EXHIBIT 14

(Part 3 of 3)

written off. Provisions for losses on accounts receivable are charged to earnings in such amounts as management believes to be adequate.

TFC derives a substantial portion of its business from financing the sale and lease of products manufactured and sold by Textron, revenues from which amounted to $7.6 million, $9.1 million and $11.8 million in 1985, 1984 and 1983, respectively.

In 1985, 1984 and 1983, TFC paid Textron $255.0 million, $300.7 million and $316.5 million, respectively, for the purchase of receivables. Under its operating agreement with Textron, TFC generally has recourse to Textron with respect to finance receivables and leases of products manufactured and sold by Textron. At December 28, 1985, net finance receivables of $379.4 million ($372.0 million at December 29, 1984) were due from Textron or subject to recourse to Textron.

The net investment in finance leases included in receivables consists of the sum of all minimum lease payments and estimated residual values, less unearned income. The investment in leveraged leases consists of the sum of all lease payments (less the portion applicable to principal and interest on non-recourse debt) plus estimated residual values, less unearned income. Unearned income and investment tax credits are included in income over the terms of the leases to produce a constant rate of return on the net investment after a portion of unearned income is recognized in earnings to offset direct acquisition costs.

Insurance subsidiaries

Credit life, disability and casualty insurance

Approximately 63% of the credit life and disability insurance premiums earned and 10% of the casualty insurance premiums earned in 1985 were directly related to the consumer loan activities of Avco's finance subsidiaries. Unearned insurance premiums are taken into earnings over the life of the policies (i) on the sum-of-the-digits method for decreasing term credit life insurance coverage and on the pro rata method for level term credit life coverage, (ii) in relation to anticipated claims for disability insurance and (iii) on the pro rata method for casualty insurance. The cost of acquiring new business (principally commissions and premium taxes) is charged to expense in the same manner as the related premiums are taken into earnings.

Health and life insurance

Group health and life insurance premiums are recognized in income when due; individual health insurance and annuity premiums are recognized in income when received.

Certain costs directly related to acquiring new health, life and annuity business, principally commissions and selling, selection and policy issue expenses, are deferred and amortized over the policies' premium paying periods in the proportion that annual premium revenue bears to total anticipated premium revenue. Amortization schedules have been based on interest and withdrawal assumptions consistent with those used to compute liabilities for future policy benefits.

Liabilities for future policy benefits have been computed by the net level premium method based upon estimated future investment yield and Paul Revere's experience on mortality, morbidity, withdrawals and other assumptions. At December 28, 1985, the liability for future policy benefits aggregated $828.7 million and included 57% for individual health, 29% for individual life, 13% for individual annuities and 1% for group products. This excludes the liability for purchase payment funds applicable to annuities aggregating $729.7 million at December 28, 1985.

Translation of foreign currencies

Adjustments resulting from the translation of the financial statements of foreign operations are excluded from the determination of income and accumulated in a separate component of equity and amounted to a charge of $24.8 million at December 28, 1985. The effects on income resulting from foreign exchange transactions were a $1.0 million loss in 1985 and a $.1 million gain in 1984.

2. Acquisition of Avco Corporation

Presented below is a condensed unaudited pro forma statement of income of Textron's finance and insurance subsidiaries for 1984 as if Textron's acquisition of Avco had occurred at the beginning of that year.

(In millions)	
Revenues	$1,494.8
Expenses	1,306.4
Income before income taxes	188.4
Income taxes	70.4
Net income	$118.0

3. Receivables

The maximum term over which consumer loans and retail installment contracts are written is 120 months, but approximately 90% of these loans are written with terms of 48 months or less. Real estate loans are written with a maximum term of 180 months. Credit card receivables are written under open ended revolving charge contracts. The maximum term over which leases, other than leveraged leases, are written is 120 months; leases are generally written for three to seven years and offer a choice of payment plans to suit the customer's cash flow and tax position.

Estimated contractual maturities of receivables outstanding at December 28, 1985 and receivables (less unearned charges) outstanding at December 28, 1985 and December 29, 1984 were as follows:

(In millions)	Contractual maturities 1986	1987	1988-2000	Less unearned charges	Receivables outstanding 1985	1984
Consumer	$867.2	$574.3	$297.8	$237.1	$1,502.2	......
Real estate	251.4	148.3	609.7	67.2	942.2	......
Installment-principally retail	428.7	163.9	324.0	179.4	737.2	$204.7
Credit card	89.5	69.8	247.4	.1	406.6	......
Commercial	39.0	......	......	......	39.0	62.0
Finance leases	185.9	143.0	278.1	126.6	480.4	120.3
Leveraged leases	3.8	3.5	212.5	73.6	146.2	110.0
Other	86.0	30.3	15.7	12.4	119.6	14.9
	$1,951.5	$1,133.1	$1,985.2	$696.4	$4,373.4	$511.9

Experience has shown that a substantial majority of consumer and real estate loans and installment contracts will be refinanced many months prior to contractual maturity dates. During 1985 and 1984, cash collections (excluding unearned charges included in net earnings) of receivables were $2.2 billion and $276 million, respectively, and the ratio of cash collections to average net receivables was approximately 54% and 61%, respectively.

4. Investments

At December 28, 1985, investments consisted of the following:

(In millions)	
Commercial paper, at cost (approximates market)	$102.6
Bonds, at amortized cost (estimated market: $1,701.3)	1,590.5
Marketable equity securities, at market (cost: $30.0)	33.1
First mortgages on real estate, at cost	276.8
Policy loans and other investments, at cost	63.6
	$2,066.6

Approximately 84% of investment income in 1985 was attributable to interest on commercial paper and bonds and 14% to income derived from first mortgages on real estate.

Investments in long-term bonds are generally held until maturity and are carried at amortized cost. Net unrealized appreciation of bond market values during 1985 was $114.5 million.

A valuation adjustment representing the excess of aggregate market value over aggregate cost of marketable equity securities has been credited directly to equity. Such excess at December 28, 1985 of $2.7 million represented gross unrealized gains (net or applicable taxes).

Net realized losses after income taxes resulting from sales of marketable equity securities were $1.4 million in 1985. The cost of securities sold was based primarily on the specific identification method.

5. Debt

AFS and TFC are independent borrowers and, accordingly, their debt is supported only by their own respective assets.

At December 28, 1985, AFS and TFC had lines of credit with various banks amounting to $1.5 billion, of which $796 million related to long-term loans. Lines of credit not used or reserved as support of outstanding commercial paper amounted to $728 million of which $100 million related to long-term loans. In support of these lines, AFS and TFC generally pay fees and/or maintain compensating balances.

In addition, Textron maintains short-term lines of credit with a number of banks. Such lines are available to TFC, principally on an informal confirmed basis, to the extent of $144 million at December 28, 1985, of which $86 million was reserved as support for outstanding commercial paper.

Under an operating agreement, Textron has made available to TFC a line of credit of up to $60 million for junior subordinated borrowings at prime rate (9.5% at December 28, 1985). The operating agreement further provides that Textron shall loan TFC interest free an amount not to exceed the deferred income tax liability of Textron attributable to the manufacturing profit deferred on products manufactured by Textron and financed by TFC. TFC had junior subordinated borrowings of $20.3 million outstanding at December 28, 1985 ($19.7 million at December 29, 1984) under this arrangement. Under the operating agreement, Textron has agreed to cause TFC's pre-tax income available for fixed charges to be not less than 135% of fixed charges.

