(ii) $14 million restructuring charge related to decisions to implement certain business realignment and facility rationalization actions ($9 million after taxes).

(f) Working capital consists of all current assets and liabilities, including cash and short-term debt.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations.***

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto. The following discussion and analysis contains forward-looking statements and estimates that involve risks and uncertainties. Actual results could differ materially from these estimates. Factors that could cause or contribute to differences from estimates include those discussed under "Cautionary Statement" and "Risk Factors" contained in Item 1 above.

We operate on a 52/53 week fiscal year ending on the Friday closest to September 30. For ease of presentation, September 30 is utilized consistently throughout Management's Discussion and Analysis of Financial Condition and Results of Operations to represent the fiscal year end date. 2010 and 2009 were both 52 week fiscal years, while 2008 was a 53 week fiscal year. All date references contained herein relate to our fiscal year unless otherwise stated.

OVERVIEW AND OUTLOOK

We benefit from a diversified and balanced business, serving both commercial and government markets. This diversification and balance was an important attribute that helped support the performance of our Company during 2010. Our Government Systems business realized revenue growth from acquisitions and from higher organic sales to customers who remain focused on increasing the effectiveness of the war fighter. Our Commercial Systems business continued to experience lingering effects from uncertainty in the global economic recovery and the adverse impact on our commercial aerospace customers. We took aggressive actions to manage the cost structure of our business and position our portfolios appropriately for these market conditions. We adjusted our operations to increase efficiency and balance capacity as we completed the closure of our facility in San Jose, California and relocated work previously done there to other locations. We focused on containing costs and accelerating the margin accretion of our DataPath, Inc. (DataPath) acquisition. As a result of these efforts, we generated the following results for 2010:

- we achieved sales of $4.67 billion
- we delivered earnings per share of $3.52
- we generated operating cash flow of $711 million
- we continued to invest in research and development (R&D) at 18.5 percent of sales

We believe our Company has proven its ability to both react quickly to changing business conditions and to execute its business plans. Our fundamental strategies continue to serve us well: the balance between our commercial and government businesses; the diversification of our customer base and product offerings; the integration of our business through our shared service operating model and our focus on innovation through R&D.

Balance—We feel our business is characterized by its balance, in terms of market segment, geographic regions and product and customer sales mix. We strive to maintain a balance between our Government and Commercial Systems businesses, believing that the segments are complementary to one another. In 2011, we expect the strength of our Commercial Systems business to drive our growth with a modest increase in our Government Systems business. We believe our balanced business portfolio is a fundamental strength of our Company.

Diversification—Our business derives its revenue streams from a large number of diverse customers, products, solutions, geographic regions and markets. Our Government Systems business executes against numerous programs every year for a variety of customers, including the U.S. Department of Defense, state and local governments, other government agencies, civil agencies, defense contractors and foreign ministries of defense. Our Commercial Systems business serves customers ranging from the world's largest aircraft manufacturers to individual aircraft owners within the general aviation marketplace. This diversification of revenue sources enables us to pursue numerous growth opportunities as business conditions vary across our portfolios.

Integration—We have a highly integrated business reliant upon a shared services operating platform. The integrated nature of our business allows us to leverage product and service capabilities across our segments in a manner we believe is unique in our industry. This integration is evidenced by our product and technology centers of excellence in areas such as displays, communication, navigation and surveillance, through which we apply our core competencies to solutions in both Government and Commercial Systems.

Innovation—A well-funded and comprehensive R&D program is a foundational aspect of our Company. Our focus on developing unique solutions to our customers' needs is evidenced by the large investment we dedicate towards R&D programs. It is this spending profile that has allowed us to successfully pursue and capture customer programs and that will continue to be the growth engine for our Company.

Looking forward to 2011, we believe we are positioned to realize a return to growth in our Commercial Systems business and continued increases, although at more modest levels than in recent years, in our Government Systems business. Highlights of our 2011 earnings guidance are as follows:

- total sales in the range of $4.8 billion to $5.0 billion, or about a 3 percent to 7 percent increase over 2010
- diluted earnings per share in the range of $3.75 to $3.95
- cash provided by operating activities in the range of $650 million to $750 million
- capital expenditures of approximately $150 million
- total company and customer-funded R&D expenditures in the range of $900 million to $950 million, or about 19 percent of total sales

See the following sections for further discussion of 2010 and anticipated 2011 results of operations. For additional disclosure on segment operating earnings see Note 23 of the ***Notes to Consolidated Financial Statements*** in Item 8 below. Please also see our ***Risk Factors*** and ***Cautionary Statement*** in Item 1A of this Form 10-K.

RESULTS OF OPERATIONS

The following management discussion and analysis of results of operations is based on reported financial results for 2008 through 2010 and should be read in conjunction with our consolidated financial statements and the notes thereto in Item 8 below.

Consolidated Financial Results

Sales

(dollars in millions)	2010	2009	2008
U.S.	$3,313	$3,080	$3,164
Non-U.S.(1)	1,352	1,390	1,605
Total	$4,665	$4,470	$4,769
Percent increase (decrease)	4%	(6)%	

(1) Sales are attributed to geographic region based on country of destination.

Sales for 2010 compared to 2009

Total sales increased $195 million, or 4 percent, in 2010 compared to 2009, primarily due to a $282 million increase in Government Systems sales partially offset by an $87 million reduction in Commercial Systems sales. Incremental sales from the May 2009 acquisition of DataPath, the December 2009 acquisition of AR Group, Inc. (Air Routing) and the November 2008 acquisition of SEOS Group Limited (SEOS), contributed a total of $209 million in revenue or 5 percentage points of revenue growth. A more detailed discussion of sales by segment in 2010 and 2009 is found in the Government Systems and Commercial Systems Financial Results sections below.

Domestic sales increased $233 million, or 8 percent, in 2010 compared to 2009, primarily attributable to sales growth in our Government Systems segment driven by higher product and service sales from the DataPath acquisition and increased sales to the U.S. Government. In addition, higher Commercial Systems sales to Boeing and incremental service sales from the Air Routing acquisition were partially offset by decreased sales to domestic business jet original equipment manufacturers (OEMs).

Non-U.S. sales decreased by $38 million, or 3 percent, in 2010 compared to 2009, primarily due to lower Commercial Systems sales impacted by reduced production rates at non-U.S. business and regional jet OEMs, partially offset by incremental sales to regions outside of the U.S. from the DataPath and SEOS acquisitions.

Sales for 2009 compared to 2008

Total sales decreased by $299 million, or 6 percent, in 2009 compared to 2008, primarily due to a $512 million reduction in Commercial Systems sales, partially offset by a $213 million increase in Government Systems sales. Incremental sales from the April 2008 acquisition of Athena Technologies, Inc. (Athena), the November 2008 acquisition of SEOS and the May 2009 acquisition of DataPath, contributed a total of $117 million in revenue, or 2 percentage points of revenue growth. A more detailed discussion of sales by segment in 2009 and 2008 is found in the Government Systems and Commercial Systems Financial Results sections below.

Domestic sales decreased by $84 million, or 3 percent, in 2009 compared to 2008, primarily due to lower sales volume of Commercial Systems products and systems to OEMs and reduced commercial avionics aftermarket hardware and service and support revenues. These decreases were partially offset by incremental revenue from the DataPath and Athena acquisitions and higher sales to the U.S. Government.

Non-U.S. sales decreased by $215 million, or 13 percent, in 2009 compared to 2008, primarily due to the decline in Commercial Systems sales resulting from lower production rates at OEMs and a reduction in commercial avionics aftermarket hardware and service and support revenues. These decreases were partially offset by incremental sales from the SEOS and DataPath acquisitions.

Cost of Sales

Total cost of sales is summarized as follows:

(dollars in millions)	2010	2009	2008
Total cost of sales	$3,379	$3,150	$3,334
Percent of total sales	72.4%	70.5%	69.9%

Cost of sales consists of all costs incurred to design and manufacture our products and includes R&D, raw material, labor, facility, product warranty and other related expenses.

