# EXHIBIT 14

(Part 2 of 3)

**BALANCE SHEETS** (Cont'd):

| | Dec. 28,'85 | Dec. 29,'84 | Dec. 31,'83 |
|---|---|---|---|
| Mkt. equity secur. val. adj. | 2,700 | ...... | ...... |
| [4]Less: Treasury stock at cost | 51,800 | 74,400 | 46,100 |
| Stockholders' equity | 1,633,300 | 1,253,900 | 1,244,600 |
| Total liabilities & equity | 4,337,400 | 2,210,000 | 2,104,600 |
| Net current assets | 1,057,900 | 869,700 | 911,000 |

[2]Less reserve to reflect certain inventories at LIFO cost (in 1985 and $186,500,000 in 1984).

[3]No par shares: 1985, 1,932,000; 1984, 1,522,000; 1983, 1,780,000.

[4]Number of shs.: $2.08 pfd.: 1985-83, 69,000.
$1.40 pfd.: 1985-79, 487,000.
Common: 1985, 1,371,000; 1984, 2,366,000; 1983, 1,337,000.

[10]No par shares: 1985, 1,189,000; 1984, 1,028,000; 1983, 1,087,000.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(As taken from Annual Report of Company)

### 1. Summary of Significant Accounting Policies

**Principles of consolidation**

The consolidated financial statements include the accounts of Textron Inc. and all of its subsidiaries except its finance and insurance subsidiaries which are accounted for on the equity method. All significant intercompany transactions are eliminated. For information about Textron's unconsolidated finance and insurance subsidiaires, see pages 55 to 62. For information on the acquisition of Avco Corporation and discontinued operations, see Notes 2 and 3, respectively.

**Long-term contracts and programs**

Sales under fixed price contracts and programs are generally recorded as deliveries are made. Sales under cost reimbursement-type contracts are recorded as costs are incurred and fees are earned. Profits expected to be realized on long-term contracts and programs are based on estimates of total sales value and cost at completion, which estimates are reviewed and revised periodically throughout the lives of the contracts and programs. Adjustments to profits resulting from such revisions are recorded in the accounting period in which the revisions are made. Estimated losses on contracts and programs are recorded when identified.

**Research and development**

Company-sponsored research and development expenditures are charged to expense as incurred. Total expenditures on research and development activities amounted to $520 million, $322 million and $289 million, in 1985, 1984 and 1983, respectively, of which $59 million, $47 million and $56 million were Company-sponsored.

**Translation of foreign currencies**

Adjustments resulting from the translation of the financial statements of most of Textron's foreign operations are excluded from the determination of its income and accumulated in a separate component of shareholders' equity. Foreign exchange losses included in income from continuing operations in 1985, 1984 and 1983 were $4 million, $3 million and $1 million, respectively.

**Income taxes**

Income tax expense is calculated based on income before income taxes per the consolidated financial statements. Such expense differs from taxes currently payable because of timing differences in that certain income and expense items are reported in Textron's consolidated statement of income in years different from those in which they are reported in Textron's income tax returns.

Deferred income taxes have not been provided for the undistributed earnings of foreign subsidiaries. Management's intention is to reinvest such undistributed earnings outside the United States for an indefinite period, except for distributions upon which incremental U.S. income taxes would not be material.

See Note 6 to the combined financial statements of Textron's finance and insurance subsidiaires for information about their income taxes.

Effective at the beginning of 1985, Textron changed its method of accounting for investment tax credits from the deferral method to the flow-through method with respect to its manufacturing operations. (In accordance with industry practice, Textron's unconsolidated finance companies continue to use the deferral method with respect to their leasing operations.) This change was made to conform to the method used by the manufacturing operations of Textron's Avco subsidiary as well as to achieve comparability with the accounting practices of most other manufacturing companies. Had the change in accounting been applied retroactively, net income for 1985, 1984 and 1983 would have been $240.0 million, ($6.43 per share), $112.9 million ($3.10 per share) and $84.7 million ($2.29 per share), respectively.

**Property, plant and equipment**

The cost of property, plant and equipment is being depreciated based on the estimated useful lives of the assets. Depreciation applicable to continuing operations using accelerated methods amounted to $47.3 million in 1985, $21.4 million in 1984 and $23.2 million in 1983; the balance was calculated using the straight line method.

**Costs in excess of net assets of companies acquired**

Such costs related to Textron's manufacturing operations are being amortized on the straight-line method principally over 40 years. Such costs applicable to and included in Textron's investments in unconsolidated finance and insurance subsidiaries in the consolidated balance sheet, are being amortized on the straight-line method over 25 years.

**Inventories**

Inventories aggregating $541 million at December 28, 1985 and $310 million at December 29, 1984 were valued by the last-in, first-out (LIFO) method. The remaining inventories, other than those related to long-term contracts and programs, are stated generally at the lower of first-in, first-out cost or market.

Reductions in certain inventory quantities resulted in the liquidation of LIFO layers, the effect of which increased income by approximately $3 million in 1985, $1 million in 1984 and $3 million in 1983.

Inventories relating to long-term contracts and programs, net of progress payments, were $491 million at December 28, 1985 and $221 million at December 29, 1984 including unamortized initial tooling and other non-recurring costs ($28 million at December 28, 1985; $37 million at December 29, 1984), direct production costs and manufacturing overhead. As to government contracts, inventory costs also include general and administrative expenses ($68 million at December 28, 1985; $11 million at December 29, 1984). Costs attributed to units delivered are based upon the estimated average cost per unit at contract or program completion. In accordance with industry practice, amounts relating to long-term contracts and programs are classified as current assets although certain of these amounts are not expected to be realized within one year.

**Pension and other postretirement benefits**

Textron has a number of pension plans covering substantially all of its employees. It makes annual contributions to the plans equal to the amounts accrued for pension expense.

Pension expense for 1985, 1984 and 1983 was approximately $41 million, $30 million and $33 million, respectively, including amortization of prior service cost over periods ranging from 10 to 30 years. The increase in pension expense in 1985 is due principally to the acquisition of AVCO. Accumulated plan benefits and plan net assets for Textron's pension plans, based on data contained in the most recent actuarial reports available, are as follows:

| (In millions) | Jan. 1, 1985 | Jan. 1, 1984 |
|---|---|---|
| Actuarial present value of accumulated plan benefits: | | |
| Vested | $1,047.7 | $733.1 |
| Nonvested | 85.1 | 51.9 |
| | $1,132.8 | $785.0 |
| Net assets available for benefits | $1,374.9 | $879.3 |

The weighted average of the assumed rates of return used in determining the actuarial present value of accumulated plan benefits was 8.2% and 7.8% for 1984 and 1985, respectively.

In December 1985, the Financial Accounting Standards Board issued Statement No. 87 relating to pensions which is required to be implemented by Textron no later than 1987. This statement is not expected to have a material effect on Textron's consolidated financial position or results of operations.

In addition to providing pension benefits, Textron provides certain health care and life insurance benefits for certain retired employees. Eligibility for these benefits is restricted to the particular benefit plans at the particular locations offering retiree benefits. These retiree benefits and similar benefits for active employees are administered by insurance companies or other carriers who determine premiums for insured plans and expected costs to be paid during the year under self-insured plans. Textron recognizes the cost of providing these benefits by expensing the premiums and costs and incurred. Such costs applicable to continuing operations were approximately $117 million and $65 million for 1985 and 1984, respectively. The cost of providing these benefits for the 8,000 retirees (4,430 in 1984) receiving such benefits is not separately identifiable from the cost of providing such benefits for the 45,000 (26,000 in 1984) active employees.

**Income per common share**

Income per common share is based on average common shares outstanding during each year assuming full conversion of preferred stock and exercise of warrants and stock options.

