

HONEYWELL INTERNATIONAL INC  
Form 10-Q  
April 20, 2007

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United States  
Securities and Exchange Commission  
Washington, D.C 20549

Form 10-Q

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-8974

**Honeywell International Inc.**

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(Exact name of registrant as specified in its charter)

Delaware

22-2640650

(State or other jurisdiction of  
incorporation or organization)

(I.R.S Employer  
Identification No.)

101 Columbia Road  
Morris Township, New Jersey

07962

(Address of principal executive offices)

(Zip Code)

(973) 455-2000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year,  
if changed since last report)

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

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to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-Accelerated filer ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

There were 779,717,661 shares of Common Stock outstanding at March 31, 2007.

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## Honeywell International Inc.

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#### Cautionary Statement about Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are those that address activities, events or developments that we or our management intends, expects, projects, believes or anticipates will or may occur in the future. They are based on management's assumptions and assessments in the light of past experience and trends, current conditions, expected future developments and other relevant factors. They are not guarantees of future performance, and actual results, developments and business decisions may differ from those envisaged by our forward-looking statements. Our forward-looking statements are also subject to risks and uncertainties, which can affect our performance in both the near- and long-term. These forward-looking statements should be considered in the light of the information included in this report and our other filings with the Securities and Exchange Commission, including, without limitation, the Risk Factors, as well as the description of trends and other factors in Management's Discussion and Analysis of Financial Condition and Results of Operations, set forth in our Form 10-K for the year ended December 31, 2006.

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## PART I. FINANCIAL INFORMATION

The financial information as of March 31, 2007 should be read in conjunction with the financial statements for the year ended December 31, 2006 contained in our form 10-K filed on February 16, 2007.

### ITEM 1. FINANCIAL STATEMENTS

#### Honeywell International Inc. Consolidated Statement of Operations (Unaudited)

|                                                       | <b>Three Months Ended<br/>March 31,</b>                    |             |
|-------------------------------------------------------|------------------------------------------------------------|-------------|
|                                                       | <b>2007</b>                                                | <b>2006</b> |
|                                                       | <b>(Dollars in millions, except<br/>per share amounts)</b> |             |
| Product sales                                         | \$ 6,450                                                   | \$ 5,806    |
| Service sales                                         | 1,591                                                      | 1,435       |
| Net sales                                             | 8,041                                                      | 7,241       |
| Costs, expenses and other                             |                                                            |             |
| Cost of products sold                                 | 5,010                                                      | 4,566       |
| Cost of services sold                                 | 1,140                                                      | 1,034       |
|                                                       | 6,150                                                      | 5,600       |
| Selling, general and administrative expenses          | 1,089                                                      | 1,002       |
| Other (income) expense                                | (11)                                                       | (25)        |
| Interest and other financial charges                  | 97                                                         | 89          |
|                                                       | 7,325                                                      | 6,666       |
| Income from continuing operations before taxes        | 716                                                        | 575         |
| Tax expense                                           | 190                                                        | 144         |
| Income from continuing operations                     | 526                                                        | 431         |
| Income from discontinued operations, net of taxes     |                                                            | 5           |
| Net income                                            | \$ 526                                                     | \$ 436      |
| Earnings per share of common stock-basic:             |                                                            |             |
| Income from continuing operations                     | \$ 0.66                                                    | \$ 0.51     |
| Income from discontinued operations                   |                                                            | 0.01        |
| Net income                                            | \$ 0.66                                                    | \$ 0.52     |
| Earnings per share of common stock-assuming dilution: |                                                            |             |
| Income from continuing operations                     | \$ 0.66                                                    | \$ 0.51     |
| Income from discontinued operations                   |                                                            | 0.01        |

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|                                          |         |             |
|------------------------------------------|---------|-------------|
| Net income                               | \$ 0.66 | \$ 0.52     |
| Cash dividends per share of common stock | \$ 0.25 | \$ 0.226875 |

The Notes to Financial Statements are an integral part of this statement.

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Honeywell International Inc.  
Consolidated Balance Sheet  
(Unaudited)

|                                                        | March 31,<br>2007     | December 31,<br>2006 |
|--------------------------------------------------------|-----------------------|----------------------|
|                                                        |                       |                      |
|                                                        | (Dollars in millions) |                      |
| ASSETS                                                 |                       |                      |
| Current assets:                                        |                       |                      |
| Cash and cash equivalents                              | \$ 1,378              | \$ 1,224             |
| Accounts, notes and other receivables                  | 5,873                 | 5,740                |
| Inventories                                            | 3,749                 | 3,588                |
| Deferred income taxes                                  | 1,197                 | 1,215                |
| Other current assets                                   | 433                   | 470                  |
| Assets held for disposal                               | 66                    | 67                   |
|                                                        |                       |                      |
| Total current assets                                   | 12,696                | 12,304               |
|                                                        |                       |                      |
| Investments and long-term receivables                  | 405                   | 382                  |
| Property, plant and equipment - net                    | 4,710                 | 4,797                |
| Goodwill                                               | 8,400                 | 8,403                |
| Other intangible assets - net                          | 1,223                 | 1,247                |
| Insurance recoveries for asbestos related liabilities  | 1,104                 | 1,100                |
| Deferred income taxes                                  | 1,002                 | 1,075                |
| Prepaid pension benefit cost                           | 733                   | 695                  |
| Other assets                                           | 940                   | 938                  |
|                                                        |                       |                      |
| Total assets                                           | \$ 31,213             | \$ 30,941            |
|                                                        |                       |                      |
| LIABILITIES                                            |                       |                      |
| Current liabilities:                                   |                       |                      |
| Accounts payable                                       | \$ 3,582              | \$ 3,518             |
| Short-term borrowings                                  | 65                    | 62                   |
| Commercial paper                                       | 997                   | 669                  |
| Current maturities of long-term debt                   | 227                   | 423                  |
| Accrued liabilities                                    | 5,493                 | 5,455                |
| Liabilities related to assets held for disposal        | 10                    | 8                    |
|                                                        |                       |                      |
| Total current liabilities                              | 10,374                | 10,135               |
|                                                        |                       |                      |
| Long-term debt                                         | 4,704                 | 3,909                |
| Deferred income taxes                                  | 367                   | 352                  |
| Postretirement benefit obligations other than pensions | 2,085                 | 2,090                |
| Asbestos related liabilities                           | 1,249                 | 1,262                |
| Other liabilities                                      | 3,271                 | 3,473                |
|                                                        |                       |                      |
| SHAREOWNERS' EQUITY                                    |                       |                      |
| Capital - common stock issued                          | 958                   | 958                  |
| - additional paid-in capital                           | 3,880                 | 3,845                |
| Common stock held in treasury, at cost                 | (7,350)               | (6,339)              |
| Accumulated other comprehensive income (loss)          | (1,249)               | (1,307)              |
| Retained earnings                                      | 12,924                | 12,563               |
|                                                        |                       |                      |
| Total shareowners' equity                              | 9,163                 | 9,720                |
|                                                        |                       |                      |
| Total liabilities and shareowners' equity              | \$ 31,213             | \$ 30,941            |

The Notes to Financial Statements are an integral part of this statement.