Cost of sales for 2010 compared to 2009

Total cost of sales increased $229 million, or 7 percent, in 2010 compared to 2009, primarily due to the following:

- incremental product and service cost of sales from the DataPath, Air Routing and SEOS acquisitions totaling $146 million
- a $66 million increase attributable to higher employee incentive compensation expenses. For 2010, $60 million of employee compensation expense was included in cost of sales. For 2009, no employee incentive compensation was awarded. In addition, a favorable adjustment to reduce cost of sales by $6 million occurred during 2009 resulting from lower than expected compensation payments made to employees in 2009 for incentive awards earned in 2008
- a $31 million increase attributable to higher defined benefit pension expense. As discussed in the Retirement Plans section below, the increase in pension expense was primarily due to the unfavorable impact of a decrease in the discount rate used to measure our U.S. pension expense from 7.60 percent in 2009 to 5.47 percent in 2010. For 2010, $12 million of pension expense was included within cost of sales, compared to $19 million of pension income during 2009
- a $19 million benefit due to lower restructuring and asset impairment charges that were incurred in 2009 and primarily related to the closure of our facility in San Jose, California
- a $10 million decrease from lower company-funded R&D costs as explained in detail below
- the remaining variance primarily related to a $68 million increase in cost of sales associated with the organic sales growth in Government Systems, partially offset by a $53 million reduction in cost of sales from lower organic Commercial Systems sales volume. See the Government Systems and Commercial Systems Financial Results sections below for further discussion

Cost of sales for 2009 compared to 2008

Total cost of sales decreased $184 million, or 6 percent, in 2009 compared to 2008, primarily due to the following:

- a $206 million decrease from lower organic Commercial Systems sales volume, partially offset by a $56 million increase associated with the organic sales growth in Government

Systems. See the Government Systems and Commercial Systems Financial Results sections below for further discussion

- a $107 million decrease attributable to lower employee incentive compensation expenses. For 2009, employee incentive compensation resulted in a favorable reduction to cost of sales of $6 million (see explanation above). For 2008, $101 million of employee incentive compensation expense was included within cost of sales
- a $40 million decrease from lower company-funded R&D costs as explained in detail below
- a $10 million decrease attributable to higher defined benefit pension income. As discussed in the Retirement Plans section below, the higher pension income was primarily due to the favorable impact of an increase in the discount rate used to measure our U.S. pension expense from 6.60 percent in 2008 to 7.60 percent in 2009. Pension income included within cost of sales was $19 million for 2009 and $9 million for 2008
- the above items were partially offset by incremental cost of sales from the DataPath, SEOS and Athena acquisitions totaling $104 million as well as $19 million of costs associated with the 2009 restructuring and asset impairment charges

R&D expense included in Cost of sales for 2010, 2009 and 2008

R&D expense is included as a component of cost of sales and is summarized as follows:

(dollars in millions)	2010	2009	2008
Customer-funded:			
Government Systems	$437	$413	$398
Commercial Systems	79	80	103
Total customer-funded	516	493	501
Company-funded:			
Government Systems	115	104	98
Commercial Systems	230	251	297
Total company-funded	345	355	395
Total Research and Development	$861	$848	$896
Percent of total sales	18.5%	19.0%	18.8%

Company-funded R&D expense consists primarily of payroll-related expenses of employees engaged in R&D activities, engineering related product materials and equipment and subcontracting costs. Customer-funded R&D expenditures are incurred pursuant to contractual arrangements and are accounted for as contract costs within cost of sales with the reimbursement accounted for as a sale when earned.

Total R&D expense increased $13 million from 2009 to 2010. The customer-funded portion of R&D expense increased $23 million from 2009 to 2010, primarily due to a $24 million increase within Government Systems from customer-funded development efforts on a European fixed-wing aircraft program and a vehicle electronics integration program. The increase in customer-funded R&D was partially offset by a $10 million decrease in company-funded R&D. Commercial Systems company-funded R&D decreased $21 million, primarily from lower spending as certain projects neared completion and the timing of other efforts were delayed as we continued to manage our cost structure and adjust to market demands. This decrease was partially offset by an $11 million increase in company-funded R&D expense within Government Systems, primarily related to the DataPath acquisition and increased spending on other programs.

Total R&D expense decreased $48 million from 2008 to 2009. This decrease was primarily related to a $46 million reduction in Commercial Systems company-funded R&D expense driven by lower development costs on the Boeing 787 program and reduced spending on certain other initiatives as global macro-economic factors adversely impacted our commercial markets, partially offset by increased spending on the Airbus A350 program. The customer-funded portion of R&D expense decreased slightly from 2008 to 2009 as lower customer-funded development on certain commercial air transport platforms with Boeing were partially offset by higher customer-funded development within Government Systems on programs such as Common Range Integrated Instrumentation System (CRIIS) and Joint Precision Approach and Landing System (JPALS).

Looking forward to 2011, total R&D expense is expected to increase by approximately 5 to 10 percent over 2010 and be in the range of $900 million to $950 million, or about 19 percent of total Company sales. The increase is primarily due to expected growth in customer-funded R&D principally related to recent awards and anticipated Government Systems development programs and other customer-funded development programs within Commercial Systems related to certain Asian regional jet programs. Increases are also expected in company-funded R&D as Government Systems continues to apply our commercial flight deck architecture into military and civil applications and Commercial Systems applies our Fusion product to certain next generation flight decks for business aircraft.

Selling, General and Administrative Expenses

(dollars in millions)	2010	2009	2008
Selling, general and administrative expenses (SG&A)	$478	$458	$485
Percent of total sales	10.2%	10.2%	10.2%

SG&A expenses consist primarily of personnel, facility and other expenses related to employees not directly engaged in manufacturing or R&D activities. These activities include marketing and business development, finance, legal, information technology and other administrative and management functions.

Total SG&A expenses increased $20 million, or 4 percent, in 2010 compared to 2009, primarily due to the following:

- a $49 million increase due to the combined impact of incremental SG&A expense from the DataPath, Air Routing and SEOS acquisitions, higher employee incentive compensation costs and an increase in defined benefit pension expense
- a $29 million decrease in SG&A expense primarily comprised of reductions in employee headcount and other cost savings

SG&A expenses decreased $27 million, or 6 percent, in 2009 compared to 2008, primarily due to the following:

- a $29 million decrease from the combined impact of lower employee incentive compensation costs and reduced defined benefit pension expense
- the remaining variance resulted from a $2 million net increase attributable primarily to incremental SG&A expense from the DataPath, SEOS and Athena acquisitions, which were mostly offset by reductions in employee headcount and other cost savings

Interest Expense

(in millions)	2010	2009	2008
Interest expense	$20	$18	$21

Interest expense increased by $2 million in 2010 compared to 2009, primarily due to a full year of interest expense associated with the $300 million of long-term debt issued May 6, 2009. See Note 10 of the ***Notes to the Consolidated Financial Statements*** in Item 8 below for more detail regarding outstanding debt.

Interest expense decreased $3 million in 2009 compared to 2008, primarily due to a more favorable interest rate environment on our variable rate short-term debt outstanding during 2009.

Other Income, Net

(in millions)	2010	2009	2008
Other income, net	$(14)	$(23)	$(24)

For information regarding the fluctuations in other income, net, see Note 15 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

Income Tax Expense

(dollars in millions)	2010	2009	2008
Income tax expense	$ 241	$ 273	$ 275
Effective income tax rate	30.1%	31.5%	28.9%

The effective income tax rate differed from the U.S. statutory tax rate as detailed below:

	2010	2009	2008
Statutory tax rate	35.0%	35.0%	35.0%
State and local income taxes	0.8	0.7	0.6
Research and development credit	(1.2)	(2.2)	(2.6)
Domestic manufacturing deduction	(1.1)	(1.3)	(1.5)
Tax settlements	(2.4)	—	(2.3)
Other	(1.0)	(0.7)	(0.3)
Effective income tax rate	30.1%	31.5%	28.9%

The difference between our effective income tax rate in 2010 and the statutory tax rate is primarily due to the benefit from the settlement of certain tax matters, the tax benefits derived from the Federal Research and Development Tax Credit (Federal R&D Tax Credit), which provides a tax benefit on certain incremental R&D expenditures, and the Domestic Manufacturing Deduction under Section 199 (DMD), which provides a tax benefit on U.S. based manufacturing.

The effective income tax rate in 2010 decreased from 2009 primarily due to the favorable impact of the Internal Revenue Service (IRS) completing its examination of the taxable years ended September 30, 2006 and 2007, partially offset by differences in the availability of the Federal R&D Tax Credit which expired December 31, 2009.

The effective income tax rate in 2009 increased from 2008 primarily due to the favorable resolution of certain tax settlements that benefited our effective income tax rate in 2008.

The effective income tax rates for 2010, 2009 and 2008 include a tax benefit related to the DMD. The DMD tax benefit available in 2010, 2009 and 2008 was being phased in by statute and was therefore lower than the full DMD tax benefit which will be effective beginning in fiscal year 2011.

For 2011, our effective income tax rate is projected to be in the range of 31 percent to 32 percent in comparison to our 2010 effective income tax rate of 30.1 percent. The projected 2011 effective income tax rate assumes the Federal R&D Tax Credit is available for the entire fiscal year, although legislation authorizing Federal R&D Tax Credit beyond December 31, 2009 has yet to be enacted.

Management believes a valuation allowance against deferred tax assets is not considered necessary because it is more likely than not the deferred tax assets will be fully realized, except for $15 million of deferred tax assets which have been fully reserved related to foreign net operating losses in Sweden and the United Kingdom which are not subject to expirations, a domestic capital loss carryforward which expires in 2015, and state R&D credit carryovers with varying expiration dates.

