

Item 8. *Financial Statements and Supplementary Data.*

MANAGEMENT’S RESPONSIBILITY FOR FINANCIAL STATEMENTS

We, the management team of Rockwell Collins, are responsible for the preparation, integrity and objectivity of the financial statements and other financial information we have presented in this report. The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, applying our estimates and judgments.

Deloitte & Touche LLP, our independent registered public accounting firm, is retained to audit our financial statements. Their accompanying report is based on audits conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), which include the consideration of our internal controls to determine the nature, timing and extent of audit tests to be applied.

Our Board of Directors exercises its responsibility for these financial statements through its Audit Committee, which consists entirely of independent, non-management Board members. The Audit Committee meets regularly with the independent registered public accounting firm and with the Company’s internal auditors, both privately and with management present, to review accounting, auditing, internal control and financial reporting matters.

/s/ Clayton M. Jones

Clayton M. Jones
Chairman, President &
Chief Executive Officer

/s/ Patrick E. Allen

Patrick E. Allen
Senior Vice President &
Chief Financial Officer

**MANAGEMENT’S REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Rockwell Collins’ internal control over financial reporting is a process designed, under the supervision of the Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Rockwell Collins; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of Rockwell Collins’ management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Rockwell Collins’ internal control over financial reporting as of October 2, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework*. Based on this assessment, management determined that Rockwell Collins maintained effective internal control over financial reporting as of October 2, 2009.

Rockwell Collins’ internal control over financial reporting as of October 2, 2009 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein.

/s/ Clayton M. Jones

Clayton M. Jones
Chairman, President &
Chief Executive Officer

/s/ Patrick E. Allen

Patrick E. Allen
Senior Vice President &
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareowners of
Rockwell Collins, Inc.

We have audited the internal control over financial reporting of Rockwell Collins, Inc. and subsidiaries (the “Company”) as of October 2, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of October 2, 2009, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended October 2, 2009 of the Company and our report dated November 23, 2009 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota
November 23, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareowners of
Rockwell Collins, Inc.

We have audited the accompanying consolidated statements of financial position of Rockwell Collins, Inc. and subsidiaries (the “Company”) as of October 2, 2009 and October 3, 2008, and the related consolidated statements of operations, cash flows, and shareowners’ equity and comprehensive income for each of the three years in the period ended October 2, 2009. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of October 2, 2009 and October 3, 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended October 2, 2009, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the consolidated financial statements, as of the beginning of fiscal 2007 the Company changed its measurement date for its defined benefit plans and as of September 28, 2007 the Company changed its method of accounting for the funded status of its defined benefit plans.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of October 2, 2009, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 23, 2009 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota
November 23, 2009

ROCKWELL COLLINS, INC.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(In Millions, Except Per Share Amounts)

	September 30	
	2009	2008
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 235	\$ 175
Receivables, net	913	950
Inventories, net	943	970
Current deferred income taxes	154	139
Other current assets	117	104
Total current assets	2,362	2,338
Property	719	680
Goodwill	695	609
Intangible Assets	269	198
Long-term Deferred Income Taxes	371	144
Other Assets	229	175
TOTAL ASSETS	<u>\$ 4,645</u>	<u>\$ 4,144</u>
LIABILITIES AND SHAREOWNERS' EQUITY		
Current Liabilities:		
Short-term debt	\$ —	\$ 287
Accounts payable	366	419
Compensation and benefits	199	295
Advance payments from customers	349	308
Product warranty costs	217	226
Other current liabilities	228	205
Total current liabilities	1,359	1,740
Long-term Debt, net	532	228
Retirement Benefits	1,254	600
Other Liabilities	208	168
Shareowners' Equity:		
Common stock (\$0.01 par value; shares authorized: 1,000; shares issued: 183.8)	2	2
Additional paid-in capital	1,395	1,378
Retained earnings	2,444	2,058
Accumulated other comprehensive loss	(1,080)	(578)
Common stock in treasury, at cost (shares held: 2009, 26.7; 2008, 25.2)	(1,469)	(1,452)
Total shareowners' equity	1,292	1,408
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	<u>\$ 4,645</u>	<u>\$ 4,144</u>

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.

CONSOLIDATED STATEMENT OF OPERATIONS
(In Millions, Except Per Share Amounts)

	Year Ended September 30		
	2009	2008	2007
Sales:			
Product sales	\$4,049	\$4,337	\$4,007
Service sales	421	432	408
Total sales	4,470	4,769	4,415
Costs, expenses and other:			
Product cost of sales	2,863	3,041	2,819
Service cost of sales	287	293	273
Selling, general and administrative expenses	458	485	482
Interest expense	18	21	13
Other income, net	(23)	(24)	(15)
Total costs, expenses and other.	3,603	3,816	3,572
Income before income taxes	867	953	843
Income tax provision	273	275	258
Net income	\$ 594	\$ 678	\$ 585
Earnings per share:			
Basic	\$ 3.76	\$ 4.22	\$ 3.50
Diluted	\$ 3.73	\$ 4.16	\$ 3.45
Weighted average common shares:			
Basic	157.8	160.8	167.1
Diluted	159.4	162.9	169.7
Cash dividends per share	\$ 0.96	\$ 0.80	\$ 0.64

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS
(In Millions)

	Year Ended September 30		
	2009	2008	2007
Operating Activities:			
Net income	\$ 594	\$ 678	\$ 585
Adjustments to arrive at cash provided by operating activities:			
Restructuring and asset impairment charge (adjustment)	21	—	(5)
Depreciation	114	106	96
Amortization of intangible assets	30	23	22
Stock-based compensation	18	19	17
Compensation and benefits paid in common stock	63	65	58
Tax benefit from stock-based compensation	2	8	34
Excess tax benefit from stock-based compensation	(2)	(8)	(33)
Deferred income taxes	88	73	43
Pension plan contributions	(139)	(14)	(90)
Changes in assets and liabilities, excluding effects of acquisitions and foreign currency adjustments:			
Receivables	39	(68)	(126)
Inventories	12	(176)	(128)
Accounts payable	(63)	26	55
Compensation and benefits	(122)	(10)	41
Advance payments from customers	15	4	61
Income taxes	—	(67)	(23)
Other assets and liabilities	(37)	(39)	—
Cash Provided by Operating Activities	633	620	607
Investing Activities:			
Property additions	(153)	(171)	(125)
Acquisition of businesses, net of cash acquired	(146)	(105)	(32)
Acquisition of intangible assets	(2)	(8)	(8)
Proceeds from settlement of discontinued license agreement	—	—	14
Proceeds from the disposition of property	—	1	—
Other investing activities	(1)	(1)	(2)
Cash Used for Investing Activities	(302)	(284)	(153)
Financing Activities:			
Purchases of treasury stock	(153)	(576)	(333)
Cash dividends	(152)	(129)	(107)
(Decrease) increase in short-term borrowings	(287)	287	—
Increase (decrease) in long-term borrowings	296	—	(27)
Proceeds from the exercise of stock options	19	17	61
Excess tax benefit from stock-based compensation	2	8	33
Cash Used for Financing Activities	(275)	(393)	(373)
Effect of exchange rate changes on cash and cash equivalents	4	1	6
Net Change in Cash and Cash Equivalents	60	(56)	87
Cash and Cash Equivalents at Beginning of Year	175	231	144
Cash and Cash Equivalents at End of Year	\$ 235	\$ 175	\$ 231

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.

**CONSOLIDATED STATEMENT OF SHAREOWNERS' EQUITY
AND COMPREHENSIVE INCOME**

(In Millions)

	Year Ended September 30		
	2009	2008	2007
Common Stock			
Beginning and ending balance	\$ 2	\$ 2	\$ 2
Additional Paid-In Capital			
Beginning balance	1,378	1,353	1,305
Tax benefit from stock-based compensation	2	8	33
Stock-based compensation	18	19	17
Other	(3)	(2)	(2)
Ending balance	1,395	1,378	1,353
Retained Earnings			
Beginning balance	2,058	1,533	1,105
Net income	594	678	585
Cash dividends	(152)	(129)	(107)
Shares issued under stock option and benefit plans	(56)	(19)	(45)
Defined benefit plans remeasurement adjustment	—	—	(5)
Change in accounting for tax contingencies	—	(5)	—
Ending balance	2,444	2,058	1,533
Accumulated Other Comprehensive Income (Loss)			
Beginning balance	(578)	(336)	(393)
Minimum pension liability adjustment	—	—	369
Defined benefit retirement plan recognition adjustment	—	—	(329)
Pension and other retirement benefit adjustment	(516)	(229)	—
Currency translation gain (loss)	14	(15)	19
Foreign currency cash flow hedge adjustment	—	2	(2)
Ending balance	(1,080)	(578)	(336)
Common Stock in Treasury			
Beginning balance	(1,452)	(979)	(813)
Share repurchases	(156)	(576)	(333)
Shares issued from treasury	139	103	167
Ending balance	(1,469)	(1,452)	(979)
Total Shareowners' Equity	\$ 1,292	\$ 1,408	\$ 1,573
Comprehensive Income			
Net income	\$ 594	\$ 678	\$ 585
Other comprehensive (loss) income, net of taxes (2009, \$303; 2008, \$132; 2007, \$(216))	(502)	(242)	386
Comprehensive income	\$ 92	\$ 436	\$ 971

See Notes to Consolidated Financial Statements.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business Description and Basis of Presentation

Rockwell Collins, Inc. (the Company or Rockwell Collins) designs, produces and supports communications and aviation electronics for commercial and military customers worldwide.

The Company operates on a 52/53 week fiscal year ending on the Friday closest to September 30. The Company's fiscal year 2009 was a 52 week year ending on October 2, 2009, while fiscal years 2008 and 2007 were 53 and 52 week years, respectively. For ease of presentation, September 30 is utilized consistently throughout these financial statements and notes to represent the fiscal year end date. All date references contained herein relate to the Company's fiscal year unless otherwise stated. Management has evaluated subsequent events through November 23, 2009, the date the Company's fiscal year 2009 Form 10-K was filed with the Securities and Exchange Commission.

2. Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries. The Company's investments in entities it does not control but over which it has the ability to exercise significant influence are accounted for under the equity method and are included in Other Assets. All intercompany transactions are eliminated.

Revenue Recognition

The Company enters into sales arrangements that may provide for multiple deliverables to a customer. The Company identifies all goods and/or services that are to be delivered separately under a sales arrangement and allocates revenue to each deliverable based on relative fair values. Fair values are generally established based on the prices charged when sold separately by the Company. In general, revenues are separated between hardware, engineering services, maintenance services, and installation services. The allocated revenue for each deliverable is then recognized using appropriate revenue recognition methods.

Sales related to long-term contracts requiring development and delivery of products over several years are accounted for under the percentage-of-completion method of accounting in accordance with the Construction-Type and Production-Type Contracts subtopic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification. Sales and earnings under these contracts 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). 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. Sales and costs related to profitable purchase options are included in estimates only when the options are exercised whereas sales and costs related to unprofitable purchase options are included in estimates when exercise is determined to be probable. Sales related to change orders are included in estimates only if they can be reliably estimated and collectability is reasonably assured. Anticipated losses on contracts are recognized in full in the period in which losses become probable and estimable. Changes in estimates of profit or loss on contracts are included in earnings on a cumulative basis in the period the estimate is changed.

Sales related to long-term separately priced product maintenance or warranty contracts are accounted for based on the terms of the underlying agreements. Certain contracts are fixed-price contracts with sales recognized ratably over the contractual life, while other contracts have a fixed hourly rate with sales recognized based on actual labor or flight hours incurred. The cost of providing these services is expensed as incurred.

The Company recognizes sales for most other products or services when all of the following criteria are met: an agreement of sale exists, product delivery and acceptance has occurred or services have been rendered, pricing is fixed or determinable, and collection is reasonably assured.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

Research and Development

The Company performs R&D activities relating to the development of new products and the improvement of existing products. Company-funded R&D programs are expensed as incurred and included in cost of sales. Customer-funded R&D expenditures are accounted for as contract costs within cost of sales, and the reimbursement is accounted for as a sale.

Cash and Cash Equivalents

Cash and cash equivalents include time deposits and certificates of deposit with original maturity dates of three months or less.

