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

FORM 10-Q

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

For the fiscal quarter ended September 30, 2003

OR

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

For the transition period from _____ to _____

Commission file number 0-27559

Textron Financial Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

05-6008768
(I.R.S. Employer
Identification No.)

40 Westminster Street, P.O. Box 6687, Providence, R.I. 02940-6687
(401) 621-4200

(Address and telephone number of Principal Executive Offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

All of the shares of common stock of the registrant are owned by Textron Inc.

TEXTRON FINANCIAL CORPORATION
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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

TEXTRON FINANCIAL CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(In thousands)			
Finance charges and discounts	\$108,194	\$110,988	\$336,361	\$321,621
Rental revenues on operating leases	7,112	6,325	21,131	20,530
Other income	32,977	39,030	96,652	107,290
Total revenues	<u>148,283</u>	<u>156,343</u>	<u>454,144</u>	<u>449,441</u>
Interest expense	45,755	49,570	138,254	144,726
Depreciation of equipment on operating leases	4,492	3,347	12,787	10,311
Net interest margin	<u>98,036</u>	<u>103,426</u>	<u>303,103</u>	<u>294,404</u>
Selling and administrative expenses	48,623	39,280	142,379	122,805
Provision for losses	25,448	44,380	86,369	99,766
Income before income taxes, distributions on preferred securities and cumulative effect of change in accounting principle	<u>23,965</u>	<u>19,766</u>	<u>74,355</u>	<u>71,833</u>
Income taxes	8,035	7,120	25,081	25,750
Distributions on preferred securities (net of tax benefits of \$198, \$368 and \$589, respectively)	—	368	748	1,093
Income before cumulative effect of change in accounting principle	<u>15,930</u>	<u>12,278</u>	<u>48,526</u>	<u>44,990</u>
Cumulative effect of change in accounting principle (net of tax benefit of \$8,278)	—	—	—	15,372
Net income	<u>\$ 15,930</u>	<u>\$ 12,278</u>	<u>\$ 48,526</u>	<u>\$ 29,618</u>

See notes to condensed consolidated financial statements (unaudited).

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	<u>September 30,</u> <u>2003</u>	<u>December 28,</u> <u>2002</u>
	<u>(Dollars in thousands)</u>	
Assets		
Cash and equivalents	\$ 41,744	\$ 21,287
Finance receivables, net of unearned income:		
Revolving loans	1,724,845	1,366,064
Installment contracts	1,604,969	1,827,797
Golf course and resort mortgages	918,715	962,459
Distribution finance receivables	912,282	792,323
Leveraged leases	506,416	460,163
Finance leases	<u>306,145</u>	<u>346,844</u>
Total finance receivables	5,973,372	5,755,650
Allowance for losses on receivables	<u>(146,253)</u>	<u>(166,510)</u>
Finance receivables — net	5,827,119	5,589,140
Equipment on operating leases — net	219,185	255,055
Goodwill	180,843	180,843
Other assets	<u>637,530</u>	<u>608,003</u>
Total assets	<u>\$6,906,421</u>	<u>\$6,654,328</u>
Liabilities and shareholder's equity		
Liabilities		
Accrued interest and other liabilities	\$ 438,708	\$ 345,270
Amounts due to Textron Inc.	22,682	23,471
Deferred income taxes	454,952	398,199
Debt	4,916,164	4,839,621
Textron Financial and Litchfield obligated mandatory redeemable preferred securities of trust subsidiary holding solely Litchfield junior subordinated debentures	<u>26,553</u>	<u>26,950</u>
Total liabilities	5,859,059	5,633,511
Shareholder's equity		
Common stock (\$100 par value, 4,000 shares authorized; 2,500 shares issued and outstanding)	250	250
Capital surplus	573,676	573,676
Investment in parent company preferred stock	(25,000)	(25,000)
Accumulated other comprehensive income (loss)	5,382	(14,637)
Retained earnings	<u>493,054</u>	<u>486,528</u>
Total shareholder's equity	<u>1,047,362</u>	<u>1,020,817</u>
Total liabilities and shareholder's equity	<u>\$6,906,421</u>	<u>\$6,654,328</u>

See notes to condensed consolidated financial statements (unaudited).

Item 1. *Financial Statements (Continued)*

TEXTRON FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002
(Unaudited)

	2003	2002
	(In thousands)	
Cash flows from operating activities:		
Net income before cumulative effect of change in accounting principle	\$ 48,526	\$ 44,990
Adjustments to reconcile income to net cash provided by operating activities:		
Provision for losses	86,369	99,766
Deferred income tax provision	44,730	46,776
Depreciation	24,435	21,061
Amortization	8,475	7,349
Decrease in accrued interest and other liabilities	(4,845)	(29,748)
Noncash gains on securitizations	(7,541)	(32,734)
Other	(3,559)	(2,447)
Net cash provided by operating activities	196,590	155,013
Cash flows from investing activities:		
Finance receivables originated or purchased	(7,420,506)	(6,678,683)
Finance receivables repaid	6,485,457	5,653,361
Proceeds from receivable sales, including securitizations	538,459	440,613
Proceeds from disposition of operating leases and other assets	63,934	35,712
Purchase of assets for operating leases	(47,118)	(47,243)
Proceeds from sale of repossessed assets and real estate owned	28,444	6,188
Other capital expenditures	(13,230)	(13,322)
Other investments	81,582	27,159
Net cash used in investing activities	(282,978)	(576,215)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	814,393	1,379,829
Principal payments on long-term debt	(1,031,083)	(937,900)
Net increase in commercial paper	214,969	606,703
Net increase (decrease) in other short-term debt	9,986	(536,944)
Proceeds from issuance of nonrecourse debt	199,198	—
Principal payments on nonrecourse debt	(58,594)	(52,181)
Net (decrease) increase in amounts due to Textron Inc.	(177)	12,896
Capital contributions from Textron Inc.	6,758	6,758
Dividends paid to Textron Inc.	(48,758)	(57,505)
Net cash provided by financing activities	106,692	421,656
Effect of exchange rate changes on cash	153	(444)
Net increase in cash	20,457	10
Cash and equivalents at beginning of period	21,287	18,489
Cash and equivalents at end of period	\$ 41,744	\$ 18,499

See notes to condensed consolidated financial statements (unaudited).

Item 1. *Financial Statements (Continued)*

TEXTRON FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY
(Unaudited)

	<u>Common Stock</u>	<u>Capital Surplus</u>	<u>Investment In Parent Company Pref. Stock</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance December 29, 2001 . . .	\$250	\$573,676	\$(25,000)	\$(18,793)	\$479,222	\$1,009,355
Comprehensive income:						
Net income	—	—	—	—	60,306	60,306
Other comprehensive income, net of income taxes:						
Unrealized net gains on interest-only securities . . .	—	—	—	9,601	—	9,601
Unrealized net losses on hedge contracts	—	—	—	(1,893)	—	(1,893)
Foreign currency translation adjustments	—	—	—	<u>(3,552)</u>	—	<u>(3,552)</u>
Other comprehensive income	—	—	—	4,156	—	<u>4,156</u>
Comprehensive income	—	—	—	—	—	64,462
Capital contributions from Textron Inc.	—	9,010	—	—	—	9,010
Dividends to Textron Inc.	<u>—</u>	<u>(9,010)</u>	<u>—</u>	<u>—</u>	<u>(53,000)</u>	<u>(62,010)</u>
Balance December 28, 2002 . . .	250	573,676	(25,000)	(14,637)	486,528	1,020,817
Comprehensive income:						
Net income	—	—	—	—	48,526	48,526
Other comprehensive income, net of income taxes:						
Unrealized net gains on hedge contracts	—	—	—	13,719	—	13,719
Unrealized net gains on interest-only securities . . .	—	—	—	3,971	—	3,971
Foreign currency translation adjustments	—	—	—	<u>2,329</u>	—	<u>2,329</u>
Other comprehensive income	—	—	—	20,019	—	<u>20,019</u>
Comprehensive income	—	—	—	—	—	68,545
Capital contributions from Textron Inc.	—	6,758	—	—	—	6,758
Dividends to Textron Inc.	<u>—</u>	<u>(6,758)</u>	<u>—</u>	<u>—</u>	<u>(42,000)</u>	<u>(48,758)</u>
Balance September 30, 2003 . . .	<u>\$250</u>	<u>\$573,676</u>	<u>\$(25,000)</u>	<u>\$ 5,382</u>	<u>\$493,054</u>	<u>\$1,047,362</u>

See notes to condensed consolidated financial statements (unaudited).