### 2. Acquisition of Avco Corporation

As a result of an offer made pursuant to an Agreement and Plan of Merger entered into in December 1984, Textron acquired for cash over 95% of the outstanding common stock of Avco Corporation effective on January 9, 1985 and the balance by statutory merger on February 28, 1985 for approximately $1.4 billion. Textron has accounted for the acquisition of Avco as a purchase and, accordingly, Avco's results of operations are included in Textron's financial statements from January 10, 1985. Textron has allocated its purchase price to the underlying assets and liabilities of Avco based on their respective fair values. Of the $628 million of Textron's purchase price in excess of the fair values of Avco's net assets, $449 million related to Avco Financial Services, Inc. (AFS), and is reflected in investments in unconsolidated finance and insurance subsidiaires; the balance is reflected in other assets.

Presented below is the condensed unaudited statement of income which combines on a pro forma basis the statements of income of Textron and Avco for their respective 1984 fiscal year ends. The pro forma statement of income has been prepared as if the purchase had occurred at the beginning of 1984. The pro forma results are not necessarily indicative of what would have occurred had the acquisition been consummated at that time.

Condensed pro forma statement of income (unaudited)

| (In millions except per share amount) | |
|---|---|
| Sales | $3,658.5 |
| Cost of sales & selling & admin. exp. | 3,414.3 |
| | 244.2 |
| Equity in pretax income of unconsol. finan. & insur. subsidiaries | 188.4 |
| Int. exp., net | 256.9 |
| Income from continuing operations before income taxes | 175.7 |
| Income taxes | 61.3 |
| Income from continuing operations | 114.4 |
| Income from discont. oper., net of inc. taxes | 36.0 |
| Net income | $150.4 |
| Inc. per comm. sh.: | |
| Income from continuing oper. | $3.13 |
| Income from discontinued oper. | .99 |
| Net income | $4.12 |

### 3. Discontinued Operations

Textron has announced its intention to reduce its consolidated indebtedness (principally attributable to its acquisition of Avco) by approximately $1 billion by mid-1986. In furtherance of this plan, Textron sold in 1985 its American Research and Development, Fafnir Bearing, Jones & Lamson, Shuron, Spencer Kellogg and Sprague Meter Divisions and the John Sands Printing unit of Valentine Sands. The aggregate cash proceeds from the sales of these divisions amounted to approximately $210 million. As further debt-reduction measures, Textron sold its Valentine Sands Division in February 1986, has contracted to sell its Bostitch and Dalmo Victor Divisions and is in the process of selling its Bridgeport Machines Division. The aggregate cash proceeds from these dispositions are estimated to be $500 million.

Gains and losses on the dispositions in 1985 have been deferred as the total disposition program is expected to result in an aggregate gain which will be recorded when the remaining divisions are sold.

The assets and liabilities of discontinued operations not yet sold have been netted and classified separately in the consolidated balance sheet at December 28, 1985. These assets and liabilities consisted primarily of receivables of $129 million, inventories of $152 million, property, plant and equipment of $86 million and accounts payable of $33 million.

Amounts in the consolidated statement of income for the years 1984 and 1983 have been restated to report separately the income for discontinued operations. Such operations had aggregate sales of $952 million, $1.1 billion and $933 million in 1985, 1984 and 1983, respectively. After-tax gains from sales of investments included in income from discontinued operations were $18.6 million, $5.6 million and $4.8 million in 1985, 1984 and 1983, respectively.

### 4. Inventories (In millions)

| | Dec. 28, 1985 | Dec. 29, 1984 |
|---|---|---|
| Finished goods | $158.4 | $303.8 |
| Work in process (less prog. pay. of $604.6 & $147.0) | 720.2 | 455.9 |
| Raw materials & supplies | 147.0 | 117.6 |
| | $1,025.6 | $877.3 |

**5. Other Assets (In millions)**

| | Dec. 28, 1985 | Dec. 29, 1984 |
|---|---|---|
| [1]Other invest. at cost | $9.3 | $104.8 |
| Costs in excess of net assets of cos. acq., less amort. | 174.8 | 43.9 |
| Other | 149.1 | 30.3 |
| | $333.2 | $179.0 |

[1]Market values aggregated $30.9 million and $163.9 million, respectively. Pretax gains from sales of investments (included in cost of sales) were $7.8 million in 1984, $6.7 million in 1983 and $11.1 million in 1982.

**6. Other Current Liabilities**

| (In millions) | Dec. 28, 1985 | Dec. 29, 1984 |
|---|---|---|
| Salaries & wages | $100.1 | $67.4 |
| Pensions | 27.9 | 33.5 |
| Customers' deposits | 32.8 | 25.7 |
| Interest | 40.6 | 3.8 |
| Supplemental unemploy. ben. | 71.0 | 43.7 |
| Taxes, oth. than fed. inc. taxes | 25.6 | 42.0 |
| Other | 315.0 | 119.5 |
| | $613.0 | $335.6 |

**7. Debt and Credit Facilities**

Long-term debt outstanding at December 28, 1985 and December 29, 1984 is summarized as follows:

| (In millions) | Dec. 28, 1985 | Dec. 29, 1984 |
|---|---|---|
| Textron | | |
| Senior: | | |
| [1]Borrowings under or supported by credit facils. | $926.0 | $...... |
| 11% Notes due 1995 | 99.7 | ...... |
| 8% Notes due 1986-1997 | ...... | 65.0 |
| 7¾% Eurodollar s.f. Debs. due 1987 | 10.8 | 11.4 |
| 7½% s.f. Debs. due 1997 | 19.2 | 19.2 |
| Other notes (avg. approximately 10%) | 27.4 | 46.2 |
| Total senior | 1,083.1 | 141.8 |
| Subordinated: | | |
| 12¾% subord. debs. due 2010 | 99.8 | ...... |
| 11¾% subord. notes due 1995 | 149.2 | ...... |
| 7¾% subord. debs. due 2005 | ...... | 85.3 |
| Total subordinated | 249.0 | 85.3 |
| Total Textron | 1,332.1 | 227.1 |
| Avco | | |
| Senior: | | |
| 12% Notes due 1990 | 64.5 | ...... |
| 11⅛% Notes due 1986-1990 | 16.5 | ...... |
| 10¼% Notes due 1987 | 28.9 | ...... |
| Other notes (average approximately 7%) | 10.8 | ...... |
| Total senior | 120.7 | ...... |
| Subordinated: | | |
| 7½% subordinated debentures due 1993 | 49.1 | ...... |
| 5½% subordinated debentures due 1993 (redeemable at $926 per $1,000 principal) | 19.3 | ...... |
| Total subordinated | 68.4 | ...... |
| Total Avco | 189.1 | ...... |
| | 1,521.2 | 227.1 |
| Less current maturities | 18.1 | 26.7 |
| | $1,503.1 | $200.4 |

[1]The weighted average interest rate on these borrowings at December 28, 1985 was 8.57% and the weighted average interest rate for the year was 9.04%.

Required payments during the next five years on long-term debt outstanding at Dec. 28, 1985 (excluding amounts that might become payable under Co.'s revolving credit agreements) are as follows: $18.1 million in 1986; $44.8 million in 1987; $4.3 million in 1988; $4.4 million in 1989 and $70.7 million in 1990.

Co. maintains credit facilities with various domestic and foreign banks for borrowing funds on a short-term and long-term basis.

Co. has lines of credit, principally on an informal basis, totaling $232 million with certain banks, which are available to the Company and Textron Financial Corporation (TFC), an unconsolidated subsidiary, for support of commercial paper borrowings. In some cases, banks require that Textron maintain certain balances which are generated by the time lag in presentation of company checks for payments.