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Honeywell International Inc.  
Consolidated Statement of Cash Flows  
(Unaudited)

|                                                                                         | Three Months Ended<br>March 31, |        |
|-----------------------------------------------------------------------------------------|---------------------------------|--------|
|                                                                                         | 2007                            | 2006   |
|                                                                                         | (Dollars in millions)           |        |
| Cash flows from operating activities:                                                   |                                 |        |
| Net income                                                                              | \$ 526                          | \$ 436 |
| Adjustments to reconcile net income to net cash provided by operating activities:       |                                 |        |
| Depreciation and amortization                                                           | 200                             | 188    |
| Repositioning and other charges                                                         | 179                             | 130    |
| Net (payments) receipts for repositioning and other charges                             | (132)                           | 7      |
| Pension and other postretirement expense                                                | 74                              | 126    |
| Pension and other postretirement payments                                               | (45)                            | (115)  |
| Stock option expense                                                                    | 24                              | 25     |
| Deferred income taxes                                                                   | 17                              | 56     |
| Excess tax benefits from share based payment arrangements                               | (8)                             |        |
| Other                                                                                   | 6                               | (57)   |
| Changes in assets and liabilities, net of the effects of acquisitions and divestitures: |                                 |        |
| Accounts, notes and other receivables                                                   | (136)                           | (147)  |
| Inventories                                                                             | (161)                           | (183)  |
| Other current assets                                                                    | 36                              | (11)   |
| Accounts payable                                                                        | 65                              | 10     |
| Accrued liabilities                                                                     | (67)                            | (226)  |
| Net cash provided by operating activities                                               | 578                             | 239    |
| Cash flows from investing activities:                                                   |                                 |        |
| Expenditures for property, plant and equipment                                          | (120)                           | (122)  |
| Proceeds from disposals of property, plant and equipment                                | 33                              | 37     |
| Cash paid for acquisitions, net of cash acquired                                        | (13)                            | (56)   |
| Proceeds from sales of businesses, net of fees paid                                     | 9                               | 475    |
| Net cash (used for)/provided by investing activities                                    | (91)                            | 334    |
| Cash flows from financing activities:                                                   |                                 |        |
| Net increase/(decrease)in commercial paper                                              | 328                             | (637)  |
| Net increase/(decrease)in short-term borrowings                                         | 3                               | (180)  |
| Payment of debt assumed with acquisitions                                               |                                 | (209)  |
| Proceeds from issuance of common stock                                                  | 119                             | 174    |
| Proceeds from issuance of long-term debt                                                | 988                             | 1,239  |
| Payments of long-term debt                                                              | (398)                           | (237)  |
| Excess tax benefits from share based payment arrangements                               | 8                               |        |
| Repurchases of common stock                                                             | (1,186)                         | (325)  |
| Cash dividends on common stock                                                          | (199)                           | (189)  |
| Net cash (used for) financing activities                                                | (337)                           | (364)  |
| Effect of foreign exchange rate changes on cash and cash equivalents                    | 4                               | (1)    |
| Net increase in cash and cash equivalents                                               | 154                             | 208    |

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|                                                  |          |          |
|--------------------------------------------------|----------|----------|
| Cash and cash equivalents at beginning of period | 1,224    | 1,234    |
| Cash and cash equivalents at end of period       | \$ 1,378 | \$ 1,442 |

The Notes to Financial Statements are an integral part of this statement.

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Honeywell International Inc.  
Notes to Financial Statements  
(Unaudited)  
(Dollars in millions, except per share amounts)

### NOTE 1. Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of Honeywell International Inc. and its consolidated subsidiaries at March 31, 2007 and the results of operations for the three months ended March 31, 2007 and 2006 and cash flows for the three months ended March 31, 2007 and 2006. The results of operations for the three month periods ended March 31, 2007 should not necessarily be taken as indicative of the results of operation that may be expected for the entire year.

We report our quarterly financial information using a calendar convention; that is, the first, second and third quarters are consistently reported as ending on March 31, June 30 and September 30, respectively. It has been our practice to establish actual quarterly closing dates using a predetermined fiscal calendar, which requires our businesses to close their books on a Saturday in order to minimize the potentially disruptive effects of quarterly closing on our business processes. The effects of this practice are generally not significant to reported results for any quarter and only exist within a reporting year. In the event that differences in actual closing dates are material to year-over-year comparisons of quarterly or year-to-date results, we will provide appropriate disclosures. Our actual closing dates for the three month periods ended March 31, 2007 and 2006 were March 31, 2007 and April 1, 2006, respectively. Our fiscal closing calendar for the years 2000 through 2012 is available on our website at [www.Honeywell.com](http://www.Honeywell.com) under the heading Investor Relations .

The financial information as of March 31, 2007 should be read in conjunction with the financial statements for the year ended December 31, 2006 contained in our Form 10-K filed on February 16, 2007.

Certain prior year amounts have been reclassified to conform to current year presentation.

### NOTE 2. Recent Accounting Pronouncements

**Recent Accounting Pronouncements** In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation ( FIN ) No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 . FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement classification, interest and penalties, accounting in interim periods, disclosure and transition. Upon adoption as of January 1, 2007, we reduced our existing reserves for uncertain tax positions by \$33 million, largely related to a reduction in state income tax matters, partially offset by a net increase for federal and international tax reserves. This reduction was recorded as a cumulative effect adjustment to shareowners' equity. Additionally, we decreased a deferred tax asset and its associated valuation allowance by \$44 million and increased goodwill by \$ 1 million.