Allowance for Doubtful Accounts

Allowances are established in order to report receivables at net realizable value on the Company's Consolidated Statement of Financial Position. The determination of these allowances requires management of the Company to make estimates and judgments as to the collectability of customer account balances. These allowances are estimated for customers who are considered credit risks by reviewing the Company's collection experience with those customers as well as evaluating the customers' financial condition. The Company also considers both current and projected economic and market conditions. Special attention is given to accounts with invoices that are past due. Past due is defined as any invoice for which payment has not been received by the due date specified on the billing invoice. The uncollectible portion of receivables is charged against the allowance for doubtful accounts when collection efforts have ceased. Recoveries of receivables previously charged-off are recorded when received.

Inventories

Inventories are stated at the lower of cost or market using costs which approximate the first-in, first-out method, less related progress payments received. Inventoried costs include direct costs of manufacturing, certain engineering costs and allocable overhead costs. The Company regularly compares inventory quantities on hand on a part level basis to estimated forecasts of product demand and production requirements as well as historical usage. Based on these comparisons, management establishes an excess and obsolete inventory reserve on an aggregate basis. Inventory valuation reserves were \$101 million and \$105 million at September 30, 2009 and 2008, respectively.

The Company defers certain pre-production engineering costs during the development phase of an aircraft program in connection with long-term supply arrangements that contain contractual guarantees for reimbursement from customers. Such 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 to the extent of the contractual guarantees and are amortized over their estimated useful lives, up to 15 years, as a component of cost of sales. The estimated useful life is limited to the amount of time the Company is virtually assured to earn revenues through a contractually enforceable right included in long-term supply arrangements with the Company's customers. 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.

Progress Payments

Progress payments relate to both receivables and inventories and represent cash collected from government-related contracts whereby the governments have a legal right of offset related to the receivable or legal title to the work-in-process inventory.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

Property

Property is stated at acquisition cost. Depreciation of property is generally provided using accelerated and straight-line methods over the following estimated useful lives: buildings and improvements, 15 – 40 years; machinery and equipment, 6 – 11 years; information systems software and hardware, 5 – 10 years; and furniture and fixtures 6 – 12 years. Depreciation methods and lives are reviewed periodically with any changes recorded on a prospective basis.

Significant renewals and betterments are capitalized and replaced units are written off. Maintenance and repairs, as well as renewals of minor amounts, are charged to expense in the period incurred. The fair value of liabilities associated with the retirement of property is recorded when there is a legal or contractual requirement to incur such costs and the costs are reasonably estimable. Upon the initial recognition of a contractual or legal liability for an asset retirement obligation, the Company capitalizes the asset retirement cost by increasing the carrying amount of the property by the same amount as the liability. This asset retirement cost is then depreciated over the estimated useful life of the underlying property. The Company did not have any significant asset retirement obligations at September 30, 2009 and 2008.

Goodwill and Intangible Assets

Goodwill and intangible assets generally result from business acquisitions. Business acquisitions are accounted for under the purchase method by assigning the purchase price to tangible and intangible assets acquired and liabilities assumed, including R&D projects which have not yet reached technological feasibility and have no alternative future use (purchased R&D). Assets acquired and liabilities assumed are recorded at their fair values; the fair value of purchased R&D is immediately charged to expense; and the excess of the purchase price over the amounts assigned is recorded as goodwill. Assets acquired and liabilities assumed are allocated to the Company's reporting units based on the Company's integration plans and internal reporting structure. Purchased intangible assets with finite lives are amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized, but reviewed at least annually for impairment.

Customer Incentives

Rockwell Collins provides 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 amortized over the period the Company has received a contractually enforceable right related to the incentives. 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. The net book value of incentives included in Customer Relationship Intangible Assets were \$109 million and \$56 million at September 30, 2009 and 2008, respectively.

Incentives earned by customers based on purchases of Company products or services are recognized as a liability when the related sale is recorded. Incentives consisting of cash payments or customer account credits are recognized as a reduction of sales while incentives consisting of free products and account credits where the customer's use is restricted to future purchases are recognized as cost of sales. The liability for these types of incentives is included in Other Current Liabilities.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment when management plans to dispose of assets or when events or circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. Assets held for disposal are reported at the lower of the carrying amount or fair value less cost to sell. Management determines fair value using a discounted future cash flow analysis or other accepted valuation techniques. Long-lived assets held for use are reviewed for impairment by comparing the carrying amount of an asset to the undiscounted future cash flows expected to be generated by the asset over its remaining useful life. If an

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value. See Note 23 for discussion of asset impairments recorded in 2009.

Goodwill and indefinite-lived intangible assets are tested annually for impairment with more frequent tests performed if indications of impairment exist. The Company's annual impairment testing date is in the second quarter of each fiscal year. Impairment for intangible assets with indefinite lives exists if the carrying value of the intangible asset exceeds its fair value. Goodwill is potentially impaired if the carrying value of a reporting unit exceeds its estimated fair value. Management determines fair value using a discounted future cash flow analysis or other accepted valuation techniques. The Company's annual impairment testing performed in the second quarter of 2009, 2008, and 2007 yielded no impairments of goodwill or indefinite-lived intangible assets.

Advance Payments from Customers

Advance payments from customers represent cash collected from customers in advance of revenue recognition.

Environmental

Liabilities for environmental matters are recorded in the period in which it is probable that an obligation has been incurred and the cost can be reasonably estimated. At environmental sites in which more than one potentially responsible party has been identified, the Company records a liability for its estimated allocable share of costs related to its involvement with the site as well as an estimated allocable share of costs related to the involvement of insolvent or unidentified parties. At environmental sites in which the Company is the only responsible party, the Company records a liability for the total estimated costs of remediation. Costs of future expenditures for environmental remediation obligations do not consider inflation and are not discounted to present values.

Income Taxes

Current tax liabilities and assets are based upon an estimate of taxes payable or refundable in the current year for each of the jurisdictions in which the Company is subject to tax. As part of the determination of its tax liability, management exercises considerable judgment in evaluating tax positions taken by the Company 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. Deferred tax assets and liabilities are recorded for the estimated future tax effects attributable to temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and their respective carrying amounts for income tax purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Derivative Financial Instruments

The Company uses derivative financial instruments in the form of foreign currency forward exchange contracts and interest rate swap contracts for the purpose of minimizing exposure to changes in foreign currency exchange rates on business transactions and interest rates, respectively. The Company's policy is to execute such instruments with banks the Company believes to be creditworthy and not to enter into derivative financial instruments for speculative purposes or to manage exposure for net investments in non-U.S. subsidiaries. These derivative financial instruments do not subject the Company to undue risk as gains and losses on these instruments generally offset gains and losses on the underlying assets, liabilities, or anticipated transactions that are being hedged.

All derivative financial instruments are recorded at fair value in the Consolidated Statement of Financial Position. For a derivative that has not been designated as an accounting hedge, the change in fair value is recognized immediately through earnings. For a derivative that has been designated as an accounting hedge of

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

an existing asset or liability (a fair value hedge), the change in the fair value of both the derivative and underlying asset or liability is recognized immediately through earnings. For a derivative designated as an accounting hedge of an anticipated transaction (a cash flow hedge), the change in the fair value is recorded on the Consolidated Statement of Financial Position in Accumulated Other Comprehensive Loss to the extent the derivative is effective in mitigating the exposure related to the anticipated transaction. The change in the fair value related to the ineffective portion of the hedge, if any, is immediately recognized in earnings. The amount recorded within Accumulated Other Comprehensive Loss is reclassified into earnings in the same period during which the underlying hedged transaction affects earnings. The Company does not exclude any amounts from the measure of effectiveness for both fair value and cash flow hedges.

Use of Estimates

The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Estimates are used in accounting for, among other items, long-term contracts, allowances for doubtful accounts, inventory obsolescence, product warranty cost liabilities, customer incentives, retirement benefits, income taxes, environmental matters, pre-production engineering costs, recoverability of long-lived assets and contingencies. Estimates and assumptions are reviewed periodically and the effects of changes, if any, are reflected in the Consolidated Statement of Operations in the period they are determined.

Concentration of Risks

The Company's products and services are concentrated within the aerospace and defense industries with customers consisting primarily of military and commercial aircraft manufacturers, commercial airlines, and the U.S. and non-U.S. governments. As a result of this industry focus, the Company's current and future financial performance is largely dependent upon the overall economic conditions within these industries. In particular, the commercial aerospace market has been historically cyclical and subject to downturns during periods of weak economic conditions, which could be prompted by or exacerbated by political or other domestic or international events. The defense market may be affected by changes in budget appropriations, procurement policies, political developments both domestically and abroad, and other factors. While management believes the Company's product offerings are well positioned to meet the needs of its customer base, any material deterioration in the economic and environmental factors that impact the aerospace and defense industries could have a material adverse effect on the Company's results of operations, financial position or cash flows.

In addition to the overall business risks associated with the Company's concentration within the aerospace and defense industries, the Company is also exposed to a concentration of collection risk on credit extended to commercial airlines and business jet aircraft manufacturers. At September 30, 2009, accounts receivable due from U.S. and international commercial airlines were approximately \$18 million and \$63 million, respectively. At September 30, 2009, accounts receivable due from business jet aircraft manufacturers were approximately \$82 million. The Company performs ongoing credit evaluations on the financial condition of all of its customers and maintains allowances for uncollectible accounts receivable based on expected collectability. Although management believes its allowances are adequate, the Company is not able to predict with certainty the changes in the financial stability of its customers. Any material change in the financial status of any one or group of customers could have a material adverse effect on the Company's results of operations, financial position or cash flows.

As of September 30, 2009, approximately 11 percent of the Company's employees were represented by collective bargaining agreements, which are generally set to expire between September 2010 and May 2013. Collective bargaining agreements representing approximately 1 percent of the Company's employees expire within one year.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

Recently Issued Accounting Standards

In September 2009, the FASB issued Accounting Standards Codification (ASC) 605-25 (Emerging Issues Task Force (EITF) Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables*) (ASC 605-25) which modifies the way companies allocate revenue to multiple deliverables in a contract. ASC 605-25 is effective for the Company at the beginning of fiscal year 2011. ASC 605-25 allows companies to allocate consideration in a multiple element arrangement in a manner that better reflects the transaction economics. When vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, companies will now be allowed to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. Additionally, ASC 605-25 eliminates the use of the residual method. The adoption of ASC 605-25 is not expected to materially affect the Company's financial position, results of operations, or cash flows as the Company generally does not use the residual method and generally allocates revenue to deliverables based on the prices charged when sold separately by the Company.

In June 2009, the FASB issued ASC 105 (Statement of Financial Accounting Standards (SFAS) No. 168, *FASB Accounting Standards Codification (Codification) and the Hierarchy of Generally Accepted Accounting Principles — a replacement of FASB Statement No. 162*) (ASC 105). The purpose of the Codification is to provide a single source of authoritative U.S. GAAP. The Company adopted ASC 105 in the fourth quarter of fiscal year 2009. The adoption of ASC 105 did not affect the Company's financial statements; however, it did impact how authoritative references are disclosed by referencing the applicable Codification section.

In November 2008, the FASB ratified ASC 350-30-25-5 (EITF Issue No. 08-7, *Accounting for Defensive Intangible Assets*) (ASC 350-30-25-5). ASC 350-30-25-5 provides guidance for accounting for defensive intangible assets subsequent to their acquisition and also provides guidance on establishing the estimated useful life for such assets. Acquired defensive intangible assets include assets that an entity does not intend to actively use, but does intend to hold or "lock up" such that others are prevented from using the asset. ASC 350-30-25-5 is effective for the Company at the beginning of fiscal year 2010. The adoption of ASC 350-30-25-5 is not expected to materially affect the Company's financial position, results of operations, or cash flows on the date the standard becomes effective; however, the standard could have a significant effect on defensive intangible assets the Company acquires beginning in fiscal year 2010.

In June 2008, the FASB issued ASC 260-10-45-60 (Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*) (ASC 260-10-45-60). ASC 260-10-45-60 specifies that unvested share-based awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and should therefore be included in the computation of earnings per share (EPS) pursuant to the two-class method. ASC 260-10-45-60 is effective for the Company at the beginning of fiscal year 2010. The Company does not expect this standard will have a material impact on the Company's financial statements or computation of EPS.