Additionally, the Company, including its restricted subsidiaries (that is, subsidiaries other than those primarily engaged in the business of a finance, real estate investment or insurance company), has revolving credit agreements with 25 banks for a credit facility of approximately $1.6 billion which is also available for support of commercial paper borrowings. The revolving credit facilities are available until November 1987, unless extended pursuant to the terms of the agreements. Based on these agreements $476 million of commercial paper and $450 million of bank borrowings have been classified as long-term debt at December 28, 1985. A commitment fee of ¼ of 1% per annum is payable on the unused portion of the facilities. Upon the expiration of the respective banks' commitments to make revolving credit loans, any amounts then outstanding will be payable in four equal annual installments, commencing one year thereafter.

Borrowings under the revolving credit agreements are in U.S. dollars and/or, if available, in Euro-currencies and, depending on the form of borrowing elected, bear interest at (a) the banks' prime rates increased by a percentage (the "applicable margin") ranging from ⅛ of 1% to ⅜ of 1% depending on whether and to what extent the ratio of the consolidated total borrowed funds of Textron and its restricted subsidiaries to their consolidated tangible capital funds is greater than 1.25:1; (b) the banks' certificate of deposit rates adjusted for reserve requirements and FDIC costs and increased by ½ of 1% and the applicable margin; or (c) the London Interbank Offered Rate adjusted for reserve requirements and increased by the applicable margin and a percentage, to be negotiated at the time of Euro-currency borrowings, not to exceed ⅜ of 1%.

Under the terms of the revolving credit agreements, Textron and its restricted subsidiaries are required to maintain their consolidated total borrowed funds at a level not exceeding two times their consolidated tangible capital funds and may not permit the ratio of their consolidated earnings before interest and taxes to their consolidated interest expense to be less than 1.25:1.

Credit facilities not used or reserved as support for outstanding commercial paper or bank borrowings were $817 million at December 28, 1985.

Textron has entered into interest rate exchange agreements, over periods ranging from 1 to 6 years, which had the effect of fixing the rate of interest on approximately $423 million of variable interest rate borrowings at December 28, 1985 at approximately 10.9%. Net amounts due under these contracts increased interest expense by approximately $8.1 million in 1985. These agreements expire as follows: $190 million in 1986; $50 million in 1987 and $183 million thereafter.

In July 1985, Textron called for redemption (in August 1985) its 7¾% Subordinated Debentures, which were exchangeable for shares of common stock of Allied Corporation owned by Textron. Holders of $83.2 million of these debentures exchanged their debentures for Allied shares, resulting in an extraordinary gain of $16.4 million.

The amount of the net assets of Avco Financial Services, Inc. and its subsidiaries available for cash dividends and other payments to their parent Avco is restricted by the terms of their agreements with lenders. As of December 28, 1985, approximately $77.5 million of their net assets of $1.2 billion were available to be transferred to Avco pursuant to these restrictions. See Note 5 to the combined financial statements of Textron's finance and insurance subsidiaries for further information about their debt.

**8. Shareholders' Equity**

**Common stock offering**

On September 30, 1985, Textron sold 4,000,000 shares of its common stock in a public offering. The net proceeds from the sale approximated $185 million and were applied to repay outstanding debt. Had the shares been sold at the beginning of 1985 and the proceeds used to repay outstanding debt, Textron's net income per share for 1985 would have been $6.39.

**Preferred Stock**

Each share of the $2.08 Preferred Stock ($23.63 approximate stated value) is convertible into 1.1 shares of Common Stock and is redeemable by Textron at $50 per share. In the event of involuntary liquidation, the stock is entitled to $50 per share and accrued dividends, and in the event of voluntary liquidation to $50 per share.

Each share of $1.40 Preferred Dividend Stock ($11.82 approximate stated value) is convertible into .9 shares of Common Stock and is redeemable by Textron at $45 per share. In the event of liquidation, holders of each share of such stock would receive accrued dividends and thereafter share ratably on a converted basis with holders of Common Stock, subject to the prior rights of the $2.08 Preferred Stock.

**Stock options and performance units**

Textron's 1982 Long-Term Incentive Plan authorizes the granting of awards to key employees in either or both of the following forms: (i) performance units and (ii) options to purchase Textron Common Stock.

Performance unit awards entitle [illegible] to incentive compensation payments u[illegible] attainment of multi-year performance [illegible] established at the time such awards are [illegible]ed. Such payments will be in cash, sha[illegible] Common Stock, or a combination there[illegible] shall be determined by a committee [illegible] Board of Directors.

The Plan provides for both incentive stock options and non-qualified stock options and requires that such options be exercisable, for no more than ten years, at a purchase price per share not less than the fair market value of Textron Common Stock at the date of grant. The total number of shares of Com[illegible] Stock for which options may be grant[illegible] 1,000,000.

In 1985 the Board of Directors granted [illegible]tions on 374,275 shares of common stock [illegible]der this plan. In addition, pursuant to the Agreement and Plan of Merger with Avco Corporation (see Note 2), Textron also issued options on 422,019 shares of common stock ([illegible] which 162,260 shares were accompanied [illegible] stock appreciation rights (SARs)) to employ[illegible]ees of Avco in substitution for their op[illegible] and SARs on Avco common stock. The [illegible]cise prices of the substitute options and SA[illegible] which are fully exercisable, range from $1[illegible] to $40.81 per share. These SARs allow [illegible] holder to receive upon exercising a stock [illegible]tion an amount of cash equal to the appr[illegible]tion in market value of the shares covered [illegible] such exercise. Options on 13,573 shares at [illegible] average purchase price of $37.34 per sh[illegible] were cancelled in 1985, none of which were [illegible]companied by SARs.

Options on 365,764 shares were exercis[illegible] 1985 at an average purchase price of $[illegible] per share; 57,513 shares were surrend[illegible] upon exercise of SARs. Options on [illegible] shares were exercised in 1984 at an avera[illegible] purchase price of $24.40 per share and options on 20,854 shares were exercised in 1983 at an average purchase price of $26.42 per share. At December 28, 1985, options were outstanding on 748,963 shares (104,747 of which were accompanied by SARs) at an average purchase price of $39.71, of which 369,152 shares, at an average purchase price of $33.36, were exercisable at that date.

**Reserved shares**

Shares of Common Stock were reserved at December 28, 1985 as follows:

| | |
|---|---|
| [1]$2.08 Cum. Conv. Pfd. Stk., Ser. A | 1,440,572 |
| [1]$1.40 Conv. Pfd. Div. Stk., Ser. B | 761,723 |
| Options granted to empl. | 748,963 |
| | 2,951,258 |

[1]Includes shares issuable upon conversion of shares of preferred stock held in treasury.

**9. Leases**

Rental expense was approximately $49 mil[illegible]lion, $24 million and $22 million in 1985, 1984 and 1983, respectively. Minimum rental com[illegible]mitments under noncancelable operating leas[illegible]es in effect at December 29, 1985 approxim[illegible]ed $82 million, of which $29 million is pay[illegible] in 1986.

**10. Income Taxes**

Textron files a consolidated federal inc[illegible] tax return which includes all U.S. subsid[illegible] except the insurance subsidiaries which [illegible] their own separate returns. In addition, [illegible]rate returns are filed for the various for[illegible] subsidiaries.