As of January 1, 2007 we had \$744 million of unrecognized tax benefits. If recognized, approximately \$575 million, net of federal tax benefits, would be

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recorded as a component of income tax expense. There have been no significant changes to these amounts during the quarter ended March 31, 2007.

In many cases our uncertain tax positions are related to tax years that remain subject to examination by the relevant taxable authorities. The following table summarizes these open tax years by major jurisdiction:

| Jurisdiction      | Open Tax Year           |      | Examination not yet initiated |
|-------------------|-------------------------|------|-------------------------------|
|                   | Examination in progress |      |                               |
| United States (1) | 1996 2005               |      | 2006                          |
| United Kingdom    | 1999 2005               |      | 2006                          |
| Canada (1)        | 1991 2004               |      | 2005 2006                     |
| Germany (1)       | 1998 2004               |      | 2005 2006                     |
| France            | 2000 2005               |      | 2006                          |
| Netherlands       | 2002, 2004 2005         | 2000 | 2001, 2003, 2006              |
| Australia         | N/A                     |      | 2003 2006                     |
| China             | N/A                     |      | 1997 2006                     |
| India             | 2002 2005               |      | 2006                          |

1 includes federal as well as state, provincial or similar local jurisdictions, as applicable

Unrecognized tax benefits for the above listed examinations in progress were \$502 million as of January 1, 2007. Based on the outcome of these examinations, or as a result of the expiration of statute of limitations for specific jurisdictions, it is reasonably possible that the related unrecognized tax benefits for tax positions taken regarding previously filed tax returns, will materially change from those recorded as liabilities for uncertain tax positions in our financial statements at January 1, 2007. In addition, the outcome of these examinations may impact the valuation of certain deferred tax assets (such as net operating losses) in future periods. Based on the number of tax years currently under audit by the relevant Federal, State and foreign tax authorities, the Company anticipates that several of these audits may be finalized in the foreseeable future. However, based on the status of these examinations, and the protocol of finalizing audits by the relevant tax authorities, which could include formal legal proceedings, it is not possible to estimate the impact of any amount of such changes, if any, to previously recorded uncertain tax positions. There have been no significant changes to the status of these examinations during the quarter ended March 31, 2007.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of Tax Expense in the Consolidated Statement of Operations and totaled \$7 million for the quarter ended March 31, 2007. Accrued interest and penalties were \$98 million and \$105 million as of January 1, 2007 and March 31, 2007 respectively.

In September 2006, the FASB issued FASB Staff Position ( FSP ) AUG AIR-1 Accounting for Planned Major Maintenance Activities (FSP AUG AIR-1). FSP AUG AIR-1 amends the guidance on the accounting for planned major maintenance activities; specifically it precludes the use of the previously acceptable accrue in advance method. FSP AUG AIR-1 is effective for fiscal years beginning after December 15, 2006. The implementation of this standard did not have a material impact on our consolidated financial position or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standard ( SFAS ) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to US GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing

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the impact of SFAS No. 157 on its consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 159 on its consolidated financial position and results of operations.

In March 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-10 Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company is currently assessing the impact of EITF 06-10 on its consolidated financial position and results of operations.

## Note 3. Repositioning and Other Charges

A summary of repositioning and other charges follows:

|                                                             | Three Months Ended<br>March 31, |        |
|-------------------------------------------------------------|---------------------------------|--------|
|                                                             | 2007                            | 2006   |
| Severance                                                   | \$ 74                           | \$ 24  |
| Asset impairments                                           | 6                               |        |
| Exit costs                                                  | 5                               | 2      |
| Adjustments                                                 | (4)                             | (2)    |
| Total net repositioning charge                              | 81                              | 24     |
| Asbestos related litigation charges, net of insurance       | 24                              | 28     |
| Probable and reasonably estimable environmental liabilities | 60                              | 62     |
| Business impairment charges                                 |                                 | 9      |
| Other                                                       | 14                              | 7      |
| Total net repositioning and other charges                   | \$ 179                          | \$ 130 |

The following table summarizes the pretax distribution of total net repositioning and other charges by income statement classification:

|                                              | Three Months Ended<br>March 31, |        |
|----------------------------------------------|---------------------------------|--------|
|                                              | 2007                            | 2006   |
| Cost of products and services sold           | \$ 159                          | \$ 130 |
| Selling, general and administrative expenses | 20                              |        |
|                                              | \$ 179                          | \$ 130 |

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The following table summarizes the pretax impact of total net repositioning and other charges by reportable segment:

|                                  | <b>Three Months Ended<br/>March 31,</b> |               |
|----------------------------------|-----------------------------------------|---------------|
|                                  | <b>2007</b>                             | <b>2006</b>   |
| Aerospace                        | \$ 26                                   | \$ 1          |
| Automation and Control Solutions | 41                                      | 9             |
| Specialty Materials              | 5                                       | 7             |
| Transportation Systems           | 31                                      | 42            |
| Corporate                        | 76                                      | 71            |
|                                  | <b>\$ 179</b>                           | <b>\$ 130</b> |

In the first quarter of 2007, we recognized a net repositioning charge of \$81 million primarily for severance costs related to workforce reductions of 1,335 manufacturing and administrative positions associated with the rationalization of manufacturing capacity and infrastructure and plant closures, principally in our Automation and Control Solutions and Aerospace segments.

In the first quarter of 2006, we recognized a net repositioning charge of \$24 million primarily for severance costs related to workforce reductions of 526 manufacturing and administrative positions in our Automation and Control Solutions, Transportation Systems and Aerospace reportable segments.