In December 2007, the FASB issued ASC 805 (SFAS No. 141R, *Business Combinations*) (ASC 805). ASC 805 significantly changes the way companies account for business combinations and will generally require more assets acquired and liabilities assumed to be measured at their acquisition-date fair value. Under ASC 805, legal fees and other transaction-related costs are expensed as incurred and are no longer included in goodwill as a cost of acquiring the business. ASC 805 also requires, among other things, acquirers to estimate the acquisition-date fair value of any contingent consideration and to recognize any subsequent changes in the fair value of contingent consideration in earnings. In addition, restructuring costs the acquirer expects, but is not obligated to incur, will be recognized separately from the business acquisition. This accounting standard is applied prospectively and is effective for the Company at the beginning of fiscal year 2010. The adoption of ASC 805 is not expected to materially affect the Company's financial position, results of operations, or cash flows on the date the standard becomes effective; however, the standard could have a significant effect on how the Company accounts for business acquisitions beginning in fiscal year 2010.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant Accounting Policies – (continued)

The Company adopted ASC 815-10-50 (SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*) (ASC 815-10-50) in the second quarter of fiscal year 2009. The adoption of ASC 815-10-50 did not have a material effect on the Company's financial statements other than providing certain enhanced disclosures. See Note 18 for additional discussion on derivative instruments and hedging activities.

In February 2007, the FASB issued ASC 825-10 (SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*) (ASC 825-10). ASC 825-10 permits entities to choose to measure certain eligible financial assets and financial liabilities at fair value (the fair value option). The Company adopted ASC 825-10 in the first quarter of fiscal year 2009 and has elected not to measure any additional financial instruments or other items at fair value. The adoption of ASC 825-10 did not impact the Company's financial statements.

The Company adopted ASC 820 (SFAS No. 157, *Fair Value Measurements*) (ASC 820) in the first quarter of fiscal year 2009. In accordance with ASC 820-10-65-1 (FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*), the Company elected to defer until the first quarter of fiscal year 2010 the adoption of ASC 820 for all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. Nonfinancial assets and nonfinancial liabilities for which the Company has not applied the provisions of ASC 820 include those measured at fair value in goodwill and indefinite-lived intangible assets impairment testing, and those non-recurring nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination. The adoption of ASC 820 for those assets and liabilities within the scope of ASC 820-10-65-1 is not expected to have a material impact on the Company's financial position, results of operations or cash flows. See Note 17 for additional discussion on fair value measurements.

3. Acquisitions

During the years ended September 30, 2009, 2008 and 2007, the Company completed four acquisitions that are summarized as follows:

(Dollars in Millions)	Fiscal Year Acquired	Cash Purchase Price	Goodwill	Intangible Assets	
				Finite Lived	Weighted Average Life in Years
DataPath, Inc	2009	\$125	\$53	\$36	6
SEOS Group Limited	2009	28	28	9	9
Athena Technologies, Inc	2008	107	66	46	10
Information Technology & Applications Corporation	2007	37	26	12	7

DataPath, Inc.

On May 29, 2009, the Company acquired all the shares of DataPath, Inc. (DataPath). DataPath, with operations in the U.S. and Sweden, is a global leader in creating satellite-based communication solutions, primarily for military applications. The purchase price, net of cash acquired, was approximately \$125 million, of which \$118 million was paid in cash during 2009 and \$7 million is to be paid over the next two years. The Company is in the process of allocating the purchase price and obtaining a valuation for acquired intangible assets and their useful lives. Based on the Company's preliminary allocation of the purchase price, \$53 million has been allocated to goodwill and \$36 million to finite-lived intangible assets with a weighted average life of approximately 6 years. The excess purchase price over net assets acquired reflects the Company's view that this acquisition will augment the Company's networked communication offerings. The Company currently estimates that none of the goodwill resulting from the acquisition is tax deductible. The goodwill is included within the Government Systems segment.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Acquisitions – (continued)

SEOS Group Limited

On November 24, 2008, the Company acquired all the shares of SEOS Group Limited (SEOS). SEOS, with operations in the United Kingdom and the U.S., is a leading global supplier of highly realistic visual display solutions for commercial and military flight simulators. SEOS is included within the results of both the Government Systems and Commercial Systems segments. The cash purchase price, net of cash acquired, was \$28 million. Additional consideration of up to \$8 million may be paid post-closing, contingent upon the achievement of certain milestones. Any such additional consideration will be accounted for as goodwill. The Company is in the process of finalizing the pre-acquisition income tax calculation and other adjustments related to the purchase price allocation. Based on the Company's preliminary allocation of the purchase price, \$28 million has been allocated to goodwill and \$9 million to finite-lived intangible assets with a weighted average life of approximately 9 years. The excess purchase price over net assets acquired reflects the Company's view that this acquisition will further enhance the Company's simulation and training capabilities and provide more innovative and integrated solutions for the Company's customers. The Company currently estimates that none of the goodwill resulting from the acquisition is tax deductible. The goodwill is allocated to the Government Systems and Commercial Systems segments in the amounts of \$20 million and \$8 million, respectively.

Athena Technologies, Inc.

On April 4, 2008, the Company acquired all the shares of Athena Technologies, Inc. (Athena). Athena, located in Warrenton, Virginia, is a provider of navigation and control solutions, primarily to the Unmanned Aerial Vehicle market segment. The total cash purchase price, net of cash acquired, was \$107 million. In the first quarter of 2009, the purchase price allocation was finalized with \$66 million allocated to goodwill and \$46 million to finite-lived intangible assets with a weighted average life of approximately 10 years. The excess purchase price over net assets acquired reflects the Company's view that this acquisition will enhance the Company's navigation and control solution capabilities. None of the goodwill resulting from the acquisition is tax deductible. The goodwill is included within the Government Systems segment.

Information Technology & Applications Corporation

On August 10, 2007, the Company acquired all of the shares of Information Technology & Applications Corporation (ITAC). ITAC, located in Reston, Virginia, is a provider of intelligence, surveillance, reconnaissance and communications solutions to support the global war on terror and homeland security. The total cash purchase price, net of cash acquired, was \$37 million. In the fourth quarter of 2008, the purchase price allocation was finalized with \$26 million allocated to goodwill and \$12 million to finite-lived intangible assets with a weighted average life of approximately 7 years. The excess purchase price over net assets acquired reflects the Company's view that this acquisition will enhance the Company's communications intelligence capabilities. None of the goodwill resulting from the acquisition is tax deductible. The goodwill is included within the Government Systems segment.

The results of operations for each of these acquired businesses are included in the Consolidated Statement of Operations since their respective dates of acquisition.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Receivables, Net

Receivables, net are summarized as follows:

(In Millions)	September 30	
	2009	2008
Billed	\$734	\$726
Unbilled.	217	254
Less progress payments	(27)	(21)
Total	924	959
Less allowance for doubtful accounts	(11)	(9)
Receivables, net	\$913	\$950

Receivables not expected to be collected during the next twelve months are classified as long-term and are included within Other Assets.

Unbilled receivables principally represent sales recorded under the percentage-of-completion method of accounting that have not been billed to customers in accordance with applicable contract terms.

5. Inventories, Net

Inventories, net are summarized as follows:

(In Millions)	September 30	
	2009	2008
Finished goods	\$177	\$244
Work in process	262	270
Raw materials, parts, and supplies	341	362
Less progress payments	(77)	(72)
Total	703	804
Pre-production engineering costs	240	166
Inventories, net	\$943	\$970

Beginning in 2009, pre-production engineering costs have been presented separately within inventories. In prior years, such amounts had been presented within work in process inventories. Prior year amounts have been reclassified to conform to the current year presentation.

In accordance with industry practice, inventories include amounts which are not expected to be realized within one year. These amounts primarily relate to life-time buy inventory and pre-production engineering costs not expected to be realized within one year of \$301 million and \$227 million at September 30, 2009 and 2008, respectively. Life-time buy inventory is inventory that is typically no longer produced by the Company's vendors but for which multiple years of supply are purchased in order to meet production and service requirements over the life span of a product.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Property

Property is summarized as follows:

(In Millions)	September 30	
	2009	2008
Land	\$ 30	\$ 30
Buildings and improvements	349	342
Machinery and equipment	891	807
Information systems software and hardware	259	243
Furniture and fixtures	62	60
Construction in progress	88	99
Total	1,679	1,581
Less accumulated depreciation	(960)	(901)
Property	\$ 719	\$ 680

Property additions acquired by incurring accounts payable, which are reflected as a non-cash transaction in the Company's Consolidated Statement of Cash Flows, were \$12 million, \$26 million, and \$29 million at September 30, 2009, 2008, and 2007, respectively.

7. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill are summarized as follows:

(In Millions)	Government Systems	Commercial Systems	Total
Balance at September 30, 2007	\$353	\$191	\$544
Athena acquisition	67	—	67
Foreign currency translation adjustment	(3)	—	(3)
Other adjustments to goodwill	1	—	1
Balance at September 30, 2008	418	191	609
SEOS acquisition	20	8	28
DataPath acquisition	53	—	53
Foreign currency translation adjustments	6	—	6
Athena goodwill adjustment	(1)	—	(1)
Balance at September 30, 2009	\$496	\$199	\$695

Intangible assets are summarized as follows:

(In Millions)	September 30, 2009			September 30, 2008		
	Gross	Accum Amort	Net	Gross	Accum Amort	Net
Intangible assets with finite lives:						
Developed technology and patents	\$214	\$(104)	\$110	\$181	\$ (87)	\$ 94
Customer relationships	174	(36)	138	105	(25)	80
License agreements	17	(4)	13	20	(4)	16
Trademarks and tradenames	15	(9)	6	14	(8)	6
Intangible assets with indefinite lives:						
Trademarks and tradenames	2	—	2	2	—	2
Intangible assets	\$422	\$(153)	\$269	\$322	\$(124)	\$198

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Goodwill and Intangible Assets – (continued)

Amortization expense for intangible assets for 2009, 2008 and 2007 was \$30 million, \$23 million and \$22 million, respectively. Annual amortization expense for intangible assets for 2010, 2011, 2012, 2013 and 2014 is expected to be \$36 million, \$35 million, \$36 million, \$32 million, and \$32 million, respectively.

8. Other Assets

Other assets are summarized as follows:

(In Millions)	September 30	
	2009	2008
Long-term receivables	\$ 97	\$ 71
Investments in equity affiliates.	10	9
Exchange and rental assets, net of accumulated depreciation of \$103 at September 30, 2009 and \$98 at September 30, 2008	50	41
Other.	72	54
Other assets	<u>\$229</u>	<u>\$175</u>

Investments in Equity Affiliates

Investments in equity affiliates primarily consist of four joint ventures:

- Vision Systems International, LLC (VSI): VSI is a joint venture with Elbit Systems, Ltd. for the joint pursuit of helmet mounted cueing systems for the worldwide military fixed wing aircraft market
- Data Link Solutions LLC (DLS): DLS is a joint venture with BAE Systems, plc for the joint pursuit of the worldwide military data link market
- Integrated Guidance Systems LLC (IGS): IGS is a joint venture with Honeywell International Inc. for the joint pursuit of integrated precision guidance solutions for worldwide guided weapons systems
- Quest Flight Training Limited (Quest): Quest is a joint venture with Quadrant Group plc (Quadrant) that provides aircrew training services primarily for the United Kingdom Ministry of Defence

Each joint venture is 50 percent owned by the Company and accounted for under the equity method. Under the equity method of accounting for investments, the Company's proportionate share of the earnings or losses of its equity affiliates are included in Net Income and classified as Other Income, Net in the Consolidated Statement of Operations. For segment performance reporting purposes, Rockwell Collins' share of earnings or losses of VSI, DLS, IGS, and Quest are included in the operating results of the Government Systems segment.

In the normal course of business or pursuant to the underlying joint venture agreements, the Company may sell products or services to equity affiliates. The Company defers a portion of the profit generated from these sales equal to its ownership interest in the equity affiliates until the underlying product is ultimately sold to an unrelated third party. Sales to equity affiliates were \$96 million, \$120 million, and \$128 million for the years ended September 30, 2009, 2008, and 2007, respectively. The deferred portion of profit generated from sales to equity affiliates was \$3 million and \$4 million at September 30, 2009 and 2008, respectively.

