

2011 Compared with 2010

Organic sales growth was 7%, with the recovery in the transport refrigeration market partially offset by declines in the U.K. and U.S. service businesses. The 4% decrease in "Acquisitions and divestitures, net" primarily reflects the net impact from acquisitions and the business transformation actions completed in the preceding twelve months as part of UTC Climate, Controls & Security's ongoing portfolio transformation initiative.

The operational profit improvement of 13% was driven by strong conversion on organic sales growth (7%), particularly in the higher margin transport refrigeration business, lower bad debt expense, and earnings improvement in a joint venture in Japan (2%). This was partially offset by lower margins and unfavorable sales mix primarily within the fire protection products business in the U.K. and higher net commodity costs (6%). The 9% increase in "Other" primarily reflects the year-over-year impact of net gains associated with UTC Climate, Control & Security's ongoing portfolio transformation. This includes an approximately \$80 million gain recorded in 2011 as a result of the contribution of legacy Carrier's HVAC operations in Brazil, Argentina, and Chile into a new venture controlled by Midea Group of China. Also included in "Other" is the favorable resolution of litigation and gains on the dispositions of U.K. security businesses and the absence of an asset impairment charge in 2010 of approximately \$58 million, all of which was partially offset by a \$66 million other-than-temporary impairment charge recorded on an equity investment in Asia in 2011.

Aerospace Businesses

The financial performance of Pratt & Whitney, UTC Aerospace Systems and Sikorsky is directly tied to the economic conditions of the commercial aerospace and defense aerospace industries. In particular, Pratt & Whitney experiences intense competition for new commercial airframe/engine combinations. Engine suppliers may offer substantial discounts and other financial incentives, performance and operating cost guarantees, participation in financing arrangements and maintenance agreements. At times, the aerospace businesses also enter into development programs and firm fixed-price development contracts, which may require the company to bear cost overruns related to unforeseen technical and design challenges that arise during the development stage of the program. Customer selections of engines and components can also have a significant impact on later sales of parts and service. Predicted traffic levels, load factors, worldwide airline profits, general economic activity and global defense spending have been reliable indicators for new aircraft and aftermarket orders within the aerospace industry. Spare part sales and aftermarket service trends are affected by many factors, including usage, technological improvements, pricing, regulatory changes and the retirement of older aircraft. Performance in the general aviation sector is closely tied to the overall health of the economy and is positively correlated to corporate profits.

Our long-term aerospace contracts are subject to strict safety and performance regulations which can affect our ability to estimate costs precisely. Contract cost estimation for the development of complex projects, in particular, requires management to make significant judgments and assumptions regarding the complexity of the work to be performed, availability of materials, the performance by subcontractors, the timing of funding from customers and the length of time to complete the contract. As a result, we review and update our cost estimates on significant contracts on a quarterly basis, and no less frequently than annually for all others, or when circumstances change and warrant a modification to a previous estimate. Changes in estimates relate to the current period impact of revisions to total estimated contract sales and costs at completion. We record changes in contract estimates using the cumulative catch-up method in accordance with the Revenue Recognition Topic of the FASB Accounting Standards Codification ("ASC"). The net decrease in operating profits as a result of significant changes in aerospace contract estimates was \$19 million in 2012, including the revision in estimate on the Sikorsky CH-148 contract discussed further below. The adverse impact of this contract adjustment was partially offset by several positive contract adjustments recorded throughout the year largely at the Pratt & Whitney segment. The impact of these adjustments was not considered significant to either the sales or operating profits of the segment in the quarter in which they were recorded other than the impact of a contract termination which was disclosed in the Pratt & Whitney segment results in the first quarter of 2012.

The commercial airline industry remained strong throughout 2012. Airline traffic growth rates, as measured by revenue passenger miles (RPMs), stabilized during 2012 and 2011 after rebounding in 2010. RPMs grew 5.5% in 2012, as compared with 2011, and we expect RPMs will continue to grow between 4% and 6% in 2013. We made significant investment in engineering and development in 2012 and expect continued investment in 2013, primarily at Pratt & Whitney as we continue to develop five separate geared turbofan platforms to meet demand for new engines which are fuel efficient and have reduced noise levels and exhaust emissions. Although airlines have generally returned to profitability, high fuel prices continue to challenge the airlines to consider the need for more fuel efficient aircraft.

Deficit reduction measures considered by the U.S. Government are expected to pressure the U.S. Department of Defense budget in the coming years, resulting in a decline in U.S. Department of Defense spending. Total sales to the U.S. Government of \$10.1 billion in 2012, \$9.1 billion in 2011, and \$9.1 billion in 2010 were 18%, 16% and 17% of total UTC sales in 2012, 2011 and 2010, respectively. The defense portion of our aerospace business is affected by changes in market demand and the global political environment. Our participation in long-term production and development programs for the U.S. Government has contributed positively to our results in 2012 and is expected to continue to benefit results in 2013.