The following table summarizes the status of our total repositioning reserves:

|                              | <b>Severance<br/>Costs</b> | <b>Asset<br/>Impairments</b> | <b>Exit<br/>Costs</b> | <b>Total</b>  |
|------------------------------|----------------------------|------------------------------|-----------------------|---------------|
| Balance at December 31, 2006 | \$ 118                     | \$ 9                         | \$ 9                  | \$ 127        |
| 2007 charges                 | 74                         | 6                            | 5                     | 85            |
| 2007 usage                   | (26)                       | (6)                          | (2)                   | (34)          |
| Adjustments                  | (4)                        |                              |                       | (4)           |
| Balance at March 31, 2007    | <b>\$ 162</b>              | <b>\$ 12</b>                 | <b>\$ 12</b>          | <b>\$ 174</b> |

In the first quarter of 2007, we recognized a charge of \$60 million for environmental liabilities deemed probable and reasonably estimable in the quarter. We recognized a charge of \$24 million representing an update to our estimated liability for the resolution of Bendix related asbestos claims as of March 31, 2007, net of probable insurance recoveries. We also recognized other charges of \$14 million for a business sale tax related to a prior divestiture (\$8 million) and for a contemplated settlement of a legal matter (\$6 million).

In the first quarter of 2006, we recognized a charge of \$62 million for environmental liabilities deemed probable and reasonably estimable in the quarter. We recognized a charge of \$28 million for Bendix related asbestos claims filed and defense costs incurred during the first quarter of 2006, net of probable insurance recoveries. We also recognized business impairment charges of \$9 million related primarily to the write-down of property, plant and equipment held for sale in our Specialty Materials reportable segment, and other charges of \$7 million related primarily to a property damage litigation matter in our Corporate segment.

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NOTE 4. Other (income) expense.

|                                                     | Three Months Ended<br>March 31, |                |
|-----------------------------------------------------|---------------------------------|----------------|
|                                                     | 2007                            | 2006           |
| Equity (income)/loss of affiliated companies        | \$ 2                            | \$ 2           |
| Gain on sale of non-strategic businesses and assets |                                 | (16)           |
| Interest income                                     | (19)                            | (19)           |
| Foreign exchange                                    | 5                               | 1              |
| Other (net)                                         | 1                               | 7              |
|                                                     | <u>\$ (11)</u>                  | <u>\$ (25)</u> |

NOTE 5. Earnings Per Share

The details of the earnings per share calculations for the three month periods ended March 31, 2007 and 2006 follow:

|                                                             | Three Months Ended March 31, |                      |                |                      |
|-------------------------------------------------------------|------------------------------|----------------------|----------------|----------------------|
|                                                             | 2007                         |                      | 2006           |                      |
|                                                             | Basic                        | Assuming<br>Dilution | Basic          | Assuming<br>Dilution |
| <u>Income</u>                                               |                              |                      |                |                      |
| Income from continuing operations                           | \$ 526                       | \$ 526               | \$ 431         | \$ 431               |
| Income from discontinued operations, net of taxes           |                              |                      | 5              | 5                    |
| Net income                                                  | <u>\$ 526</u>                | <u>\$ 526</u>        | <u>\$ 436</u>  | <u>\$ 436</u>        |
| <u>Average shares</u>                                       |                              |                      |                |                      |
| Average shares outstanding                                  | 794.5                        | 794.5                | 830.0          | 830.0                |
| Dilutive securities issuable in connection with stock plans |                              | 7.7                  |                | 5.8                  |
| Total average shares outstanding                            | <u>794.5</u>                 | <u>802.2</u>         | <u>830.0</u>   | <u>835.8</u>         |
| <u>Earnings per share of common stock</u>                   |                              |                      |                |                      |
| Income from continuing operations                           | \$ 0.66                      | \$ 0.66              | \$ 0.51        | \$ 0.51              |
| Income from discontinued operations, net of taxes           |                              |                      | 0.01           | 0.01                 |
| Net income                                                  | <u>\$ 0.66</u>               | <u>\$ 0.66</u>       | <u>\$ 0.52</u> | <u>\$ 0.52</u>       |

The diluted earnings per share calculations exclude the effect of stock options when the options exercise prices exceed the average market price of the common shares during the period. For the three month periods ended March 31, 2007 and 2006, the number of stock options not included in the computations were 11.3 and 27.8 million, respectively. These stock options were outstanding at the end of each of the respective periods.

NOTE 6. Accounts, notes and other receivables

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|                                        | March 31,<br>2007 | December<br>31,<br>2006 |
|----------------------------------------|-------------------|-------------------------|
| Trade                                  | \$ 5,542          | \$ 5,373                |
| Other                                  | 553               | 584                     |
|                                        | 6,095             | 5,957                   |
| Less - Allowance for doubtful accounts | (222)             | (217)                   |
|                                        | \$ 5,873          | \$ 5,740                |

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NOTE 7. Inventories

|                              | March 31,<br>2007 | December<br>31,<br>2006 |
|------------------------------|-------------------|-------------------------|
| Raw materials                | \$ 1,623          | \$ 1,625                |
| Work in process              | 838               | 808                     |
| Finished products            | 1,460             | 1,342                   |
|                              | <u>3,921</u>      | <u>3,775</u>            |
| Less Progress payments       | (10)              | (17)                    |
| Reduction to LIFO cost basis | (162)             | (170)                   |
|                              | <u>\$ 3,749</u>   | <u>\$ 3,588</u>         |

NOTE 8. Goodwill and Other Intangible Assets - Net

The change in the carrying amount of goodwill for the three months ended March 31, 2007 by reportable segment is as follows:

|                                  | Dec. 31, 2006   | Acquisitions  | Divestitures | Currency<br>Translation<br>Adjustment | March 31, 2007  |
|----------------------------------|-----------------|---------------|--------------|---------------------------------------|-----------------|
| Aerospace                        | \$ 1,745        | \$ 4          | \$           | \$ (1)                                | \$ 1,748        |
| Automation and Control Solutions | 4,959           | (7)           |              |                                       | 4,952           |
| Specialty Materials              | 1,151           | 1             |              | 1                                     | 1,153           |
| Transportation Systems           | 548             |               |              | (1)                                   | 547             |
|                                  | <u>\$ 8,403</u> | <u>\$ (2)</u> | <u>\$</u>    | <u>\$ (1)</u>                         | <u>\$ 8,400</u> |