Exchange and Rental Assets

Exchange and rental assets consist primarily of Company products that are either loaned or rented to customers on a short-term basis in connection with warranty and other service related activities or under operating leases. These assets are recorded at acquisition or production cost and depreciated using the straight-line method over their estimated lives up to 15 years. Depreciation methods and lives are reviewed periodically with any changes recorded on a prospective basis.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Other Current Liabilities

Other current liabilities are summarized as follows:

(In Millions)	September 30	
	2009	2008
Customer incentives.	\$122	\$119
Contract reserves.	11	13
Income taxes payable.	4	2
Other.	91	71
Other current liabilities.	\$228	\$205

10. Debt

Short-term Debt

Under the Company's commercial paper program, the Company may sell up to \$850 million face amount of unsecured short-term promissory notes in the commercial paper market. The commercial paper notes may bear interest or may be sold at a discount, and will have a maturity of not more than 364 days from the time of issuance. At September 30, 2009, there were no outstanding short-term commercial paper borrowings. At September 30, 2008, short-term commercial paper borrowings outstanding were \$266 million with a weighted average interest rate and maturity period of 1.99 percent and 12 days, respectively.

Revolving Credit Facilities

The Company has an \$850 million unsecured revolving credit facility with various banks that matures in March 2012. The credit facility has options to 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 lenders. This credit facility exists primarily to support the Company's commercial paper program, but may be used for other corporate purposes in the event access to the commercial paper market is impaired or eliminated. The credit facility includes one financial covenant requiring the Company to maintain a consolidated debt to total capitalization ratio of not greater than 60 percent. The ratio excludes the accumulated other comprehensive loss equity impact related to defined benefit retirement plans. The ratio was 18 percent as of September 30, 2009. In addition, the credit facility contains other non-financial covenants that require the Company to satisfy certain conditions in order to incur debt secured by liens, engage in sale/leaseback transactions, or merge or consolidate with another entity. Borrowings under this credit facility bear interest at the London Interbank Offered Rate (LIBOR) plus a variable margin based on the Company's unsecured long-term debt rating or, at the Company's option, rates determined by competitive bid. At September 30, 2009 and 2008, there were no outstanding borrowings under this revolving credit facility.

In addition, short-term credit facilities available to non-U.S. subsidiaries amounted to \$62 million as of September 30, 2009, of which \$22 million was utilized to support commitments in the form of commercial letters of credit. As of September 30, 2009, there were no short-term borrowings outstanding under the Company's non-U.S. subsidiaries' credit facilities. At September 30, 2008 there were \$21 million of short-term borrowings outstanding under the Company's non-U.S. subsidiaries' credit facilities.

At September 30, 2009 and 2008, there were no significant commitment fees or compensating balance requirements under any of the Company's credit facilities.

Long-term Debt

In addition to the Company's credit facilities and commercial paper program, the Company has a shelf registration statement filed with the Securities and Exchange Commission pursuant to which the Company 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.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Debt – (continued)

On May 6, 2009, the Company issued \$300 million of 5.25 percent fixed rate unsecured debt due July 15, 2019 (the 2019 Notes). The net proceeds to the Company from the sale of the 2019 Notes, after deducting a \$2 million discount and \$2 million of debt issuance costs, were \$296 million. The 2019 Notes are included in the Consolidated Statement of Financial Position net of the unamortized discount within the caption Long-term Debt, net. The debt issuance costs are capitalized within Other Assets on the Consolidated Statement of Financial Position. The discount and debt issuance costs are amortized over the life of the 2019 Notes and recorded in Interest Expense.

On November 20, 2003, the Company issued \$200 million of 4.75 percent fixed rate unsecured debt due December 1, 2013 (the 2013 Notes). At the time of the debt issuance, the Company entered into interest rate swap contracts which effectively converted \$100 million aggregate principal amount of the 2013 Notes to floating rate debt based on six-month LIBOR less 7.5 basis points. See Notes 17 and 18 for additional information relating to the interest rate swap contracts.

The 2019 Notes and 2013 Notes each contain covenants that require the Company to satisfy certain conditions in order to incur debt secured by liens, engage in sales/leaseback transactions, merge or consolidate with another entity or transfer substantially all of the Company's assets.

In June 2006, the Company entered into a five-year unsecured variable rate loan agreement for a non-U.S. subsidiary for \$30 million. The interest rate is variable at the Euro Interbank Offered Rate plus 35 basis points and interest is payable quarterly. The outstanding balance of this loan was \$26 million and \$24 million at September 30, 2009 and 2008, respectively. The interest rate was 1.11 percent and 5.31 percent at September 30, 2009 and 2008, respectively. The variable rate loan contains customary loan covenants, none of which are financial covenants. Failure to comply with customary covenants or the occurrence of customary events of default contained in the agreement would require the repayment of any outstanding borrowings under the agreement.

Long-term debt and a reconciliation to the carrying amount is summarized as follows:

(In Millions)	September 30	
	2009	2008
Principal amount of 2019 Notes, net of discount	\$298	\$ —
Principal amount of 2013 Notes.	200	200
Principal amount of variable rate loan due June 2011	26	24
Fair value swap adjustment (Note 17).	8	4
Long-term debt, net	\$532	\$228

The Company was in compliance with all debt covenants at September 30, 2009 and 2008.

Interest paid on debt for the years ended September 30, 2009, 2008, and 2007 was \$13 million, \$20 million, and \$13 million, respectively.

11. Retirement Benefits

The Company sponsors defined benefit pension (Pension Benefits) and other postretirement (Other Retirement Benefits) plans which provide monthly pension and other benefits to eligible employees upon retirement.

Pension Benefits

The Company historically provided pension benefits to most of the Company's U.S. employees in the form of non-contributory, defined benefit plans that are considered qualified plans under applicable laws. The benefits provided under these plans for salaried employees are generally based on years of service and average

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

compensation. The benefits provided under these plans for hourly employees are generally based on specified benefit amounts and years of service. In addition, the Company sponsors an unfunded non-qualified defined benefit plan for certain employees.

In June 2003 the Company amended its U.S. qualified and non-qualified defined benefit pension plans to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. These changes impacted all of the Company's domestic pension plans for all salaried and hourly employees who were not covered by collective bargaining agreements. Concurrently, the Company supplemented its existing defined contribution savings plan effective October 1, 2006 to include an additional Company contribution.

The Company also maintains four defined benefit pension plans in countries outside of the U.S., two of which are unfunded.

Other Retirement Benefits

Other retirement benefits consist of retiree health care and life insurance benefits that are provided to substantially all of the Company's U.S. employees hired before October 1, 2006 and their beneficiaries. Employees generally become eligible to receive these benefits if they retire after age 55 with at least 10 years of service. Most plans are contributory with retiree contributions generally based upon years of service and adjusted annually by the Company. Retiree medical plans pay a stated percentage of expenses reduced by deductibles and other coverage, principally Medicare. The amount the Company will contribute toward retiree medical coverage for most employees is fixed. Additional premium contributions will be required from participants for all costs in excess of the Company's fixed contribution amount. Retiree life insurance plans provide coverage at a flat dollar amount or as a multiple of salary. With the exception of certain bargaining unit plans, Other Retirement Benefits are funded as expenses are incurred.

Components of Expense (Income)

The components of expense (income) for Pension Benefits and Other Retirement Benefits are summarized below:

<u>(In Millions)</u>	Pension Benefits			Other Retirement Benefits		
	2009	2008	2007	2009	2008	2007
Service cost.	\$ 5	\$ 8	\$ 8	\$ 2	\$ 4	\$ 4
Interest cost.	169	163	151	14	14	15
Expected return on plan assets.	(203)	(201)	(189)	—	(1)	(1)
Amortization:						
Prior service cost	(19)	(19)	(19)	(22)	(33)	(39)
Net actuarial loss	30	46	58	10	14	16
Net benefit expense (income).	\$ (18)	\$ (3)	\$ 9	\$ 4	\$ (2)	\$ (5)

Funded Status and Net Liability

The Company recognizes the unfunded status of defined benefit retirement plans on the Consolidated Statement of Financial Position as a Retirement Benefit Liability. The current portion of the liability is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next twelve months exceeds the fair value of the plan assets and is reflected in Compensation and Benefits in the Consolidated Statement of Financial Position.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

The following table reconciles the projected benefit obligations (PBO), plan assets, funded status, and net liability for the Company's Pension Benefits and the Other Retirement Benefits.

<u>(In Millions)</u>	<u>Pension Benefits</u>		<u>Other Retirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
PBO at beginning of period	\$ 2,322	\$2,554	\$ 200	\$ 238
Service cost	5	8	2	4
Interest cost	169	163	14	14
Discount rate change	612	(284)	41	(17)
Actuarial losses (gains)	11	40	—	(28)
Plan amendments	—	3	—	9
Plan participant contributions	—	—	11	12
Benefits paid	(149)	(150)	(31)	(36)
Other	(2)	(12)	3	4
PBO at end of period	<u>2,968</u>	<u>2,322</u>	<u>240</u>	<u>200</u>
Plan assets at beginning of period	1,898	2,490	12	15
Actual return on plan assets	45	(448)	—	(2)
Company contributions	139	14	15	19
Plan participant contributions	—	—	11	12
Benefits paid	(149)	(150)	(31)	(36)
Other	(5)	(8)	3	4
Plan assets at end of period	<u>1,928</u>	<u>1,898</u>	<u>10</u>	<u>12</u>
Funded status of plans	<u><u>\$(1,040)</u></u>	<u><u>\$ (424)</u></u>	<u><u>\$(230)</u></u>	<u><u>\$(188)</u></u>
Funded status consists of:				
Retirement benefits liability	\$(1,030)	\$ (415)	\$(219)	\$(180)
Compensation and benefits liability	(10)	(9)	(11)	(8)
Net liability	<u><u>\$(1,040)</u></u>	<u><u>\$ (424)</u></u>	<u><u>\$(230)</u></u>	<u><u>\$(188)</u></u>

The Company's non-U.S. defined benefit pension plans represented 4 percent and 5 percent of the total PBO at September 30, 2009 and 2008, respectively. The accumulated benefit obligation for all defined benefit pension plans was \$2,961 million and \$2,316 million at September 30, 2009 and September 30, 2008, respectively.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

Other Comprehensive Loss

The following table summarizes the amounts included in Accumulated Other Comprehensive Loss before tax related to retirement benefits as of September 30, 2009 and 2008 and changes recognized in Other Comprehensive Loss before tax for the year ended September 30, 2009:

(In Millions)	Pension Benefits	Other Retirement Benefits	Total
Balance at September 30, 2007	\$ 501	\$ 70	\$ 571
Current year prior service cost	3	9	12
Current year net actuarial (gain) loss	404	(43)	361
Amortization of prior service cost	19	33	52
Amortization of actuarial loss	(46)	(14)	(60)
Foreign currency translation	(3)	—	(3)
Balance at September 30, 2008	878	55	933
Current year net actuarial loss	780	41	821
Amortization of prior service cost	19	22	41
Amortization of actuarial loss	(30)	(10)	(40)
Foreign currency translation	(3)	—	(3)
Balance at September 30, 2009	<u>\$1,644</u>	<u>\$108</u>	<u>\$1,752</u>

The estimated amounts that will be amortized from Accumulated Other Comprehensive Loss into expense (income) for Pension Benefits and Other Retirement Benefits during the year ending September 30, 2010 are as follows:

(In Millions)	Pension Benefits	Other Retirement Benefits	Total
Prior service cost	\$(19)	\$(22)	\$(41)
Net actuarial loss	<u>90</u>	<u>13</u>	<u>103</u>
Total	<u>\$ 71</u>	<u>\$ (9)</u>	<u>\$ 62</u>

In September 2006, the FASB issued guidance related to an employer's accounting for defined benefit plans. This guidance required entities to report the funded status of their defined benefit plans on their statement of financial position and to measure plan assets and obligations as of the end of the employer's fiscal year. During the first quarter of 2007, the Company adopted the measurement date provisions of the new accounting standard and changed its measurement date from June 30 to September 30 for all of the Company's defined benefit plans. In addition, the Company adopted the recognition provisions of the new accounting standard at the end of fiscal year 2007. Effective September 30, 2007, the Company recognized the funded status of its retirement benefit plans on the Statement of Financial Position. At September 30, 2007, the previously unrecognized differences between actual amounts and estimates based on actuarial assumptions were recorded as a \$329 million increase to Accumulated Other Comprehensive Loss as reflected on the Consolidated Statement of Shareowner's Equity and Comprehensive Income.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

Actuarial Assumptions

The following table presents the significant assumptions used in determining the benefit obligations:

	Pension Benefits				Other Retirement Benefits	
	U.S.		Non-U.S.		U.S.	
	2009	2008	2009	2008	2009	2008
Discount rate	5.47%	7.60%	5.94%	6.23%	5.23%	7.60%
Compensation increase rate	—	—	3.50%	4.10%	—	—

Discount rates used to determine the benefit obligations are determined by using a weighted average of market-observed yields for high quality fixed income securities that correspond to the payment of benefits.