Net Income and Diluted Earnings Per Share

(dollars and shares in millions, except per share amounts)	2010	2009	2008
Net income	$ 561	$ 594	$ 678
Net income as a percent of sales	12.0%	13.3%	14.2%
Diluted earnings per share	$ 3.52	$ 3.73	$ 4.16
Weighted average diluted common shares	159.2	159.4	162.9

Net income for 2010 decreased 6 percent to $561 million, or 12.0 percent of sales, from net income of $594 million, or 13.3 percent of sales, for 2009. Diluted earnings per share decreased 6 percent to $3.52 for 2010 compared to $3.73 for 2009. The decrease in net income and diluted earnings per share was primarily the result of higher expense from increased pension and employee incentive compensation costs and lower earnings from reduced Commercial Systems sales volume as discussed in the Commercial Systems Financial Results section. These items were partially offset by higher earnings from increased Government Systems sales volume as discussed in the Government Systems Financial Results section, a reduction to the effective income tax rate as discussed in the Income Taxes section and lower restructuring and asset impairment charges which occurred in 2009 and primarily related to the closure of our facility in San Jose, California. The 2009 restructuring and asset impairment charge was $14 million after-taxes, or $21 million before income taxes.

Net income in 2009 decreased 12 percent to $594 million, or 13.3 percent of sales, from net income in 2008 of $678 million, or 14.2 percent of sales. Diluted earnings per share decreased 10 percent in 2009 to $3.73, compared to $4.16 in 2008. The decrease in net income was primarily due to lower earnings from reduced Commercial Systems sales volume as discussed in the Commercial Systems Financial Results section, an increase to the effective income tax rate as discussed in the Income Taxes section and the $14 million after-tax restructuring and asset impairment charge ($21 million before income taxes) that was primarily related to the decision to close our San Jose, California facility. These items were partially offset by lower employee incentive compensation costs, higher earnings from increased Government Systems sales volume as discussed in the Government Systems Financial Results section and lower company-funded R&D costs. The decrease in earnings per share was lower than the decrease in net income due to the positive impact of our share repurchase program.

Segment Financial Results

Government Systems

Overview and Outlook

Our Government Systems business provides communication and electronic systems, products and services for airborne and surface applications to the U.S. Department of Defense, state and local governments, other government agencies, civil agencies, defense contractors and foreign ministries of defense. These systems, products and services support airborne (fixed and rotary wing), ground and shipboard applications. The short and long-term performance of our Government Systems business is affected by a number of factors, including the amount and prioritization of defense spending by the U.S. and non-U.S. governments, which is generally based on the security environment and underlying political landscape resulting from budget deficits in the U.S. and abroad.

We expect global baseline defense budgets to be constrained as we move into 2011 and the available funding for our R&D and procurement budgets to be relatively flat due to a combination of factors. These factors include: a reduction in supplemental appropriations that could put further pressure on procurement budgets; the impact of announced program cuts such as completion of the F-22 program and restructuring of Future Combat Systems; and the potential for Eurofighter program delays and other program delays similar to those realized in 2010. In spite of the market environment, we believe high priority military transformation initiatives and customer demand for cost-effective solutions to modernize and extend the life of current systems or to replace systems returning from deployment will lead to funding support for our military communications and electronics equipment. We expect that these customer priorities, combined with our strengthening positions in certain faster growing areas of our served defense electronics and communications markets, should enable us to deliver modest revenue growth in 2011. We continue to expand our involvement in certain segments of the defense electronics market and expect to see future growth from sales of our products and services for unmanned air vehicles, ground vehicles and soldier systems.

Risks affecting future performance of our Government Systems business include, but are not limited to:

- potential impact of geopolitical and economic events
- overall funding and prioritization of the U.S. and non-U.S. defense budgets
- delayed or reduced funding for programs we have won
- our ability to win new business, successfully develop products and execute on programs pursuant to contractual requirements

We expect Government Systems sales to increase by approximately 2 percent in 2011 compared to 2010. Growth areas are expected to be as follows:

- rotary wing platform avionics
- electronic systems integration
- simulation and training systems
- Micro-Defense Advanced GPS Receiver (DAGR) products
- surface communication equipment programs

Growth in the above areas is likely to be partially offset by expected declines in the following:

- KC-135 Global Air Traffic Management (GATM) program
- reduced shipments of display and communications equipment for fighter jet platforms
- Joint Tactical Radio System (JTRS) programs as it transitions from development to low rate initial production
- lower volume following initial deliveries on an electronic system integration program for the California Highway Patrol
- reduced production rates for legacy global-positioning-system (GPS) products

We project Government Systems 2011 segment operating margins will be comparable to the 21.2 percent segment operating margin reported in 2010 as expected increases in employee incentive compensation expenses are expected to be offset by a decrease in defined benefit pension plan expenses as discussed in the Retirement Plans section below.

For additional disclosure on Government Systems segment results see Note 23 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

Government Systems Sales

The following table represents Government Systems sales by product category:

(dollars in millions)	2010	2009	2008
Airborne solutions	$1,852	$1,761	$1,662
Surface solutions	1,009	818	704
Total	$2,861	$2,579	$2,366
Percent increase	11%	9%	

Government Systems Sales for 2010 compared to 2009

Airborne solutions sales increased $91 million, or 5 percent, in 2010 compared to 2009, primarily due to the following:

- a $66 million increase in tanker / transport and special mission program revenues, due primarily to the combined impact of recent non-U.S. program wins to upgrade fixed-wing aircraft and higher development revenues on KC-135 programs
- a $40 million increase comprised of higher sales from deliveries of satellite radio units for certain mission system programs, increased effort on a secure network infrastructure upgrade program and higher simulation and training revenues from deliveries of visual display systems
- incremental sales from the November 2008 SEOS acquisition contributed $5 million, or less than 1 percentage point of revenue growth
- the above items were partially offset by a $27 million reduction in sales of display and communications equipment for fighter jets due to the wind-down of several programs

Surface solutions sales increased $191 million, or 23 percent, in 2010 compared to 2009, primarily due to the following:

- incremental sales from the May 2009 DataPath acquisition contributed $172 million, or 21 percentage points of revenue growth
- organic sales increased $19 million, or 2 percent, primarily due to $54 million of higher revenue from initial deliveries on a vehicle electronics integration program, partially offset by $36 million of lower revenue from GPS products as production rates were reduced in accordance with U.S. Department of Defense fielding requirements

Government Systems Sales for 2009 compared to 2008

Airborne solutions sales increased $99 million, or 6 percent, in 2009 compared to 2008, primarily due to the following:

- a $53 million increase in simulation and training program revenues, primarily for the E-2 Hawkeye aircraft and Blackhawk helicopter
- incremental sales from the April 2008 acquisition of Athena and the November 2008 acquisition of SEOS contributed a total of $27 million, or 2 percentage points of revenue growth
- a $23 million increase in development program revenues on the CRIIS program
- the above items were partially offset by a $19 million decrease in international C-130 upgrade program revenues

Surface solutions sales increased $114 million, or 16 percent, in 2009 compared to 2008, primarily due to the following:

- incremental sales from the May 2009 DataPath acquisition contributed $84 million, or 12 percentage points of revenue growth
- a $21 million increase from the JPALS development program
- a $17 million increase from a non-U.S. fixed-site radio upgrade program
- the above items were partially offset by a $20 million decrease in DAGR program revenues

Government Systems Segment Operating Earnings

(dollars in millions)	2010	2009	2008
Segment operating earnings	$ 606	$ 602	$ 486
Percent of sales	21.2%	23.3%	20.5%

Government Systems Operating Earnings for 2010 compared to 2009

Government Systems operating earnings were $606 million, or 21.2 percent of sales, for 2010 compared to operating earnings of $602 million, or 23.3 percent of sales, for 2009. The $4 million increase in Government Systems operating earnings was primarily due to the following:

- the $282 million increase in sales volume discussed in the Government Systems Sales section above resulted in a $219 million increase to costs and incremental operating earnings of $63 million. The higher costs primarily resulted from acquisitions and the vehicle electronics integration program discussed in the Government Systems Sales section above
- a $14 million benefit to operating earnings resulted from lower warranty expense. The reduction in warranty expense was primarily due to the combined impact of a favorable adjustment recorded in 2010 to reduce warranty reserves for certain tanker transport aircraft programs and the absence of unfavorable charges which occurred in 2009 related to retrofits of fielded product. During 2010, net warranty expense for the Government Systems segment was $1 million compared to $15 million during 2009
- a $62 million reduction in operating earnings attributable to the combined impact of a $44 million increase in employee incentive compensation costs and an $18 million increase in pension expense as discussed in the Cost of Sales section above. For 2010, employee incentive compensation costs and defined benefit pension expense were $41 million and $8 million, respectively. For 2009, employee incentive compensation and defined benefit pension income benefited operating earnings by $3 million and $10 million, respectively
- an $11 million reduction in operating earnings related to higher company-funded R&D expense, as explained in the Cost of Sales section above

The decline in Government Systems operating earnings as a percent of sales during 2010 compared to 2009 was primarily due to higher employee incentive compensation, pension and company-funded R&D expenses explained above and lower margin acquisition revenues, partially offset by the reduction in warranty expense.