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Basis of Presentation

The financial statements should be read in conjunction with the financial statements included in Textron Financial Corporation's Annual Report on Form 10-K for the year ended December 28, 2002. The accompanying unaudited consolidated financial statements include the accounts of Textron Financial Corporation (Textron Financial or the Company) and its subsidiaries. All significant intercompany transactions are eliminated. The consolidated financial statements are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of Textron Financial's consolidated financial position at September 30, 2003 and December 28, 2002, and its consolidated results of operations and cash flows for each of the respective three- and nine-month periods ended September 30, 2003 and 2002. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. Certain prior balances have been reclassified to conform to the current year presentation.

Note 2. Other Income

	Three Months Ended		Nine Months Ended	
	September 30, 2003	September 30, 2002	September 30, 2003	September 30, 2002
	(In thousands)			
Securitization gains	\$10,444	\$13,496	\$26,312	\$ 32,734
Servicing fees	8,966	7,182	24,437	19,680
Investment income	3,111	4,214	9,806	14,599
Prepayment gains	3,482	3,397	9,507	8,265
Late charges	2,361	2,320	6,844	7,338
Syndication gains	1,109	1,541	3,246	5,459
Other	<u>3,504</u>	<u>6,880</u>	<u>16,500</u>	<u>19,215</u>
Total other income	<u>\$32,977</u>	<u>\$39,030</u>	<u>\$96,652</u>	<u>\$107,290</u>

The Other component of Other income includes custodial fees, commitment fees, residual gains, insurance fees and other miscellaneous fees, which are primarily recognized as income when received.

Note 3. Allowance for Losses on Receivables

	Nine Months Ended September 30, 2003	Twelve Months Ended December 28, 2002
		(In thousands)
Balance at beginning of period	\$ 166,510	\$ 143,756
Provision for losses	86,369	138,542
Receivable charge-offs	(117,121)	(138,862)
Recoveries	10,495	10,971
Acquisitions and other	<u>—</u>	<u>12,103</u>
Balance at end of period	<u>\$ 146,253</u>	<u>\$ 166,510</u>

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

Note 4. Managed and Serviced Finance Receivables

Textron Financial manages finance receivables for a variety of investors, participants and third-party portfolio owners.

	<u>September 30, 2003</u>	<u>December 28, 2002</u>
	(In thousands)	
Total managed and serviced finance receivables.....	\$ 9,509,008	\$ 9,395,778
Third-party portfolio servicing	(683,029)	(515,546)
Nonrecourse participations	(544,797)	(435,393)
SBA sales agreements	<u>(50,318)</u>	<u>(55,913)</u>
Managed finance receivables	8,230,864	8,388,926
Securitized receivables	<u>(2,257,492)</u>	<u>(2,633,276)</u>
Owned finance receivables	<u>\$ 5,973,372</u>	<u>\$ 5,755,650</u>

Third-party portfolio servicing largely relates to finance receivable portfolios of resort developers, third-party securitization servicing, as well as private label bank and leasing company portfolio servicing.

Nonrecourse participations consist of undivided interests in loans originated by Textron Financial, primarily in vacation interval resorts and golf finance, which are sold to independent investors.

Owned finance receivables include approximately \$94 million of finance receivables that were unfunded at September 30, 2003, primarily as a result of holdback arrangements. The corresponding liability is included in Accrued interest and other liabilities on Textron Financial's Condensed Consolidated Balance Sheets.

Note 5. Loan Impairment

Textron Financial periodically evaluates finance receivables, excluding homogeneous loan portfolios and finance leases, for impairment. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment is measured by comparing the fair value of a loan to its carrying cost. Fair value is based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or, if the loan is collaterally dependent, at the fair value of the collateral. If the fair value of the loan is less than its carrying amount, the Company establishes a reserve based on this difference. This evaluation is inherently subjective, as it requires estimates, including the amount and timing of future cash flows expected to be received on impaired loans, that may differ from actual results.

The Company suspends the accrual of interest income for accounts that are contractually delinquent by more than three months, unless collection is not doubtful. In addition, detailed reviews of loans may result in earlier suspension if collection is doubtful. Cash payments on nonaccrual accounts, including finance charges, generally are applied to reduce principal. The Company had \$177.4 million of nonaccrual finance receivables at September 30, 2003, compared to \$181.6 million at December 28, 2002. Nonaccrual finance receivables resulted in Textron Financial's revenues being reduced by approximately \$13.3 million and \$12.5 million for the first nine months of 2003 and 2002, respectively. No interest income was recognized using the cash basis method. Excluding homogeneous loan portfolios and finance leases, the Company had impaired loans of \$124.7 million and \$122.1 million at September 30, 2003 and December 28, 2002, respectively. Impaired loans with identified reserve requirements were \$65.6 million and \$109.9 million at September 30, 2003 and December 28, 2002, respectively. The allowance for losses on receivables related to impaired loans with

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

identified reserve requirements was \$26.9 million and \$32.7 million at September 30, 2003 and December 28, 2002, respectively. The average recorded investment in impaired loans during the first nine months of 2003 was \$129.2 million, compared to \$90.3 million in the corresponding period in 2002.

Note 6. Goodwill

On December 30, 2001, Textron Financial adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which requires companies to stop amortizing goodwill and certain intangible assets with indefinite useful lives and requires an annual review for impairment. All existing goodwill as of December 30, 2001 was required to be tested for impairment on a reporting unit basis with the adoption of this standard. Goodwill is considered to be impaired when the net book value of a reporting unit exceeds its estimated fair value. Fair values were established using a discounted cash flow methodology.

Upon adoption, Textron Financial recorded an after-tax transitional impairment charge of \$15.4 million (\$23.7 million, pre-tax) in the second quarter of 2002, which was retroactively recorded in the first quarter of 2002. This charge is included in the caption "Cumulative effect of change in accounting principle, net of income taxes" in Textron Financial's Condensed Consolidated Statements of Income. This after-tax charge related to the Franchise Finance division within the Other segment and was primarily the result of decreasing loan volumes and an unfavorable securitization market.

Note 7. Other Assets

	<u>September 30,</u> <u>2003</u>	<u>December 28,</u> <u>2002</u>
	(In thousands)	
Retained interests in securitizations	\$234,220	\$257,147
Investment in equipment residuals	109,230	115,394
Interest-only securities	68,583	92,798
Other long-term investments	53,387	24,104
Fixed assets — net	48,868	50,196
Repossessed assets and properties	16,377	36,234
Other	<u>106,865</u>	<u>32,130</u>
Total other assets	<u>\$637,530</u>	<u>\$608,003</u>

The Investment in equipment residuals represents the remaining equipment residual values associated principally with Textron golf and turf equipment lease payments that were securitized in years 2000 through 2003.