The Company's U.S. qualified and non-qualified plans were amended to discontinue benefit accruals for salary increases and services rendered after September 30, 2006. The only U.S. plans that continue to accrue benefits are certain plans associated with collective bargaining agreements and these plans are not impacted by increases in compensation as the benefit formula is dependent solely on years of service. As a result, the compensation increase rate assumption for U.S. plans is zero.

Significant assumptions used in determining the net benefit expense (income) are as follows:

	Pension Benefits				Other Retirement Benefits	
	U.S.		Non-U.S.		U.S.	
	2009	2008	2009	2008	2009	2008
Discount rate	7.60%	6.60%	6.23%	5.50%	7.60%	6.50%
Expected long-term return on plan assets	8.75%	8.75%	8.75%	8.75%	8.75%	8.75%
Compensation increase rate	—	—	4.10%	4.50%	—	—
Pre-65 health care cost gross trend rate*	—	—	—	—	11.00%	11.00%
Post-65 health care cost gross trend rate*	—	—	—	—	11.00%	11.00%
Ultimate trend rate*	—	—	—	—	5.50%	5.50%
Year that trend reaches ultimate rate*	—	—	—	—	2014	2013

* Due to the effect of the fixed Company contribution, increasing or decreasing the health care cost trend rate by one percentage point would not have a significant impact on the Company's cost of providing Other Retirement Benefits.

Expected long-term return on plan assets for each year presented is based on both historical long-term actual and expected future investment returns considering the current investment mix of plan assets. Actuarial gains and losses in excess of 10 percent of the greater of the projected benefit obligation or market-related value of assets are amortized on a straight-line basis over the average remaining service period of active participants. Prior service costs resulting from plan amendments are amortized in equal annual amounts over the average remaining service period of affected active participants or over the remaining life expectancy of affected retired participants. The Company uses a five-year, market-related value asset method of amortizing the difference between actual and expected returns on plan assets.

Plan Assets

Total plan assets for Pension Benefits and Other Retirement Benefits as of September 30, 2009 and 2008 were \$1,938 million and \$1,910 million, respectively. The Company has established investment objectives that seek to preserve and maximize the amount of plan assets available to pay plan benefits. These objectives are achieved through investment guidelines requiring diversification and allocation strategies designed to maximize the long-term returns on plan assets while maintaining a prudent level of investment risk. These

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

investment strategies are implemented using actively managed and indexed assets. Target and actual asset allocations as of September 30, 2009 and 2008 are as follows:

	<u>Target Mix</u>	<u>2009</u>	<u>2008</u>
Equities	40% – 70%	65%	64%
Fixed income	25% – 60%	34%	36%
Alternative investments	0% – 15%	—	—
Cash	0% – 5%	1%	—

Alternative investments may include real estate, hedge funds, venture capital, and private equity. There were no plan assets invested in the securities of the Company as of September 30, 2009 and 2008 or at any time during the years then ended. Target and actual asset allocations are periodically rebalanced between asset classes in order to mitigate investment risk and maintain asset classes within target allocations.

For the years ended September 30, 2009 and 2008, the Company made contributions to its pension plans as follows:

<u>(In Millions)</u>	<u>2009</u>	<u>2008</u>
Contributions to U.S. qualified plan	\$125	\$—
Contributions to U.S. non-qualified plan	8	7
Contributions to non-U.S. plans	6	7
Total	<u>\$139</u>	<u>\$14</u>

The Company’s objective with respect to the funding of its pension plans is to provide adequate assets for the payment of future benefits. Pursuant to this objective, the Company will fund its pension plans as required by governmental regulations and may consider discretionary contributions as conditions warrant.

In October 2009, subsequent to the Company’s fiscal year ended September 30, 2009, the Company made a \$98 million contribution to the U.S. qualified pension plan. The Company does not currently anticipate that it will be required by governmental regulations to make any additional contributions to the U.S. qualified pension plan in 2010. 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. The Company may elect to make additional discretionary contributions during 2010 to further improve the funded status of this plan. Contributions to the non-U.S. plans and the U.S. non-qualified plan are expected to total \$13 million in 2010.

Contributions to the Company’s other postretirement plans are expected to total \$22 million in 2010.

Benefit Payments

The following table reflects estimated benefit payments to be made to eligible participants for each of the next five years and the following five years in aggregate:

<u>(In Millions)</u>	<u>Pension Benefits</u>	<u>Other Retirement Benefits</u>
2010	\$147	\$22
2011	162	22
2012	167	22
2013	173	23
2014	180	18
2015 – 2019	989	90

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Retirement Benefits – (continued)

Estimated benefit payments for Other Retirement Benefits is shown net of plan participant contributions and reflects the Company's portion only. Substantially all of the Pension Benefit payments relate to the Company's U.S. qualified funded plans which are paid from the pension trust.

Defined Contribution Savings Plans and Employee Stock Purchase Plan

The Company sponsors defined contribution savings plans that are available to the majority of its employees. The plans allow employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. The Company matches a percentage of employee contributions using common stock of the Company up to certain limits. Employees may transfer at any time all or a portion of their balance in Company common stock to any of the other investment options offered within the plans. The Company is authorized to issue 16.5 million shares under the defined contribution savings plans, of which 7.3 million shares are available for future contributions at September 30, 2009. Additionally, the defined contribution savings plan includes a cash contribution based on an employee's age and service.

The Company's expense related to the defined contribution savings plans for 2009, 2008, and 2007 are as follows:

(In Millions)	2009		2008		2007	
	Shares	Expense	Shares	Expense	Shares	Expense
Contribution in shares:						
Defined contribution savings plans	1.4	\$51	0.9	\$52	0.7	\$45
Contribution in cash:						
Retirement contribution		36		37		28
Other		1		1		2
Total		\$88		\$90		\$75

The Company also offers an Employee Stock Purchase Plan (ESPP) which allows employees to have their base compensation withheld to purchase the Company's common stock each month at 95 percent of the fair market value on the last day of the month. The Company is authorized to issue 9.0 million shares under the ESPP, of which 3.9 million shares are available for future grant at September 30, 2009. The ESPP is considered a non-compensatory plan and accordingly no compensation expense is recorded in connection with this benefit. During 2009, 2008, and 2007, 0.3 million, 0.2 million, and 0.2 million shares, respectively of Company common stock were issued to employees at a value of \$12 million, \$13 million, and \$13 million for the respective periods.

12. Shareowners' Equity

Common Stock

The Company is authorized to issue one billion shares of common stock, par value \$0.01 per share, and 25 million shares of preferred stock, without par value, of which 2.5 million shares are designated as Series A Junior Participating Preferred Stock (Junior Preferred Stock) for issuance in connection with the exercise of preferred share purchase rights.

Preferred Share Purchase Rights

Each outstanding share of common stock provides the holder with one Preferred Share Purchase Right (Right). The Rights will become exercisable only if a person or group acquires, or offers to acquire, without prior approval of the Board of Directors, 15 percent or more of the Company's common stock. However, the Board of Directors is authorized to reduce the 15 percent threshold for triggering the Rights to not less than 10 percent. Upon exercise, each Right entitles the holder to 1/100th of a share of Junior Preferred Stock at a price of \$125, subject to adjustment.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Shareowners' Equity – (continued)

Upon acquisition of the Company, each Right (other than Rights held by the acquirer) will generally be exercisable for \$250 worth of either common stock of the Company or common stock of the acquirer for \$125. In certain circumstances, each Right may be exchanged by the Company for one share of common stock or $\frac{1}{100}$ th of a share of Junior Preferred Stock. The Rights will expire on June 30, 2011, unless earlier exchanged or redeemed at \$0.01 per Right. The Rights have the effect of substantially increasing the cost of acquiring the Company in a transaction not approved by the Board of Directors.

Treasury Stock

The Company repurchased shares of its common stock as follows:

(In Millions)	2009	2008	2007
Amount of share repurchases	\$156	\$576	\$333
Number of shares repurchased	3.9	9.0	4.6

At September 30, 2009, the Company was authorized to repurchase an additional \$209 million of outstanding stock under the Company's share repurchase program. Approximately \$3 million of the 2009 treasury share repurchases reflected in the table above are included within accounts payable at September 30, 2009 and are therefore reflected as a non-cash transaction in the Company's 2009 Consolidated Statement of Cash Flows. The Company paid \$19 million in 2007 related to the settlement of an accelerated share repurchase agreement executed in 2006, which is reflected in the table above.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of the following:

(In Millions)	September 30		
	2009	2008	2007
Unamortized pension and other retirement benefits, net of taxes of \$647 for 2009; \$344 for 2008 and \$211 for 2007.	\$(1,105)	\$(589)	\$(360)
Foreign currency translation adjustment	26	12	27
Foreign currency cash flow hedge adjustment	(1)	(1)	(3)
Accumulated other comprehensive loss	<u>\$(1,080)</u>	<u>\$(578)</u>	<u>\$(336)</u>

13. Stock-Based Compensation

Stock-Based Compensation Program Description

Under the Company's 2001 Long-Term Incentives Plan and Directors Stock Plan, up to 14.3 million shares of common stock may be issued by the Company as non-qualified options, incentive stock options, performance units, performance shares, stock appreciation rights, and restricted stock. Shares available for future grant or payment under these plans were 0.3 million at September 30, 2009.

Under the Company's 2006 Long-Term Incentives Plan, up to 11.0 million shares of common stock may be issued by the Company as non-qualified options, incentive stock options, performance units, performance shares, stock appreciation rights, restricted stock, restricted stock units, dividend equivalent rights, and other awards. Each share issued pursuant to an award of restricted stock, restricted stock units, performance shares, and performance units counts as three shares against the authorized limit. Shares available for future grant or payment under this plan were 5.1 million at September 30, 2009.

Options to purchase common stock of the Company have been granted under various incentive plans to directors, officers, and other key employees. All of the Company's stock-based incentive plans require options to be granted at prices equal to or above the fair market value of the common stock on the dates the options are granted. The plans provide that the option price for certain options granted under the plans may be paid by the employee in cash, shares of common stock, or a combination thereof. Certain option awards provide

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Stock-Based Compensation – (continued)

for accelerated vesting if there is a change in control. Stock options generally expire ten years from the date they are granted and generally vest ratably over three years. The Company has an ongoing share repurchase plan and expects to satisfy share option exercises from treasury stock.

The Company utilizes performance shares and restricted stock that cliff vest at the end of three years. The number of performance shares that will ultimately be issued is based on achievement of performance targets over a three-year period that considers cumulative sales growth and return on sales with an additional potential adjustment up or down depending on the Company's total return to shareowners compared to a group of peer companies. The Company's stock-based compensation awards are designed to align management's interests with those of the Company's shareowners and to reward outstanding Company performance. The Company's stock-based compensation awards serve as an important retention tool because the awards generally vest over a three-year period or cliff vest at the end of three years.