Government Systems Operating Earnings for 2009 compared to 2008

Government Systems operating earnings were $602 million, or 23.3 percent of sales, for 2009 compared to operating earnings of $486 million, or 20.5 percent of sales, for 2008. The $116 million increase in Government Systems operating earnings was primarily due to the following:

- the $213 million increase in sales volume discussed in the Government Systems Sales section above resulted in a $161 million increase to costs and incremental operating earnings of $52 million. The higher costs primarily resulted from acquisitions and the simulation and training programs discussed in the Government Systems Sales section above
- a $70 million benefit to operating earnings resulted from lower employee incentive compensation and pension costs discussed in the Cost of Sales section above. For 2009, employee incentive compensation and defined benefit pension income benefited operating earnings by $3 million and $10 million, respectively. For 2008, employee incentive compensation costs were $61 million and defined benefit pension income was $4 million
- a $6 million reduction in operating earnings related to higher company-funded R&D expense, as explained in the Cost of Sales section above

The increase in Government Systems operating earnings as a percent of sales during 2009 compared to 2008 was primarily due to the lower employee incentive compensation and pension expenses explained above.

Commercial Systems

Overview and Outlook

Our Commercial Systems business supplies aviation electronics systems, products and services to customers located throughout the world. The customer base is comprised of OEMs of commercial air transport, business and regional aircraft, commercial airlines and fractional and other business aircraft operators. The near and long-term performance of our Commercial Systems business is impacted by general worldwide economic health, commercial airline flight hours, the financial condition of airlines worldwide as well as corporate profits.

We are experiencing diverging trends in the commercial markets that we serve. The strength of backlog and projected recovery of aircraft orders has prompted an increase in production rates by our air transport OEM customers. These increased rates are a positive sign that airlines expect to see continued favorable traffic trends as we move into 2011. Conversely, the market for new business and regional jets has remained stressed on weak orders and uncertainty relative to macroeconomic indicators. Thus we expect deliveries of business and regional jets in 2011 to be relatively flat as compared to 2010. We expect a favorable commercial aftermarket environment due to continued increases in passenger traffic and airline capacity. Additionally, stronger airline profitability is expected to drive significant increases in demand for our retrofit and spare products.

Risks to the Commercial Systems market include, among other things:

- turbulence in global economic and financial markets could continue to have a significant impact on demand for air travel, airline demand for new aircraft and the availability of financing for new aircraft
- occurrence of an unexpected geopolitical or health pandemic event that could have a significant impact on demand for air travel and airline demand for new aircraft
- potential negative impact that fuel prices could have on the profitability of airline and other aircraft operator customers

- our ability to develop products and execute on programs pursuant to contractual requirements
- development and market acceptance of our products and systems
- continued pressure on corporate profits

We expect Commercial Systems sales to increase by 10 percent in 2011 compared to 2010 primarily due to the following:

- sales to air transport aircraft OEMs are expected to increase approximately 10 percent as a result of the entry into service and ramp-up in production of Boeing's 787 and planned production rate increases of Airbus' A320
- sales to business and regional jet aircraft OEMs are projected to increase in the low teens due to the introduction of our avionics on Bombardier Global aircraft and a full year of production of the Cessna CJ-4
- excluding Wide-body IFE service and support activities, air transport aftermarket are expected to experience approximately 10 percent revenue growth due to continued increases in passenger traffic, airlines bringing in additional capacity and stronger airline profitability
- business and regional jet aftermarket revenues are expected to increase in the mid teens as a result of continued improvement in aircraft utilization and demand for retrofit products
- the above items are expected to be partially offset by an estimated reduction of $20 million in sales of Wide-body IFE products and systems due to our decision in 2005 to cease investing in this product area. Sales related to Wide-body IFE services are expected to decline an additional $10 million as customers continue to retire older aircraft or replace their IFE systems

We project Commercial Systems 2011 operating margins will be higher than the 16.2 percent segment operating margins reported in 2010, due primarily to the forecasted increase in sales volumes. Anticipated increases in employee incentive compensation expense are expected to be largely offset by a decrease in defined benefit pension plan expenses as discussed in the Retirement Plans section below.

For additional disclosure on Commercial Systems segment results see Note 23 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

Commercial Systems Sales

The following table represents Commercial Systems sales by product category:

(dollars in millions)	2010	2009	2008
Air transport aviation electronics:			
Original equipment	$ 439	$ 365	$ 464
Aftermarket	509	536	651
Wide-body in-flight entertainment products	50	85	142
Total air transport aviation electronics	998	986	1,257
Business and regional aviation electronics:			
Original equipment	466	605	805
Aftermarket	340	300	341
Total business and regional aviation electronics	806	905	1,146
Total	$1,804	$1,891	$2,403
Percent decrease	(5)%	(21)%	

Commercial Systems Sales for 2010 compared to 2009

Total air transport aviation electronics sales increased $12 million, or 1 percent, in 2010 compared to 2009, primarily due to the following:

- air transport OEM sales increased $74 million, or 20 percent, primarily from higher sales to Boeing across multiple platforms as sales in the prior year were adversely impacted by Boeing's labor strike and resulting inventory rationalization
- air transport aftermarket sales decreased $27 million, or 5 percent, due primarily to a $30 million reduction in aftermarket hardware sales driven by lower retrofits and spares
- Wide-body IFE decreased $35 million, or 41 percent. Wide-body IFE relates to sales of twin-aisle IFE products and systems to customers in the air transport aviation electronics market. In September 2005 we announced our strategic decision to shift research and development resources away from traditional IFE systems for next generation wide-body aircraft. We continue to execute on Wide-body IFE contracts and plan to support existing customers, which includes on-going service and support activities. Sales related to Wide-body IFE service and support activities are included in the air transport aviation electronics aftermarket

Total business and regional aviation electronics sales decreased $99 million, or 11 percent, in 2010 compared to 2009, primarily due to the following:

- business jet OEM sales decreased $127 million, or 27 percent, primarily due to lower business jet OEM production rates
- regional jet OEM sales decreased $12 million, or 10 percent, primarily due to depressed regional jet OEM production rates at Bombardier, partially offset by higher customer-funded development programs
- incremental revenue from the Air Routing acquisition contributed $28 million to business and regional aviation electronics aftermarket sales
- organic business and regional aftermarket sales increased $12 million, or 4 percent, primarily due to a $9 million increase in service revenues from improved aircraft utilization

Commercial Systems Sales for 2009 compared to 2008

Total air transport aviation electronics sales decreased $271 million, or 22 percent, in 2009 compared to 2008, primarily due to the following:

- air transport aftermarket sales decreased $115 million, or 18 percent, due primarily to a $64 million reduction in aftermarket hardware sales and a $51 million decrease in service and support revenues as airlines reduced capacity and deferred discretionary upgrade and retrofit programs due to the overall weakness in the economic environment
- air transport OEM sales decreased $99 million, or 21 percent, driven by a $66 million reduction in sales to Boeing resulting primarily from the adverse impact of Boeing's 2009 labor strike and lower Boeing 787 program-related revenue
- Wide-body IFE decreased $57 million, or 40 percent

Total business and regional aviation electronics sales decreased $241 million, or 21 percent, in 2009 compared to 2008, primarily due to the following:

- business jet OEM sales decreased $188 million, or 28 percent, primarily due to depressed business jet OEM production rates

- business and regional aftermarket sales decreased $41 million, or 12 percent, due to a $22 million reduction in hardware revenue and a $19 million reduction in service and support sales resulting from decreases in business aircraft utilization
- regional jet OEM sales decreased $12 million, or 9 percent, as a $22 million decrease in sales for a Chinese turbo-prop regional aircraft was partially offset by higher customer-funded development revenue on new programs

Commercial Systems Segment Operating Earnings

(dollars in millions)	2010	2009	2008
Segment operating earnings	$ 293	$ 353	$ 560
Percent of sales	16.2%	18.7%	23.3%

Commercial Systems Operating Earnings for 2010 compared to 2009

Commercial Systems operating earnings decreased $60 million, or 17 percent, for 2010 compared to 2009, primarily due to the following:

- the $87 million reduction in sales volume explained in the Commercial Systems Sales section above resulted in a $39 million decrease to operating earnings and a $48 million decrease to costs
- a $42 million reduction in operating earnings attributable to the combined impact of a $29 million increase in employee incentive compensation costs and a $13 million increase in pension expense as discussed in the Cost of Sales section above. For 2010, employee incentive compensation costs and defined benefit pension expenses were $26 million and $5 million, respectively. For 2009, employee incentive compensation and defined benefit pension income benefited operating earnings by $3 million and $8 million, respectively
- a $21 million benefit to operating earnings due to lower company-funded R&D expense, as explained in the Cost of Sales section above

The decline in Commercial Systems operating earnings as a percent of sales during 2010 compared to 2009 was primarily due to the lower sales volume and higher employee incentive compensation and pension expenses, partially offset by the reduction in company-funded R&D expenses noted above and lower SG&A from headcount reductions and other cost savings.