AFS and TFC have entered into interest rate exchange agreements, over periods ranging from 1 to 9 years, which had the effect of fixing the rate of interest on approximately $440 million of variable interest rate borrowings at December 28, 1985 at approximately 10.6%. Net amounts due under these contracts increased interest expense by approximately $6.5 million during 1985, decreased interest expense by approximately $.2 million during 1984 and increased interest expense by approximately $.9 million during 1983. These agreements expire as follows: $25 million in 1986; $122 million in 1987 and $293 million thereafter.

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

(In millions)	Dec. 28, 1985	Dec. 29, 1984
Senior notes and debs.; interest at 5%-20.315%; 1986 to 1999 maturity dates	$2,474.4	$204.0
Senior subord. notes and debs.; interest at 8¼%-12¾%; 1986 to 1996 maturity dates	295.1	......
Junior subord. and capital notes; interest at 8¾%-13.62%; 1986 to 1992 maturity dates	95.5	......
	$2,865.0	$204.0

Required payments during the next five years on long-term debt outstanding at December 28, 1985 are as follows: $244.0 million in 1986; $277.4 million in 1987; $620.7 million in 1988; $158.7 million in 1989 andd $421.7 million in 1990.

The long-term notes, debentures and loan agreements of AFS and TFC contain various restrictions on the declaration or payment of cash dividends. The long-term notes, debentures and loan agreements also contain various provisions restricting additional debt, the creation of liens or guarantees and the making of investments.

6. Income Taxes

The provisions for income taxes of the U.S. finance subsidiaries were calculated based on these subsidiaries being included in the consolidated U.S. federal income tax return filed by Textron. The provisions for income taxes also include amounts for the U.S. insurance subsidiaries and foreign subsidiaries which file their own separate income tax returns.

The Deficit Reduction Act of 1984 (1984 Act) enacted on July 18, 1984, changed the method by which life insurance companies were taxed, retroactive to tax years beginning after December 31, 1983. Among the many changes of the 1984 Act were: (i) the elimination of the three phase tax structure in favor of a single phase system, (ii) the establishment of a uniform method of computing reserves based on standard interest and mortality assumptions, (iii) the establishment of a taxable income adjustment equal to 20% of taxable income as defined, and (iv) the closure of future additions to the policyholders' surplus account.

Under the statutes in effect before the 1984 Act, a portion of "gain from operations" was not subject to current income taxation but was accumulated for tax purposes in a memorandum tax account. The 1984 Act prohibited any additions to the policyholder's surplus memorandum account for taxable years beginning after December 31, 1983. At December 28, 1985 policyholders' surplus was $104.9 million. Under present circumstances it is not anticipated that any of these untaxed earnings will become taxable.

Details of income before income taxes, income taxes and the deferred income tax effects of timing differences are summarized as follows:

(In millions)	1985	1984	1983
Income before income taxes:			
U.S.	$143.2	$21.2	$17.3
Foreign	70.2	......	......
Total	$213.4	$21.2	$17.3

Income taxes:			
Current:			
Federal	$(36.6)	$(22.0)	$(2.7)
State	4.7	.2	.2
Foreign	29.3	......	......
	(2.6)	(21.8)	(2.5)
Deferred:			
Federal	84.7	30.7	9.8
State	2.4	.2	.3
Foreign	1.0	......	......
	88.1	30.9	10.1
Total	$85.5	$9.1	$7.6

Deferred income tax effects of timing differences:			
Leveraged leases	$40.8	$28.0	$8.8
Finance leases	29.3	4.8	3.1
Insurance policy acquisition costs	15.9	......	......
Liabilities for future policy benefits	(8.4)	......	......
Other	10.5	(1.9)	(1.8)
Total	$88.1	$30.9	$10.1

Incremental income taxes (those in excess of available foreign tax credits) have not been provided on the cumulative undistributed earnings of foreign subsidiaries aggregating approximately $286 million at December 28, 1985. 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.

Investment tax credits are accounted for under the deferral method for the leasing operations and under the flow-through method for all other operations. Investment tax credits included in net income were $12.0 million, $1.6 million and $.9 million in 1985, 1984 and 1983, respectively.

Following is a reconciliation of the federal statutory income tax rate to the effective income tax rate:

	1985	1984	1983
Federal statutory income tax rate	46.0%	46.0%	46.0%
Incr. (reduction) in taxes resulting from:			
State income taxes, net of federal tax benefit	1.6	1.0	1.2
Invest. tax credits	(3.4)	(3.4)	(2.4)
Tax exempt interest and divs., received deduction	(2.8)	(1.3)	(.8)
Foreign income taxed at lower effective rates	(1.6)	......	......
Special deductions allowed life insurance companies	(2.3)	......	......
Net capital gains	(1.3)	......	......
Amort. of costs in excess of net assets of companies acquired	3.9	......	......
Other, net	......	.8	(.1)
Effective tax rate	40.1%	43.1%	43.9%

7. Profit Sharing, Retirement and Pension Plans

The various subsidiaries have retirement plans, principally non-contributory, which cover substantially all employees. Retirement plan expense for 1985 was $10.5 million. The amounts in 1984 and 1983 were insignificant. Retirement costs are funded as accrued.

8. Financial Information by Business Segment

(In millions)	1985	1984	1983
Revenues:			
Finance:			
Consumer	$735.4	$......	$......
Commercial	107.3	60.8	50.6
	842.7	60.8	50.6
Insurance:			
Credit life, disability and casualty	250.4	......	......
Health and life	589.6	......	......
	840.0	......	......
	$1,682.7	$60.8	$50.6
Income:			
Finance:			
Consumer	$119.0	$......	$......
Commercial	22.8	21.2	17.3
	141.8	21.2	17.3
Insurance:			
Credit life, disability and casualty	21.3	......	......
Health and life	50.3	......	......
	71.6	......	......
	$213.4	$21.2	$17.3
Identifiable assets:			
Finance:			
Consumer	$3,591.7	$......	$......
Commercial	938.2	511.8	416.7
	4,529.9	511.8	416.7
Insurance:			
Credit life, disability and casualty	616.7	......	......
Health and life	2,163.0	......	......
	2,779.7	......	......
	$7,309.6	$511.8	$416.7

Notes to Business Segments:

(i) Income attributable to U.S. operations was 67% of income for 1985 and 100% of income for 1984 and 1983.

(ii) Identifiable assets in the U.S. amounted to 81% of total identifiable assets at the end of 1985 and 100% of total identifiable assets at the end of 1984 and 1983.

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

9. Leases

Offices are occupied under non-cancellable operating leases expiring on various dates through 2008. At December 28, 1985, minimum annual rentals relating to such leases were $26.7 million for 1986, excluding payments required under certain leases for taxes, insurance and other maintenance expenses. The remaining minimum annual rentals decrease annually thereafter and aggregate $165.6 million.

Total rental expense was approximately $37.5 million for 1985, $.2 million for 1984 and $.1 million for 1983.