Stock-based compensation expense is recognized on a straight-line basis over the requisite service period. Total stock-based compensation expense included within the Consolidated Statement of Operations for 2009, 2008, and 2007 is as follows:

(In Millions)	2009	2008	2007
Stock-based compensation expense included in:			
Product cost of sales	\$ 4	\$ 4	\$ 4
Service cost of sales	1	2	1
Selling, general and administrative expenses	13	13	12
Total	<u>\$18</u>	<u>\$19</u>	<u>\$17</u>

General Option Information

The following summarizes the activity of the Company's stock options for 2009, 2008, and 2007:

(Shares in Thousands, Remaining Life in Years)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life
Outstanding at September 30, 2006	8,091	\$28.16	
Granted	456	58.36	
Exercised	(2,388)	26.44	
Forfeited or expired	(29)	45.01	
Outstanding at September 30, 2007	6,130	30.99	
Granted	373	72.22	
Exercised	(637)	25.96	
Forfeited or expired	(38)	46.24	
Outstanding at September 30, 2008	5,828	34.09	
Granted	1,329	30.62	
Exercised	(647)	29.96	
Forfeited or expired	(19)	47.16	
Outstanding at September 30, 2009	<u>6,491</u>	<u>\$33.75</u>	<u>5.3</u>
Vested or expected to vest ^(a)	<u>6,405</u>	<u>\$33.69</u>	<u>5.2</u>
Exercisable at September 30, 2009	<u>4,779</u>	<u>\$31.94</u>	<u>4.0</u>

(a) Represents outstanding options reduced by expected forfeitures

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Stock-Based Compensation – (continued)

	2009	2008	2007
Weighted-average fair value per share of options granted	\$7.13	\$22.97	\$16.70
Intrinsic value of options exercised	\$9 million	\$24 million	\$94 million
Tax deduction resulting from intrinsic value of options exercised . .	\$3 million	\$ 8 million	\$34 million

The intrinsic value of options outstanding and options exercisable at September 30, 2009 was \$107 million and \$83 million, respectively.

The following summarizes the activity of the Company's stock options that have not vested for the years ended September 30, 2009, 2008, and 2007:

(Shares in Thousands)	Shares	Weighted Average Exercise Price
Nonvested at September 30, 2006	2,112	\$36.39
Granted	456	58.36
Vested	(1,295)	33.61
Forfeited	(29)	45.01
Nonvested at September 30, 2007	1,244	47.13
Granted	373	72.22
Vested	(759)	43.17
Forfeited	(25)	58.59
Nonvested at September 30, 2008	833	61.62
Granted	1,329	30.62
Vested	(443)	56.90
Forfeited	(7)	51.36
Nonvested at September 30, 2009	1,712	\$38.83

The total fair value of options vested was \$8 million, \$9 million, and \$13 million during the years ended September 30, 2009, 2008, and 2007, respectively. Total unrecognized compensation expense for options that have not vested as of September 30, 2009 is \$7 million and will be recognized over a weighted average period of 1.0 year.

Stock Option Fair Value Information

The Company's determination of fair value of option awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of subjective variables. These assumptions include, but are not limited to: the Company's expected stock price volatility, the projected employee stock option exercise term, the expected dividend yield, and the risk-free interest rate. Changes in these assumptions can materially affect the estimated value of the stock options.

The fair value of each option granted by the Company was estimated using a binomial lattice pricing model and the following weighted average assumptions:

	2009 Grants	2008 Grants	2007 Grants
Risk-free interest rate	2.37%	3.86%	4.55%
Expected dividend yield	1.59%	0.98%	1.09%
Expected volatility	24.00%	30.00%	28.00%
Expected life	6 years	6 years	5 years

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Stock-Based Compensation – (continued)

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. The binomial lattice model assumes that employees' exercise behavior is a function of the option's remaining expected life and the extent to which the option is in-the-money. The binomial lattice model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and forfeitures on all past option grants made by the Company.

Performance Shares, Restricted Shares, and Restricted Stock Units Information

The following summarizes the Company's performance shares, restricted shares, and restricted stock units for 2009, 2008, and 2007:

	Performance Shares		Restricted Shares		Restricted Stock Units	
	Shares	Weighted Average Grant Price	Shares	Weighted Average Grant Price	Shares	Weighted Average Grant Price
Outstanding at September 30, 2006	77,229		61,475		18,523	
Granted	64,377	\$58.36	42,520	\$58.69	21,323	\$65.32
Restrictions released	—		(886)		(1,516)	
Forfeited	(7,756)		(1,760)		—	
Outstanding at September 30, 2007	133,850		101,349		38,330	
Granted	118,072	72.26	45,900	72.12	21,830	64.57
Restrictions released	—		(2,371)		(8,110)	
Forfeited	(7,226)		(3,150)		(1,060)	
Outstanding at September 30, 2008	244,696		141,728		50,990	
Granted	308,963	30.63	98,670	30.39	43,854	36.20
Restrictions released	(68,694)		(51,557)		—	
Forfeited	(2,071)		(2,077)		(630)	
Outstanding at September 30, 2009	<u>482,894</u>	<u>\$43.94</u>	<u>186,764</u>	<u>\$46.79</u>	<u>94,214</u>	<u>\$49.72</u>
(In Millions, Remaining Life in Years)						
Total unrecognized compensation costs at September 30, 2009	\$ 9		\$ 4		\$—	
Weighted average life remaining at September 30, 2009	1.5		1.4		—	

The maximum number of shares of common stock that can be issued in respect of performance shares granted in 2009 based on the achievement of performance targets for fiscal years 2009 through 2011 is 739,534. The maximum number of shares of common stock that can be issued in respect of performance shares granted in 2008 based on the achievement of performance targets for fiscal years 2008 through 2010 is 275,683. The number of shares of common stock that will be issued in respect of performance shares granted in 2007 based on the achievement of performance targets for fiscal years 2007 through 2009 is 100,610.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Stock-Based Compensation – (continued)

Earnings Per Share and Diluted Share Equivalents

The computation of basic and diluted earnings per share is as follows:

(In Millions, Except per Share Amounts)	2009	2008	2007
Numerator:			
Numerator for basic and diluted earnings per share –			
Net income	\$ 594	\$ 678	\$ 585
Denominator:			
Denominator for basic earnings per share –			
weighted average common shares	157.8	160.8	167.1
Effect of dilutive securities:			
Stock options	1.2	1.8	2.4
Performance shares, restricted shares and restricted stock units	0.4	0.3	0.2
Dilutive potential common shares	1.6	2.1	2.6
Denominator for diluted earnings per share –			
adjusted weighted average shares and assumed conversion	159.4	162.9	169.7
Earnings per share:			
Basic	\$ 3.76	\$ 4.22	\$ 3.50
Diluted	\$ 3.73	\$ 4.16	\$ 3.45

The average outstanding diluted shares calculation excludes options with an exercise price that exceeds the average market price of shares during the year. Stock options excluded from the average outstanding diluted shares calculation were 1.3 million, 0.4 million and less than 0.1 million in 2009, 2008, and 2007, respectively.

14. Research and Development

R&D expense consists of the following:

(In Millions)	2009	2008	2007
Customer-funded	\$493	\$501	\$480
Company-funded	355	395	347
Total research and development	\$848	\$896	\$827

15. Other Income, Net

Other income, net consists of the following:

(In Millions)	2009	2008	2007
Earnings from equity affiliates	\$ (8)	\$ (8)	\$ (8)
Interest income	(5)	(8)	(4)
Royalty income	(7)	(11)	(6)
Other, net	(3)	3	3
Other income, net	\$(23)	\$(24)	\$(15)

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Income Taxes

The components of income tax expense are as follows:

<u>(In Millions)</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current:			
U.S. federal	\$175	\$200	\$189
Non-U.S.	6	2	12
U.S. state and local	4	—	14
Total current	<u>185</u>	<u>202</u>	<u>215</u>
Deferred:			
U.S. federal	72	58	41
Non-U.S.	10	11	(1)
U.S. state and local	6	4	3
Total deferred.	<u>88</u>	<u>73</u>	<u>43</u>
Income tax expense.	<u>\$273</u>	<u>\$275</u>	<u>\$258</u>

Net current deferred income tax benefits (liabilities) consist of the tax effects of temporary differences related to the following:

<u>(In Millions)</u>	<u>September 30</u>	
	<u>2009</u>	<u>2008</u>
Inventory	\$ (1)	\$ 6
Product warranty costs	72	77
Customer incentives.	30	27
Contract reserves.	12	11
Compensation and benefits	7	(3)
Other, net.	<u>32</u>	<u>18</u>
Current deferred income taxes, net.	<u>\$152</u>	<u>\$136</u>

Net long-term deferred income tax benefits (liabilities) consist of the tax effects of temporary differences related to the following:

<u>(In Millions)</u>	<u>September 30</u>	
	<u>2009</u>	<u>2008</u>
Retirement benefits	\$407	\$173
Intangibles	(37)	(27)
Property	(83)	(69)
Stock-based compensation	20	17
Other, net.	<u>49</u>	<u>40</u>
Long-term deferred income taxes, net.	<u>\$356</u>	<u>\$134</u>

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Income Taxes – (continued)

Current deferred income tax assets and liabilities and long-term deferred income tax assets and liabilities are included in the Consolidated Statement of Financial Position as follows:

(In Millions)	September 30	
	2009	2008
Current deferred income taxes	\$154	\$139
Other current liabilities	(2)	(3)
Current deferred income taxes, net	<u>\$152</u>	<u>\$136</u>
Long-term deferred income taxes	\$371	\$144
Other liabilities	(15)	(10)
Long-term deferred income taxes, net	<u>\$356</u>	<u>\$134</u>

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. Significant factors considered by management in its determination of the probability of the realization of the deferred tax assets include: (a) the historical operating results of Rockwell Collins (\$1,873 million of U.S. taxable income over the past three years), (b) expectations of future earnings, and (c) the extended period of time over which the retirement benefit liabilities will be paid.

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

	2009	2008	2007
Statutory tax rate	35.0%	35.0%	35.0%
State and local income taxes	0.7	0.6	1.1
Research and development credit	(2.2)	(2.6)	(4.0)
Domestic manufacturing deduction	(1.3)	(1.5)	(0.7)
Tax settlements	—	(2.3)	—
Extraterritorial income exclusion	—	—	(0.5)
Other	(0.7)	(0.3)	(0.3)
Effective income tax rate	<u>31.5%</u>	<u>28.9%</u>	<u>30.6%</u>

Income tax expense was calculated based on the following components of income before income taxes:

(In Millions)	2009	2008	2007
U.S. income	\$799	\$898	\$802
Non-U.S. income	68	55	41
Total	<u>\$867</u>	<u>\$953</u>	<u>\$843</u>

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

The Company's U.S. Federal income tax returns for the tax years ended September 30, 2005 and prior have been audited by the Internal Revenue Service (IRS) and are closed to further adjustments by the IRS. The IRS is currently auditing the Company's tax returns for the years ended September 30, 2006 and 2007. The Company has received certain proposed audit adjustments from the IRS which are not expected to have a material effect on the Company's results of operations, financial condition or cash flows. The Company is also currently under audit in various U.S. states and non-U.S. jurisdictions. The U.S. state and non-U.S. jurisdictions have statutes of limitations generally ranging from 3 to 5 years. The Company believes it has adequately provided for any tax adjustments that may result from the various audits.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Income Taxes – (continued)

No provision has been made as of September 30, 2009 for U.S. federal or state, or additional non-U.S. income taxes related to approximately \$198 million of undistributed earnings of non-U.S. subsidiaries which have been or are intended to be permanently reinvested. It is not practicable to estimate the amount of tax that might be payable on the undistributed earnings.

The Company paid income taxes, net of refunds, of \$157 million, \$268 million, and \$212 million, in 2009, 2008, and 2007, respectively.

In accordance with the Income Taxes topic of the FASB Accounting Standards Codification, the Company adopted the provisions related to accounting for uncertain income tax positions at the beginning of fiscal year 2008. The \$5 million cumulative effect of adoption was recorded as a reduction to retained earnings in the first quarter of 2008. At September 30, 2008, the Company had gross unrecognized tax benefits of \$73 million recorded within Other Liabilities in the Consolidated Statement of Financial Position, of which \$41 million would affect the effective income tax rate if recognized. At September 30, 2009, the Company had gross unrecognized tax benefits of \$98 million recorded within Other Liabilities in the Consolidated Statement of Financial Position, of which \$56 million would affect the effective income tax rate if recognized. Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months a reduction in unrecognized tax benefits may occur in the range of \$0 to \$33 million, a significant portion of which would not impact the effective income tax rate.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for the years ended September 30 is as follows:

(In Millions)	2009	2008
Beginning balance	\$73	\$ 84
Additions for tax positions related to the current year	24	19
Additions for tax positions of prior years	1	2
Reductions for tax positions of prior years	—	(20)
Reductions for tax positions related to settlements with taxing authorities	—	(12)
Ending balance	<u>\$98</u>	<u>\$ 73</u>

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. The total amount of interest and penalties recognized within Other Liabilities in the Consolidated Statement of Financial Position was \$9 million and \$5 million as of September 30, 2009 and 2008, respectively.