The cost of fixed assets is being depreciated using the straight-line method based on the estimated useful lives of the assets.

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

Note 8. Debt and Credit Facilities

	<u>September 30, 2003</u>	<u>December 28, 2002</u>
	(In thousands)	
Short-term debt:		
Commercial paper	\$1,087,366	\$ 872,397
Other short-term debt	<u>53,941</u>	<u>43,955</u>
Total short-term debt	1,141,307	916,352
Long-term debt:		
2.75%-5.95% notes; due 2004 to 2007	1,447,011	1,152,682
6.00%-6.84% notes; due 2005 to 2009	575,544	595,836
7.13% note; due 2004	599,281	598,827
7.25% note; due 2007	29,467	25,718
7.37% notes; due 2003	213,000	213,000
Variable rate notes; due 2003 to 2007	<u>910,554</u>	<u>1,337,206</u>
Total long-term debt	<u>3,774,857</u>	<u>3,923,269</u>
Total debt	<u>\$4,916,164</u>	<u>\$4,839,621</u>

The weighted average interest rates on short-term borrowings have been determined by relating the annualized interest cost to the daily average dollar amounts outstanding. The combined weighted average interest rate was 1.49% during the nine months ended September 30, 2003, and 1.26% at September 30, 2003.

Interest on Textron Financial's variable rate notes is predominately tied to the three-month LIBOR for U.S. dollar deposits. The weighted average interest rate on these notes, before consideration of the effect of interest rate exchange agreements, was 2.44% at September 30, 2003.

The fair value adjustments to designated fixed rate debt in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," were increases of \$50 million and \$67 million at September 30, 2003 and December 28, 2002, respectively.

During the third quarter, Textron Financial renewed and extended its bank lines of credit. In addition, Textron Inc. (Textron) amended its credit facilities to permit Textron Financial to borrow under those facilities. The Company has bank lines of credit of \$1.5 billion, of which \$500 million expires in 2004 and \$1.0 billion expires in 2008. Textron Financial's lines of credit not reserved as support for commercial paper or utilized for letters of credit at September 30, 2003, were \$385 million. Textron had unused and unreserved primary lines of credit of \$1.5 billion at September 30, 2003. The Company also maintains a CAD 50 million committed facility under which it can borrow an additional CAD 50 million on an uncommitted basis. At September 30, 2003, the Company had fully used the committed portion of the facility, in addition to borrowing CAD 13 million under the uncommitted portion of the facility. The Canadian facility expires in the third quarter of 2004. Textron Financial also has a \$25 million multi-currency facility, of which \$18 million remains unused at September 30, 2003. Textron Financial generally pays fees in support of these lines.

Through its subsidiary, Textron Financial Canada Funding Corp. (Textron Canada Funding), the Company periodically issues debt securities. Textron Financial owns 100% of the common stock of Textron Canada Funding. Textron Canada Funding is a financing subsidiary of Textron Financial with no operations,

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

revenues or cash flows other than those related to the issuance, administration and repayment of debt securities that are fully and unconditionally guaranteed by Textron Financial.

Securitizations are an important source of liquidity for Textron Financial and involve the periodic transfer of finance receivables to qualified special purpose trusts. At September 30, 2003 and December 28, 2002, the outstanding amount of debt issued by these qualified special purpose trusts was \$2.1 billion and \$2.3 billion, respectively.

The terms of certain of the Company's loan agreements and credit facilities, under the most restrictive covenant, limit the payment of dividends to \$456 million at September 30, 2003. In the first nine months of 2003, Textron Financial declared and paid dividends of \$48.8 million.

Note 9. Textron Financial and Litchfield Obligated Mandatory Redeemable Preferred Securities of Trust Subsidiary Holding Solely Litchfield Junior Subordinated Debentures

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," that became effective at the beginning of the third quarter of 2003. SFAS No. 150 established standards for how an issuer classifies and measures certain financial instruments with characteristics of liabilities and equity. Financial instruments within its scope that were previously classified as equity, such as mandatorily redeemable shares, must be classified as a liability. Upon adoption, Textron Financial classified its obligated mandatory redeemable preferred securities as a liability and related distributions on preferred securities as interest expense.

Prior to Textron Financial's acquisition of Litchfield on November 3, 1999, a trust, sponsored and wholly-owned by Litchfield, issued to the public \$26.2 million of mandatory redeemable preferred securities (Preferred Securities). The trust subsequently invested the proceeds in \$26.2 million aggregate principal amount of Litchfield 10% Series A Junior Subordinated Debentures (Series A Debentures), due 2029. The Series A Debentures are the sole asset of the trust. The amounts due to the trust under the Series A Debentures and the related income statement amounts have been eliminated in Textron Financial's consolidated financial statements.

The Preferred Securities were recorded by Textron Financial at the fair value of \$28.6 million as of the acquisition date and the fair value adjustment is being amortized through June 2004.

The Preferred Securities accrue and pay cash distributions quarterly at a rate of 10% per annum. The trust's obligations under the Preferred Securities are fully and unconditionally guaranteed by Litchfield, including, without limitation, all obligations arising under the Declaration Trust, the Trust Preferred Securities, the Indenture, the Debentures and the ancillary agreements entered into in connection with the foregoing. The trust will redeem all of the outstanding Preferred Securities when the Series A Debentures are paid at maturity on June 30, 2029, or otherwise become due. Litchfield will have the right to redeem 100% of the principal plus accrued and unpaid interest on or after June 30, 2004.

As a result of the acquisition, Textron Financial has agreed to make payments to the holders of the Preferred Securities, when due, to the extent not paid by or on behalf of the trust or the subsidiary.

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

Note 10. Accumulated Other Comprehensive Income (Loss) and Comprehensive Income

Accumulated other comprehensive income (loss) is as follows:

	<u>Nine Months Ended</u>	
	<u>September 30, 2003</u>	<u>September 30, 2002</u>
	(In thousands)	
Beginning of period	\$(14,637)	\$(18,793)
Net deferred gain (loss) on hedge contracts, net of income tax of \$7,203 and income tax benefit of \$1,206, respectively	12,005	(2,010)
Amortization of deferred loss on terminated hedge contracts, net of income taxes of \$1,028 and \$1,103, respectively	1,714	1,839
Net deferred gain on interest-only securities, net of income taxes of \$2,383 and \$3,125, respectively	3,971	5,208
Foreign currency translation adjustments	<u>2,329</u>	<u>(2,552)</u>
End of period	<u>\$ 5,382</u>	<u>\$(16,308)</u>

Comprehensive income is summarized below:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2003</u>	<u>September 30, 2002</u>	<u>September 30, 2003</u>	<u>September 30, 2002</u>
	(In thousands)			
Net income	\$15,930	\$12,278	\$48,526	\$29,618
Other comprehensive (loss) income	<u>(5,170)</u>	<u>5,144</u>	<u>20,019</u>	<u>2,485</u>
Comprehensive income	<u>\$10,760</u>	<u>\$17,422</u>	<u>\$68,545</u>	<u>\$32,103</u>

Note 11. Contingencies

In March 2003, the United States Department of Justice (DOJ) authorized the filing of a civil action against Textron Financial and its Litchfield Financial Corporation (Litchfield), and other third parties, arising from the financing of certain land purchases by consumers through a third-party land developer. Also, during the third quarter, the Florida Attorney General's office opened a preliminary investigation into Litchfield's activities relative to Buyer's Source. Although the Company believes it has good defenses to any governmental or potential consumer litigation, it is engaged in settlement discussions with the government agencies and other parties to resolve the matter. As a result of the most recent discussions, the Company believes that it is reasonably possible that this matter will be resolved for less than \$10 million.