Other intangible assets are comprised of:

|                                            | March 31, 2007              |                             |                           | December 31, 2006           |                             |                           |
|--------------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                            | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Intangible assets with determinable lives: |                             |                             |                           |                             |                             |                           |
| Patents and technology                     | \$ 924                      | \$ (429)                    | \$ 495                    | \$ 923                      | \$ (410)                    | \$ 513                    |
| Customer relationships                     | 510                         | (77)                        | 433                       | 506                         | (68)                        | 438                       |
| Trademarks                                 | 130                         | (25)                        | 105                       | 130                         | (22)                        | 108                       |
| Other                                      | 326                         | (238)                       | 88                        | 322                         | (236)                       | 86                        |
|                                            | <u>1,890</u>                | <u>(769)</u>                | <u>1,121</u>              | <u>1,881</u>                | <u>(736)</u>                | <u>1,145</u>              |
| Trademarks with indefinite lives           | 102                         |                             | 102                       | 102                         |                             | 102                       |
|                                            | <u>\$ 1,992</u>             | <u>\$ (769)</u>             | <u>\$ 1,223</u>           | <u>\$ 1,983</u>             | <u>\$ (736)</u>             | <u>\$ 1,247</u>           |

Amortization expense related to intangible assets for the three months ended March 31, 2007 and 2006 was \$38 and \$30 million, respectively.



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## NOTE 9. Long-term Debt and Credit Agreements

|                                                                                             | March 31,<br>2007 | December 31,<br>2006 |
|---------------------------------------------------------------------------------------------|-------------------|----------------------|
| 7.0% notes due 2007                                                                         | \$                | \$ 350               |
| 7-1/8% notes due 2008                                                                       | 200               | 200                  |
| 6.20% notes due 2008                                                                        | 200               | 200                  |
| Floating rate notes due 2009                                                                | 300               | 300                  |
| Zero coupon bonds and money multiplier notes 13.0%-14.26%, due 2009                         | 100               | 100                  |
| Floating rate notes due 2009-2011                                                           | 239               | 239                  |
| 7.50% notes due 2010                                                                        | 1,000             | 1,000                |
| 6-1/8% notes due 2011                                                                       | 500               | 500                  |
| 5.40% notes due 2016                                                                        | 400               | 400                  |
| 5.30% notes due 2017                                                                        | 400               |                      |
| Industrial development bond obligations, 3.25%-9.50% maturing at various dates through 2037 | 65                | 65                   |
| 6-5/8% debentures due 2028                                                                  | 216               | 216                  |
| 9.065% debentures due 2033                                                                  | 51                | 51                   |
| 5.70% notes due 2036                                                                        | 550               | 550                  |
| 5.70% notes due 2037                                                                        | 600               |                      |
| Other (including capitalized leases), 0.53%-15.69% maturing at various dates through 2020   | 110               | 161                  |
|                                                                                             | 4,931             | 4,332                |
| Less current portion                                                                        | (227)             | (423)                |
|                                                                                             | \$ 4,704          | \$ 3,909             |

The schedule of principal payments on long term debt is as follows:

|                      | At March 31, 2007 |
|----------------------|-------------------|
| 2007                 | \$ 23             |
| 2008                 | 416               |
| 2009                 | 511               |
| 2010                 | 1,130             |
| 2011                 | 527               |
| Thereafter           | 2,324             |
|                      | 4,931             |
| Less-current portion | (227)             |
|                      | \$ 4,704          |

In March 2007, the Company issued \$400 million 5.30% Senior Notes due 2017 and \$600 million 5.70% Senior Notes due 2037 (collectively, the "Notes"). The Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of \$1 billion, offset by \$12 million in debt issuance costs.

## NOTE 10. Stock-Based Compensation Plans

Compensation cost related to stock options recognized in operating results (included in selling, general and administrative expenses) under SFAS No. 123R was \$24 and \$25 million in the three months ended March 31, 2007 and 2006, respectively. The associated future income tax benefit recognized was \$9 and \$10 million in the three months ended March 31, 2007 and 2006, respectively.



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The following table sets forth fair value per share information, including related weighted-average assumptions, used to determine compensation cost for our stock options consistent with the requirements of SFAS No. 123R.

|                                                                                                                                               | Three Months<br>Ended<br>March 31, 2007 | Three Months<br>Ended<br>March 31, 2006 |
|-----------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|-----------------------------------------|
| Weighted average fair value per share of options granted during the period (estimated on grant date using Black-Scholes option-pricing model) | \$ 10.20                                | \$ 9.38                                 |

Assumptions:

|                                |        |        |
|--------------------------------|--------|--------|
| Expected volatility            | 20.15% | 22.24% |
| Expected annual dividend yield | 2.10%  | 2.15%  |
| Risk free rate of return       | 4.66%  | 4.60%  |
| Expected option term (years)   | 5.3    | 5.0    |

The following table summarizes information about stock option activity for the three months ended March 31, 2007:

|                                                   | Number<br>Of<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic<br>Value (\$M) |
|---------------------------------------------------|-------------------------|------------------------------------------|-----------------------------------------------------------------|---------------------------------------|
| Outstanding at December 31, 2006                  | 54,232,677              | \$ 39.98                                 | 5.7                                                             | \$ 406                                |
| Granted                                           | 5,712,700               | 47.38                                    |                                                                 |                                       |
| Exercised                                         | (3,229,011)             | 36.15                                    |                                                                 |                                       |
| Lapsed or canceled                                | (698,398)               | 48.98                                    |                                                                 |                                       |
| Outstanding at March 31, 2007                     | 56,017,968              | \$ 40.84                                 | 6.0                                                             | \$ 399                                |
| Vested and expected to vest at March 31, 2007 (1) | 53,225,297              | \$ 40.65                                 | 6.0                                                             | \$ 387                                |
| Exercisable at March 31, 2007                     | 41,034,742              | \$ 40.12                                 | 4.9                                                             | \$ 343                                |

(1) The expected to vest options are the result of applying the pre-vesting forfeiture rate assumption to total outstanding options.

The total intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the three months ended March 31, 2007 was \$33 million. During the three months ended March 31, 2007, the amount of cash received from the exercise of stock options was \$117 million with an associated tax benefit realized of \$12 million. Consistent with the requirements of SFAS No. 123R, we classified \$8 million of this benefit as a financing cash inflow in the Consolidated Statement of Cash Flows, and the balance was classified as cash from operations.

At March 31, 2007, there was \$111 million of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 2.46 years. The total fair value of options vested during the three months ended March 31, 2007 was \$69 million.