Details of income before income taxes, [illegible]come taxes and the deferred income tax ef[illegible] of timing differences are summarized as [illegible]lows:

| (In millions) | 1985 | 1984 | 1983 |
|---|---|---|---|
| Inc. bef. inc. taxes: | | | |
| United States | 191.9 | 126.8 | 105.5 |
| Foreign | 108.9 | 5.9 | 6.5 |
| Total | $300.8 | $132.7 | $112.0 |
| Income taxes: | | | |
| Contint. oper. | $120.7 | $55.2 | $43.0 |
| Discont. oper. | 26.2 | 29.2 | 16.8 |
| Extra. gain | 6.4 | ...... | ...... |
| Total | $153.3 | $84.4 | $59.8 |
| Income taxes: | | | |
| Current: | | | |
| Federal | $36.9 | $34.8 | $17.5 |
| State | 16.8 | 3.5 | 2.2 |
| Foreign | 33.3 | 9.0 | 10.8 |
| | 87.0 | 47.3 | 30.5 |
| Deferred: | | | |
| Federal | 63.5 | 31.5 | 28.2 |
| State | .7 | 3.2 | .4 |
| Foreign | 2.1 | 2.4 | .7 |
| | 66.3 | 37.1 | 29.3 |
| Total | 153.3 | $84.4 | $59.8 |
| Deferred income tax effects of timing differences: | | | |
| Addit. depr. for tax purp. | $8.9 | $9.3 | $9.7 |
| Funding of empl. ben. | (11.8) | ...... | 9.5 |
| Inventory val. & lg.-tm. contract amts. | (2.9) | (.6) | 5.0 |
| Disp. of div. | 13.0 | ...... | ...... |

| | | | |
|---|---|---|---|
| Insur. policy acq. costs | 15.9 | ...... | ...... |
| Liab. ofr future policy benefits | (8.4) | ...... | ...... |
| Finance co. transact.—princ. leveraged leases | 66.5 | 36.7 | 10.7 |
| Other—net | 5.3 | (8.3) | (5.6) |
| Total | $66.3 | $37.1 | $29.3 |

Following is a reconciliation of the federal statutory income tax rate to the effective income tax rate as reflected in the consolidated statement of income:

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Fed. stat. inc. tax rate | 46.0% | 46.0% | 46.0% |
| Inc. (reduct.) in taxes resulting from: | | | |
| State inc. taxes, net of fed. tax ben. | 3.0 | 1.5 | .7 |
| Invest. tax cr. | (4.8) | (4.8) | (4.9) |
| Tax exempt int. & divs. rec'd. deduct. | (2.3) | (1.4) | (1.3) |
| Special deduct. | (1.6) | ...... | ...... |
| Amort. | 3.5 | .1 | ...... |
| Capital gains | (2.1) | ...... | ...... |
| Other—net | (1.6) | .2 | (2.1) |
| Effective inc. tax rate | 40.1% | 41.6% | 38.4% |

**11. Contingencies**

In May 1983, Canadair, Ltd. filed a $109,600,000 (Can.) lawsuit against Avco in Quebec, Canada, alleging that Avco failed to fulfill its obligations under a 1977 contract to supply Canadair with turbofan engines for the Challenger aircraft, and the amount claimed in this action was increased to $480,015,000 (Can.) by an amended complaint filed in December 1983. In August 1983, Avco filed a $100,000,000 (U.S.) lawsuit against Canadair in Connecticut, alleging in part that Canadair's unilateral cuts in production constituted a termination of the 1977 agreement. A resolution of the issues raised by these two lawsuits in court could be expected to take years, but the parties have commenced discussions which could lead to the negotiation of a settlement of their differences. Textron's management, based upon the information provided to it to date by Canadair, does not anticipate that the ultimate settlement or other resolution of these matters will have a material effect on its financial statements.

There are pending against Textron a number of lawsuits and proceedings, including some which purport to be class actions. Several of these suits and proceedings seek compensatory, treble or punitive damages in substantial amounts. Although these suits and proceedings are being defended or contested on behalf of Textron and its subsidiaries, it is not possible at this time to predict with certainty their outcome or the ultimate effect on Textron. However, on the basis of information presently available, Textron believes that any such liability, to the extent not provided for through insurance or otherwise, would not have a material effect on Textron's financial statements.

**12. Financial Information by Business Segment and Geographic Area**

Financial information by business segment and geographic area includes amounts related to continuing operations of both consolidated and unconsolidated subsidiaries.

The 1985 data include the operations of Avco from January 10, 1985. In connection with the acquisition of Avco, Textron's business segments have been revised as follows:

| Segment | Divisions |
|---|---|
| Aerospace/Technology: | |
| Propulsion | Avco Lycoming Stratford; Avco Lycoming Williamsport; Avco Lycoming Greer |
| Helicopters | Bell Helicopter Textron |
| Systems and Electronics | Avco Aerostructures; Bell Aerospace Textron; Avco Electronics; HR Textron; Avco Research Laboratory; Avco Specialty Materials; Avco Systems |
| Commercial Products: | |
| Industrial | Camcar; Cherry; Townsend; CWC Castings; Randall |
| Consumer | E-Z-Go; Homelite; Jacobsen Turf; Gorham; Sheaffer Eaton; Speidel |
| Financial and Other Services: | |
| Finance | Avco Financial Services; Textron Financial Corporation |
| Insurance | Avco Financial Insurance/Balboa Insurance Group; Paul Revere Insurance Group |
| Management Services | Avco Management Services |

**Note:** Prior years have been reclassified to conform to the current year's presentation and restated for discontinued operations.

For a description of the business comprising each segment, see pages 30 to 32 of this report.

## FINANCIAL INFORMATION BY BUSINESS SEGMENT AND GEOGRAPHIC AREA

**Business Segments (In millions)**

| | Revenues | | | Income | | |
|---|---|---|---|---|---|---|
| | 1985 | 1984 | 1983 | 1985 | 1984 | 1983 |
| Aerospace/Technology: | | | | | | |
| Propulsion | $827 | $[1]...... | $[1]...... | $78 | $[1]...... | $[1]...... |
| Helicopters | 855 | 672 | 766 | 60 | 30 | 48 |
| Systems and Electronics | 1,144 | 339 | 252 | 75 | 29 | 23 |
| | 2,826 | 1,011 | 1,018 | 213 | 59 | 71 |
| Commercial Products: | | | | | | |
| Industrial | 504 | 505 | 392 | 52 | 57 | 23 |
| Consumer | 642 | 632 | 636 | 30 | 46 | 42 |
| | 1,146 | 1,137 | 1,028 | 82 | 103 | 65 |
| Financial and Other Services: | | | | | | |
| Finance | 843 | 61 | 51 | 142 | 21 | 17 |
| Insurance | 840 | [1]...... | [1]...... | 71 | [1]...... | [1]...... |
| Management Services | 66 | [1]...... | [1]...... | 40 | [1]...... | [1]...... |
| | 1,749 | 61 | 51 | 253 | 21 | 17 |
| | $5,721 | $2,209 | $2,097 | 548 | 183 | 153 |
| Corporate expenses and other-net | | | | (43) | (28) | (20) |
| Interest expense-net | | | | (204) | (22) | (21) |
| Income from continuing operations before income taxes | | | | $301 | $133 | $112 |