Five-Year Summary

(Dollars in millions except per share amounts)

	1985	1984	1983	1982	1981
[1]**Operating Results**					
Sales	$4,038.5	$2,148.0	$2,046.6	$1,982.7	$2,195.1
Costs and expenses:					
Cost of sales	3,175.2	1,712.5	1,637.8	1,587.1	1,688.9
Selling and admin.	571.8	302.1	293.1	283.2	314.4
	291.5	133.4	115.7	112.4	191.8
Equity in pre-tax income of unconsolidated finance and insur. subsidiaries	213.4	21.2	17.3	16.9	9.9
Int. inc.	12.1	11.0	12.4	8.6	12.3
Int. exp.	(216.2)	(32.9)	(33.4)	(41.7)	(49.7)
Gains on exchange of common stock for debs.	......	......	......	10.3	......
Inc. from continuing operations before inc. taxes	300.8	132.7	112.0	106.5	166.3
Inc. taxes	120.7	55.2	43.0	37.9	64.1
Income from continuing operations before extraord. gain and cumul. effect of a change in accnting. principle	180.1	77.5	69.0	68.6	100.2
Inc. from discont. opers., net of income taxes	43.5	36.0	19.7	15.8	51.6
Extraord. gain, net of income taxes	16.4	......	......	......	......
Cumul. effect of a change in accnting. principle	11.8	......	......	......	......
Net income	$251.8	$113.5	$88.7	$84.4	$151.8
Per common share:					
Income from continuing oper.	$4.83	$2.12	$1.87	$1.87	$2.68
Income from discont. oper.	1.16	.99	.53	.43	1.38
Extraord. gain	.44	......	......	......	......
Cumul. effect of a change in accnting. principle	.32	......	......	......	......
Net income	$6.75	$3.11	$2.40	$2.30	$4.06
Dividends	$1.80	$1.80	$1.80	$1.80	$1.80
Average common shares outstanding	37,318,000	36,469,000	36,989,000	36,754,000	37,415,000
Financial Position at Year-End					
Working capital	$1,057.1	$869.7	$911.0	$861.7	$878.1
Prop., plant and equip.—net	$588.9	$452.4	$412.9	$436.1	$438.5
Total assets	$4,337.4	$2,210.0	$2,104.6	$2,038.2	$2,164.2
Long-term debt	$1,503.1	$200.4	$231.6	$245.9	$286.8
Shareholders' equity	$1,633.3	$1,253.9	$1,244.6	$1,227.3	$1,227.0
Book value per comm. sh.	$39.88	$34.46	$33.09	$32.57	$32.40
Other Data					
[1]Capital expenditures	$160.4	$81.6	$31.1	$49.2	$58.7
[1]Deprec.	$101.3	$45.1	$41.5	$39.5	$41.9
[1]Research and develop. expenditures	$520.0	$322.3	$287.9	$186.9	$160.9
Number of employees	56,000	43,000	41,000	41,000	49,000
[2]Number of comm. shareholders	40,000	43,000	46,000	50,000	52,000
[2]Number of pfd. shareholders	5,000	6,000	7,000	8,000	8,000

[1]The 1985 data include the operations of Avco from January 10, 1985. Prior years' amounts have been restated for discontinued operations.

[2]Includes holders of record and individual participants in security position listings at year-end.

FINANCIAL & OPERATING DATA

Statistical Record

	1985	1984	1983
Earned per share—preferred	$98.16	$56.92	$38.18
Earned per share—common:			
On year end shares	$6.34	$3.16	$2.44
[3]On avge. shs.:			
On continuing oper.	$4.83	$2.12	$1.87
Discontinued oper.	$1.16	$0.99	$0.53
Net income	$6.75	$3.11	$2.40
Extraord. gain	cr$0.44	......	......
Cum. eff. of acct. chge.	cr$0.32	......	......
Divs. paid per share—$2.08 preferred	$2.08	$2.08	$2.08
—$1.40 preferred	$1.40	$1.40	$1.40
—common	$1.80	$1.80	$1.80

FINANCIAL & OPERATING DATA (Cont'd):

	1985	1984	1983
Price range—$2.08 preferred	65-36	47¼-28¾	40-25½
—$1.40 preferred	53-28¾	38-23¾	32-20⅝
—common	59¾-32⅜	43½-25⅞	36⅞-23½
Net tang. assets per sh.—$2.08 pfd.	$636.76	$832.76	$706.02
—$1.40 pfd.	[4].....	[4].....	[4].....
—common	[1]$39.28	[1]$34.46	[1]$33.09
Price range—deb. 7½s, 1997	76½-65⅞	66½-60⅜	72¼-64
—11% notes, 1995	101⅞-99½	.....	.....
—Avco 12% sr. notes, 1990	103½-98⅝	100-85⅛	102-94
—Avco conv. deb. 5½s, 1993	92½-87	90½-63⅛	80-65
—Avco deb. 7½s, 1993	83¾-70	72-60⅛	74¾-63
[4]Times fixed charges earned:			
Before income taxes	2.39	5.03	4.35
After income taxes	1.83	3.36	3.06
Times interest & pfd. divs. earn.	1.80	2.98	2.69
Preferred dividends times earned	76.30	27.68	19.28
Net tang. assets per $1,000 lg. trm. debt	$2,087	$7,038	$6,216
Net curr. assets per $1,000 lg. trm. debt	$704	$4,340	$3,934
Number of shares—$2.08 preferred	1,863,000	1,453,000	1,711,000
—$1.40 preferred	702,000	541,000	600,000
Number of shares—common:			
At year end	39,183,000	33,792,000	34,484,000
[3]Average	37,318,000	36,469,000	36,989,000
Financial & Operating Ratios			
Current assets ÷ current liabilities	2.00	2.35	2.63
% cash & securities to current assets	2.25	2.83	11.27
% inventories to current assets	48.47	57.92	56.26
% net current assets to net worth	64.77	69.36	73.20
% property depreciated	45.97	59.85	60.63
% annual depr., etc. to gross property	9.07	6.11	6.16
Capitalization:			
% long term debt	47.92	13.78	15.69
% preferred stock	1.31	3.31	3.72
% common stock & surplus	50.77	82.91	80.59
Sales ÷ inventories	3.94	2.46	2.47
Sales ÷ receivables	6.55	3.91	4.66
% sales to net property	685.77	474.80	495.66
% sales to total assets	93.11	97.19	97.24
% net income to total assets	5.81	5.14	4.21
% net income to net worth	15.42	9.05	7.13
Analysis of Operations	%	%	%
Sales	100.00	100.00	100.00
Cost of sales	78.62	79.73	80.03
Selling, & admin. expenses	14.16	14.06	14.32
Operating inc.	7.22	6.21	5.65
Int. inc.	0.30	0.51	0.61
Interest exp.	5.35	1.53	1.63
Equity in inc. of unconsol. co.	5.28	0.99	0.85
Inc. from cont. oper. bef. inc. taxes	7.45	6.18	5.48
Prov. inc. tax.	2.99	2.57	2.10
Inc. from cont. oper.	4.46	3.61	3.38
Discont. oper.	1.08	1.68	0.96
Extraord. item	0.41	.....	.....
Cum. eff. of acct. chge.	0.29	.....	.....
Net income	6.24	5.29	4.34

[1]As reported by Co. after giving effect to liquidation value of $2.08 pfd. and conv. of $1.40 pfd. [3]As reported by company, based on average shares and assuming conversion of preferred stock and exercise of warrants and stock options. [4]Shares ratably with common. [5]Based on continuing oper.

LONG TERM DEBT

1. Textron Inc. sinking fund debentures 7½s, due 1997:

Rating—A3

AUTH.—$50,000,000; outstg., Dec. 28, 1985, $19,200,000.

DATED—July 15, 1972. DUE—July 15, 1997.

INTEREST—J&J15 to holders registered J&J1.

TRUSTEE—Chemical Bank, NYC.

DENOMINATION—Fully registered $1,000 and authorized multiples thereof.

CALLABLE—As a whole or in part at any time on at least 30 days' notice to each July 15 as follows:

1985 .....103.00 1986 .....102.63 1987 .....102.25
1988 .....101.88 1989 .....101.50 1990 .....101.13
1991 .....100.75 1992 .....100.38

thereafter at 100.