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The following table summarizes information about Restricted Stock Unit (RSU) activity for the three months ended March 31, 2007:

|                                 | <b>Number of<br/>Restricted<br/>Stock<br/>Units</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value<br/>Per Share</b> |
|---------------------------------|-----------------------------------------------------|-------------------------------------------------------------------------|
| Non-vested at December 31, 2006 | 4,751,999                                           | \$ 35.85                                                                |
| Granted                         | 714,240                                             | 47.21                                                                   |
| Vested                          | (4,475)                                             | 40.60                                                                   |
| Forfeited                       | (131,900)                                           | 35.19                                                                   |
| Non-vested at March 31, 2007    | 5,329,864                                           | \$ 37.38                                                                |

At March 31, 2007, there was approximately \$219 million of total unrecognized compensation cost related to non-vested RSUs granted under our stock plans which is expected to be recognized over a weighted-average period of 2.4 years. Compensation expense related to RSUs for the three months ended March 31, 2007 and 2006 was \$15 and \$9 million, respectively, and is included in selling, general and administrative expenses.

## NOTE 11. Other Comprehensive Income/(Loss)

Other comprehensive income/(loss) consists of the following:

|                                                    | <b>Three Months Ended<br/>March 31,</b> |             |
|----------------------------------------------------|-----------------------------------------|-------------|
|                                                    | <b>2007</b>                             | <b>2006</b> |
| Net income                                         | \$ 526                                  | \$ 436      |
| Foreign exchange translation adjustments           | 18                                      | (30)        |
| Pension and postretirement benefit adjustments     | 45                                      |             |
| Change in fair value of effective cash flow hedges | (5)                                     | (4)         |
|                                                    | \$ 584                                  | \$ 402      |

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NOTE 12. Segment Financial Data

|                                                | Three Months Ended<br>March 31, |                 |
|------------------------------------------------|---------------------------------|-----------------|
|                                                | 2007                            | 2006            |
| <b>Net Sales</b>                               |                                 |                 |
| Aerospace                                      | \$ 2,840                        | \$ 2,629        |
| Automation and Control Solutions               | 2,801                           | 2,365           |
| Specialty Materials                            | 1,199                           | 1,152           |
| Transportation Systems                         | 1,201                           | 1,095           |
| Corporate                                      |                                 |                 |
|                                                | <u>\$ 8,041</u>                 | <u>\$ 7,241</u> |
| <b>Segment Profit</b>                          |                                 |                 |
| Aerospace                                      | \$ 500                          | \$ 440          |
| Automation and Control Solutions               | 274                             | 221             |
| Specialty Materials                            | 192                             | 162             |
| Transportation Systems                         | 156                             | 142             |
| Corporate                                      | (43)                            | (45)            |
| Total Segment Profit                           | <u>1,079</u>                    | <u>920</u>      |
| Other income (expense)                         | 11                              | 25              |
| Interest and other financial charges           | (97)                            | (89)            |
| Stock option expense                           | (24)                            | (25)            |
| Pension and other postretirement expense (A)   | (74)                            | (126)           |
| Repositioning and other charges (A)            | (179)                           | (130)           |
| Income from continuing operations before taxes | <u>\$ 716</u>                   | <u>\$ 575</u>   |

(A) Amounts included in cost of products and services sold and selling, general and administrative expenses in the Consolidated Statement of Operations.

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## NOTE 13. Pension and Other Postretirement Benefits

Net periodic pension and other postretirement benefits costs for our significant defined benefit plans include the following components:

|                                        | Three Months Ended<br>March 31, |              |
|----------------------------------------|---------------------------------|--------------|
|                                        | 2007                            | 2006         |
| <b>Pension Benefits</b>                |                                 |              |
| Service cost                           | \$ 68                           | \$ 70        |
| Interest cost                          | 237                             | 219          |
| Expected return on plan assets         | (333)                           | (304)        |
| Amortization of transition liability   |                                 | 2            |
| Amortization of prior service cost     | 6                               | 6            |
| Recognition of actuarial losses        | 48                              | 79           |
|                                        | <u>\$ 26</u>                    | <u>\$ 72</u> |
| <b>Other Postretirement Benefits</b>   |                                 |              |
| Service cost                           | \$ 5                            | \$ 5         |
| Interest cost                          | 32                              | 30           |
| Expected return on plan assets         |                                 |              |
| Amortization of prior service (credit) | (11)                            | (10)         |
| Recognition of actuarial losses        | 12                              | 18           |
|                                        | <u>\$ 38</u>                    | <u>\$ 43</u> |

## NOTE 14. COMMITMENTS AND CONTINGENCIES

### Environmental Matters

We are subject to various federal, state, local and foreign government requirements relating to the protection of the environment. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and personal injury and that our handling, manufacture, use and disposal of hazardous or toxic substances are in accordance with environmental and safety laws and regulations. However, mainly because of past operations and operations of predecessor companies, we, like other companies engaged in similar businesses, have incurred remedial response and voluntary cleanup costs for site contamination and are a party to lawsuits and claims associated with environmental and safety matters, including past production of products containing toxic substances. Additional lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future.

With respect to environmental matters involving site contamination, we continually conduct studies, individually or jointly with other potentially responsible parties, to determine the feasibility of various remedial techniques to address environmental matters. It is our policy to record appropriate liabilities for environmental matters when remedial efforts or damage claim payments are probable and the costs can be reasonably estimated. Such liabilities are based on our best estimate of the undiscounted future costs required to complete the remedial work. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical or legal information becomes available. Given the uncertainties regarding the status of laws, regulations, enforcement policies, the impact of other potentially responsible parties, technology and information related to individual sites, we do not believe it is possible to develop an estimate of the range of reasonably possible environmental loss in excess of our accruals. We expect to fund expenditures for these matters from operating cash flow. The timing of cash expenditures depends on



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a number of factors, including the timing of remedial investigations and feasibility studies, the timing of litigation and settlements of remediation liability, personal injury and property damage claims, regulatory approval of cleanup projects, remedial techniques to be utilized and agreements with other parties. The following table summarizes information concerning our recorded liabilities for environmental costs:

|                                                                             | <b>Three Months Ended<br/>March 31, 2007</b> |
|-----------------------------------------------------------------------------|----------------------------------------------|
| Beginning of period                                                         | \$ 831                                       |
| Accruals for environmental matters deemed probable and reasonably estimable | 61                                           |
| Environmental liability payments                                            | (66)                                         |
| Other adjustments                                                           | 2                                            |
| End of period                                                               | <u>\$ 828</u>                                |