| | Depreciation | | | Capital expenditures | | | Identifiable assets | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1985 | 1984 | 1983 | 1985 | 1984 | 1983 | 1985 | 1984 | 1983 |
| Aerospace/Technology: | | | | | | | | | |
| Propulsion | $18 | $[1]...... | $[1]...... | $17 | $[1]...... | $[1]...... | $602 | $[1]...... | $[1]...... |
| Helicopters | 15 | 14 | 13 | 33 | 42 | 5 | 646 | 635 | 597 |
| Systems and Electronics | 31 | 5 | 5 | 58 | 7 | 4 | 607 | 208 | 148 |
| | 64 | 19 | 18 | 108 | 49 | 9 | 1,855 | 843 | 745 |
| Commercial Products: | | | | | | | | | |
| Industrial | 11 | 12 | 11 | 12 | 11 | 8 | 206 | 670 | 612 |
| Consumer | 13 | 12 | 12 | 19 | 17 | 13 | 306 | 405 | 383 |
| | 24 | 24 | 23 | 31 | 28 | 21 | 512 | 1,075 | 995 |
| Financial and Other Services: | | | | | | | | | |
| Finance | 5 | ...... | ...... | 9 | ...... | ...... | 4,530 | 627 | 508 |
| Insurance | 5 | [1]...... | [1]...... | 8 | [1]...... | [1]...... | 2,780 | [1]...... | [1]...... |
| Management Services | ...... | [1]...... | [1]...... | ...... | [1]...... | [1]...... | 55 | [1]...... | [1]...... |
| | 10 | ...... | ...... | 17 | ...... | ...... | 7,365 | 627 | 508 |
| Discontinued operations | 23 | 24 | 23 | 29 | 37 | 24 | 398 | ...... | ...... |
| Corporate | 3 | 2 | 1 | 4 | 5 | 1 | 223 | 114 | 223 |
| Eliminations | ...... | ...... | ...... | ...... | ...... | ...... | (5) | (1) | (1) |
| | $124 | $69 | $65 | $189 | $119 | $55 | $10,348 | $2,658 | $2,470 |

[1] These segments relate solely to units of Avco, which was acquired by Textron in 1985.

**Notes to Business Segments:**

(i) Income excludes interest expense except for the finance subsidiaries.

(ii) Income of the insurance subsidiaries includes net capital gains of $12 million in 1985.

(iii) Management Services income primarily represents profits of a foreign venture in the Middle East. such profits are recognized to the extent they are available for remittance.

(iv) corporate expenses for 1985 include a pretax gain of $10 million on the sale of securities.

**Geographic Areas (In millions)**

| | Revenues | | | Income | | |
|---|---|---|---|---|---|---|
| | 1985 | 1984 | 1983 | 1985 | 1984 | 1983 |
| Revenues and income by origin-continuing operations: | | | | | | |
| U.S. | $5,176 | $2,062 | $1,985 | $441 | $172 | $143 |
| Canada | 219 | 66 | 51 | 25 | 6 | 4 |
| Australia | 120 | 31 | 21 | 35 | 4 | 2 |
| Western Europe | 89 | 39 | 40 | 2 | 2 | 4 |
| Middle East | 47 | ...... | ...... | 41 | ...... | ...... |
| Other locations | 70 | 11 | ...... | 4 | (1) | ...... |
| | $5,721 | $2,209 | $2,097 | 548 | 183 | 153 |
| Corporate expenses and other—net | | | | (43) | (28) | (20) |
| Interest expense—net | | | | (204) | (22) | (21) |
| Income from continuing operations before income taxes | | | | $301 | $133 | $112 |

| | Export sales 1985 | 1984 | 1983 |
|---|---|---|---|
| **Destination of U.S. exports-continuing operations:** | | | |
| Western Europe | $232 | $65 | $71 |
| Far East | 173 | 95 | 88 |
| Middle East | 145 | 87 | 89 |
| Canada | 67 | 50 | 40 |
| South America | 48 | 26 | 53 |
| Other locations | 52 | 45 | 30 |
| | $717 | $368 | $371 |

| | Identifiable assets 1985 | 1984 | 1983 |
|---|---|---|---|
| **Identifiable assets by location:** | | | |
| United States | $8,187 | $2,297 | $2,044 |
| Canada | 758 | 60 | 46 |
| Australia | 417 | 121 | 108 |
| Western Europe | 224 | 106 | 118 |
| Middle East | 44 | ...... | ...... |
| Other locations | 121 | 34 | 18 |
| Discontinued operations | 398 | ...... | ...... |
| Corporate | 223 | 114 | 228 |
| Eliminations | (24) | (74) | (75) |
| | $10,348 | $2,658 | $2,470 |

**Notes:** Revenues include sales to the U.S. Government of $1.9 billion, $613 million and $584 million in 1985, 1984 and 1983, respectively.

Revenues between segments were approximately 1% of total revenues in each of the years 1983 to 1985. Revenues between geographic areas, predominantly revenues of U.S. divisions, were approximately 1% of total revenues in each of the years 1983 to 1985.

Corporate assets are principally cash and short-term investments and notes receivable.

### REPORT OF MANAGEMENT

(As taken from Annual Report of Company)

The consolidated financial statements of Textron Inc. have been prepared by management and have been audited by Textron's certified public accountants, Arthur Young & Company, whose report appears on this page. Management is responsible for the consolidated financial statements, which have been prepared in conformity with generally accepted accounting principles and include amounts based on management's judgments.

Management is also responsible for maintaining internal accounting control systems designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded and that transactions are executed and recorded in accordance with established policies and procedures. Textron's systems are under continuing review and are supported by, among other things, business conduct and other written guidelines, an internal audit program and the selection and training of qualified personnel.

The Board of Directors is responsible for the Company's financial and accounting policies, practices and reports. Its Audit Committee, composed of six outside directors, meets regularly with the certified public accountants, representatives of management, and the internal auditors to discuss and make inquiries into their activities. Both the certified public accountants and the internal auditors have free access to the Audit Committee, with and without management representatives in attendance.

B.F. Dolan
President and
Chief Executive Officer

William J. Ledbetter
Executive Vice President and
Chief Financial Officer
February 7, 1986

### REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

(As taken from Annual Report of Company)

Arthur Young & Company
277 Park Avenue
New York, New York 10172

The Board of Directors and Shareholders
Textron Inc.

We have examined the accompanying consolidated balance sheet of Textron Inc. at December 28, 1985 and December 29, 1984, and the related consolidated statements of income, changes in financial position and changes in shareholders' equity for each of the three years in the period ended December 28, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Textron Inc. and the combined financial position of Textron's unconsolidated finance and insurance subsidiaries at December 28, 1985 and December 29, 1984, and the consolidated results of operations and changes in financial position for each of the three years in the period ended December 28, 1985, in conformity with generally accepted accounting principles applied on a consistent basis during the period except for the change, with which we concur, in the method of accounting for investment tax credits as described in Note 1 to the consolidated financial statements.

Arthur Young & Company
February 7, 1986

### SUPPLEMENTARY INFORMATION—EFFECTS OF INFLATION AND CHANGING PRICES

(As Taken From Annual Report of Company)

Historical dollar accounting (as reflected in the conventional financial statements) does not reflect entirely the cumulative effects of increasing costs and changes in the purchasing power of the dollar. To provide more information on the effects of inflation, the Financial Accounting Standards Board (FASB) requires large companies to provide supplementary information to the financial statements prepared on the traditional (historical) basis.

**Statement of Income for 1985 Adjusted for the Effects of Changes in Specific Prices**

Under the FASB's guidelines, Textron has restated its historical statement of income for 1985 to take into account changes in specific prices of certain resources used, by utilizing the "current cost" approach. This approach adjusts the historical costs of specific assets (inventories and property, plant and equipment) to estimates of their costs if purchased or replaced during the current year. Current cost data for property, plant and equipment were developed on the basis of indexes published by governmental or other external organizations appropriate to the various industries in which Textron is engaged. Depreciation expense was calculated on the indexed cost of such property, plant and equipment using the same methods and estimated useful lives as used in the historical financial statements. Inventories were measured on the basis of recent production or replacement cost. Cost of sales related to FIFO inventories (exclusive of inventories pertaining to long-term contracts) were adjusted by applying indexes to reflect price changes during the period of time the inventories were held. On December 28, 1985, current cost of inventories was [illegible] billion and current cost of property, plant and equipment net of accumulated depreciation was $768.1 million.