Textron Financial and Litchfield, together with other third parties, are currently defending a class action arising from the sale of promissory notes issued by, and the operation of, certain trusts organized by DynaCorp Financial Strategies Inc. ("DFS"). The complaint, which was filed in 2001 in Superior Court in Marin County, California, alleges that DFS and the trusts engaged in a variety of improper dealings with regard to the sale by the trusts of approximately \$50 million of notes and the operation of the trusts. During a portion of the time that the allegedly improper activities occurred, Litchfield extended credit to DFS and was a shareholder of DFS, and a Litchfield officer was a director on DFS' Board. The plaintiffs allege several bases

Item 1. Financial Statements (Continued)

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

for liability, including that Litchfield's former officer participated in the misrepresentations, that Litchfield received favorable treatment as a creditor, and that Litchfield was a controlling person of DFS. Litchfield denies these allegations and is aggressively defending the litigation. On August 8, 2003, Litchfield was notified that the judge hearing the class action issued an order affirming her preliminary ruling denying Litchfield's motion to dismiss Litchfield from the case. The preliminary ruling became final in September, 2003. The Company intends to vigorously defend this action and believes that a substantial part of any settlement or judgment would be covered by insurance. The Company anticipates this matter will proceed to trial in the first quarter of 2004.

There are other pending or threatened lawsuits and other proceedings against Textron Financial and its subsidiaries. Some of these suits and proceedings seek compensatory, treble or punitive damages in substantial amounts. These suits and proceedings are being defended by, or contested on behalf of, Textron Financial and its subsidiaries. On the basis of information presently available, Textron Financial believes any such liability would not have a material effect on Textron Financial's financial position or results of operations.

Note 12. New Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. Textron Financial had not entered into any new arrangements with variable interest entities subsequent to January 31, 2003.

On October 8, 2003, the FASB deferred the implementation date for variable interest entities that existed prior to February 1, 2003 from the third quarter to the fourth quarter of 2003. With this deferral and due to the recently issued and pending FASB staff positions, management is continuing to evaluate the impact of the adoption of FIN 46. Textron Financial is party to various arrangements that are being evaluated from a FIN 46 perspective. At this time, based on the interpretations issued to date, management does not anticipate that adoption will have a material effect on Textron Financial's results of operations or financial position.

Note 13. Financial Information about Industry Segments

During the third quarter of 2002, the Company made a strategic decision to realign its business units into seven operating segments based on the markets served and the products offered: Aircraft Finance, Asset-Based Lending, Distribution Finance, Golf Finance, Resort Finance, and Structured Capital. In addition, the Company maintains an Other segment that includes franchise finance, media finance and small business finance, in addition to liquidating portfolios related to a 2001 strategic realignment of the Company's business and product lines.

Item 1. *Financial Statements (Continued)*

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

	Three Months Ended		Nine Months Ended	
	September 30, 2003	September 30, 2002	September 30, 2003	September 30, 2002
	(In thousands)			
Revenues				
Distribution Finance	\$ 36,845	\$ 26,849	\$112,493	\$ 70,661
Resort Finance	22,155	26,998	62,379	71,317
Golf Finance	17,478	17,556	58,782	51,335
Aircraft Finance	17,457	20,600	55,259	63,886
Asset-Based Lending	14,437	16,287	43,744	47,580
Structured Capital	8,590	8,842	25,767	25,752
Other	31,321	39,211	95,720	118,910
Total revenues	<u>\$148,283</u>	<u>\$156,343</u>	<u>\$454,144</u>	<u>\$449,441</u>
Income (loss) before income taxes, distributions on preferred securities and cumulative effect of change in accounting principle (1) (2)				
Distribution Finance	\$ 15,133	\$ 10,265	\$ 44,086	\$ 25,518
Resort Finance	2,636	15,533	14,067	35,901
Golf Finance	3,509	6,253	17,673	14,164
Aircraft Finance	1,335	(5,280)	2,308	(2,535)
Asset-Based Lending	4,824	7,298	13,570	13,259
Structured Capital	2,300	5,524	9,172	12,395
Other	<u>(5,772)</u>	<u>(19,827)</u>	<u>(26,521)</u>	<u>(26,869)</u>
Total income before income taxes, distributions on preferred securities and cumulative effect of change in accounting principle	<u>\$ 23,965</u>	<u>\$ 19,766</u>	<u>\$ 74,355</u>	<u>\$ 71,833</u>
			September 30, 2003	December 28, 2002
			(In thousands)	
Finance assets (3)				
Aircraft Finance			\$1,260,317	\$1,216,144
Resort Finance			1,100,566	1,052,734
Distribution Finance			946,842	841,118
Golf Finance			910,565	964,271
Structured Capital			626,981	581,207
Asset-Based Lending			515,126	521,067
Other			<u>1,313,957</u>	<u>1,359,841</u>
Total finance assets			<u>\$6,674,354</u>	<u>\$6,536,382</u>

(1) Interest expense is allocated to each segment in proportion to its net investment in finance assets. Net investment in finance assets includes deferred income taxes, security deposits and other specifically identified liabilities. The interest allocated matches, to the extent possible, variable rate debt with variable rate finance assets and fixed rate debt with fixed rate finance assets.

Item 1. *Financial Statements (Continued)*

TEXTRON FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

- (2) Indirect expenses are allocated to each segment based on the use of such resources. Most allocations are based on the segment's proportion of net investment in finance assets, headcount, number of transactions, computer resources and senior management time.
- (3) Finance assets include: finance receivables; equipment on operating leases, net of accumulated depreciation; repossessed assets and properties; retained interests in securitizations; interest-only securities; investment in equipment residuals; ADC arrangements; and other long-term investments (some of which are classified in Other assets on Textron Financial's Condensed Consolidated Balance Sheets).

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

TEXTRON FINANCIAL CORPORATION

Financial Condition

Liquidity and Capital Resources

Textron Financial Corporation (Textron Financial or the Company) uses a broad base of financial resources for its liquidity and capital needs. Cash is provided from operations and several sources of borrowings, including the issuance of commercial paper and other short-term debt, and sales of medium and long-term debt in the U.S. and foreign public and private markets. For liquidity purposes, Textron Financial has a policy of maintaining sufficient unused lines of credit to support its outstanding commercial paper. Textron Financial has bank lines of credit of \$1.5 billion, of which \$500 million expires in 2004 and \$1.0 billion expires in 2008. The \$500 million facility includes a one-year term out option, effectively extending its expiration into 2005. In addition, during the third quarter, Textron Inc. (Textron) amended its credit facilities to permit Textron Financial to borrow under those facilities. None of these lines of credit were used at September 30, 2003, or December 28, 2002. Textron Financial also maintains a CAD 50 million committed facility, under which it can borrow an additional CAD 50 million on an uncommitted basis. At September 30, 2003, Textron Financial had fully used the committed portion of the facility, in addition to borrowing CAD 13 million under the uncommitted portion of the facility. The Canadian facility expires in the third quarter of 2004. Textron Financial also has a \$25 million multi-currency facility, of which \$18 million remains unused at September 30, 2003. Lines of credit not reserved as support for commercial paper or utilized for letters of credit were \$385 million at September 30, 2003, compared to \$716 million at December 28, 2002. Further, Textron had unused and unreserved primary lines of credit of \$1.5 billion at September 30, 2003. The decrease in the unreserved portion of Textron Financial's lines of credit is principally attributable to the maturity of term debt, the voluntary termination and liquidation of a revolving securitization conduit through a receivable repurchase and finance receivable growth, partially offset by the securitization of golf equipment receivables, the sale of franchise finance receivables and the issuance of term notes.