Environmental liabilities are included in the following balance sheet accounts:

|                     | <b>March 31, 2007</b> | <b>December 31, 2006</b> |
|---------------------|-----------------------|--------------------------|
| Accrued liabilities | \$ 255                | \$ 251                   |
| Other liabilities   | 573                   | 580                      |
|                     | <u>\$ 828</u>         | <u>\$ 831</u>            |

Although we do not currently possess sufficient information to reasonably estimate the amounts of liabilities to be recorded upon future completion of studies, litigation or settlements, and neither the timing nor the amount of the ultimate costs associated with environmental matters can be determined, they could be material to our consolidated results of operations or operating cash flows in the periods recognized or paid. However, considering our past experience and existing reserves, we do not expect that these environmental matters will have a material adverse effect on our consolidated financial position.

**New Jersey Chrome Sites** Provisions have been made in our financial statements for the estimated costs of the court-ordered excavation and transport for offsite disposal of approximately one million tons of chromium residue present at a predecessor Honeywell site located in Jersey City, New Jersey, which are expected to be incurred evenly over a five-year period that started in April 2006. We do not expect implementation of this remedy to have a material adverse effect on our future consolidated results of operations, operating cash flows or financial position. Provision also has been made in our financial statements for the estimated costs of implementing groundwater and sediment remedial plans, which have been proposed for the site and are presently under review by the court in which litigation concerning the site is pending. The ultimate cost of remediating the river sediments may be reduced as numerous third parties could be responsible for an as yet undetermined portion of these costs.

The above-referenced site is the most significant of the twenty-one sites located in Hudson County, New Jersey which are the subject of an Administrative Consent Order (ACO) entered into with the New Jersey Department of Environmental Protection (NJDEP) in 1993. Remedial investigations and activities consistent with the ACO have been conducted and are underway at the other sites (the Honeywell ACO Sites). We have recorded reserves for the Honeywell ACO Sites where appropriate under the accounting policy described above.

On May 3, 2005, NJDEP filed a lawsuit in New Jersey Superior Court against Honeywell and two other companies seeking declaratory and injunctive relief, unspecified damages, and the reimbursement of unspecified total costs relating to sites in New Jersey allegedly contaminated with chrome ore processing residue. The claims against Honeywell relate to the activities of a predecessor company which ceased its New Jersey manufacturing operations in the mid-1950's. While the

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complaint is not entirely clear, it appears that approximately 100 sites are at issue, including 17 of the Honeywell ACO Sites, sites that the other two companies have agreed to remediate under separate administrative consent orders, as well as approximately 53 other sites (identified in the complaint as the Publicly Funded Sites ) for which none of the three companies has signed an administrative consent order. In addition to claims specific to each company, NJDEP claims that all three companies should be collectively liable for all the chrome sites based on a market share theory. In addition, NJDEP is seeking treble damages for all costs it has incurred or will incur at the Publicly Funded Sites. Honeywell believes that it has no connection with the sites covered by the other companies' administrative consent orders and, therefore, has no responsibility for those sites. At the Honeywell ACO Sites, we are conducting remedial investigations and activities consistent with the ACO; thus, we do not believe the lawsuit will significantly change our obligations with respect to the Honeywell ACO Sites. Lawsuits have also been filed against Honeywell in the District Court under the Resource Conservation and Recovery Act (RCRA) by two New Jersey municipal utilities seeking the cleanup of chromium residue at two Honeywell ACO sites and by a citizens' group against Honeywell and thirteen other defendants with respect to contamination on about a dozen of the Honeywell ACO Sites. Discovery is underway in these cases. For the reasons stated above, we do not believe these lawsuits will significantly change our obligations with respect to the Honeywell ACO sites.

Although it is not possible at this time to predict the outcome of the litigation and administrative proceedings discussed above, we believe that the allegations are without merit and we intend to vigorously defend against these lawsuits. We do not expect these matters to have a material adverse effect on our consolidated financial position. While we expect to prevail, an adverse litigation outcome could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid.

Onondaga Lake, Syracuse, NY A predecessor company to Honeywell operated a chemical plant which is alleged to have contributed mercury and other contaminants to the Lake. In July 2005, the New York State Department of Environmental Conservation (the DEC) issued its Record of Decision with respect to remediation of industrial contamination in the Lake. In October 2006, Honeywell entered into a Consent Decree with the State of New York to implement the remedy set forth in the Record of Decision. In January 2007, the Consent Decree was approved by the United States District Court for the Northern District of New York.

The Record of Decision calls for a combined dredging/capping remedy generally in line with the approach recommended in the Feasibility Study submitted by Honeywell in May 2004. Based on currently available information and analysis performed by our engineering consultants, we have accrued for our estimated cost of implementing the remedy set forth in the Record of Decision. Our estimating process considered a range of possible outcomes and the amounts recorded reflect our best estimate at this time. Given the scope and complexity of this project, it is possible that actual costs could exceed estimated costs by an amount that could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid. At this time, however, we cannot identify any legal, regulatory or technical reason to conclude that a specific alternative outcome is more probable than the outcome for which we have made provisions in our financial statements. The DEC's aggregate cost estimate, which is higher than the amount reserved, is based on the high end of the range of potential costs for major elements of the Record of Decision and includes a contingency. The actual cost of the Record of Decision will depend upon, among other things, the resolution of certain technical issues during the design phase of the remediation. We do not believe that this matter will have a material adverse impact on our consolidated financial position. In December 2006, the United States Fish and Wildlife Service published notice of its intent to pursue natural resource damages related to the site. It is not possible to predict the

outcome or timing of its assessments, which are typically lengthy processes lasting several years, or the amounts of or responsibility for these damages.

