ 1,080
31-60 days past due	104	117
61-90 days past due	17	28
Over 90 days past due	46	29
Total	$ 1,183	$ 1,254
60 + days contractual delinquency as a percentage of finance receivables	5.33%	4.55%

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 discussed above. Impaired finance receivables include both nonaccrual accounts and accounts for which full collection of principal and interest remains probable, but the account s original terms have been, or are expected to be, significantly modified. If the modification specifies an interest rate equal to or greater than a market rate for a finance receivable with comparable risk, the account is not considered impaired in years subsequent to the modification. Interest income recognized on impaired loans was not significant in the first half of 2015 or 2014.

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

(In millions)	July 4, 2015	January 3, 2015
Recorded investment:		
Impaired loans with related allowance for losses	$ 61	$ 68
Impaired loans with no related allowance for losses	41	42
Total	$ 102	$ 110
Unpaid principal balance	$ 108	$ 115
Allowance for losses on impaired loans	22	20
Average recorded investment	103	115

A summary of the allowance for losses on finance receivables that are evaluated on an individual basis and on a collective basis is provided below. The finance receivables included in the table below specifically exclude leveraged leases in accordance with generally accepted accounting principles.

(In millions)	July 4, 2015	January 3, 2015
Allowance based on collective evaluation	$ 32	$ 31
Allowance based on individual evaluation	22	20
Finance receivables evaluated collectively	$ 962	$ 1,023
Finance receivables evaluated individually	102	110

Allowance for Losses

We maintain an allowance for losses on finance receivables at a level considered adequate to cover inherent losses in the portfolio based on management s evaluation. For larger balance accounts specifically identified as impaired, a reserve is established based on comparing the expected future cash flows, discounted at the finance receivable s effective interest rate, or the fair value of the underlying collateral if the finance receivable is collateral dependent, to its carrying amount. The expected future cash flows consider collateral value; financial performance and liquidity of our borrower; existence and financial strength of guarantors; estimated recovery costs, including legal expenses; and costs associated with the repossession and eventual disposal of collateral. When there is a range of potential outcomes, we perform multiple discounted cash flow analyses and weight the potential outcomes based on their relative likelihood of occurrence. The evaluation of our portfolio is inherently subjective, as it requires estimates, including the amount and timing of future cash flows expected to be received on impaired finance receivables and the estimated fair value of the underlying collateral, which may differ from actual results. While our analysis is specific to each individual account, critical factors included in this analysis include industry valuation guides, age and physical condition of the collateral, payment history and existence and financial strength of guarantors.

We also establish an allowance for losses to cover probable but specifically unknown losses existing in the portfolio. This allowance is established as a percentage of non-recourse finance receivables, which have not been identified as requiring specific

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reserves. The percentage is based on a combination of factors, including historical loss experience, current delinquency and default trends, collateral values and both general economic and specific industry trends. Finance receivables are charged off at the earlier of the date the collateral is repossessed or when no payment has been received for six months, unless management deems the receivable collectible.

A rollforward of the allowance for losses on finance receivables is provided below:

	Six Months Ended	
(In millions)	**July 4, 2015**	**June 28, 2014**
Balance at the beginning of period	$ 51	$ 55
Provision for losses	(1)	6
Charge-offs	(2)	(10)
Recoveries	6	3
Balance at the end of period	$ 54	$ 54

Note 5. Inventories

Inventories are composed of the following:

(In millions)	**July 4, 2015**	**January 3, 2015**
Finished goods	$ 1,895	$ 1,582
Work in process	3,114	2,683
Raw materials and components		