During the third quarter, Textron Financial filed a shelf registration statement with the Securities and Exchange Commission enabling the Company to issue public debt securities, in one or more offerings, up to a total maximum offering of \$4 billion. At September 30, 2003, Textron Financial had \$4 billion available under this facility. Under a shelf registration statement previously filed with the Securities and Exchange Commission, Textron Financial issued \$816 million of term notes during the first nine months that mature in 2005 and 2006.

Securitizations are an important source of funding for the Company. During the first nine months of 2003, Textron Financial received net proceeds of \$225 million, \$102 million, \$47 million and \$38 million from the securitizations of Distribution Finance receivables (on a revolving basis), golf equipment receivables, Resort Finance receivables and Aircraft Finance receivables, respectively. These securitizations provided Textron Financial with an alternate source of liquidity. Textron used the proceeds from the securitizations to retire commercial paper. Cash collections on current and prior period securitization gains were \$39 million and \$26 million for the nine-month periods ended September 30, 2003 and September 30, 2002, respectively. Textron Financial anticipates that it will enter into additional securitization transactions during the remainder of 2003.

During the first quarter of 2003, Textron Financial's short and long-term debt credit ratings were downgraded from F1 to F2 and from A to A-, respectively, by Fitch. In the second quarter of 2003, Standard & Poor's affirmed the Company's long-term debt rating at A- and upgraded the outlook from negative to stable. Further downgrades in Textron Financial's ratings could increase borrowing spreads or limit its access to the commercial paper, securitization and long-term debt markets. In addition, Textron Financial's \$1.5 billion revolving bank line of credit agreements contain certain financial covenants that Textron Financial needs to comply with to maintain its ability to borrow under the facilities. Textron Financial was in full compliance with such covenants at September 30, 2003.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Textron Financial believes that it has adequate credit facilities and access to credit markets to meet its long-term financing needs.

Cash flows provided by operations were \$197 million during the first nine months of 2003, compared to \$155 million in the corresponding period last year. The increase was principally due to the timing of payments of accrued interest and other liabilities.

Cash flows used in investing activities were funded primarily from the collection of receivables and through the issuance of debt. The increase in proceeds from receivable sales primarily reflects the sales of a franchise portfolio (\$122 million).

Textron Financial declared and paid dividends to Textron of \$48.8 million during the first nine months of 2003, compared to \$59.8 million of dividends declared and \$57.5 million of dividends paid during the corresponding period of 2002. The decrease in 2003 was due to the retention of capital to support finance receivable growth.

Because the finance business involves the purchase and carrying of receivables, a relatively high ratio of borrowings to net worth is customary. Debt as a percentage of total capitalization was 83% at September 30, 2003 and December 28, 2002. Textron Financial's ratio of earnings to fixed charges was 1.53x for the nine months ended September 30, 2003, compared to 1.49x for the corresponding period in 2002. Commercial paper and Other short-term debt as a percentage of total debt was 23% at September 30, 2003, compared to 19% at December 28, 2002. Textron Financial has a policy of matching the duration of its assets with its debt. Changes in short and long-term debt are primarily related to the duration of Textron Financial's assets and liabilities, and to a lesser extent the timing of long-term debt issuances.

Finance Assets

Textron Financial's financing activities are confined almost exclusively to secured lending and leasing to commercial markets. Management believes that the portfolio avoids excessive concentration of risk through diversification across geographic regions, industries and types of collateral, and among borrowers.

Total finance assets, which includes finance receivables, equipment on operating leases — net of accumulated depreciation, repossessed assets and properties, retained interests in securitizations, interest-only securities, investment in equipment residuals, ADC arrangements and other long-term investments (some of which are classified in Other assets on Textron Financial's Condensed Consolidated Balance Sheets), were \$6.7 billion at September 30, 2003, up 2% from \$6.5 billion at December 28, 2002. The increase in finance assets was mostly due to small business finance within the Other segment (\$175 million), which was primarily the result of the liquidation of a revolving securitization conduit, Distribution Finance (\$106 million) and Resort Finance (\$48 million), partially offset by the liquidating portfolios within the Other segment (\$220 million).

Finance receivable additions for the first nine months of 2003 were \$7.4 billion, compared to \$6.7 billion in the corresponding period last year. The majority of the growth in finance receivable additions was from Distribution Finance (\$698 million).

Nonperforming Assets

Nonperforming assets, which includes independent and nonrecourse captive finance assets, as a percentage of finance assets decreased to 2.90% (\$194 million) at September 30, 2003, compared to 3.33% (\$218 million) at December 28, 2002. The \$24 million decrease in nonperforming assets at September 30, 2003, compared to December 28, 2002, was due to decreases in the Other segment (\$22 million), Asset-Based Lending (\$9 million), Distribution Finance (\$6 million) and Aircraft Finance (\$4 million) segments, partially offset by an increase in the Resort Finance (\$17 million) segment. The decrease in the Other segment is due to a reduction in the liquidating portfolios (\$33 million), partially offset by increases in small business finance (\$7 million) and franchise finance (\$2 million). The Other segment represents 20% of

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

finance assets and 35% of nonperforming assets at September 30, 2003. The Company believes that nonperforming assets will generally be in the range of 2% to 4% of finance assets depending on economic conditions.

The allowance for losses on receivables was \$146.3 million at September 30, 2003, as compared to \$166.5 million at December 28, 2002. The reduction in the allowance for loan losses on receivables was the result of charge-offs related to previously reserved accounts. The allowance for losses on receivables as a percentage of total finance receivables was 2.5% at September 30, 2003, compared to 2.9% at December 28, 2002 (2.7% and 3.1%, respectively, excluding captive receivables with recourse to Textron). The allowance for losses on receivables as a percentage of nonaccrual finance receivables was 83% at September 30, 2003, as compared to 92% at December 28, 2002. The decrease in the percentage reflects a \$44.3 million decrease in nonaccrual loans with identified reserve requirements, to \$65.6 million at September 30, 2003 from \$109.9 million at December 28, 2002.

Interest Rate Sensitivity

Textron Financial's mix of fixed and floating rate debt is continuously monitored by management and is adjusted, as necessary, based on evaluations of internal and external factors.

Management's strategy of matching interest-sensitive assets with interest-sensitive liabilities limits Textron Financial's risk to changes in interest rates, and includes entering into interest rate exchange agreements. At September 30, 2003, interest-sensitive assets in excess of interest-sensitive liabilities were \$1.2 billion, net of \$1.6 billion of interest rate exchange agreements on long-term debt and \$244 million of interest rate exchange agreements on finance receivables. However, classified within interest-sensitive assets are approximately \$1.1 billion of floating rate loans with index rate floors that are on average 168 basis points above the applicable index rate (predominately the prime rate). As a consequence, these assets have become interest-insensitive, and will remain so until the prime rate increases above the floor rates.

