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Aerospace & Defense (GICS) | Aerospace & Defense (Citi)  
North America | United States

# Textron Inc. (TXT)

## Alert: Progressing through the Uncertainty

### Company Update

- What's New** — We hosted a fireside chat with CFO Frank Connor this morning at Citi's Global Industrials Conference in Boston at which he discussed TXT's various end-markets. Overall, the shorter-cycle markets are trading somewhat in line with the broader economy with volumes holding up amidst some pockets of softness. Cessna continues to be a spot market in slow/uncertain recovery, military contracting is tough, and Bell Commercial continues to see strong demand as it regains market share.
- Cessna** – The new management team at Cessna is expanding the sales and service footprint globally, although several uncertainties (economic, election, and budget) are preventing some potential customers from pulling the trigger. We're likely to see a back-loaded year, with the strong potential of some activity slipping into 1Q13. But TXT maintains that there's a lot of dialogue going on and that they're seeing the beginnings of a replacement cycle. It also expects to regain some pricing power once it rolls out its new platforms. Supply and demand are still somewhat mismatched but Cessna is well positioned to benefit once volumes return.
- Bell** – There's still strong order activity at Bell as it continues to regain market share ceded over the previous decade (from 50-60% at the peak to 15% last year). The Bell 429 is doing well and TXT expects there to be further discussion with the FAA which recently rejected a weight exemption request that would have expanded the addressable market.
- Military** – The contracting environment continues to be very difficult amidst budget pressure. One of the victims of the slowed environment looks to be the V-22 MYP2 contract that looks like it won't be signed until 1H13 (MYP1 lasts through 2015). Conversations continue with potential foreign buyers (10-20 countries are interested) which would soak up excess capacity in 2015 once the US buy steps down (foreigners could make up for ~10/year).
- Industrials** – Volumes are holding in, although softness in Europe is being offset by better than expected performance in the US. He noted that Kautex has the most exposure but that it's hanging in alright thanks to auto export activity (BMW, Volvo).
- TFC** – They're still liquidating the non-captive portfolio and expect that by early/mid next year it will be largely immaterial size-wise. At this point, TXT does not think it creates any economic exposure from a P&L standpoint.
- M&A** – Reiterated that management is perfectly happy with the portfolio and confirmed that Cessna is eyeing some Hawker assets (although timeline for a decision is undetermined).

<b>Neutral</b>	<b>2</b>
Price (20 Sep 12)	US\$27.46
Target price	US\$27.00
Expected share price return	-1.7%
Expected dividend yield	0.3%
<b>Expected total return</b>	<b>-1.4%</b>
Market Cap	US\$7,715M

### Price Performance (RIC: TXT.N, BB: TXT US)



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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Textron Inc.

### Valuation

In our view, a sum-of-the-parts methodology is appropriate at this time given the varying stages of recovery at each of the company's businesses, and it should give investors a better sense of break-up value. We apply a target multiple of 12.8x FTM PE to Cessna, representing a discount to our target commercial multiple of 15x given the low margins and pressured outlook in the SMID cabin bizjet business. Our Bell target multiple of 11.1x is a blend of military (70%) and commercial (30%). Our Systems multiple is 8.8x, representing a 30% discount to the market (12.6x), in line with where we believe a ground-exposed defense business should trade. For the company's finance business, we use a 7.5x multiple given the valuation levels of a broad selection of financial companies. The resulting blended multiple of 11.4x yields our \$27 PT when applied to our FTM EPS estimate twelve months from now.

### Risks

Strong brand recognition and relatively broad end-market exposure are offset by limited end-market visibility (i.e. bizjets) and risks associated with other elements of the portfolio (i.e. finance and end-market industrial demand). Aviation and helicopter sales could experience further weakness based on economic pressure and increased competition. And in our view, Cessna's small-cabin bizjets are still relatively out-of-favor given macro uncertainty. The finance segment may also be volatile due to broader market gyrations impacting valuation and liquidation pace, despite the segment being in wind-down mode. Meanwhile, US Government spending (31% of revenues) is under increasing fiscal pressure which could result in program cancellations or delays, including the V-22 Osprey. As war op tempo slows, war budgets may also move away from TXT. Meanwhile, there is headline risk associated with Systems' Sensor Fuzed Weapon, which some consider a banned cluster munition.

We would become more negative if op tempo decreased faster than anticipated, the bizjet recovery was delayed beyond 2012, or commercial demand for new aircraft was slower to materialize than expected. We would become more positive if the small-cabin market improved faster than expected and if evidence emerged of Bell's ability to recapture commercial market share. If the impact on the company from any of these factors proves to be greater than we anticipate in either direction, the stock will likely have difficulty achieving our target price.

## Appendix A-1

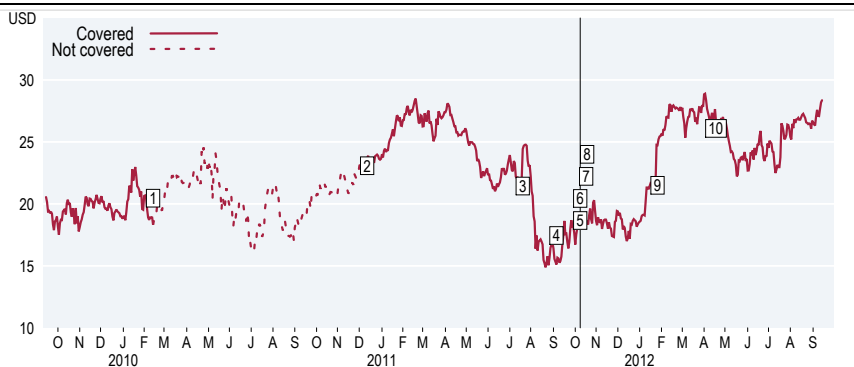
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Analyst: Jason Gursky  
Covered since December 13 2010



Date	Rating	Target Price	Closing Price
1 12-Feb-10	Coverage terminated		
2 13-Dec-10	2H	*26.00	23.66
3 20-Jul-11	2H	*28.00	24.43
4 6-Sep-11	2H	*18.50	15.11

\* Indicates change

Date	Rating	Target Price	Closing Price
5 8-Oct-11	Stock rating system changed		
6 8-Oct-11	*2	18.50	18.34
7 18-Oct-11	2	*18.70	18.66
8 19-Oct-11	2	*21.00	18.59

Date	Rating	Target Price	Closing Price
9 26-Jan-12	2	*25.00	24.74
10 18-Apr-12	2	*27.00	26.65

Rating/target price changes above reflect Eastern Standard Time

### Textron Inc. (TXT) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jason Gursky  
Covered since December 13 2010



Date	Rating	Target Price	Closing Price
1 20-Jan-11	*ADD LP	-	26.05

\* Indicates change

Date	Rating	Target Price	Closing Price
2 16-Apr-12	*REM LP	-	27.01

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Data current as of 30 Jun 2012

12 Month Rating			Relative Rating		
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