17. Fair Value of Financial Instruments

Fair Value Measurements

The Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. The topic indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. It establishes a valuation hierarchy for disclosure of the inputs to valuation techniques used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 — quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 — quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument
- Level 3 — unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. Fair Value of Financial Instruments – (continued)

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The fair value of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2009 are as follows:

(In Millions)	Carrying Amount Asset (Liability)	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Deferred compensation plan investments	\$ 35	\$35	\$ —	\$—
Interest rate swaps	8	—	8	—
Foreign currency forward exchange contract assets	8	—	8	—
Foreign currency forward exchange contract liabilities	(11)	—	(11)	—

Valuation Techniques

The deferred compensation plan investments consist of investments in marketable securities (primarily mutual funds) and the fair value is determined using the market approach based on quoted market prices of identical assets in active markets.

The fair value of the interest rate swaps is determined using the market approach and is calculated by a pricing model with observable market inputs.

The fair value of foreign currency forward exchange contracts is determined using the market approach and is calculated as the value of the quoted forward currency exchange rate less the contract rate multiplied by the notional amount.

As of September 30, 2009, there has not been any impact to the fair value of derivative liabilities due to the Company's own credit risk. Similarly, there has not been any impact to the fair value of derivative assets based on the Company's evaluation of counterparties' credit risks.

The carrying amounts and fair values of the Company's financial instruments are as follows:

(In Millions)	Asset (Liability)			
	September 30, 2009		September 30, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 235	\$ 235	\$ 175	\$ 175
Short-term debt	—	—	(287)	(287)
Long-term debt	(532)	(559)	(228)	(216)

The fair value of cash and cash equivalents approximate their carrying value due to the short-term nature of the instruments. The fair value of short-term debt approximates its carrying value due to the short-term nature of the debt. Fair value information for long-term debt is based on current market interest rates and estimates of current market conditions for instruments with similar terms, maturities, and degree of risk. These fair value estimates do not necessarily reflect the amounts the Company would realize in a current market exchange.

18. Derivative Financial Instruments

The Company uses derivative financial instruments in the form of foreign currency forward exchange contracts and interest rate swap contracts for the purpose of minimizing exposure to changes in foreign currency exchange rates on business transactions and interest rates, respectively. The Company's policy is to execute such instruments with banks the Company believes to be creditworthy and not to enter into derivative financial instruments for speculative purposes or to manage exposure for net investments in non-U.S.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Derivative Financial Instruments – (continued)

subsidiaries. These derivative financial instruments do not subject the Company to undue risk as gains and losses on these instruments generally offset gains and losses on the underlying assets, liabilities, or anticipated transactions that are being hedged.

All derivative financial instruments are recorded at fair value in the Consolidated Statement of Financial Position. For a derivative that has not been designated as an accounting hedge, the change in the fair value is recognized immediately through earnings. For a derivative that has been designated as an accounting hedge of an existing asset or liability (a fair value hedge), the change in the fair value of both the derivative and underlying asset or liability is recognized immediately through earnings. For a derivative designated as an accounting hedge of an anticipated transaction (a cash flow hedge), the change in the fair value is recorded on the Consolidated Statement of Financial Position in Accumulated Other Comprehensive Loss (AOCL) to the extent the derivative is effective in mitigating the exposure related to the anticipated transaction. The change in the fair value related to the ineffective portion of the hedge, if any, is immediately recognized in earnings. The amount recorded within AOCL is reclassified into earnings in the same period during which the underlying hedge transaction affects earnings. The Company does not exclude any amounts from the measure of effectiveness for both fair value and cash flow hedges. All of the Company's derivatives were designated as accounting hedges as of September 30, 2009.

The fair values of derivative instruments are presented on a gross basis as the Company does not have any derivative contracts which are subject to master netting arrangements. The Company does not have any hedges with credit-risk-related contingent features or that required the posting of collateral as of September 30, 2009. The cash flows from derivative contracts are recorded in operating activities in the Consolidated Statement of Cash Flows.

Interest Rate Swaps

The Company manages its exposure to interest rate risk by maintaining an appropriate mix of fixed and variable rate debt, which over time should moderate the costs of debt financing. When considered necessary, the Company may use financial instruments in the form of interest rate swaps to help meet this objective. On November 20, 2003, the Company entered into two interest rate swap contracts (the Swaps) which expire on December 1, 2013 and effectively convert \$100 million of the 4.75 percent fixed rate long-term notes to floating rate debt based on six-month LIBOR less 7.5 basis points. The Company has designated the Swaps as fair value hedges. At September 30, 2009 and September 30, 2008, the Swaps were recorded within Other Assets at a fair value of \$8 million and \$4 million, respectively, offset by a fair value adjustment to Long-Term Debt (Note 10) of \$8 million and \$4 million, respectively. Cash payments or receipts between the Company and the counterparties to the Swaps are recorded as an adjustment to interest expense.

Foreign Currency Forward Exchange Contracts

The Company transacts business in various foreign currencies which subjects the Company's cash flows and earnings to exposure related to changes in foreign currency exchange rates. These exposures arise primarily from purchases or sales of products and services from third parties and intercompany transactions. Foreign currency forward exchange contracts provide for the purchase or sale of foreign currencies at specified future dates at specified exchange rates and are used to offset changes in the fair value of certain assets or liabilities or forecasted cash flows resulting from transactions denominated in foreign currencies. As of September 30, 2009 and September 30, 2008, the Company had outstanding foreign currency forward exchange contracts with notional amounts of \$353 million and \$218 million, respectively. These notional values consist primarily of contracts for the euro, British pound sterling and Japanese yen, and are stated in U.S. dollar equivalents at spot exchange rates at the respective dates.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Derivative Financial Instruments – (continued)

Fair Value of Derivative Instruments

Fair values of derivative instruments in the Consolidated Statement of Financial Position as of September 30, 2009 are as follows:

<u>(In Millions)</u>	Asset Derivatives		Liability Derivatives	
	Classification	Fair Value	Classification	Fair Value
Foreign currency forward exchange contracts	Other current assets	\$ 8	Other current liabilities	\$11
Interest rate swaps	Other assets	8	Other liabilities	—
Total		\$16		\$11

The effect of derivative instruments on the Consolidated Statement of Operations for the fiscal year ended September 30 is as follows:

<u>(In Millions)</u>	<u>Location of Gain (Loss)</u>	<u>Amount of Gain (Loss) at September 30 2009</u>
<i>Fair Value Hedges</i>		
Foreign currency forward exchange contracts	Cost of sales	\$—
Interest rate swaps	Interest expense	4
<i>Cash Flow Hedges</i>		
Foreign currency forward exchange contracts:		
Amount of loss recognized in AOCL (effective portion)	AOCL	\$(1)
Amount of loss reclassified from AOCL into income	Cost of sales	(2)

There was no significant impact to the Company's earnings related to the ineffective portion of any hedging instruments during the fiscal year ended September 30, 2009. In addition, there was no significant impact to the Company's earnings when a hedged firm commitment no longer qualified as a fair value hedge or when a hedged forecasted transaction no longer qualified as a cash flow hedge during the fiscal year ended September 30, 2009.

Cash flow hedges are designated as fair value hedges once the underlying transaction is recorded on the balance sheet, or approximately 60 days from the maturity date of the hedge. The Company expects to reclassify approximately \$4 million of net gains into earnings over the next 12 months. The maximum duration of a foreign currency cash flow hedge contract at September 30, 2009 is 130 months.

19. Guarantees and Indemnifications

Product Warranty Costs

Accrued liabilities are recorded to reflect the Company's contractual obligations relating to warranty commitments to customers. Warranty coverage of various lengths and terms is provided to customers depending on standard offerings and negotiated contractual agreements. An estimate for warranty expense is recorded at the time of sale based on the length of the warranty and historical warranty return rates and repair costs.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. Guarantees and Indemnifications – (continued)

Changes in the carrying amount of accrued product warranty costs are summarized as follows:

<u>(In Millions)</u>	<u>September 30</u>	
	<u>2009</u>	<u>2008</u>
Balance at beginning of year	\$226	\$213
Warranty costs incurred	(54)	(53)
Product warranty accrual	46	68
Acquisitions	2	1
Pre-existing warranty adjustments	(3)	(3)
Balance at September 30	<u>\$217</u>	<u>\$226</u>

Guarantees

In connection with the 2006 acquisition of the Quest joint venture (see Note 8) the Company entered into a parent company guarantee related to various obligations of Quest. The Company has guaranteed, jointly and severally with Quadrant (the other joint venture partner), the performance of Quest in relation to its contract with the United Kingdom Ministry of Defence (which expires in 2030) and the performance of certain Quest subcontractors (up to \$2 million). In addition, the Company has also pledged equity shares in Quest to guarantee payment by Quest of a loan agreement executed by Quest. In the event of default on this loan agreement, the lending institution can request that the trustee holding such equity shares surrender them to the lending institution in order to satisfy all amounts then outstanding under the loan agreement. As of September 30, 2009, the outstanding loan balance was approximately \$6 million. Quadrant has made an identical pledge to guarantee this obligation of Quest.

Should Quest fail to meet its obligations under these agreements, these guarantees may become a liability of the Company. As of September 30, 2009, the Quest guarantees are not reflected on the Company's Consolidated Statement of Financial Position because the Company believes that Quest will meet all of its performance and financial obligations in relation to its contract with the United Kingdom Ministry of Defence and the loan agreement.

Letters of Credit

The Company has contingent commitments in the form of letters of credit. Outstanding letters of credit are issued by banks on the Company's behalf to support certain contractual obligations to its customers. If the Company fails to meet these contractual obligations, these letters of credit may become liabilities of the Company. Total outstanding letters of credit at September 30, 2009 were \$80 million. These commitments are not reflected as liabilities on the Company's Consolidated Statement of Financial Position.

Indemnifications

The Company enters into indemnifications with lenders, counterparties in transactions such as administration of employee benefit plans, and other customary indemnifications with third parties in the normal course of business. The following are other than customary indemnifications based on the judgment of management.

The Company became an independent, publicly held company on June 29, 2001, when Rockwell International Corporation (Rockwell), renamed Rockwell Automation Inc., spun off its former avionics and communications business and certain other assets and liabilities of Rockwell by means of a distribution of all the Company's outstanding shares of common stock to the shareowners of Rockwell in a tax-free spin-off (the spin-off). In connection with the spin-off, the Company may be required to indemnify certain insurers against claims made by third parties in connection with the Company's legacy insurance policies.

In connection with agreements for the sale of portions of its business, the Company at times retains the liabilities of a business of varying amounts that relate to events occurring prior to its sale, such as tax,

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. Guarantees and Indemnifications – (continued)

environmental, litigation and employment matters. The Company at times indemnifies the purchaser of a Rockwell Collins business in the event that a third party asserts a claim that relates to a liability retained by the Company.

The Company also provides indemnifications of varying scope and amounts to certain customers against claims of product liability or intellectual property infringement made by third parties arising from the use of Company or customer products or intellectual property. These indemnifications generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party product liability or intellectual property claims arising from these transactions.

The amount the Company could be required to pay under its indemnification agreements is generally limited based on amounts specified in the underlying agreements, or in the case of some agreements, the maximum potential amount of future payments that could be required is not limited. When a potential claim is asserted under these agreements, the Company considers such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. A liability is recorded when a potential claim is both probable and estimable. The nature of these agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay should counterparties to these agreements assert a claim; however, the Company currently has no material claims pending related to such agreements.