Commercial Systems Operating Earnings for 2009 compared to 2008

Commercial Systems operating earnings decreased $207 million, or 37 percent, in 2009 compared to 2008, primarily due to the following:

- the $512 million reduction in sales volume explained in the Commercial Systems Sales section above resulted in a $294 million decrease to operating earnings and a $218 million decrease to costs
- a $17 million decrease to operating earnings resulting from the absence of certain favorable adjustments related to contract option exercises and royalty income which both benefited 2008
- a $58 million benefit to operating earnings resulting from lower employee incentive compensation and pension costs discussed in the Cost of Sales section above. For 2009, employee incentive compensation costs and defined benefit pension income benefited operating earnings by $3 million and $8 million, respectively. For 2008, employee incentive

compensation costs were $51 million and defined benefit pension income benefited operating earnings by $4 million

- a $46 million benefit to operating earnings due to lower company-funded R&D expense, as explained in the Cost of Sales section above

The decline in Commercial Systems operating earnings as a percent of sales during 2009 compared to 2008 was primarily due to lower sales volume and the absence of certain favorable adjustments related to contract option exercises and royalty income, partially offset by the reduction in employee incentive compensation and pension costs and reduced company-funded R&D expenses as noted above.

General Corporate, Net

(in millions)	2010	2009	2008
General corporate, net	$54	$31	$53

General corporate, net expense increased $23 million during 2010 as compared to 2009 primarily due to the combined impact of a $6 million increase in employee incentive compensation and a $13 million increase in defined benefit pension expenses as discussed in the Cost of Sales section above. For 2010, employee incentive compensation and defined benefit pension expenses were $5 million and $13 million, respectively. For 2009, employee incentive compensation resulted in a $1 million benefit to general corporate, net while pension expense was zero.

General corporate, net expense decreased $22 million in 2009 compared to 2008. The decrease was primarily attributable to the combined impact of a $13 million reduction in employee incentive compensation and a $5 million reduction in defined benefit pension expenses as discussed in the Cost of Sales section above. For 2009, employee incentive compensation resulted in a $1 million benefit to general corporate, net while pension expense was zero. For 2008, employee incentive compensation and defined benefit pension expenses were $12 million and $5 million, respectively.

Retirement Plans

Net benefit expense (income) for pension benefits and other retirement benefits is as follows:

(in millions)	2010	2009	2008
Pension benefits	$26	$(18)	$(3)
Other retirement benefits	5	4	(2)
Net benefit expense (income)	$31	$(14)	$(5)

Pension Benefits

In 2003, we amended our U.S. qualified and non-qualified pension plans covering all salary and hourly employees not covered by collective bargaining agreements to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. Concurrently, we replaced this benefit by supplementing our existing defined contribution savings plan to include an additional Company contribution effective October 1, 2006. The supplemental contribution to our existing defined contribution savings plan was $34 million, $36 million and $37 million for 2010, 2009 and 2008, respectively.

Defined benefit pension expense (income) for the years ended September 30, 2010, 2009 and 2008 was $26 million, $(18) million and $(3) million, respectively. The higher pension expense in 2010 compared to 2009 was primarily due to the unfavorable impact of a decrease in the discount rate used to measure pension expense from 7.60 percent in 2009 to 5.47 percent in 2010. The higher pension income in 2009

compared to 2008 was primarily due to the favorable impact of an increase in the discount rate that was used to measure pension expense from 6.60 percent in 2008 to 7.60 percent in 2009.

During 2010, the funded status of our pension plans declined from a deficit of $1,040 at September 30, 2009 to a deficit of $1,185 million at September 30, 2010, primarily due to a decrease in the discount rate used to measure our U.S. pension obligations from 5.47 percent at September 30, 2009 to 4.85 percent at September 30, 2010, partially offset by an increase in plan assets driven by improved market returns in 2010. During 2009, the funded status of our pension plans declined from a deficit of $424 million at September 30, 2008 to a deficit of $1,040 million at September 30, 2009, primarily due to a decrease in the discount rate used to measure our U.S. pension obligations from 7.60 percent at September 30, 2008 to 5.47 percent at September 30, 2009.

We expect defined benefit pension income of $16 million in 2011, compared to $26 million of pension expense in 2010. The expected $42 million reduction in pension expense from 2010 to 2011 is primarily due to a change in the period of time over which actuarial gains and losses are amortized as explained in further detail in Note 11 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

Our objective with respect to the funding of our pension plans is to provide adequate assets for the payment of future benefits. Pursuant to this objective, we will fund our pension plans as required by governmental regulations and may consider discretionary contributions as conditions warrant. We believe our strong financial position continues to provide us the opportunity to make contributions to our pension fund without inhibiting our ability to pursue strategic investments.

We plan to contribute $100 million to our U.S. qualified pension plan in 2011, which we anticipate will fully satisfy the minimum statutory funding requirements for 2011. Any additional future contributions necessary to satisfy the minimum statutory funding requirements are dependent upon actual plan asset returns, interest rates and any changes to U.S. pension funding legislation. We may elect to make additional discretionary contributions during 2011 to further improve the funded status of this plan. Contributions to our non-U.S. plans and our U.S. non-qualified plan are expected to total $13 million in 2011.

Other Retirement Benefits

We have historically provided retiree medical and life insurance benefits to substantially all of our employees. We have undertaken two major actions over the past number of years with respect to these benefits that have lowered both the current and future costs of providing these benefits:

- in July of 2002, the pre-65 and post-65 retiree medical plans were amended to establish a fixed Company contribution. Additional premium contributions will be required from participants for all costs in excess of this fixed contribution amount. This amendment eliminated the risk to us related to health care cost escalations for retiree medical benefits going forward as additional contributions will be required from retirees for all costs in excess of our fixed contribution amount
- as a result of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, we amended our retiree medical plans on June 30, 2004 to discontinue post-65 prescription drug coverage effective January 1, 2008. Post-65 retirees have the option of receiving these benefits through Medicare. We believe the Medicare prescription drug benefit is generally better than the benefit that was provided by our discontinued post-65 drug plan

Other retirement benefits expense (income) for the years ended September 30, 2010, 2009 and 2008 was $5 million, $4 million and $(2) million, respectively. Other retirement benefits expense was relatively flat in 2010 compared to 2009. The increase in other retirement benefits expense in 2009

compared to 2008 was primarily due to the completion of favorable amortization for a plan amendment. We expect other retirement benefits expense of approximately $10 million in 2011.

FINANCIAL CONDITION AND LIQUIDITY

Cash Flow Summary

Our ability to generate significant cash flow from operating activities coupled with our expected ability to access the credit markets enables us to execute our growth strategies and return value to our shareowners. During 2010 we made $110 million of pension plan contributions and also made significant cash expenditures aimed at future growth and enhanced shareowner value, as shown below:

- $109 million of capital expenditures
- $91 million related to the acquisition of Air Routing
- $151 million of dividend payments
- $183 million of cash payments for share repurchases

Operating Activities

(in millions)	2010	2009	2008
Cash provided by operating activities	$711	$633	$620

The $78 million increase in cash provided by operating activities in 2010 compared to 2009 was primarily due to the following:

- payments for incentive pay decreased $113 million in 2010 compared to 2009. Incentive pay is expensed in the year it is incurred and paid in the first fiscal quarter of the following year. During 2009, $113 million was paid for employee incentive pay costs incurred during 2008. For the full year 2009, no incentive pay costs were incurred; accordingly, there was no 2010 payment for incentive pay
- cash receipts from customers increased $58 million to $4,587 million in 2010 compared to $4,529 million in 2009, primarily due to the higher sales volume in 2010 as discussed in the Results of Operations section above and higher advances from government related contracts for financing of inventory
- payments for income taxes decreased $32 million to $125 million in 2010 compared to $157 million in 2009 primarily due to lower estimated taxable income in 2010
- pension contributions decreased $29 million in 2010 compared to 2009
- the above items were partially offset by a $182 million increase in payments for inventory and other operating costs to $3,641 million in 2010 compared to $3,459 million in 2009. The increase was primarily due to increased costs associated with the higher sales volume in 2010 discussed in the Results of Operations section above and inventory purchases for anticipated production volume

The $13 million increase in cash provided by operating activities in 2009 compared to 2008 was primarily due to the following:

- payments for inventory and other operating costs decreased $251 million to $3,459 million in 2009 compared to $3,710 million in 2008. The decrease was primarily due to decreased costs associated with the lower sales volume in 2009 discussed in the Results of Operations section above

- payments for income taxes decreased $111 million to $157 million in 2009 compared to $268 million in 2008 primarily due to lower estimated taxable income in 2009
- the above items were partially offset by a decrease in cash receipts from customers of $201 million to $4,529 million in 2009 compared to $4,730 million in 2008, primarily due to the lower sales volume in 2009 as discussed in the Results of Operations section above and higher advances from government related contracts for financing of inventory
- finally, pension contributions increased $125 million in 2009 compared to 2008

In 2011 cash provided by operating activities is expected to be in the range of $650 to $750 million. The projected range of cash provided by operating activities accommodates a $100 million expected contribution to our U.S. qualified defined benefit pension plan, a projected $110 million increase in pre-production engineering costs and a $72 million anticipated increase in employee incentive compensation payments.