**Supplementary Five-Year Comparison of Selected Financial Data Adjusted for the Effects of Changing Prices**

The five-year comparison expresses selected financial data under the current cost method in terms of average current year dollars as measured by the U.S. Consumer Price Index for all Urban Consumers (CPI-U).

This table also includes the amount of Textron's gain in purchasing power of net monetary liabilities. Such gain is based on the concept that during inflationary periods monetary assets, such as cash and receivables, decrease in value while monetary liabilities, such as debts owed to others, can be settled with dollars of diminished purchasing power. The result is a net gain in purchasing power when monetary liabilities exceed monetary assets. The amount of this gain has been calculated based on Textron's average net monetary liabilities multiplied by the change in the CPI-U for the year.

**Statement of Income for 1985 Adjusted for the Effects of Changes in Specific Prices** (In millions)

| | |
|---|---|
| Inc from contin. oper. | $180.1 |
| Adjust. to restate costs for effects of changes in specific prices: | |
| Cost of sales | 13.8 |
| Depreciation | 20.2 |
| | 34.0 |
| Inc. from contin. oper. as adjusted | $146.1 |

**Supplementary Five-Year Comparison of Selected Financial Data Adjusted for the Effects of Changing Prices** (In average 1985 dollars) (In millions except per share amounts)

| | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|
| Historical sales restated for 1981-1984 | $4,038.5 | $2,224.6 | $2,209.8 | $2,209.7 | $2,596.4 |
| Historical cost information adjusted for changes in specific prices (current cost basis): | | | | | |
| Income from continuing operations | $146.1 | $45.8 | $33.1 | $28.6 | $68.4 |
| Income per common share—continuing operations | $3.92 | $1.25 | $.90 | $.78 | $1.82 |
| Net assets at year end | $1,900.8 | $1,769.9 | $1,817.3 | $1,880.5 | $1,985.9 |
| Other information: | | | | | |
| Gain in purchasing power of net monetary liab. | $31.1 | $7.5 | $8.5 | $13.9 | $36.7 |
| Incr. in inventories & prop., plant & equip. held during year: | | | | | |
| Using the U.S. CPI-U | $69.8 | $69.4 | $69.7 | $78.9 | $180.4 |
| Using specific prices | 10.8 | 69.8 | 38.8 | 89.5 | 146.2 |
| Incr. in gen. inflat. in excess of incr. in specific prices (incr. in specific prices in excess of incr. in gen. infl.) | $59.0 | $(.4) | $30.9 | (10.6) | $34.2 |
| Dividends per common share | $1.80 | 1.86 | 1.95 | 2.02 | 2.16 |
| Market price per common share at year end | $48.88 | $34.95 | $35.23 | $26.46 | $30.47 |
| Average Consumer Price Index for All Urban Consumers (U.S. CPI-U) | 322.2 | 311.1 | 298.4 | 289.1 | 272.4 |

### QUARTERLY FINANCIAL AND STOCK INFORMATION 1985 AND 1984

(Unaudited)

(As taken from Annual Report of Company)

| (In millions except per share amounts) | 1st Quarter 1985 | 1984 | 2nd Quarter 1985 | 1984 | 3rd Quarter 1985 | 1984 | 4th Quarter 1985 | 1984 |
|---|---|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | | | |
| Sales | 921.2 | 524.8 | 994.8 | 535.8 | 936.0 | 489.6 | 1,186.5 | 597.8 |
| Costs & expenses: | | | | | | | | |
| Cost of sales | 738.8 | 417.2 | 802.0 | 430.7 | 742.2 | 382.2 | 892.2 | 482.4 |
| Selling & administrative | 124.4 | 72.9 | 131.3 | 72.7 | 122.7 | 72.6 | 193.4 | 83.9 |
| | 58.0 | 34.7 | 61.5 | 32.4 | 71.1 | 34.8 | 100.9 | 31.5 |
| Equity in pre-tax income of unconsolid. finan. and insur. subsidiaries | 58.2 | 4.8 | 56.8 | 4.9 | 53.6 | 5.1 | 44.8 | 6.4 |
| Interest expense-net | 47.6 | 3.7 | 54.9 | 4.8 | 55.5 | 4.5 | 46.1 | 8.9 |

| (In millions except per share amounts) | 1st Quarter 1985 | 1984 | 2nd Quarter 1985 | 1984 | 3rd Quarter 1985 | 1984 | 4th Quarter 1985 | 1984 |
|---|---|---|---|---|---|---|---|---|
| Income from continuing oper. before inc. taxes | 68.6 | 35.8 | 63.4 | 32.5 | 69.2 | 35.4 | 99.6 | 29.0 |
| Income taxes | 26.1 | 14.9 | 24.5 | 13.2 | 28.5 | 15.3 | 41.6 | 11.8 |
| Income from continuing operations before extraord. gain and cumul. effect of a change in accnting. principle | 42.5 | 20.9 | 38.9 | 19.3 | 40.7 | 20.1 | 58.0 | 17.2 |
| Inc. from discont. oper., net of inc. taxes | 6.1 | 5.6 | 9.7 | 7.9 | 13.7 | 5.2 | 14.0 | 17.3 |
| Extraord. gain, net of income taxes | ...... | ...... | ...... | ...... | 16.4 | ...... | ...... | ...... |
| Cumul. effect of a change in accnting. principle | 11.8 | ...... | ...... | ...... | ...... | ...... | ...... | ...... |
| Net income | $60.4 | $26.5 | $48.6 | $27.2 | $70.8 | $25.3 | $72.0 | $34.5 |
| Inc. per comm. share: | | | | | | | | |
| Inc. from continuing operations before extraord. gain and cumul. effect of a change in accnting. principle | $1.18 | $.57 | $1.07 | $.53 | $1.12 | $.55 | $1.46 | $.47 |
| Income from discont. oper. | .17 | .15 | .27 | .21 | .37 | .15 | .35 | .48 |
| Extraord. gain | ...... | ...... | ...... | ...... | .45 | ...... | ...... | ...... |
| Cumul. effect of a change in accnting. principle | .33 | ...... | ...... | ...... | ...... | ...... | ...... | ...... |
| Net income | $1.68 | $.72 | $1.34 | $.74 | $1.94 | $.70 | $1.81 | $.95 |
| **Common Stock Information** | | | | | | | | |
| Price Range: | | | | | | | | |
| High | $45¾ | $35¼ | $55 | $31⅜ | $59¾ | $33 | $51¾ | $43½ |
| Low | $32⅝ | $25⅞ | $43¼ | $26¼ | $45 | $27 | $44⅛ | $30½ |
| Div. per sh. | $.45 | $.45 | $.45 | $.45 | $.45 | $.45 | $.45 | $.45 |

Notes: The 1985 data include the operations of Avco from January 10, 1985.
Amounts for 1984 and the first three quarters of 1985 have been restated for discontinued operations.

## FINANCIAL REVIEW

(As Taken From Annual Report of Company)

### Liquidity and Capital Resources

The acquisition of Avco Corporation in early 1985 required funds of approximately $1.4 billion, which were financed through bank borrowings. As a result of these borrowings and the assumption of Avco's debt, Textron's ratio of debt to total capital was approximately 62% shrotly after the acquisition had been completed.