20. Contractual Obligations and Other Commitments

The following table reflects certain of the Company's non-cancelable contractual commitments as of September 30, 2009:

<u>(In Millions)</u>	<u>Payments Due by Period</u>						
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Thereafter</u>	<u>Total</u>
Non-cancelable operating leases	\$ 53	\$ 40	\$29	\$22	\$ 20	\$ 43	\$ 207
Purchase contracts	36	36	36	38	12	1	159
Long-term debt	—	26	—	—	200	300	526
Interest on long-term debt	26	25	25	25	18	76	195
Total	<u>\$115</u>	<u>\$127</u>	<u>\$90</u>	<u>\$85</u>	<u>\$250</u>	<u>\$420</u>	<u>\$1,087</u>

Non-cancelable Operating Leases

The Company leases 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. Some leases include renewal options, which permit extensions of the expiration dates at rates approximating fair market rental rates. Rent expense for the years ended September 30, 2009, 2008, and 2007 was \$61 million, \$48 million, and \$29 million, respectively. The Company's commitments under these operating leases, in the form of non-cancelable future lease payments, are not reflected as a liability on the Consolidated Statement of Financial Position.

Purchase Contracts

The Company may enter into purchase contracts with suppliers under which there is a commitment to buy a minimum amount of products or pay a specified amount. These commitments are not reflected as a liability on the Company's Consolidated Statement of Financial Position. Amounts purchased under these agreements for the years ended September 30, 2009, 2008, and 2007 were \$31 million, \$27 million, and \$15 million, respectively.

Interest on Long-term Debt

Interest payments under long-term debt obligations exclude the potential effects of the related interest rate swap contracts.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. Environmental Matters

The Company is subject to federal, state and local regulations relating to the discharge of substances into the environment, the disposal of hazardous wastes, and other activities affecting the environment that have had and will continue to have an impact on the Company's manufacturing operations. These environmental protection regulations may require the investigation and remediation of environmental impairments at current and previously owned or leased properties. In addition, lawsuits, claims and proceedings have been asserted on occasion against the Company alleging violations of environmental protection regulations, or seeking remediation of alleged environmental impairments, principally at previously owned or leased properties. As of September 30, 2009, the Company is involved in the investigation or remediation of eight sites under these regulations or pursuant to lawsuits asserted by third parties. Management estimates that the total reasonably possible future costs the Company could incur for seven of these sites is not significant. Management estimates that the total reasonably possible future costs the Company could incur from one of these sites to be approximately \$8 million. The Company has recorded environmental reserves for this site of \$3 million as of September 30, 2009, which represents management's best estimate of the probable future cost for this site.

To date, compliance with environmental regulations and resolution of environmental claims has been accomplished without material effect on the Company's liquidity and capital resources, competitive position or financial condition. Management believes that expenditures for environmental capital investment and remediation necessary to comply with present regulations governing environmental protection and other expenditures for the resolution of environmental claims will not have a material adverse effect on the Company's business or financial position, but could possibly be material to the results of operations or cash flows of any one quarter.

22. Legal Matters

The Company is subject to various lawsuits, claims and proceedings that have been or may be instituted or asserted against the Company relating to the conduct of the Company's business, including those pertaining to product liability, antitrust, intellectual property, safety and health, exporting and importing, contract, employment and regulatory matters. Although the outcome of these matters cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to the Company, management believes the disposition of matters that are pending or asserted are not expected to have a material adverse effect on the Company's business or financial position, but could possibly be material to the results of operations or cash flows of any one quarter.

23. Restructuring and Asset Impairment Charges

In September 2009, the Company recorded restructuring and asset impairment charges totaling \$21 million. These charges are primarily comprised of employee severance costs and a real estate impairment charge related to the Company's plans to close its Government Systems facility in San Jose, California and relocate engineering, production, and service work to other existing facilities. The charge also includes severance costs and an asset impairment charge related to other actions taken in response to the global economic factors that have negatively impacted the Company's commercial markets.

As a result of these actions, the Company intends to reduce its workforce by approximately 700 employees. Approximately 5 percent of employee separation costs were incurred in 2009 with the remainder to be incurred during 2010. Employee separation costs of \$10 million are included in Compensation and Benefits in the Consolidated Statement of Financial Position at September 30, 2009.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

23. Restructuring and Asset Impairment Charges – (continued)

The total restructuring and asset impairment charges are included in cost of sales and Selling, General and Administrative Expenses in the amounts of \$19 million and \$2 million, respectively. The components of the restructuring and asset impairment charges by segment are as follows:

(In Millions)	Government Systems	Commercial Systems	Total
Employee separation costs	\$ 8	\$2	\$10
Asset impairments	8	3	11
Total restructuring and asset impairment charges	<u>\$16</u>	<u>\$5</u>	<u>\$21</u>

24. Business Segment Information

Rockwell Collins designs, produces and supports communications and aviation electronics for military and commercial customers worldwide. The Company has two operating segments consisting of the Government Systems and Commercial Systems businesses.

Government Systems provides communication and electronic systems, products and services for airborne and surface applications to the U.S. Department of Defense, other government agencies, civil agencies, defense contractors and foreign ministries of defense.

Commercial Systems supplies aviation electronics systems, products, and services to customers located throughout the world. The customer base is comprised of original equipment manufacturers (OEMs) of commercial air transport, business and regional aircraft, commercial airlines, fractional and other business aircraft operators.

Sales made to the U.S. Government were 43 percent, 38 percent, and 36 percent of total sales for the years ended September 30, 2009, 2008, and 2007, respectively.

The following table reflects the sales and operating results for each of the Company's operating segments:

(In Millions)	2009	2008	2007
Sales:			
Government Systems	\$2,579	\$2,366	\$2,231
Commercial Systems	1,891	2,403	2,184
Total sales	<u>\$4,470</u>	<u>\$4,769</u>	<u>\$4,415</u>
Segment operating earnings:			
Government Systems	\$ 602	\$ 486	\$ 441
Commercial Systems	353	560	485
Total segment operating earnings	955	1,046	926
Interest expense	(18)	(21)	(13)
Stock-based compensation	(18)	(19)	(17)
Restructuring and asset impairment (charge)/adjustment	(21)	—	5
General corporate, net	(31)	(53)	(58)
Income before income taxes	867	953	843
Income tax provision	(273)	(275)	(258)
Net income	<u>\$ 594</u>	<u>\$ 678</u>	<u>\$ 585</u>

The Company evaluates performance and allocates resources based upon, among other considerations, segment operating earnings. The Company's definition of segment operating earnings excludes income taxes, stock-based compensation, unallocated general corporate expenses, interest expense, gains and losses from the

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

24. Business Segment Information – (continued)

disposition of businesses, restructuring and asset impairment charges, and other special items as identified by management from time to time. Intersegment sales are not material and have been eliminated. The accounting policies used in preparing the segment information are consistent with the policies described in Note 2.

The 2009 restructuring and asset impairment charges are discussed in Note 23.

The 2007 adjustment to the restructuring charge was due to lower than expected employee separation costs associated with a 2006 business realignment and relates to the operating segments as follows: Government Systems, \$3 million, and Commercial Systems, \$2 million.

The following tables summarize the identifiable assets and investments in equity affiliates at September 30, 2009, 2008 and 2007 as well as the provision for depreciation and amortization, the amount of capital expenditures for property, and earnings from equity affiliates for each of the three years ended September 30, for each of the operating segments and Corporate:

(In Millions)	2009	2008	2007
Identifiable assets:			
Government Systems	\$1,937	\$1,706	\$1,472
Commercial Systems	1,858	1,870	1,711
Corporate	850	568	567
Total identifiable assets	<u>\$4,645</u>	<u>\$4,144</u>	<u>\$3,750</u>
Investments in equity affiliates:			
Government Systems	\$ 10	\$ 9	\$ 10
Commercial Systems	—	—	—
Total investments in equity affiliates	<u>\$ 10</u>	<u>\$ 9</u>	<u>\$ 10</u>
Depreciation and amortization:			
Government Systems	\$ 66	\$ 54	\$ 55
Commercial Systems	78	75	63
Total depreciation and amortization	<u>\$ 144</u>	<u>\$ 129</u>	<u>\$ 118</u>
Capital expenditures for property:			
Government Systems	\$ 88	\$ 97	\$ 65
Commercial Systems	65	74	60
Total capital expenditures for property	<u>\$ 153</u>	<u>\$ 171</u>	<u>\$ 125</u>
Earnings from equity affiliates:			
Government Systems	\$ 8	\$ 8	\$ 8
Commercial Systems	—	—	—
Total earnings from equity affiliates	<u>\$ 8</u>	<u>\$ 8</u>	<u>\$ 8</u>

The Company's operating segments share many common resources, infrastructures and assets in the normal course of business. Certain assets have been allocated between the operating segments primarily based on occupancy or usage, principally property, plant and equipment. Identifiable assets at Corporate consist principally of cash and net deferred income tax assets for all years presented and for the year ended September 30, 2007 also includes a prepaid pension asset.

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

24. Business Segment Information – (continued)

The following table summarizes sales by product category for the years ended September 30, 2009, 2008 and 2007:

(In Millions)	2009	2008	2007
Airborne solutions	\$1,761	\$1,662	\$1,605
Surface solutions	818	704	626
Government Systems sales	2,579	2,366	2,231
Air transport aviation electronics	986	1,257	1,175
Business and regional aviation electronics	905	1,146	1,009
Commercial Systems sales	1,891	2,403	2,184
Total sales	<u>\$4,470</u>	<u>\$4,769</u>	<u>\$4,415</u>

Product category sales for defense-related products in the Government Systems segment are delineated based upon the difference in underlying customer base and markets served.

The air transport and business and regional aviation electronics product categories are delineated based upon the difference in underlying customer base, size of aircraft, and markets served.

The following table reflects sales for the years ended September 30, 2009, 2008 and 2007 and property at September 30, 2009, 2008 and 2007 by geographic region:

(In Millions)	Sales			Property		
	2009	2008	2007	2009	2008	2007
U.S.	\$3,080	\$3,164	\$2,987	\$641	\$630	\$559
Europe	813	927	840	69	43	42
Asia-Pacific	270	293	252	8	5	4
Canada	185	229	218	—	—	—
Africa/Middle East	80	102	79	—	—	—
Latin America	42	54	39	1	2	2
Total	<u>\$4,470</u>	<u>\$4,769</u>	<u>\$4,415</u>	<u>\$719</u>	<u>\$680</u>	<u>\$607</u>

Sales are attributed to the geographic regions based on the country of destination.

25. Quarterly Financial Information (Unaudited)

Quarterly financial information for the years ended September 30, 2009 and 2008 is summarized as follows:

(In Millions, Except per Share Amounts)	2009 Quarters				
	First	Second	Third	Fourth	Total
Sales	\$1,058	\$1,138	\$1,084	\$1,190	\$4,470
Gross profit (total sales less product and service cost of sales)	326	353	325	316	1,320
Net income	151	164	145	134	594
Earnings per share:					
Basic	\$ 0.96	\$ 1.04	\$ 0.92	\$ 0.85	\$ 3.76
Diluted	\$ 0.95	\$ 1.03	\$ 0.91	\$ 0.84	\$ 3.73

ROCKWELL COLLINS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

25. Quarterly Financial Information (Unaudited) – (continued)

<u>(In Millions, Except per Share Amounts)</u>	<u>2008 Quarters</u>				
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
Sales	\$1,112	\$1,186	\$1,194	\$1,277	\$4,769
Gross profit (total sales less product and service cost of sales)	343	346	367	379	1,435
Net income	154	168	174	182	678
Earnings per share:					
Basic	\$ 0.95	\$ 1.04	\$ 1.09	\$ 1.14	\$ 4.22
Diluted	\$ 0.93	\$ 1.03	\$ 1.07	\$ 1.13	\$ 4.16

Earnings per share amounts are computed independently each quarter. As a result, the sum of each quarter's per share amount may not equal the total per share amount for the respective year.

Net income in the fourth quarter of 2009 includes \$14 million (\$21 million before income taxes) related to the restructuring charge and impairment of long-lived assets discussed in Note 23. \$19 million of the restructuring and asset impairment charges are included within Gross Profit.

Net income in the fourth quarter of 2008 includes a discrete item related to the retroactive reinstatement and extension of the Federal R&D Tax Credit, which lowered the Company's effective income tax rate by about 6 percentage points within the quarter.

Net income in the second and third quarters of 2008 includes discrete items related to favorable income tax adjustments resulting from the resolution of certain tax settlements, which lowered the Company's effective income tax rate by 7 and 3 percentage points in the second and third quarters of 2008, respectively.