Investing Activities

(in millions)	**2010**	**2009**	**2008**
Cash used for investing activities	$(232)	$(302)	$(284)

The $70 million reduction in cash used for investing activities in 2010 compared to 2009 was primarily due to the following:

- in 2010 we acquired Air Routing for $91 million compared to the 2009 acquisitions of DataPath and SEOS for $146 million
- a $44 million reduction in property additions in 2010 compared to 2009
- the above items were partially offset by $21 million of short-term investments purchased in 2010 at a non-U.S. subsidiary

The $18 million increase in cash used for investing activities in 2009 as compared to 2008 is primarily due to the following:

- in 2009 we acquired DataPath and SEOS for $146 million compared to the 2008 acquisition of Athena for $107 million
- the above item was partially offset by an $18 million reduction in property additions in 2009 compared to 2008

Financing Activities

(in millions)	**2010**	**2009**	**2008**
Cash used for financing activities	$(279)	$(275)	$(393)

The $4 million increase in cash used for financing activities in 2010 compared to 2009 was primarily due to the following:

- cash repurchases of common stock increased $30 million to $183 million in 2010 from $153 million in 2009
- the above item was mostly offset by changes in other financing activities, including higher cash proceeds and tax benefits from stock option exercises

The $118 million decrease in cash used for financing activities in 2009 compared to 2008 was primarily due to the following:

- cash repurchases of common stock decreased $423 million to $153 million in 2009 from $576 million in 2008
- net proceeds from borrowings decreased $278 million to $9 million in 2009 from $287 million in 2008
- cash dividends increased $23 million to $152 million in 2009 from $129 million in 2008

Share Repurchase Program
Strong cash flow from operations provided funds for repurchasing our common stock under our share repurchase program as follows:

(in millions, except per share amounts)	2010	2009	2008
Amount of share repurchases	$ 182	$ 156	$ 576
Number of shares repurchased	3.2	3.9	9.0
Weighted average price per share	$57.50	$40.01	$63.76

Approximately $2 million and $3 million of the 2010 and 2009 share repurchases reflected in the table above are included within accounts payable at September 30, 2010 and 2009 and are therefore reflected as a non-cash transaction in our 2010 and 2009 Consolidated Statement of Cash Flows, respectively.

Dividends
We declared and paid cash dividends of $151 million, $152 million and $129 million in 2010, 2009 and 2008, respectively. The increase in cash dividends in 2009 was the result of an increase in the quarterly cash dividend from $0.16 to $0.24 per share beginning with the dividend paid on June 2, 2008. Based on our current dividend policy, we will pay quarterly cash dividends which, on an annual basis, will equal $0.96 per share. We expect to fund dividends using cash generated from operations. The declaration and payment of future dividends is at the sole discretion of the Board of Directors.

Financial Condition and Liquidity

We have historically maintained a financial structure characterized by conservative levels of debt outstanding that enables us sufficient access to credit markets. When combined with our ability to generate strong levels of cash flow from our operations, this capital structure provides the strength and flexibility necessary to pursue strategic growth opportunities and to return value to our shareowners. A comparison of key elements of our financial condition as of September 30, 2010 and 2009 are as follows:

	September 30	
(in millions)	2010	2009
Cash and cash equivalents	$ 435	$ 235
Short-term investments	20	—
Short-term debt	(24)	—
Long-term debt, net	(525)	(532)
Net debt(1)	$ (94)	$ (297)
Total equity	$1,486	$1,295
Debt to total capitalization(2)	27%	29%
Net debt to total capitalization(3)	6%	19%

(1) Calculated as total of short-term and long-term debt, net (Total Debt), less cash and cash equivalents and short-term investments

(2) Calculated as Total Debt divided by the sum of Total Debt plus Total equity

(3) Calculated as Net debt divided by the sum of Net debt plus Total equity

We primarily fund our contractual obligations, capital expenditures, small to medium sized acquisitions, dividends and share repurchases from cash generated from operating activities. Due to the seasonality of cash flows, we supplement our internally generated cash flow from time to time by issuing

short-term commercial paper. Under our commercial paper program, we may sell up to $850 million face amount of unsecured short-term promissory notes in the commercial paper market. The commercial paper notes have maturities of not more than 364 days from the date of issuance. We had no commercial paper borrowings outstanding at September 30, 2010 and 2009.

In the event our access to the commercial paper markets is impaired, we have access to an $850 million Revolving Credit Facility through a network of banks that matures in 2012, with options to further extend the term for up to two one-year periods and/or increase the aggregate principal amount up to $1.2 billion. These options are subject to the approval of the lenders. Our only financial covenant under the Revolving Credit Facility requires that we maintain a consolidated debt to total capitalization ratio of not greater than 60 percent, excluding the accumulated other comprehensive loss equity impact related to defined benefit retirement plans. Our debt to total capitalization ratio at September 30, 2010 based on this financial covenant was 17 percent. We had no borrowings at September 30, 2010 under our Revolving Credit Facility.

In addition, alternative sources of liquidity could include funds available from the issuance of equity securities, debt securities and potential asset securitization strategies. We have a shelf registration statement filed with the Securities and Exchange Commission pursuant to which we can publicly offer and sell securities from time to time. This shelf registration covers an unlimited amount of debt securities, common stock, preferred stock or warrants that may be offered in one or more offerings on terms to be determined at the time of sale. To date, we have not raised capital through the issuance of equity securities as we prefer to use debt financing to lower our overall cost of capital and increase our return on shareowners' equity.

Credit ratings are a significant factor in determining our ability to access short-term and long-term financing as well as the cost of such financing in terms of interest rates. Our strong credit ratings have enabled continued access to both short and long-term credit markets. If our credit ratings were to be adjusted downward by the rating agencies, the implications of such actions could include impairment or elimination of our access to credit markets and an increase in the cost of borrowing. The following is a summary of our credit ratings as of September 30, 2010:

Credit Rating Agency	Short-Term Rating	Long-Term Rating	Outlook
Fitch Ratings	F1	A	Stable
Moody's Investors Service	P-1	A1	Stable
Standard & Poor's	A-1	A	Stable

We were in compliance with all debt covenants at September 30, 2010 and 2009.

Off-balance Sheet Arrangements

As of September 30, 2010, other than operating leases, we had no material off-balance sheet arrangements, including guarantees, retained or contingent interests in assets transferred to unconsolidated entities, derivative instruments indexed to our stock and classified in shareowners' equity on our Consolidated Statement of Financial Position or variable interests in entities that provide financing, liquidity, market risk or credit risk support to our Company.

Contractual Obligations

The following table summarizes certain of our contractual obligations as of September 30, 2010, as well as when these obligations are expected to be satisfied:

	Payments Due by Period				
(in millions)	Total	Less than 1 Year	1 - 3 Years	4 - 5 Years	Thereafter
Long-term debt	$ 500	$ —	$ —	$200	$300
Interest on long-term debt	170	26	50	34	60
Non-cancelable operating leases	235	56	80	49	50
Purchase obligations:					
Purchase orders	1,078	944	122	11	1
Purchase contracts	143	47	74	15	7
Total	$2,126	$1,073	$326	$309	$418

Interest payments under long-term debt obligations exclude the potential effects of the related interest rate swap contracts. See Note 10 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

We lease certain office and manufacturing facilities as well as certain machinery and equipment under various lease contracts with terms that meet the accounting definition of operating leases. Our commitments under these operating leases, in the form of non-cancelable future lease payments, are not reflected as a liability on our Consolidated Statement of Financial Position.

Purchase obligations include purchase orders and purchase contracts. Purchase orders are executed in the normal course of business and may or may not be cancelable. Purchase contracts include agreements with suppliers under which there is a commitment to buy a minimum amount of products or pay a specified amount regardless of actual need. Generally, items represented in purchase obligations are not reflected as liabilities on our Consolidated Statement of Financial Position.