Management believes that its asset/liability management policy provides adequate protection against interest rate risks. Increases in interest rates, however, could have an adverse effect on interest margin. Variable rate receivables are generally tied to changes in the prime rate offered by major U.S. banks or LIBOR. Changes in short-term borrowing costs generally precede changes in variable rate receivable yields. Textron Financial assesses its exposure to interest rate changes using an analysis that measures the potential loss in net income, over a twelve-month period, resulting from a hypothetical change in interest rates of 100 basis points across all maturities occurring at the outset of the measurement period (sometimes referred to as a "shock test"). Textron Financial also assumes in its analysis that prospective receivable additions will be match funded, existing portfolios will not prepay and all other relevant factors will remain constant. This shock test model, when applied to Textron Financial's asset and liability position at September 30, 2003, indicates that an increase in interest rates of 100 basis points would have a negative impact on Textron Financial's net income and cash flows of \$2.3 million for the following twelve-month period, including the effects of the rate floors.

Financial Risk Management

Textron Financial's results are affected by changes in U.S. and, to a lesser extent, foreign interest rates. As part of managing this risk, Textron Financial enters into interest rate exchange agreements. Textron Financial's objective of entering into such agreements is not to speculate for profit, but generally to convert variable rate debt into fixed rate debt and vice versa. The overall objective of Textron Financial's interest rate risk management is to achieve a prudent balance between floating and fixed rate debt. These agreements do not involve a high degree of complexity or risk. Textron Financial does not trade in interest rate exchange agreements or enter into leveraged interest rate exchange agreements.

Textron Financial manages its foreign currency exposure by funding most foreign currency denominated assets with liabilities in the same currency. The Company may enter into foreign currency exchange

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

agreements to convert foreign currency denominated assets and liabilities into functional currency denominated assets and liabilities. In addition, as part of managing its foreign currency exposure, Textron Financial may enter into foreign currency forward exchange contracts. The objective of such agreements is to manage any remaining exposure to changes in currency rates. The notional amounts of outstanding foreign currency forward exchange contracts were nominal.

Results of Operations

For the three and nine months ended September 30, 2003 vs. September 30, 2002

Revenues

Three months ended September 30, 2003 vs. September 30, 2002

Third quarter 2003 revenues decreased by \$8.1 million, or 5.2%, compared to the corresponding period in 2002. The decrease in revenues principally reflects lower other income (\$6.1 million) and lower finance charges and discounts (\$2.8 million) due to a lower level of average finance receivables (\$3.9 million), partially offset by higher receivable pricing (\$1.1 million). The lower level of average finance receivables (\$159 million) was primarily due to the Aircraft Finance, Golf Finance and Other segments, partially offset by an increase in the Resort Finance segment. The decrease in other income was mostly due to lower other fee income (\$3.4 million), securitization income (\$3.1 million) and investment income (\$1.1 million), partially offset by higher servicing fees (\$1.8 million).

Nine months ended September 30, 2003 vs. September 30, 2002

Revenues for the first nine months of 2003 increased by \$4.7 million, or 1%, compared to the corresponding period in 2002. The increase in revenues principally reflects higher finance charges and discounts (\$14.7 million) largely due to a higher level of average finance receivables (\$8.7 million) and higher receivable pricing (\$6.0 million). The higher level of average finance receivables (\$208 million) was primarily due to growth in the Distribution Finance and Resort Finance segments, partially offset by a decrease in the Aircraft Finance and Other segments. This increase was partially offset by lower other income (\$10.6 million), primarily due to lower securitization gains (\$6.4 million), investment income (\$4.8 million), other fee income (\$2.7 million) and syndication gains (\$2.2 million), partially offset by higher servicing fees (\$4.8 million) and prepayment gains (\$1.2 million).

Interest Expense

Three months ended September 30, 2003 vs. September 30, 2002

Third quarter 2003 interest expense decreased by \$3.8 million, or 7.7%, on 5.2% higher average debt outstanding. The lower interest expense reflects a decrease in the average borrowing rate to 3.38% from 3.85%, primarily attributable to a lower interest rate environment and the maturity of higher cost debt.

Nine months ended September 30, 2003 vs. September 30, 2002

Interest expense for the first nine months of 2003 decreased by \$6.5 million, or 4.5%, on 4.4% higher average debt outstanding. The lower interest expense reflects a decrease in the average borrowing rate to 3.51% from 3.84%, primarily attributable to a lower interest rate environment and the maturity of higher cost debt.

Interest Margin

Textron Financial's earnings are influenced by the interest margin earned on finance receivables (i.e., revenues earned less interest expense on borrowings and operating lease depreciation).

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Three months ended September 30, 2003 vs. September 30, 2002

Interest margin decreased \$5.4 million, or 16 basis points (6.68% versus 6.84%) for the third quarter of 2003 compared to the corresponding period in 2002. The contraction in the interest margin percentage was primarily due to lower other income.

Nine months ended September 30, 2003 vs. September 30, 2002

Interest margin increased \$8.7 million, and decreased 1 basis point (6.74% versus 6.75%) for the first nine months of 2003 compared to the corresponding period in 2002. The increase in interest margin was primarily due to higher finance charges and discounts from higher average finance receivables, higher receivable pricing and a lower relative borrowing cost, partially offset by lower other income.

Selling and Administrative Expenses

Three months ended September 30, 2003 vs. September 30, 2002

Selling and administrative expenses of \$48.6 million increased \$9.3 million in the third quarter of 2003 compared to the corresponding period in 2002. The increase in 2003 principally reflects higher legal and collection (\$6.3 million), data processing (\$1.1 million) and telecommunication (\$0.9 million) expenses. Selling and administrative expenses as a percentage of average managed and serviced finance receivables were 2.01% (on an annualized basis) in the third quarter of 2003, compared to 1.64% in 2002.

Nine months ended September 30, 2003 vs. September 30, 2002

Selling and administrative expenses of \$142.4 million increased \$19.6 million in the first nine months of 2003 compared to the corresponding period in 2002. The increase in 2003 principally reflects higher legal and collection (\$10.0 million), data processing (\$3.0 million) and telecommunication (\$2.3 million) expenses as well as costs related to growth in managed and serviced finance receivables (\$4.5 million). Selling and administrative expenses as a percentage of average managed and serviced finance receivables were 1.97% (on an annualized basis) in the first nine months of 2003, compared to 1.76% in 2002.

Provision for Losses

Three months ended September 30, 2003 vs. September 30, 2002

The provision for losses of \$25.4 million for the third quarter of 2003 decreased from \$44.4 million for the corresponding period in 2002. The decrease in the provision for losses reflects a declining rate of portfolio growth and an improvement in portfolio quality. Net charge-offs were \$44.3 million in the third quarter of 2003, consistent with \$44.1 million in the corresponding period of 2002. Net charge-offs increased in Distribution Finance (\$2.7 million), Resort Finance (\$1.0 million) and Golf Finance (\$0.5 million), mostly offset by decreases in Aircraft Finance (\$2.8 million) and Asset-Based Lending (\$1.0 million). Net charge-offs within the Other segment were consistent with prior year, however, net charge-off decreases in syndicated bank loans (\$10.5 million) and small-ticket equipment finance (\$4.9 million), were offset by increases in the other liquidating portfolios.