Also callable for sinking fund (which see) at 100.

SINKING FUND—Annually, each July 14, 1978-96 to retire at par debs., cash (or debs.) equal to $2,500,000 plus similar optional payments. Payments calculated to retire 95% of debs. prior to maturity.

SECURITY—Not secured; Co. or any restricted subsidiary may not create any lien on its property without equally securing debs., except (1) liens on property hereafter acquired or constructed; (2) liens on a Corp. existing at time it becomes a subsidiary; (3) liens on property to finance construction; and (4) liens on assets permitting Co. to perform contracts requested by U.S. Government.

SALE AND LEASEBACK—Co. or restricted subsidiaries may not sell and leaseback for periods exceeding 24 months any manufacturing plant or equipment owned on July 15, 1972 or thereafter acquired (except for such property owned for less than 90 days) unless fair value of such sale and net proceeds are applied to either redemption of debs., or other senior funded debt of Co., or restricted subsidiaries.

RIGHTS ON DEFAULT—Trustee, or 25% of debs. outstg. may declare principal due and payable (30 days' grace for payment of interest or sinking fund).

INDENTURE MODIFICATION—Indenture may be modified, except as provided, with consent of 66⅔% debs. outstg.

LISTED—On New York Stock Exchange.

PURPOSE—Proceeds for working capital, possible acquisitions and for purchase of com. stock.

OFFERED—($50,000,000) at 100 (proceeds to Co., 99.125) on July 19, 1972 thru Merrill Lynch, Pierce, Fenner & Smith, Inc. and Lehman Brothers, Inc. and associates.

2. Textron Inc. 11% notes, due 1995:

Rating—A3

AUTH.—$100,000,000; outstg. this series $100,000,000.

DATED—May 1, 1985. DUE—July 1, 1995.

INTEREST—J&J 1 to holders registered D&J 15.

TRUSTEE—Manufacturers Hanover Trust Company.

DENOMINATION—Fully registered, $1,000 and integral multiples thereof. Transferable and exchangeable without service charge.

CALLABLE—As a whole or in part on or after July 1, 1992, at the option of Co. on at least 30 days' but not more than 60 days' notice at 100 plus accrued interest.

SECURITY—Not secured. Subordinated in right of payment to the prior payment in full of all senior indebtedness of Co. Co. or any restricted subsidiary may not issue, assume or guarantee, any mortgage, security interest, pledge, lien or other encumbrance upon any principal property of Co. or any restricted subsidiary or upon any shares of stock or indebtedness of any restricted subsidiary without equally and ratably securing the Senior Securities. The foregoing restriction, however, will not apply to: (a) mortgages on property, shares of stock or indebtedness of any corporation existing at the time such corporation becomes a restricted subsidiary; (b) mortgages existing at the time of acquisition of such property or mortgages to secure the payment of all or any part of the purchase price of such property upon the acquisition thereof, or mortgages to secure the cost of improvements to such acquired property; (c) mortgages to secure indebtedness of a subsidiary to Co. or another restricted subsidiary; (d) mortgages existing at the date of the senior indenture; (e) mortgages on property of a corporation existing at the time such corporation is merged into or consolidated with Co. or a subsidiary; (f) certain mortgages in favor of governmental entities; or (g) extensions, renewals or replacements of any mortgage referred to in the foregoing clauses (a) through (f).

SALE AND LEASEBACK—Co. will covenant that it will not, nor will it permit any restricted subsidiary to, enter into any sale and lease-back transaction with respect to any principal property other than any such transaction involving a lease for a term of not more than three years or any such transaction between Co. and a restricted subsidiary or between restricted subsidiaries, unless either (a) Co. or such restricted subsidiary would be entitled to incur indebtedness secured by a mortgage on principal property at least equal in amount to the attributable debt with respect to such sale and lease-back transaction, without equally and ratably securing the securities, pursuant to the limitation in the senior indenture on liens, or (b) Co. shall apply an amount equal to the greater of the net proceeds of such sale or the attributable debt with respect to such sale and lease-back transaction to (i) the retirement of senior indebtedness that matures more than twelve months after the creation of such senior indebtedness or (ii) the acquisition, construction, development or improvement of properties, facilities or equipment which are, or upon such acquisition, construction, development, or improvement will be, a principal property or a part thereof.

INDENTURE MODIFICATION—Indenture may be modified, except as provided, with consent of a majority of notes outstg.

RIGHTS ON DEFAULT—Trustee, or 25% of notes outstg., may declare principal due and payable (30 days' grace for payment of interest).

LISTED—On the New York Stock Exchange.

PURPOSE—Proceeds will be applied to repay outstanding commercial paper.

OFFERED—($100,000,000) at 99.700 plus accrued interest (proceeds to Co., 99.025) on June 27, 1985 thru Salomon Brothers Inc.; Kidder, Peabody & Co. Incorporated; Morgan Stanley & Co. Incorporated and associates.

3. Textron Inc. debenture 9¼s, due 2016:

Rating—A3

AUTH.—$150,000,000; outstg., Mar. 5, 1986.

DUE—Mar. 15, 2016.

INTEREST—M&S15.

TRUSTEE—Manufacturers Hanover Trust Co.

DENOMINATION—Fully registered, $1,000 and integral multiples thereof.

CALLABLE—As a whole or in part at the option of Co. on not less than 30 nor more than 60 days notice as follows to each Mar. 14 incl.:

1987 .....109.25 1988 .....108.79 1989 .....108.33
1990 .....107.86 1991 .....107.40 1992 .....106.94
1993 .....106.48 1994 .....106.01 1995 .....105.55
1996 .....105.09 1997 .....104.63 1998 .....104.16
1999 .....103.70 2000 .....103.24 2001 .....102.78
2002 .....102.31 2003 .....101.85 2004 .....101.39
2005 .....100.93 2006 .....100.46

and thereafter at 100 provided that no optional redemption may be effected prior to March 15, 1996, as a part of, or in anticipation of, any refunding operation by the application, directly or indirectly, of moneys borrowed by or for the account of Textron at an interest cost of less than 9.25% per annum.

SINKING FUND—Annually, each Mar. 15, in each year: $7,500,000 from 1997-2015, inclusive, plus similar optional payments.
SECURITY—Not secured.
RIGHTS ON DEFAULT—Trustee, or 25% of debs. outstg., may declare principal due and payable (30 days grace for payment of interest).
PURPOSE—Proceeds will be applied to repay outstanding commercial paper.
OFFERED—($150,000,000) at 100.00 plus accrued interest (proceeds to Co., 99.125) on Mar. 5, 1986 thru Salomon Brothers Inc.; Kidder, Peabody & Co., Inc.; and Morgan Stanley & Co., Inc. and associates.

4. Textron Inc. 10¾% euronotes, due 1998:

Rating—A3

OUTSTG.—$100,000,000.
INTEREST—Jan. 7.
CALLABLE—At 101½.
OTHER DETAILS—Not reported.