In March 1985, Textron announced its plan to reduce consolidated indebtedness by approximately $1 billion by mid-1986. In furtherance of this plan, Textron sold in 1985 its American Research and Development, Fafnir Bearing, Jones & Lamson, Shuron, Spencer Kellogg and Sprague Meter Divisions and the John Sands Printing unit of Valentine Sands. Aggregate cash proceeds from these dispositions amounted to approximately $210 million. In addition, in August, holders of Textron subordinated debt exchanged approximately $83 million of such debt for common stock of Allied Corporation owned by Textron, and in September Textron sold 4,000,000 shares of its common stock for net proceeds of approximately $185 million. Proceeds from these transactions allowed Textron to reduce its outstanding debt—which reached a peak of $2.1 billion during 1985—to $1.5 billion by year-end.

To reduce debt further and accomplish its strategic restructuring of operations, Textron sold its Valentine Sands Division in February 1986, has contracted to sell its Bostitch and Dalmo Victor Divisions and is in the process of selling its Bridgeport Machines Division. Aggregate cash proceeds from these sales are estimated to be approximately $500 million. Upon the completion of these sales, Textron will have largely accomplished its debt-reduction goal, and its available credit facilities, plus cash flow from continuing operations, should be more than sufficient to meet working capital needs and provide Textron with the resources necessary to continue its growth.

Financing for Textron is conducted through several independent borrowing entities comprised of the parent company and its unconsolidated finance subsidiaries, Avco Financial Services, Inc. (AFS) and Textron Financial Corporation (TFC). This framework allows such units, with specialized needs related to carrying highly liquid portfolios of receivables, to finance operations through their own external group of creditors. As independent borrowers, their debt is supported by their own assets, without guarantee from the parent corporation. Accordingly, the capital changes and liquidity of Textron's operations are best understood by separately considering its independent borrowing entities.

Sources of cash to the parent company to meet working capital requirements and capital additions, as well as requirements for interest and debt repayment, corporate expenses, taxes and dividends, are derived from earnings generated by subsidiaries and divisions included in the consolidated financial statements and from dividends received from unconsolidated finance subsidiaries, supplemented through short- and long-term borrowings. See Note 7 to the accompanying Textron consolidated financial statements for further information with respect to Textron's debt and credit facilities.

Textron's unconsolidated finance subsidiaries, AFS and TFC, utilize a broad base of financial support for their liquidity and capital requirements. Cash is provided both from operations and from borrowings from several different sources. These sources include unsecured borrowings under bank lines of credit, the issuance of commercial paper, and sales of medium- and long-term debt. See Note 5 to the accompanying combined financial statements of Textron's finance and insurance subsidiaries for information concerning debt and credit lines of AFS and TFC.

### Results of Operations

#### 1985 vs. 1984

Results of operations for 1985 include the results of Avco Corporation from January 10, 1985, the date as of which Textron had purchased over 95% of Avco's outstanding common stock. As a result of this acquisition, as well as solid operating performances by most divisions, Textron reported record results in 1985. Total revenues from continuing operations were $5.7 billion (including $1.7 billion attributable to Textron's unconsolidated finance and insurance subsidiaries) compared to $2.2 billion in 1984. Income from continuing operations was $180.1 million, or $4.83 per share, up 132% from the $77.5 million, or $2.12 per share, reported in 1984. These amounts exclude the results of discontinued divisions as if they had been sold at the beginning of the year. Income for 1985 from continuing operations would have increased to approximately $207.4 million, or $5.56 per share, had these divisions, in fact, been sold and the proceeds therefrom been available for debt repayment at the beginning of 1985.

Net income for 1985 totaled $251.8 million, or $6.75 per share, up from the $113.5 million, or $3.11 per share, in 1984. Such income for 1985 included a total of $28.2 million ($.76 per share) from an extraordinary gain and an accounting change.

#### 1984 vs. 1983

On a slight increase in revenues, net income increased by 28% in 1984 to $113.5 million ($3.11 per share) from $88.7 million ($2.40 per share) in 1983 and income from continuing operations increased to $77.5 million in 1984 ($2.12 per share) from $69.0 million in 1983 ($1.87 per share). The improvements were due to substantial gains in the commercial products category.

#### Propulsion

The Propulsion segment represents the three Lycoming units acquired in 1985 in the Avco acquisition. See pages 6-8 for discussion of the 1985 results of these units.

#### Helicopters

Revenues for 1985 were $855 million, $183 million over their 1984 level. Increases occurred primarily in the areas of spare parts, U.S. Government programs, international sales and sales of used aircraft.

Increased spares revenues resulted from a continuing trend to increase flight hours on existing aircraft both in commercial and military areas. Commercial operators are putting additional hours on their current equipment. Military users are also adding hours as their current fleet gets older and replacement aircraft are still under development. Sales to the U.S. Government increased substantially, primarily due to ongoing production programs such as the AH-1S and TH-57 and expanded customer-funded R&D activity associated with the V-22.

Income for 1985 of $60 million is double that of 1984. The improvement is primarily volume-related. In 1984, operating profit declined 38% from 1983 levels as a result of lower volume, due to weak worldwide demand for commercial helicopters. For further information on results for this segment, see discussion on pages 8-11.

#### Systems and Electronics

The improvement in both revenues and profits was attributable to the inclusion in this segment of five Avco divisions in 1985. These five divisions generated revenues and income of approximately $811 million and $46 million, respectively. Major factors which contributed to the solid operating performance of these divisions include sales on the Peacekeeper (MX) missile program, sales of wing sets for the B-1B and C-5 programs, as well as the manufacture and sale of commercial electronics products for U.S. computer and telecommunications companies. Bell Aerospace and HR Textron continued to have strong operations and reported improved profits on Bell's higher volume on the LCAC air cushion vehicle program and increased sales of filter products by HR Textron's Purolator Technologies unit.

The improved results in 1984 over 1983 were due to increased sales of defense-related aerospace equipment at both Bell Aerospace and HR Textron.

#### Industrial Products

Aggregate revenues in 1985 approximated those in 1984, as the increased volume from Randall's automotive products and from Cherry's blind fastener systems were offset by lower demand at CWC for truck engine blocks and cylinder heads. CWC's lower volume and costs associated with reorganizing and consolidating its manufacturing facilities offset profit improvements at Cherry and Randall.

Revenues for 1984 were 29% higher than in 1983 as a result of the strength in the heavy truck and automotive industries. The higher volume and continuing benefits of operating efficiencies made in prior years contributed to the increase in this segmennt's operating profit.

#### Consumer Products

Improved results in 1985 at E-Z-Go and Jacobsen, and, to a lesser extent, at Gorham, were due to the effects of higher sales volumes. E-Z-Go benefited from expanded product lines and Jacobsen's results were helped by intensive promotional efforts. The aggregate profits of the outher units in this segment declined, principally due to depressed results at Homelite and Sheaffer Eaton. Both units suffered from the effects of excess capacity in their respective markets and resultant competitive pricing pressures.

The segment's results for 1984 approximated those for 1983, with the benefits of higher sales volumes at E-Z-Go, Gorham and Jacobsen offsetting the effects of weak demand for Homelite's chain saw and lawn and garden equipment.

#### Impact of Inflation and Changing Prices on Sales and Income from Continuing Operations

Historical dollar accounting (as reflected in the conventional financial statements) does not reflect entirely the cumulative effects of increasing costs and changes in the purchasing power of the dollar. To provide further information about those effects, pages 52 and 53 reflect a Statement of Income for 1985 Adjusted for the Effects of Changes in Specific Prices and certain other supplementary data adjusted for the effects of changing prices. This information indicates the significant impact of changing prices on Textron's operations.

Inflation also affects Textron's monetary assets and liabilities, since the amounts are fixed without reference to specific future prices. In inflationary periods, the purchasing power of monetary assets is decreased because such assets will purchase fewer goods or services in the future. However, since Textron's monetary liabilities exceed its monetary assets, there is an economic benefit in the form of increased purchasing power. Such economic gain however, does not represent income that can be reflected in the historical financial statements nor does it constitute funds available for distribution to shareholders.