Nine months ended September 30, 2003 vs. September 30, 2002

The provision for losses of \$86.4 million for the first nine months of 2003 decreased from \$99.8 million for the corresponding period in 2002. The decrease in the provision for losses reflects a declining rate of portfolio growth and an improvement in portfolio quality. Net charge-offs of \$106.6 million for the first nine months of 2003, increased by \$12.8 million compared to the corresponding period in 2002. The increase in net charge-offs was primarily related to the Distribution Finance (\$7.8 million), Resort Finance (\$3.1 million), Golf Finance (\$2.5 million) and Aircraft Finance (\$1.5 million) segments, partially offset by a decrease in the Other segment (\$1.8 million).

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Although management believes it has made adequate provision for anticipated losses, realization of these assets remains subject to uncertainties. Subsequent evaluations of nonperforming assets, in light of factors then prevailing, including economic conditions, may require additional increases in the allowance for losses for such assets.

Operating Results by Segment

Segment income below represents income before special charges, income taxes, distributions on preferred securities and cumulative effect of change in accounting principle.

Three months ended September 30, 2003 vs. September 30, 2002

Distribution Finance income increased \$4.9 million reflecting higher interest margin (\$10.3 million), partially offset by higher operating expenses (\$3.7 million) and higher provision for losses (\$1.7 million) largely related to growth in finance receivables. The higher interest margin was primarily due to higher receivable pricing (\$4.4 million), higher other income (\$4.7 million), principally securitization related income, and higher average finance receivables (\$78 million).

Resort Finance income decreased \$12.9 million primarily reflecting higher operating expenses (\$6.4 million), mostly legal and collection, and lower interest margin (\$5.9 million). The lower interest margin largely reflects lower other income (\$3.8 million), principally securitization gains, and lower receivable pricing (\$3.5 million), despite higher average finance receivables (\$105 million).

Golf Finance income decreased \$2.7 million reflecting higher operating expenses (\$1.8 million), primarily related to the golf equipment portfolio, and lower interest margin (\$0.9 million), reflecting lower average finance receivables (\$86 million).

Aircraft Finance income increased \$6.6 million reflecting lower provision for losses (\$6.1 million) and lower operating expenses (\$1.4 million), partially offset by lower interest margin (\$0.9 million).

Asset-Based Lending income decreased \$2.5 million principally reflecting lower interest margin (\$1.4 million) primarily due to lower average finance receivables (\$39 million) and lower other income (\$0.7 million).

Structured Capital income decreased \$3.2 million primarily due to higher provision for losses (\$1.8 million) and lower interest margin (\$1.5 million).

Other segment income increased \$14.0 million reflecting lower provision for losses (\$17.5 million) and lower operating expenses (\$1.7 million), partially offset by lower interest margin (\$5.2 million). The decrease in interest margin principally reflects lower securitization income.

Nine months ended September 30, 2003 vs. September 30, 2002

Distribution Finance income increased \$18.6 million reflecting higher interest margin (\$37.5 million), partially offset by higher operating expenses (\$12.3 million) and higher provision for losses (\$6.6 million) largely related to growth in finance receivables. The higher interest margin was principally due to higher average finance receivables (\$291 million), higher receivable pricing (\$13.0 million) and higher other income (\$10.2 million).

Resort Finance income decreased \$21.8 million reflecting lower interest margin (\$11.3 million), higher operating expenses (\$8.4 million), mostly legal and collection, and higher provision for losses (\$2.1 million). The decrease in interest margin largely reflects lower receivable pricing (\$10.5 million) despite higher average finance receivables (\$90 million) and lower other income (\$4.6 million), principally securitization gains.

Golf Finance income increased \$3.5 million reflecting higher interest margin (\$6.5 million), partially offset by higher operating expenses (\$3.0 million). The increase in interest margin was mostly due to higher other income (\$5.0 million), principally securitization related income and residual gains.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Aircraft Finance income increased by \$4.8 million principally reflecting lower provision for losses (\$8.4 million), partially offset by a lower interest margin (\$3.3 million). The decrease in interest margin was primarily due to lower other income (\$2.2 million).

Asset-Based Lending income increased \$0.3 million reflecting lower provision for losses (\$4.2 million), partially offset by lower interest margin (\$2.8 million) and higher operating expenses (\$1.1 million). The decrease in interest margin was mostly due to lower average finance receivables (\$55 million) and lower other income (\$1.0 million), partially offset by higher receivable pricing (\$0.9 million).

Structured Capital income decreased \$3.2 million primarily reflecting higher provision for losses (\$2.2 million).

Other segment income increased \$0.3 million reflecting a lower provision for losses (\$11.6 million) and lower operating expenses (\$5.5 million), partially offset by a lower interest margin (\$16.8 million). The lower interest margin largely reflects lower other income (\$18.8 million), primarily securitization related income.

Income Before Cumulative Effect of Change in Accounting Principle

Three months ended September 30, 2003 vs. September 30, 2002

Income before cumulative effect of change in accounting principle for the third quarter was \$15.9 million, \$3.7 million or 29.7% higher than the corresponding period in 2002. The increase reflects a lower provision for losses (\$18.9 million) and a lower effective tax rate, partially offset by higher selling and administrative expenses (\$9.3 million) and a lower interest margin (\$5.4 million).

Nine months ended September 30, 2003 vs. September 30, 2002

Income before cumulative effect of change in accounting principle for the first nine months of 2003 was \$48.5 million, \$3.5 million or 7.9% higher than the corresponding period in 2002. The increase reflects a lower provision for losses (\$13.4 million), a higher interest margin (\$8.7 million) and a lower effective tax rate, partially offset by higher selling and administrative expenses (\$19.6 million).

Contingencies

In March 2003, the United States Department of Justice (DOJ) authorized the filing of a civil action against Textron Financial and its Litchfield Financial Corporation (Litchfield), and other third parties, arising from the financing of certain land purchases by consumers through a third-party land developer. Also, during the third quarter, the Florida Attorney General's office opened a preliminary investigation into Litchfield's activities relative to Buyer's Source. Although the Company believes it has good defenses to any governmental or potential consumer litigation, it is engaged in settlement discussions with the government agencies and other parties to resolve the matter. As a result of the most recent discussions, the Company believes that it is reasonably possible that this matter will be resolved for less than \$10 million.

Textron Financial and Litchfield, together with other third parties, are currently defending a class action arising from the sale of promissory notes issued by, and the operation of, certain trusts organized by DynaCorp Financial Strategies Inc. ("DFS"). The complaint, which was filed in 2001 in Superior Court in Marin County, California, alleges that DFS and the trusts engaged in a variety of improper dealings with regard to the sale by the trusts of approximately \$50 million of notes and the operation of the trusts. During a portion of the time that the allegedly improper activities occurred, Litchfield extended credit to DFS and was a shareholder of DFS, and a Litchfield officer was a director on DFS' Board. The plaintiffs allege several bases for liability, including that Litchfield's former officer participated in the misrepresentations, that Litchfield received favorable treatment as a creditor, and that Litchfield was a controlling person of DFS. Litchfield denies these allegations and is aggressively defending the litigation. On August 8, 2003, Litchfield was notified that the judge hearing the class action issued an order affirming her preliminary ruling denying Litchfield's motion to dismiss Litchfield from the case. The preliminary ruling became final in September, 2003. The

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Company intends to vigorously defend this action and believes that a substantial part of any settlement or judgment would be covered by insurance. The Company anticipates this matter will proceed to trial in the first quarter of 2004.