5. Textron Inc. 11¾% subordinated notes, due 1995:

Rating—Baa1

AUTH.—$150,000,000; outstg. this series Dec. 28, 1985, $149,200,000.
DATED—May 1, 1985. DUE—May 1, 1995.
INTEREST—M&N 1 to holders registered A&O 15.
TRUSTEE—The Chase Manhattan Bank, N.A.
DENOMINATION—Fully registered, $1,000 and any multiple thereof. Transferable and exchangeable without service charge.
CALLABLE—As a whole or in part, at the option of Co., on and after May 1, 1992 on at least 30 and not more than 60 days' notice at 100 plus accrued interest.
SECURITY—Not secured. Subordinated and subject in right of payment to the prior payment in full of all senior indebtedness of Co.
INDENTURE MODIFICATION—Indenture may be modified, except as provided with consent of a majority of notes outstg.
RIGHTS ON DEFAULT—Trustee, or 25% of notes outstg., may declare principal due and payable (30 days' grace for payment of interest).
LISTED—On New York Stock Exchange.
PURPOSE—Proceeds will be applied to repay outstanding commercial paper.
OFFERED—($150,000,000) at 99.410 plus accrued interest (proceeds to Co., 98.710) on May 6, 1985 thru Morgan Stanley & Co. Incorporated; Kidder, Peabody & Co. Incorporated; Salomon Brothers Inc. and associates.

6. Textron Inc. subordinated debenture 12⅜s, due 2010:

Rating—Baa1

AUTH.—$100,000,000; outstg. this series Dec. 28, 1985, $99,800,000.
DATED—May 1, 1985. DUE—May 1, 2010.
INTEREST—M&N 1 to holders registered A&O 15.
TRUSTEE—The Chase Manhattan Bank, N.A.
DENOMINATION—Fully registered, $1,000 and any multiple thereof. Transferable and exchangeable without service charge.
CALLABLE—As a whole or in part, at the option of Co. on at least 30 but not more than 60 days' notice to each April 30 as follows:

1986	.....112.55	1987	.....111.92	1988	.....111.30
1989	.....110.67	1990	.....110.04	1991	.....109.41
1992	.....108.79	1993	.....108.16	1994	.....107.53
1995	.....106.90	1996	.....106.28	1997	.....105.65
1998	.....105.02	1999	.....104.39	2000	.....103.77
2001	.....103.14	2002	.....102.51	2003	.....101.88
2004	.....101.26	2005	.....100.63		

and thereafter at 100%. Not callable prior to May 1, 1995, as a part of, or in anticipation of, any refunding operation by the application, directly or indirectly, of moneys borrowed by or for the account of Co. at an interest cost of less than 12.78% per annum. Also callable for sinking fund (which see) at 100.
SINKING FUND—Annually May 1, 1996-2009, sufficient to redeem $6,500,000 principal amount of debs., plus similar optional payments. Sinking fund is designed to retire 91% of debs. prior to maturity.
SECURITY—Same as 11¾% notes, due 1995.
INDENTURE MODIFICATION—Indenture may be modified, except as provided with consent of a majority of debs. outstg.
RIGHTS ON DEFAULT—Trustee, or 25% of debs. outstg., may declare principal due and payable (30 days' grace for payment of interest).
LISTED—On New York Stock Exchange.
PURPOSE—Proceeds will be applied to repay outstanding commercial paper.
OFFERED—($100,000,000) at 99.800 plus accrued interest (proceeds to Co., 98.925) on May 6, 1985 thru Morgan Stanley & Co. Incorporated; Kidder, Peabody & Co. Incorporated; Salomon Brothers Inc. and associates.

7. Textron International Inc. guaranteed sinking fund debenture, 7¾s, due 1987:

Rating—A3

AUTH.—$30,000,000; outstg., Dec. 28, 1985, $10,800,000.
DATED—Oct. 2, 1972. DUE—Oct. 1, 1987.
INTEREST—Annually, each Oct. 1, commencing 1973, at offices of paying agents listed below.
TRUSTEE—Morgan Guaranty Trust Co. of New York, NYC.
PAYING AGENTS—Morgan Guaranty Trust Co. of New York, NYC, Brussels, Frankfurt/Main, London, Paris and Tokyo; Banca Morgan Vonwiller S.p.A., Milan; Bank Mees & Hope N.V., Amsterdam; and Banque Generale du Luxembourg S.A., Luxembourg.
DENOMINATION—Bearer, $1,000.
CALLABLE—As a whole or in part on at least 30 days' notice at 100.

If, as a result of any change in the laws of U.S. or any subdivision or taxing authority thereof or therein or any change in official application of such laws effective after Sept. 15, 1972, it would be required, pursuant to provisions of debs., to pay additional interest (see Taxes on Principal, Premium or Interest), debs. may be redeemed as a whole on at least 30 days' notice at 100.

Also callable on like notice for sinking fund (which see) at 100.
SINKING FUND—Annually, each Oct. 1, in each year: $1,200,000 from 1978-81, inclusive; $2,400,000 in 1982-83; and $4,800,000 from 1984-86, inclusive, plus similar optional payments. Sinking fund designed to retire 80% of issue prior to maturity.
SECURITY—Not secured; subordinated to all senior debt.
GUARANTEED—Unconditionally by Textron Inc., parent, as to payment of principal, premium, if any, and interest and sinking fund.
TAXES ON PRINCIPAL, PREMIUM OR INTEREST—Co. will pay as additional interest such amounts as may be necessary to reimburse non-resident alien holders for any present or future U.S. withholding tax.
RIGHTS ON DEFAULT—Trustee, or 25% of debs. outstg. may declare principal due and payable (30 days' grace for payment of interest).
INDENTURE MODIFICATION—Indenture may be modified, except as provided, with consent of 66⅔% of debs. outstg.
PURPOSE—Proceeds for debt repayment and investments in overseas subsidiaries and affiliates of Textron, Inc., parent.
OFFERED—($30,000,000) at 100¼ (proceeds to Co., 97.75) on Sept. 15, 1972 thru Merrill Lynch, Pierce, Fenner & Smith Securities Underwriter Ltd., S.G. Warburg & Co. Ltd., Banca Commerciale Italiana, Daiwa Securities Co., Ltd. and Union Bank of Switzerland (Underwriters) Ltd. and associates.

8. Textron Financial 5⅝% eurobonds, due 1986:

Rating—Baa1

OUTSTG.—$70,000,000.
DUE—1996.
INTEREST—Oct. 23.
CALLABLE—At 102½.
OTHER DETAILS—Not reported.