## TEXTRON INC.—FINANCE AND INSURANCE SUBSIDIARIES COMBINED STATEMENT OF INCOME

For each of the three years in the period ended Dec. 28, 1985

| (In Millions) | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Revenues:** | | | |
| Int., disc. and service chges. | $835.7 | $60.8 | $50.6 |
| Credit life, disability and casualty insur. prem. | 216.7 | ...... | ...... |
| Life, accident and helath insur. prem., annuities and other | 410.9 | ...... | ...... |
| Investment inc. (including net capital gains) | 219.4 | ...... | ...... |
| Total revenues | 1,682.7 | 60.8 | 50.6 |
| **Expenses:** | | | |
| Int. and debt exp., net | 358.8 | 34.2 | 29.2 |
| Provision for losses on collection of receivables, less recoveries | 74.9 | .8 | ...... |
| Credit life, disability and casualty insurance losses and adjust. exp., less recoveries | 134.1 | ...... | ...... |
| Death and other insur. benefits | 212.2 | ...... | ...... |
| Increase in insurance policy and deposit liab. | 182.4 | ...... | ...... |
| Amort. of insur. policy acquisition costs (including cost of insurance in force) | 72.1 | ...... | ...... |
| Other oper. exp. | 434.8 | 4.6 | 4.1 |
| Total expenses | 1,469.3 | 39.6 | 33.3 |
| Income before income taxes | 213.4 | 21.2 | 17.3 |
| Income taxes | 85.5 | 9.1 | 7.6 |
| Net income | $127.9 | $12.1 | $9.7 |

## TEXTRON INC.—FINANCE AND INSURANCE SUBSIDIARIES COMBINED BALANCE SHEET

| (In millions) | Dec. 28, 1985 | Dec. 29, 1984 |
|---|---|---|
| **Assets** | | |
| Cash | $49.8 | $...... |
| Invest. | 2,066.6 | ...... |
| Receiv. | 5,069.8 | 646.2 |
| Unearned charges | (696.4) | (134.3) |
| Net receiv. | 4,373.4 | 511.9 |
| Allow. for losses | (137.4) | (.8) |
| | 4,236.0 | 511.1 |
| Prepaid exp. and other receiv. | 93.9 | .1 |
| Unamort. insur. policy acquisition costs (including cost of insur. in force) | 279.9 | ...... |
| Costs in excess of net assets of companies acquired, less accum. amort. of $18.1 | 447.8 | ...... |
| Other assets | 135.6 | .6 |
| Total assets | $7,309.6 | $511.8 |
| **Liabilities and equity** | | |
| Short-term debt-unsecured: | | |
| Banks | $93.9 | $16.0 |
| Comml. paper | 800.8 | 143.5 |
| Total short-term debt | 894.7 | 159.5 |
| Accounts payable and accrued liab. | 228.9 | 27.1 |
| Inc. taxes (principally deferred) | 142.4 | 57.4 |
| Insur. reserves and claims: | | |
| Future policy benefits and claim liab. | 828.7 | ...... |
| Premium deposits and purch. payment funds | 729.7 | ...... |
| Unearned insur. premiums | 222.2 | ...... |
| Losses and adjust. exp. | 98.6 | ...... |
| Long-term debt-unsecured: | | |
| Senior notes and debs. | 2,474.4 | 204.0 |
| Senior subord. notes and debs. | 295.1 | ...... |
| Junior subord. and capital notes | 95.5 | ...... |
| Total long-term debt | 2,865.0 | 204.0 |
| Equity | 1,299.4 | 63.8 |
| Total liabilities and equity | $7,309.6 | $511.8 |

## COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

For each of the three years in the period ended Dec. 28, 1985

| (In millions) | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Source of funds:** | | | |
| From operations: | | | |
| Net income | $127.9 | $12.1 | $9.7 |
| Increase in insur. policy liab. | 182.4 | ...... | ...... |
| Amort. of insur. policy acquisition costs (including cost of insur. in force) | 72.1 | ...... | ...... |
| Provisions for losses on collection of receiv. | 92.8 | .8 | ...... |
| Incr. (decr.) in accounts payable, accrued liab. and other | (19.1) | 42.5 | 20.6 |
| Increase in unearned insurance premiums and reserves for insurance losses and adjustment exp. | 63.3 | ...... | ...... |
| Deprec. and amort. | 28.5 | .3 | 1.1 |
| Total from operations | 547.9 | 55.7 | 31.4 |
| Additions to long-term debt | 1,330.6 | 125.0 | 26.0 |
| Proceeds from sales of invest. | 893.9 | ...... | ...... |
| Capital contribution from Textron | 15.4 | ...... | ...... |
| Decr. in cash (excludes AFS cash at acquisition) | 20.6 | ...... | ...... |
| Other, net | 132.3 | (.4) | 5.8 |
| Total | $2,940.7 | $180.3 | $63.2 |
| **Use of funds:** | | | |
| Net increase in receivables | $629.8 | $95.8 | $45.8 |
| Purch. of investments | 1,313.1 | ...... | ...... |
| Reductions in long-term debt | 759.5 | 150.3 | 30.4 |
| Additions to insur. policy acquisition costs | 95.6 | ...... | ...... |
| Cash divs. paid | 49.4 | ...... | ...... |
| Decrease (increase) in short-term debt | 93.3 | (65.8) | (13.0) |
| Total | $2,940.7 | $180.3 | $63.2 |

## TEXTRON INC.—FINANCE AND INSURANCE SUBSIDIARIES NOTES TO COMBINED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies

**Principles of combination**

The accompanying combined financial statements include the accounts of Textron's subsidiaries engaged in finance and insurance operations: Textron Financial Corporation (TFC) and Avco Financial Services, Inc. (AFS), consisting of Avco Financial Services Group, Avco Financial Insurance Group and the Paul Revere Insurance Group.

The results of operations of AFS are included in the combined financial statements from January 10, 1985 and Textron's allocation of its purchase price to the assets and liabilities of AFS is reflected in these combined financial statements.

Costs in excess of net assets of companies acquired, principally the excess of Textron's purchase price of Avco related to AFS over the fair values of AFS's net assets of $449 million, are being amortized on the straight-line method over 25 years.

Changes in Textron's equity in the finance and insurance subsidiaries during 1985 were as follows:

| (In millions) | |
|---|---|
| Equity at December 29, 1984 | $63.8 |
| Euqity of AFS at date of acquisition | 1,163.9 |
| Net income | 127.9 |
| Cash divs. | (49.4) |
| Capital contribution from Textron to TFC | 15.4 |
| Change in currency translation adjust. | (24.8) |
| Change in marketable equity securities valuation adjust. | 2.7 |
| Other | (.1) |
| Equity at December 28, 1985 | $1,299.4 |

**Finance subsidiaries**

Interest and discount charges are gene[illegible] recognized in revenues on the effective[illegible] method. Unearned charges represent the [illegible] tion of the finance charge or discount incl[illegible] in the original face amount of the rela[illegible] ceivables which is determined to be une[illegible] on the balance sheet date. The unea[illegible] charges are transferred to revenues on th[illegible] crual basis beginning in the month follo[illegible] acquisition. Generally, no portion of une[illegible] charges is recognized in earnings to off[illegible] quisition costs except on leasing con[illegible] When charges are not included in the o[illegible] face amount of the loan, the charges are [illegible] erally recognized in revenues as collect[illegible]

Receivables are written off when th[illegible] deemed uncollectible, but in any eve[illegible] sumer, real estate, retail installment and [illegible] card accounts for which no payment h[illegible] received for eight consecutive mo[illegible]