The table excludes obligations with respect to pension and other post-retirement benefit plans (see Note 11 of the ***Notes to Consolidated Financial Statements*** in Item 8 below). We plan to contribute $100 million to our U.S. qualified pension plan in 2011, which will fully satisfy the minimum statutory funding requirements for 2011. Assuming that actual pension plan asset returns are consistent with our expected return of 8.75 percent, interest rates remain constant and there are no additional changes to U.S. pension funding legislation, we expect that we would be required to make contributions to our U.S. qualified pension plan in order to satisfy minimum statutory funding requirements for years beyond 2011 as follows: $175 million in 2012, $205 million in 2013, $137 million in 2014 and $137 million in 2015. Any additional future contributions necessary to satisfy the minimum statutory funding requirements are dependent upon actual plan asset returns, interest rates and potential changes to U.S. pension funding legislation. With the exception of certain bargaining unit plans, payments due under other post-retirement benefit plans are funded as the expenses are incurred.

In addition, the table excludes liabilities for unrecognized tax benefits, which totaled $78 million at September 30, 2010, as we cannot reasonably estimate the ultimate timing of cash settlements to the respective taxing authorities (see Note 16 of the ***Notes to Consolidated Financial Statements*** in Item 8 below).

The following table reflects certain of our commercial commitments as of September 30, 2010:

(in millions)	Amount of Commitment Expiration by Period				
	Total Amount Committed	Less than 1 Year	1 - 3 Years	4 - 5 Years	Thereafter
Letters of credit*	$87	$55	$25	$7	$—

* See Note 19 of the ***Notes to Consolidated Financial Statements*** in Item 8 below for a discussion of letters of credit.

RECENTLY ISSUED ACCOUNTING STANDARDS

For information related to recently issued accounting standards, see Note 2 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

ENVIRONMENTAL

For information related to environmental claims, remediation efforts and related matters, see Note 21 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.

CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates, judgments and assumptions that affect our financial condition and results of operations that are reported in the accompanying consolidated financial statements as well as the related disclosure of assets and liabilities contingent upon future events.

Understanding the critical accounting policies discussed below and related risks is important in evaluating our financial condition and results of operations. We believe the following accounting policies used in the preparation of the consolidated financial statements are critical to our financial condition and results of operations as they involve a significant use of management judgment on matters that are inherently uncertain. If actual results differ significantly from management's estimates, there could be a material effect on our financial condition, results of operations and cash flows. Management regularly discusses the identification and development of these critical accounting policies with the Audit Committee of the Board of Directors.

Accounting for Long-Term Contracts

A substantial portion of our sales to government customers and certain of our sales to commercial customers are made pursuant to long-term contracts requiring development and delivery of products over several years and often contain fixed-price purchase options for additional products. Certain of these contracts are accounted for under the percentage-of-completion method of accounting. Sales and earnings under the percentage-of-completion method are recorded either as products are shipped under the units-of-delivery method (for production effort), or based on the ratio of actual costs incurred to total estimated costs expected to be incurred related to the contract under the cost-to-cost method (for development effort).

The percentage-of-completion method of accounting requires management to estimate the profit margin for each individual contract and to apply that profit margin on a uniform basis as sales are recorded under the contract. The estimation of profit margins requires management to make projections of the total sales to be generated and the total costs that will be incurred under a contract. These projections require management to make numerous assumptions and estimates relating to items such as the complexity of design and related development costs, performance of subcontractors, availability and cost of materials, labor productivity and cost, overhead and capital costs and manufacturing efficiency. These contracts often include purchase options for additional quantities and customer change orders for additional or revised product functionality. Sales and costs related to profitable purchase options are included in our estimates only when the options are exercised while sales and costs related to unprofitable purchase options are included in our estimates when exercise is determined to be probable. Sales related to change orders are included in profit estimates only if they can be reliably estimated and collectability is reasonably assured. Purchase options and change orders are accounted for either as an integral part of the original contract or separately depending upon the nature and value of the item. Anticipated losses on contracts are recognized in full in the period in which losses become probable and estimable.

Estimates of profit margins for contracts are typically reviewed by management on a quarterly basis. Assuming the initial estimates of sales and costs under a contract are accurate, the percentage-of-completion method results in the profit margin being recorded evenly as revenue is recognized under the contract. Changes in these underlying estimates due to revisions in sales and cost estimates, the combining of contracts or the exercise of contract options may result in profit margins being recognized unevenly over a contract as such changes are accounted for on a cumulative basis in the period estimates are revised. Significant changes in estimates related to accounting for long-term contracts may have a material effect on our results of operations in the period in which the revised estimate is made.

Program Investments

We defer certain pre-production engineering costs in Inventories, net and record up-front sales incentives in Intangible Assets (collectively referred to as Program Investments). These Program Investments are amortized over their estimated useful lives, up to a maximum of 15 years. Estimated useful lives are limited to the amount of time we are virtually assured to earn revenues through a contractually enforceable right included in long-term supply arrangements with our customers. This provides the best matching of expense over the related period of benefit. The following provides an overview of the Program Investments:

	September 30	
(in millions)	**2010**	**2009**
Pre-production engineering costs	$320	$240
Up-front sales incentives	142	109
Total Program Investments	$462	$349

We defer the cost of certain pre-production engineering costs incurred during the development phase of an aircraft program in connection with long-term supply arrangements that contain contractual guarantees for reimbursement from customers. These customer guarantees generally take the form of a minimum order quantity with quantified reimbursement amounts in the event the minimum order quantity is not taken by the customer. These costs are deferred in Inventories, net to the extent of the contractual guarantees. Pre-production engineering costs in excess of the contractual guarantee and costs incurred pursuant to supply arrangements that do not contain customer guarantees for

reimbursement are expensed as incurred. These costs are amortized over their estimated useful lives, up to 15 years, as a component of cost of sales.

We also provide up-front sales incentives prior to delivering products or performing services to certain commercial customers in connection with sales contracts. Up-front sales incentives are recorded as a Customer Relationship Intangible Asset and are amortized over their estimated useful lives, up to 15 years. Up-front sales incentives consisting of cash payments or customer account credits are amortized as a reduction of sales whereas incentives consisting of free products are amortized as cost of sales.

Risks inherent in recovering the value of our Program Investments include, but are not limited to, the following:

- changes in market conditions may affect product sales under a program. In particular, the commercial aerospace market has been historically cyclical and subject to downturns during periods of weak economic conditions, which could be prompted or exacerbated by political or other domestic or international events
- bankruptcy or other significant financial difficulties of our customers
- our ability to produce products could be impacted by the performance of subcontractors, the availability of specialized materials and other production risks

We evaluate the carrying amount of Program Investments for recovery at least annually or when potential indicators of impairment exist, such as a change in the estimated number of products to be delivered under a program. No impairment charges related to Program Investments were recorded in 2010, 2009 or 2008. While we believe our Program Investments are recoverable over time, the cancellation of a program by a customer would represent the most significant impairment factor related to Program Investments. Due to the long-term nature of the procurement cycle and the significant investment to bring a program to market in the aerospace and defense industry, we believe the likelihood of a customer abruptly cancelling a program is remote. We also evaluate our amortization of Program Investments quarterly based on our expectation of delivery rates on a program-by-program basis. The impact of changes in expected delivery rates on the Program Investments' amortization is adjusted as needed on a prospective basis. There were no significant changes in the rate of Program Investment amortization in 2010, 2009 and 2008.

Income Taxes

At the end of each quarterly reporting period, we estimate an effective income tax rate that is expected to be applicable for the full fiscal year. The estimate of our effective income tax rate involves significant judgments resulting from uncertainties in the application of complex tax regulations across many jurisdictions, implementation of tax planning strategies and estimates as to the jurisdictions where income is expected to be earned. These estimates may be further complicated by new laws, new interpretations of existing laws and rulings by taxing authorities. Due to the subjectivity and complex nature of these underlying issues, our actual effective income tax rate and related tax liabilities may differ from our initial estimates. Differences between our estimated and actual effective income tax rates and related liabilities are recorded in the period they become known or as our estimates are revised based on additional information. The resulting adjustment to our income tax expense could have a material effect on our results of operations in the period the adjustment is recorded. A one percentage point change in our effective income tax rate would change our annual net income by approximately $8 million.

Deferred tax assets and liabilities are recorded for tax carryforwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. The future realization of our deferred tax assets ultimately depends on our ability

to generate sufficient taxable income of the appropriate character (for example, ordinary income or capital gains) within the carryback and carryforward periods available under the tax law and, to a lesser extent, our ability to execute successful tax planning strategies. Management believes it is more likely than not that the current and long-term deferred tax assets will be realized through the reduction of future taxable income, except for deferred tax assets which have been fully reserved and relate to foreign net operating losses, state R&D credit carryovers and a domestic capital loss carryforward. A change in the ability of our operations to continue to generate future taxable income, or our ability to implement desired tax planning strategies, could affect our ability to realize the future tax deductions underlying our net deferred tax assets, and require us to provide a valuation allowance against our net deferred tax assets. The recognition of a valuation allowance would result in a reduction to net income and if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

As part of the determination of our tax liability, management exercises considerable judgment in evaluating tax positions taken by us in determining the income tax provision and establishes reserves for tax contingencies in accordance with the Income Taxes topic of the FASB Accounting Standards Codification. See Note 16 of the ***Notes to Consolidated Financial Statements*** in Item 8 below for further detail regarding unrecognized tax benefits, deferred taxes and the factors considered in evaluating deferred tax asset realization.