9. Avco Corp. 12% senior notes, due 1990:

Rating—Baa3

AUTH.—$65,000,000; outstg., Nov. 30, 1983, $65,000,000.
DATED—June 15, 1980. DUE—June 15, 1990.
INTEREST—J&D15.
TRUSTEE—Irving Trust Co.
DENOMINATION—Fully registered, $1,000 and any multiple of $1,000. Transferable and exchangeable without service charge.
CALLABLE—As a whole or in part at anytime on or after June 15, 1987 on at least 30 days' notice at 100.
SECURITY—Ranks equally with all other unsecured debt of Avco, except subordinated debt. The Indenture will provide that Avco will not itself, and will not permit any Restricted Subsidiary to, directly or indirectly, create, incur, issue, assume, guarantee or otherwise become liable for or suffer to exist any indebtedness for money borrowed or evidenced by a bond, debenture, note or other similar instrument, whether or not for money borrowed, given in connection with the acquisition of any business, properties or assets, including securities, secured by any mortgage, pledge, lien, security interest, conditional sale or other title retention agreement or other similar encumbrance on any Principal Property of Avco or of any Restricted Subsidiary or any capital stock or Funded Debt owned directly by Avco or any Restricted Subsidiary, without making effective provision whereby the Notes will be equally and ratably secured except (a) Mortgages on property of any corporation existing at the time such corporation becomes a Restricted Subsidiary; (b) Mortgages existing at the time of the acquisition of such property or to secure the purchase price or cost of construction thereof or to secure any indebtedness incurred prior to, at the time of, or within 120 days after the latest of the acquisition, the completion of constitution or the commencement of full operation of the Principal Property for the purpose of financing the purchase price or cost of construction thereof, provided that such Mortgages are limited to such property; (c) Mortgages in favor of Avco or any Restricted subsidiary; (d) certain liens in favor of governmental bodies; (e) certain liens created in the ordinary course of business and not securing indebtedness for borrowed money; (f) extensions, renewals or replacements of the foregoing Mortgages or other liens; and (g) other liens in addition to those permitted by the foregoing exceptions if the aggregate principal amount of [illegible] ness secured by such other liens together with all Funded Debt of Restricted Subsidiaries and Attributable Debt in respect of Sale and Leaseback Transactions permitted would not exceed 7½% of the consolidated Net Tangible Assets of Avco and its Restricted Subsidiaries.
CREATION OF ADDITIONAL DEBT—The Indenture will provide that Avco will not, and will not permit any Restricted Subsidiary, to create, incur, issue, assume or guarantee or otherwise become liable for any Senior Funded Debt or sell, transfer or otherwise dispose of any senior Funded Debt of Avco or a Restricted Subsidiary unless, after giving effect hereto and to the retirement of any Senior Funded Debt to be retired substantially concurrently herewith, Consolidated net Tangible Assets will aggregate at least 200% of Senior funded Debt of Avco and its Restricted Subsidiaries.
DIVIDEND RESTRICTIONS—Same as Avco Corp. conv. subord. deb. 5½s, due 1993, except the date is Nov. 30, 1979 and the amount is $40,000,000.
INDENTURE MODIFICATION—Indenture may be modified, except as provided, with consent of 66⅔% of notes outstg.
RIGHTS ON DEFAULT—Trustee, or 25% of notes outstg. may declare principal due and payable (30 days' grace for payment of interest).
LISTED—On New York Stock Exchange.
PURPOSE—Proceeds will be added to general funds and applied to reduce outstg. bank borrowings.
OFFERED—($75,000,000) at 100 plus accrued interest (proceeds to Co., 99) on June 19, 1980 thru Salomon Brothers; Kidder, Peabody & Co. and associates.

10. Avco Corp. convertible subordinated debenture 5½s, due 1993:

Rating—Ba2

AUTHORIZED—Maximum of $199,5[illegible] outstanding, Dec. 28, 1985, $19,300,000.
DATED—Jan. 15, 1969. DUE—5% Nov. [illegible] 1992; balance Nov. 30, 1993.
INTEREST—May 31 & Nov. 30 to holders registered on 15th day prior to interest date.
TRUSTEE—Bankers Trust Co., NYC.
DENOMINATION—Fully registered, [illegible] $500, $1,000 and authorized multiples [illegible] $1,000.
CALLABLE—As a whole or in part on at least 30 days' notice to each Nov. 30 incl., as follows:

1985	.....102.20	1986	.....101.65	1987	.....101.10
1988	.....100.55	1993	.....100.00		

SECURITY—Not secured; subordinated to prior payment of senior debt. Avco or any subsidiary may not create, except in favor of company or a wholly-owned subsidiary, any mortgage on property without equally and ratably securing the debentures (subject to senior debt); excepted are purchase money mortgages and liens created on acquisition or construction of property.
CREATION OF ADDITIONAL DEBT—Avco may not create additional funded debt (except for refundings) unless thereafter consolidated tangible assets less consolidated liabilities (other than funded debt) of company and subsidiaries equal at least 250% of funded debt.
DIVIDEND RESTRICTION—Avco may not pay cash divs. on or acquire capital stock in excess of consolidated net income after Nov. 30, 1967 plus net proceeds from sale of stock or debt converted into stock after such date plus $50,000,000.
RIGHTS ON DEFAULT—In event of default (30 day grace period for interest payment), trustee or 25% of debentures may declare principal due and payable.
INDENTURE MODIFICATION—Indenture may be modified, except as provided, with consent of 66⅔% of debentures.
CONVERTIBLE—Into $926 cash.
LISTED—On New York Stock Exchange.
PURPOSE—Issued in Jan., 1969 in connection with acquisition of Seaboard Finance Co.

11. Avco Corp. subordinated debenture 7½s, due 1993:

Rating—Ba2

AUTHORIZED—Maximum of $146,731,600; outstanding, Dec. 28, 1985, $49,100,000.
DATED—Jan. 15, 1969. DUE—5% Nov. 30, 1992; balance Nov. 30, 1993.
INTEREST—May 31 & Nov. 30 to holders registered on 15th day prior to interest date.
TRUSTEE—Bankers Trust Co., NYC.
DENOMINATION—Fully registered, $100, $500, $1,000 and authorized multiples of $1,000.
CALLABLE—As a whole or in part on at least 30 days' notice at 100.
SECURITY—OTHER PROVISIONS—Same as Avco Corp. conv. subord. deb. 5½s, 1993.
DIVIDEND RESTRICTION—See conv. subord. deb. 5½s, 1993.
LISTED—On New York Stock Exchange.
PURPOSE—Issued Jan., 1969 in connection with acquisition of Seaboard Finance Co.

12. Other Long-Term Debt: Outstg., Dec. 28, 1985, $1,074,100,000. For details, see "Long-Term Debt" under "Notes to Consolidated Financial Statements," above.

Subsequent Retirement of Debt: In Jan. 1985 the Co.'s 5⅞% debentures, due 1992, were called in their entirety and in Mar. 1985 the Co. paid in full the outstanding balance of its 8% notes due 1985-97.

On Aug. 23, 1985 the Co.'s 7¾% subord. debentures, due 2005 were called in their entirety at $1,045 plus accrued interest.

CAPITAL STOCK

1. Textron Inc. $2.08 cumulative convertible preferred stock, series A; no par:

AUTHORIZED—All series, 15,000,000 shares; outstanding, ser. A Dec. 28, 1985, 1,863,000 shares; in treasury, 69,000 shares; no par.

PREFERENCES—Has equal preference with ser. B as to assets and dividends.

DIVIDEND RIGHTS—Entitled to cumulative dividends at rate of $2.08 per share annually payable quarterly Jan. 1 etc., to stock of record about Dec. 15, etc.

DIVIDEND RECORD—Initial dividend of $0.52 per share paid Apr. 1, 1968; regular quarterly dividends paid thereafter.

VOTING RIGHTS—Ser. A Stock has one vote per share and except as stated below or provided by statute votes together with all other stock now outstanding. Whenever dividends are in arrears upon any series of Preferred Stock in an amount equal to at least six quarter-yearly dividends, then until all dividends in arrears have been paid thereon, all outstanding series of Preferred Stock, voting as a class, may elect two members of Board of Directors. In addition, Ser. A Stock votes separately as a class on any proposal, including a proposal for authorization and issuance of any class of stock prior to Ser. A Stock as to dividend or liquidation preferences, which adversely affects rights of holders of Ser. A Stock. Series A Stock is also entitled to vote with any other Series of Preferred Stock on any proposal (a) to increase authorized amount of Preferred Stock beyond 5,000,000 shares or (b) to create any class of stock ranking on a parity with Preferred Stock as to dividend or liquidation preferences.

LIQUIDATION RIGHTS—In liquidation entitled to $50 per share of involuntary and to redemption price (see below) if voluntary.

CALLABLE—As a whole or in part at any time at $50 a sh.