There are other pending or threatened lawsuits and other proceedings against Textron Financial and its subsidiaries. Some of these suits and proceedings seek compensatory, treble or punitive damages in substantial amounts. These suits and proceedings are being defended by, or contested on behalf of, Textron Financial and its subsidiaries. On the basis of information presently available, Textron Financial believes any such liability would not have a material effect on Textron Financial's financial position or results of operations.

Selected Financial Ratios

	Three Months Ended		Nine Months Ended	
	September 30, 2003	September 30, 2002	September 30, 2003	September 30, 2002
Net interest margin as a percentage of average net investment (1)	6.68%	6.84%	6.74%	6.75%
Return on average equity (2)	6.09%	4.94%	6.32%	6.06%
Return on average assets (3)	0.92%	0.71%	0.93%	0.89%
Ratio of earnings to fixed charges	1.52x	1.39x	1.53x	1.49x
Selling and administrative expenses as a percentage of average managed and serviced finance receivables (4)	2.01%	1.64%	1.97%	1.76%
Operating efficiency ratio (5)	49.5%	38.0%	47.0%	41.7%
Net charge-offs as a percentage of average finance receivables	2.97%	2.89%	2.34%	2.13%
			September 30, 2003	December 28, 2002
60+ days contractual delinquency as a percentage of finance receivables (6)			2.53%	2.88%
Nonperforming assets as a percentage of finance assets (7)			2.90%	3.33%
Allowance for losses on receivables as a percentage of finance receivables			2.45%	2.89%
Allowance for losses on receivables as a percentage of nonaccrual finance receivables			82.5%	91.7%
Total debt to tangible shareholder's equity (8)			5.7x	5.7x

- (1) Represents revenues earned less interest expense on borrowings and operating lease depreciation as a percentage of average net investment. Average net investment includes finance receivables plus operating leases, less deferred taxes on leveraged leases.
- (2) Return on average equity excludes the cumulative effect of change in accounting principle.
- (3) Return on average assets excludes the cumulative effect of change in accounting principle.
- (4) Average managed and serviced finance receivables include owned receivables, receivables serviced under securitizations, participations and third-party portfolio servicing agreements.
- (5) Operating efficiency ratio is selling and administrative expenses divided by net interest margin.
- (6) Delinquency excludes captive receivables with recourse to Textron. Captive receivables represent third-party finance receivables originated in connection with the sale or lease of Textron manufactured products. Percentages are expressed as a function of total Textron Financial independent and nonrecourse captive receivables.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

- (7) Finance assets include: finance receivables; equipment on operating leases, net of accumulated depreciation; repossessed assets and properties; retained interests in securitizations; interest-only securities; investment in equipment residuals; ADC arrangements; and long-term investments (some of which are classified in Other assets on Textron Financial's Condensed Consolidated Balance Sheets). Nonperforming assets include independent and nonrecourse captive finance assets.
- (8) Tangible shareholder's equity equals Shareholder's equity, excluding Accumulated other comprehensive income or loss, less Goodwill.

New Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. Textron Financial had not entered into any new arrangements with variable interest entities subsequent to January 31, 2003.

On October 8, 2003, the FASB deferred the implementation date for variable interest entities that existed prior to February 1, 2003 from the third quarter to the fourth quarter of 2003. With this deferral and due to the recently issued and pending FASB staff positions, management is continuing to evaluate the impact of the adoption of FIN 46. Textron Financial is party to various arrangements that are being evaluated from a FIN 46 perspective. At this time, based on the interpretations issued to date, management does not anticipate that adoption will have a material effect on Textron's results of operations or financial position.

Forward-looking Information

Certain statements in this Form 10-Q and other oral and written statements made by Textron Financial from time to time are forward-looking statements, including those that discuss strategies, goals, outlook or other nonhistorical matters; or project revenues, income, returns or other financial measures. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements, including the following: (a) changes in worldwide economic and political conditions that impact interest and foreign exchange rates; (b) the occurrence of further downturns in customer markets to which Textron products are sold or supplied and financed or where Textron Financial offers financing; (c) the ability to control costs and successful implementation of various cost reduction programs; (d) the ability to maintain portfolio credit quality; (e) Textron Financial's access to debt financing at competitive rates; (f) access to equity in the form of retained earnings and capital contributions from Textron; and (g) uncertainty in estimating contingent liabilities and establishing reserves tailored to address such contingencies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For information regarding Textron Financial's Quantitative and Qualitative Disclosure About Market Risk, see "Interest Rate Sensitivity" and "Financial Risk Management" in Item 2 of this Form 10-Q.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have carried out an evaluation, under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer (the "CEO") and our Executive Vice President and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of

Item 4. *Controls and Procedures (Continued)*

1934, as amended (the “Act’’) as of the end of the fiscal quarter covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

TEXTRON FINANCIAL CORPORATION

Item 6. *Exhibits and Reports on Form 8-K*

(a) Exhibits

- 4.1 Indenture dated as of December 9, 1999, between Textron Financial Corporation and SunTrust Bank (formerly known as Sun Trust Bank, Atlanta), (including form of debt securities). Incorporated by reference to Exhibit 4.1 to Amendment No. 2 to Textron Financial Corporation's Registration Statement on Form S-3 (No. 333-88509).
- 4.2 Indenture dated as of November 30, 2001, between Textron Financial Canada Funding Corp. and SunTrust Bank, guaranteed by Textron Financial Corporation. Incorporated by reference to Exhibit 4.2 to Textron Financial Corporation's Registration Statement on Form S-3 (No. 333-108464).
- 10.1 364-Day Credit Agreement dated July 28, 2003 among Textron Financial Corporation, the Banks listed therein, and JPMorgan Chase Bank, as Administrative Agent. Incorporated by reference to Exhibit 10.1 to Textron Financial Corporation's Report on 8-K as filed on August 26, 2003.
- 10.2 Five-Year Credit Agreement dated July 28, 2003 among Textron Financial Corporation, the Banks listed therein, and JPMorgan Chase Bank, as Administrative Agent. Incorporated by reference to Exhibit 10.2 to Textron Financial Corporation's Report on 8-K as filed on August 26, 2003.
- 10.3 364-Day Credit Agreement dated March 31, 2003 among Textron Inc., the Banks listed therein, and JPMorgan Chase Bank, as Administrative Agent. Incorporated by reference to Exhibit 10.3 to Textron Inc.'s Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2003.
- 10.4 Five-Year Credit Agreement dated April 1, 2002 among Textron Inc., the Banks listed therein, and JPMorgan Chase Bank, as Administrative Agent. Incorporated by reference to Exhibit 10.2 to Textron Inc.'s Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2003.
- 10.5 Amendment to Five-Year and 364-day Credit Agreements among Textron Inc., the Banks listed therein, and JPMorgan Chase Bank, as Administrative Agent.
- 12 Computation of Ratios of Earnings to Fixed Charges
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)
- 32.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350
- 32.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350

NOTE: Instruments defining the rights of holders of certain issues of long-term debt of Textron Financial Corporation have not been filed as exhibits to this Report because the authorized principal amount of any one such issues does not exceed 10% of the total assets of Textron Financial Corporation and its subsidiaries on a consolidated basis. Textron Financial Corporation agrees to furnish a copy of each such instrument to Commission upon request.

(b) Reports on Form 8-K

The Company filed a report on Form 8-K on August 26, 2003 reporting under Item 5 of Form 8-K on the Company's renewal of certain credit facilities and updating its disclosure with respect to certain litigation matters.

SIGNATURES

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

Date: November 7, 2003

TEXTRON FINANCIAL CORPORATION

/s/ THOMAS J. CULLEN

Thomas J. Cullen
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)