Goodwill

As of September 30, 2010, we had $766 million of goodwill related to various business acquisitions. We perform impairment tests on goodwill on an annual basis during the second quarter of each fiscal year, or on an interim basis if events or circumstances indicate that it is more likely than not that impairment has occurred.

Goodwill is potentially impaired if the carrying value of the reporting unit that contains the goodwill exceeds its estimated fair value. The fair values of our reporting units are determined using a combination of an income approach, which estimates fair value based upon future discounted cash flows, and a market approach, which estimates fair value using market multiples, ratios and valuations of a set of comparable public companies within our industry.

The valuation methodology and underlying financial information that is used to estimate the fair value of our reporting units requires significant judgments to be made by management. These judgments include, but are not limited to, the long-term projections of future financial performance and the selection of appropriate discount rates used to present value future cash flows. Our five-year strategic operating plan serves as the basis for these valuations and represents our best estimate of future business conditions in our industry as well as our ability to compete. Discount rates are determined based upon the weighted average cost of capital for a set of comparable companies adjusted for risks associated with our different operations. Our goodwill impairment tests that were performed in the second quarter of 2010, 2009 and 2008 yielded no impairments. If there were a significant downturn in our business, we could incur a goodwill impairment.

Warranty

Accrued liabilities are recorded on our Consolidated Statement of Financial Position to reflect our contractual obligations relating to warranty commitments to our customers. We provide warranty coverage of various lengths and terms to our customers depending on standard offerings and negotiated contractual agreements. We record an estimate for warranty expense at the time of sale based on historical warranty return rates and repair costs. We believe our primary source of warranty risk relates to extended warranty terms. At September 30, 2010, we have recorded $183 million of warranty liabilities. Should future warranty experience differ materially from our historical experience, we may be

required to record additional warranty liabilities which could have a material adverse effect on our results of operations and cash flows in the period in which these additional liabilities are required.

Pension Benefits

We historically provided retirement benefits to most of our employees in the form of defined benefit pension plans. Accounting standards require the cost of providing these pension plans be measured on an actuarial basis. These accounting standards will generally reduce, but not eliminate, the volatility of pension expense as actuarial gains and losses resulting from both normal year-to-year changes in valuation assumptions and the differences from actual experience are deferred and amortized. The application of these accounting standards requires management to make numerous assumptions and judgments that can significantly affect these measurements. Critical assumptions made by management in performing these actuarial valuations include the selection of discount rates and expectations on the future rate of return on pension plan assets.

Discount rates are used to determine the present value of our pension obligations and also affect the amount of pension expense recorded in any given period. We estimate this discount rate based on the rates of return of high quality, fixed-income investments with maturity dates that reflect the expected time horizon that benefits will be paid (see Note 11 of the ***Notes to Consolidated Financial Statements*** in Item 8 below). Changes in the discount rate could have a material effect on our reported pension obligations and would also impact the related pension expense.

The expected rate of return is our estimate of the long-term earnings rate on our pension plan assets and is based upon both historical long-term actual and expected future investment returns considering the current investment mix of plan assets. Differences between the actual and expected rate of return on plan assets can impact our expense for pension benefits.

Holding all other factors constant, the estimated impact on 2010 pension expense caused by hypothetical changes to key assumptions is as follows:

(in millions) Assumption	Change in Assumption	
	25 Basis Point Increase	25 Basis Point Decrease
Pension obligation discount rate	$4 pension expense decrease	$4 pension expense increase
Expected long-term rate of return on plan assets	$6 pension expense decrease	$6 pension expense increase

Inventory Valuation Reserves

Inventory valuation reserves are recorded in order to report inventories at the lower of cost or market value on our Consolidated Statement of Financial Position. The determination of inventory valuation reserves requires management to make estimates and judgments on the future salability of inventories. Valuation reserves for excess, obsolete and slow-moving inventory are estimated by comparing the inventory levels of individual parts to both future sales forecasts or production requirements and historical usage rates in order to identify inventory that is unlikely to be sold above cost. Other factors that management considers in determining these reserves include overall market conditions and other inventory management initiatives. Management can generally react to reduce the likelihood of severe excess and slow-moving inventory issues by changing purchasing behavior, although abrupt changes in market conditions can limit our ability to react quickly.

Management believes its primary source of risk for excess and obsolete inventory is derived from life-time buy inventory. Life-time buy inventory consists of inventory that is typically no longer being produced by our vendors but for which we purchase multiple years of supply in order to meet production and service requirements over the life span of a product. Total life-time buy inventory on hand at September 30, 2010 was $95 million.

Excluding pre-production engineering costs and progress payments, we had $838 million of gross inventory on hand at September 30, 2010 with $98 million of inventory valuation reserves. Although management believes these reserves are adequate, any abrupt changes in market conditions may require us to record additional inventory valuation reserves which could have a material adverse effect on our results of operations in the period in which these additional reserves are required. Pre-production engineering costs are discussed in the "Program Investments" section of our Critical Accounting Policies above.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk.*

Interest Rate Risk

In addition to using cash provided by normal operating activities, we utilize a combination of short-term and long-term debt to finance operations. Our operating results and cash flows are exposed to changes in interest rates that could adversely affect the amount of interest expense incurred and paid on debt obligations in any given period. In addition, changes in interest rates can affect the fair value of our debt obligations. Such changes in fair value are only relevant to the extent these debt obligations are settled prior to maturity. We manage our exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt and when considered necessary, we may employ financial instruments in the form of interest rate swaps to help meet this objective.

At September 30, 2010, we had $200 million of 4.75 percent fixed rate long-term debt obligations outstanding with a carrying value of $200 million and a fair value of $222 million. In 2004 we converted $100 million of this fixed rate debt to floating rate debt bearing interest at six-month LIBOR less .075 percent by executing "receive fixed, pay variable" interest rate swap contracts. At September 30, 2010, we also had $300 million of 5.25 percent fixed rate long-term debt obligations outstanding with a carrying value of $299 million and a fair value of $336 million. In January 2010 we converted $150 million of this fixed rate debt to floating rate debt based on six-month LIBOR plus 1.235 percent by executing "receive fixed, pay variable" interest rate swap contracts.

A hypothetical 10 percent increase or decrease in average market interest rates would have decreased or increased the fair value of our long-term fixed rate debt, exclusive of the effects of the interest rate swap contracts, by $3 million and $3 million, respectively. The fair value of the $250 million notional value of interest rate swap contracts was a $26 million asset at September 30, 2010. A hypothetical 10 percent increase or decrease in average market interest rates would decrease or increase the fair value of our interest rate swap contracts by $4 million and $4 million, respectively. At September 30, 2010, we also had $24 million of variable rate short-term debt outstanding. Our results of operations are affected by changes in market interest rates related to variable rate debt. Inclusive of the effect of the interest rate swaps, a hypothetical 10 percent increase or decrease in average market interest rates would not have a material effect on our operations or cash flows. For more information related to outstanding debt obligations and derivative financial instruments, see Notes 10, 17 and 18 in the ***Notes to Consolidated Financial Statements*** in Item 8 below.

Foreign Currency Risk

We transact business in various foreign currencies which subjects our cash flows and earnings to exposure related to changes to foreign currency exchange rates. We attempt to manage this exposure through operational strategies and the use of foreign currency forward exchange contracts (foreign currency contracts). All foreign currency contracts are executed with banks we believe to be creditworthy and are denominated in currencies of major industrial countries. The majority of our non-functional currency firm and anticipated receivables and payables are hedged using foreign currency contracts. It is our policy not to manage exposure to net investments in non-U.S. subsidiaries or enter into derivative financial instruments for speculative purposes. Notional amounts of outstanding foreign currency forward exchange contracts were $404 million and $353 million at September 30, 2010 and 2009, respectively. Notional amounts are stated in U.S. dollar equivalents at spot exchange rates at the respective dates. Principal currencies that are hedged include the European euro, British pound sterling and Japanese yen. The duration of foreign currency contracts is generally five years or less. The net fair value of these foreign currency contracts was a net asset of $1 million and a net liability of $3 million at September 30, 2010 and 2009, respectively. A 10 percent increase or decrease in the value of the U.S. dollar against all currencies would decrease or increase the fair value of our foreign currency contracts by $6 million.

For more information related to outstanding foreign currency forward exchange contracts, see Notes 17 and 18 of the ***Notes to Consolidated Financial Statements*** in Item 8 below.