CONVERTIBLE—Into common at any time at rate of 1.1 common shares for each preferred share.

TRANSFER AGENT AND REGISTRAR—Morgan Guaranty Trust Co. of New York, New York, N.Y.

LISTED—On NYSE (Symbol: TXT Pr A).

PURPOSE—(3,046,388 shares) Issued Jan. 3, 1968 in connection with acquisition of Fafnir Bearing Co.

2. Textron, Inc. $1.40 cumulative convertible preferred stock, series B; no par:

AUTH.—All series, 15,000,000 shs., outstanding, ser. B, Dec. 28, 1985, 702,000 shares; in treasury, 487,000 shares; no par.

PREFERENCES—Has equal preference with ser. A as to divs. only.

DIVIDEND RIGHTS—Entitled to cum. cash divs. of $1.40 annually, payable quarterly, Jan. 1, etc.

DIVIDEND RECORD—Initial dividend of $0.35 paid Oct. 1, 1968; regular quarterly dividends paid thereafter.

LIQUIDATION RIGHTS—In any liquidation, entitled to accrued divs. and then to shares ratably on a converted basis with com.

VOTING RIGHTS—Has one vote per sh. with non-cumulative voting for directors except if divs. are in arrears for 6 quarterly payments then pfd., voting as a class, may elect 2 additional directors.

Consent of 66⅔% of pfd. needed to issue prior stock or change terms adversely. Consent of majority of pfd. needed to increase authorized amount of pfd. or issue stock ranking on a parity with pfd.

CALLABLE—As a whole or in part after Dec. 31, 1973 on at least 40 days' notice at $45 a sh.

CONVERTIBLE—Into com. at any time (if called, on or before 10th day prior to redemption date) at rate of 0.9 of a com. sh. for each pfd. sh. No adjustment for divs. Cash paid in lieu of fractional shs. Conversion privilege protected against dilution.

PREEMPTIVE RIGHTS—None.

TRANSFER AGENT AND REGISTRAR—Morgan Guaranty Trust Co. of New York, New York, N.Y.

LISTED—On NYSE (Symbol: TXT Pr B).

ISSUED—In July 1968 pursuant to acquisition of Talon, Inc.

3. Textron Inc. common; par $0.25:

AUTHORIZED—75,000,000 shares; outstanding, Dec. 28, 1985, 39,183,000 shares; in treasury, 1,371,000 shares; reserved for conversion of $2.08 preferred, 1,440,572 shares; for conversion of $1.40 preferred, 761,723 shares; for options, 748,963 shares; par $0.25.

Par changed from $1 to 50 cents Sept. 10, 1945; from 50 cents to 25 cents Dec. 17, 1965, both by 2-for-1 split; 25 cent par shares split 2-for-1 Sept. 1, 1967.

DIVIDENDS—

On $1 par shares:

1936	$0.60	1937	$0.50	1938-39	Nil
1940	0.10	1941	Nil	1942	$0.30
1943	0.55	1944	0.50		

On 50 cents par shares:

1945-46	0.50	1947	1.00	[1]1948	0.75
1949-50	1.00	1951	1.75	1952	0.75
1953	[2]	1954	0.10	1955	0.60
1956	1.60	1957	1.15	1958	1.00
1959	1.12½	1960-62	1.25	1963	1.36¼
1964	1.55	1965	1.75		

On 25 cents par shares:

1966	1.05	1967	0.90

On 25 cents par shares after 2-for-1 split:

1967	0.17½	1968	0.72½	1969	0.82½
1970-71	0.90	1972	0.91½	1973	0.98
1974-75	1.10	1976	1.15	1977	1.35
1978	1.55	1979	1.75	1980-85	1.80
[3]1986	[4]0.90				

[1]Also one share of Dorset Fabrics, Inc., $1 par stock for each share held.

[2]One share of Indian Head Mills, Inc., common for each 10 shares Textron held.

[3]To Apr. 1.

[4]Also one pfd. stk. purchase right for each com. sh. held. See below.

DIVIDEND REINVESTMENT PLAN—Company offers its holders of common stock the opportunity to buy additional shares of common stock through its Dividend Reinvestment Plan of Morgan Guaranty Trust Co., of New York. Participating share-owners may invest from $25.00 to $1,000, whether or not he is reinvesting his dividends, at their option.

VOTING RIGHTS—Has one vote per share.

PREEMPTIVE RIGHTS—None.

DIVIDEND RESTRICTIONS—See Long Term Debt, above.

OFFERED—(4,000,000 shs.) at $47.25 a sh. on Sept. 23, 1985 thru Morgan Stanley & Co., Inc.; Kidder, Peabody & Co., Inc.; Salomon Brothers Inc. and associates.

TRANSFER AGENT and REGISTRAR—Morgan Guaranty Trust Co. of New York, New York, N.Y.

LISTED—On NYSE (Symbol: TXT); also listed on Pacific and Midwest Stock Exchanges; unlisted trading on Boston, Philadelphia, and Cincinnati Stock Exchanges.

Preferred Stockholders' Rights: In Apr. 1986, the board of directors adopted a shareholder rights plan in which pfd. stock purchase rights will be distributed as a dividend at the rate of one right for each com. sh. held as of the close of business on March 21, 1986. The rights will expire on March 20, 1996. Each right will entitle shareholders to buy one one-hundredth of a newly issued sh. of Series C junior participating pfd. stock of the Co. at an exercise price of $175. The rights will be exercisable only if a person or group acquires beneficial ownership of 20% or more of Co.'s com. shs. or announces a tender or exchange offer upon consummation of which such person or group would beneficially own 30% or more of the com. shs. If any person becomes the beneficial owner of 30% or more of Co.'s com. shs., if Co. is the surviving corporation in a merger with a 20% or more shareholder and its com. shs. are not changed or converted, or if such 20% or more shareholder engages in certain self-dealing transactions, each right not owned by such person or related parties will enable its holder to purchase, at the rights then current exercise price, com. shs. (or, in certain circumstances, equivalent value in the form of cash or other securities or property) having a value of twice the right's exercise price. In addition, if Co. is involved in a merger or other business combination transaction with another person in which its com. shs. are changed or converted, or sells 50% or more of its assets to another person, each right will entitle its holder to purchase, at the right's then-current exercise price, com. shs. of such other person having a value of twice the right's exercise price. Co. will be entitled to redeem the rights at $0.05 per right at any time until the 10th day following public announcement that a 20% position has been acquired. The redemption period may be extended by the Co. at any time prior to its expiration.

TII INDUSTRIES, INC.

CAPITAL STRUCTURE

LONG TERM DEBT

Issue	Rating	Amount Outstanding	Times Charges Earned 1985	Times Charges Earned 1984	Interest Dates	Call Price	Price Range 1985	Price Range 1984
1. 7%-13% secur. install. notes, 2010	....	$203,000	1.41	18.30	....	.....	....	....
2. Unsecur. loan, 1990	....	5,000,000			....	.....	....	....

CAPITAL STOCK

Issue	Par Value	Amount Outstanding	Earned per Sh. 1985	Earned per Sh. 1984	[4]Divs. per Sh. 1985	[4]Divs. per Sh. 1984	Call Price	[2]Price Range 1985	[2]Price Range 1984
1. Common	$0.01	[1]2,947,000 shs.	[1]$0.11	[1]$1.00	Nil	[3]..	.....	12¾- 5⅞	17½-[illegible]

[1]Based on weighted average and common equivalent shares as reported by Company before extraordinary item; after: 1984, $1.01. [2]Calendar years. [3][illegible] 10% stk. div. [4]Fiscal years.

HISTORY

Incorporated in Delaware and in Feb., 1979, acquired former parent TII Corp. which was incorporated in N.Y. Aug. 17, 1964, as A.J.R. Electronics, Inc. Changed name June 28, 1968 to Telecommunications Industries, Inc. and to TII Corp. Feb. 27, 1976.

On July 24, 1969, acquired Environmental Testing Laboratory for $176,500 (including $155,000 in unsecured notes) plus expenses.

In Mar. 1973 Co. acquired assets and patent rights of Ozonator Corp., Rochester, N.Y.

In Apr. 1974, sold TII Testing Laboratories, Inc.

In 1975, formed TII Engineering Ltd. as a subsidiary division.

In 1982, organized several new subsidiaries one of which acquired EHV Systems, Inc.

In Apr. 1982, formed TII Computer Systems, Inc.

SUBSIDIARIES

TII Corp.
TII Electronics, Inc.

Affiliate: TII Computer Systems, Inc. (36.7%)

BUSINESS

The Company is engaged in the development, manufacture and sale of overvoltage protective devices and station electronics for use on telephone and other signal circuits, power lines and electrical equipment. Additionally, since March 1982, a subsidiary of the Company (TII Electronics, Inc.) has engaged in the development, manufacture and sale of uninterruptible power supplies for computers and other electronic equipment. Since April 1982, an affiliate of the Company (TII Computer Systems, Inc.) has engaged in the development, manufacture and marketing of a family of telephone system test equipment.

PROPERTY

The Company's manufacturing plants are located in Setauket, N.Y., Toa Alta, Puerto Rico and Haiti.

LETTER TO STOCKHOLDERS

The following is the letter to stockholders of Alfred J. Roach, Chairman and Chief Executive Officer and Timothy J. Roach, President, Vice-Chmn. and Assistant Chief Operating Officer of TII Industries, Inc. as it appeared in the Company's 1985 Annual Report.

To Our Stockholders:

Fiscal 1985 was a year of challenge and transition for your company. While revenues continued at their strong 1984 levels, numerous factors caused earnings to drop for the year.

The breakup of the Bell System represented the most significant restructure of the telecommunications industry in the past half century. Under the January 1, 1984 settlement, AT&T divested its 22 telephone operating companies and Seven Regional Bell Operating Companies were formed.

This breakup and restructure had a twofold effect on the market in which TII operates—TII may now more easily sell to the divested companies; however, this open market has dramatically increased competition from other suppliers of similar telecommunications products. Simultaneously, the strength of the dollar has also attracted foreign competition into the U.S. Market, with the result that our operating margins during this past year were under constant pressure.

Throughout fiscal 1985, TII effected numerous changes in its operations that should enable it to both maintain its competitive edge and take full advantage of the opportunities created by the breakup of AT&T and the rapidly expanding Telecommunications marketplace.

Working with President Reagan's Caribbean Basin Initiative, TII began an operation in Port Au Prince, Haiti where it now has the benefit of high quality, low-cost labor. Labor intensive aspects of company operations have been and will continue to be shifted to our second plant; however, the high technology capital intensive manufacturing of the company's products will remain in Puerto Rico.

During the year the company continued to reduce and consolidate administrative departments. Administrative expenses were cut almost 10 percent from fiscal 1984 levels while research and development expenses remained constant.

Operational functions throughout the company were streamlined and vertical integration of the manufacturing facility increased.

The principal departments of our wholly owned subsidiary, TII electronics, were consolidated into the parent. This not only helped control costs but added technical, administrative and manufacturing strength to the operation.

These resultant reductions in costs throughout the company were not accomplished by sacrificing our high quality standards. The Telecommunications Industry, though in a state of historic change, still demands products of the highest quality and exacting specifications. Consistent with this need, we have strengthened our quality control and manufacturing engineering in our production facilities in Puerto Rico and Haiti.

These operational and administrative changes should enable a more lean TII to bid more successfully on large long-term contracts, as well as make new products introduced into this expanding marketplace more competitive.

Notwithstanding the restructuring of the Bell System, $74 million reman to be shipped by TII to AT&T against the 1981 t[illegible] contract. Products purchased by AT&T [illegible] this agreement are manufactured in our [illegible]ty in Puerto Rico and consist prima[illegible] products licensed to TII by AT&T.

We believe that with the continued efforts of our talented and dedicated staff, fiscal 19[illegible] will be a year of progress while continuing to set the stage for renewed long term growth.

We express our sincere gratitude to our stockholders, customers, vendors and employees for their loyal support.

Sincerely

Alfred J. Roach
Chairman of the Board

Timothy J. Roach
President

October, 1985

MANAGEMENT

Officers

A.J. Roach, Chmn. & Chief Exec. Off.
T.J. Roach, Pres., Vice-Chmn. & Asst. Chief Oper. Off.
S.L. Takacs, Exec. Vice-Pres. & Chief Oper. Off.
J.T. Hyland, Jr., Vice-Pres./Fin.
C.B. Barksdale, Vice-Pres./Prod. Devel.
Dorothy Roach, Sec.—Treas.
Frances Giambanco, Asst. Sec.

Directors

(Showing Principal Corporate Affiliations)

Alfred J. Roach, Chmn. & Chief Exec. Off. of Company.

Timothy J. Roach, Pres., Vice-Chmn. & Asst. Chief Exec. Off.

C. Bruce Barksdale, Vice-Pres. of Company.

Dorothy Roach, Sec.—Treas. of Company.

James R. Grover, Jr., General Counsel, Babylon, N.Y.

Joseph C. Hogan, Dean Emeritus, College of Engineering, University of Notre Dame.

Auditors: Arthur Andersen & Co.

General Counsel: J.R. Grover, Jr.

Corporate Counsel: L.W. Suroff.

Annual Meeting: In Dec.

No. of Stockholders: June 30, 1983, 1,100.

No. of Employees: Sept. 9, 1985, 849.

Executive Office: 1375 Akron Steet, Copiague, NY 11726. Tel.: (516)789-5000.

INCOME ACCOUNTS

CONSOLIDATED INCOME ACCOUNT, YEARS ENDED
(in thousands of dollars)

	6/28/85	6/29/84	[2]6/24/83	[2]6/25/82
Net sales	31,353	32,653	23,379	23,109
Cost of sales	21,530	20,430	14,673	13,269
Gross profit	9,823	12,223	8,706	9,840
Sell—gen. & admin. exp.	7,580	8,256	6,863	6,825
Res. & devel. exp.	1,403	1,495	1,451	1,359
Oper. inc.	820	2,472	392	1,656
Other income (expense):				
Interest income	118	370	757	881
Gain on sale of affil. stk.	236	1,202	171	......
Royalty income, net	......	50	143	105
Interest expense	(473)	(180)	(166)	(78)
Other income, net	163	69	56	107
Inventory write-down prov.	......	......	(2,805)	......
Total other income (expense)	44	1,511	(1,844)	1,015
Income before taxes, etc.	864	3,983	(1,452)	2,671
Income tax provision	(114)	190	50	80
Equity in net loss of affil.	(668)	(869)	(698)	(84)
[1]Extraordinary credit	......	30	50	80
Net income	310	2,954	(2,150)	2,587
Retain. earn. begin. of year	11,682	8,728	10,878	8,291
Retain. earn. end of year	11,992	11,682	8,728	10,878

[1]Utilization of net operating loss carryforward.
[2]Certain amounts have been reclassified to conform to the 1984 presentation.