Dundalk Marine Terminal, Baltimore Chrome residue from legacy chrome plant operations in Baltimore was deposited as fill at the Dundalk Marine Terminal ( DMT ), which is owned and operated by the Maryland Port Administration ( MPA ). Honeywell and the MPA have been sharing costs to investigate and mitigate related environmental issues, and have entered into a cost sharing agreement under which Honeywell will bear a 77 percent share of the costs of developing and implementing permanent remedies for the DMT facility. The investigative phase (which began in April 2006) is expected to take approximately 18 to 36 months, after which the appropriate remedies will be identified and chosen. We have negotiated a Consent Decree with the MPA and Maryland Department of the Environment ( MDE ) with respect to the investigation and remediation of the DMT facility, and that Consent Decree was filed with the Maryland state court for Baltimore County, Maryland. BUILD, a Baltimore community group, together with a local church and two individuals, have intervened and are challenging the Consent Decree. We do not believe that this matter will have a material adverse impact on our consolidated financial position or operating cash flows. Given the scope and complexity of this project, it is possible that the cost of remediation, when determinable, could have a material adverse impact on our results of operations in the periods recognized.

#### Asbestos Matters

Like many other industrial companies, Honeywell is a defendant in personal injury actions related to asbestos. We did not mine or produce asbestos, nor did we make or sell insulation products or other construction materials that have been identified as the primary cause of asbestos related disease in the vast majority of claimants. Products containing asbestos previously manufactured by Honeywell or by previously owned subsidiaries primarily fall into two general categories: refractory products and friction products.

Refractory Products Honeywell owned North American Refractories Company (NARCO) from 1979 to 1986. NARCO produced refractory products (high temperature bricks and cement) that were sold largely to the steel industry in the East and Midwest. Less than 2 percent of NARCO S products contained asbestos.

When we sold the NARCO business in 1986, we agreed to indemnify NARCO with respect to personal injury claims for products that had been discontinued prior to the sale (as defined in the sale agreement). NARCO retained all liability for all other claims. On January 4, 2002, NARCO filed for reorganization under Chapter 11 of the U.S Bankruptcy Code.

As a result of the NARCO bankruptcy filing, all of the claims pending against NARCO are automatically stayed pending the reorganization of NARCO. In addition, the bankruptcy court enjoined both the filing and prosecution of NARCO-related asbestos claims against Honeywell. Although the stay has remained in effect continuously since January 4, 2002, there is no assurance that such stay will remain in effect. In connection with NARCO s bankruptcy filing, we paid NARCO s parent company \$40 million and agreed to provide NARCO with up to \$20 million in financing. We also agreed to pay \$20 million to NARCO s parent company upon the filing of a plan of reorganization for NARCO acceptable to Honeywell (which amount was paid in December 2005 following the filing of NARCO s Third Amended Plan of Reorganization), and to pay NARCO s parent company \$40 million, and to forgive any outstanding NARCO indebtedness to Honeywell, upon the effective date of the plan of reorganization.

We believe that, as part of the NARCO plan of reorganization, a trust will be established for the benefit of all asbestos claimants, current and future, pursuant to Trust Distribution Procedures negotiated with the NARCO Asbestos Claimants Committee and the Court-appointed legal representative for future asbestos claimants. If the trust is put in place and approved by the Court as fair

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and equitable, Honeywell as well as NARCO will be entitled to a permanent channeling injunction barring all present and future individual actions in state or federal courts and requiring all asbestos related claims based on exposure to NARCO products to be made against the federally-supervised trust. Honeywell has reached agreement with the representative for future NARCO claimants and the Asbestos Claimants Committee to cap its annual contributions to the trust with respect to future claims at a level that would not have a material impact on Honeywell's operating cash flows.

The vast majority of the asbestos claimants voted in favor of NARCO's Third Amended Plan Of Reorganization (NARCO Plan). The court conducted its evidentiary hearing on confirmation issues on June 5 and 6, 2006. All objections to the NARCO Plan have either been resolved or dismissed by the Bankruptcy Court. The Court's confirmation order for the NARCO Plan was delayed, however, due to additional evidentiary requirements relating to the confirmation of a plan of reorganization for one of NARCO's affiliates. Although we expect the NARCO Plan and the NARCO trust to be ultimately approved by the Court, no assurances can be given as to the Court's ruling or the time frame for resolving any appeals of such ruling.

Our consolidated financial statements reflect an estimated liability for settlement of pending and future NARCO-related asbestos claims as of March 31, 2007 and December 31, 2006 of \$1.3 billion. The estimated liability for pending claims is based on terms and conditions, including evidentiary requirements, in definitive agreements with approximately 260,000 current claimants, and an estimate of the unsettled claims pending as of the time NARCO filed for bankruptcy protection. Substantially all settlement payments with respect to current claims are expected to be completed by the end of 2007. Approximately \$90 million of payments due pursuant to these settlements is due only upon establishment of the NARCO trust.

The estimated liability for future claims represents the estimated value of future asbestos related bodily injury claims expected to be asserted against NARCO through 2018 and the aforementioned obligations to NARCO's parent. In light of the uncertainties inherent in making long-term projections we do not believe that we have a reasonable basis for estimating asbestos claims beyond 2018 under SFAS No. 5,

Accounting for Contingencies. The estimate is based upon the disease criteria and payment values contained in the NARCO Trust Distribution Procedures negotiated with the NARCO Asbestos Claimants Committee and the NARCO future claimants' representative. Honeywell projects the probable number and value, including trust claim handling costs, of asbestos related future liabilities based upon experience of asbestos claims filing rates in the tort system and in certain operating asbestos trusts, and the claims experience in those forums (as a result of more clearly defined proof requirements and possible enactment of state medical criteria bills). The valuation methodology also includes an analysis of the population likely to have been exposed to asbestos containing products, epidemiological studies to estimate the number of people likely to develop asbestos related diseases, NARCO claims filing history, the pending inventory of NARCO asbestos related claims and payment rates expected to be established by the NARCO trust. This methodology used to estimate the liability for future claims has been commonly accepted by numerous courts and is the same methodology that is utilized by an expert who is routinely retained by the asbestos claimants committee in asbestos related bankruptcies.

As of March 31, 2007 and December 31, 2006, our consolidated financial statements reflect an insurance receivable corresponding to the liability for settlement of pending and future NARCO-related asbestos claims of \$953 and \$955 million, respectively. This coverage reimburses Honeywell for portions of the costs incurred to settle NARCO related claims and court judgments as well as defense costs and is provided by a large number of insurance policies written by dozens of insurance companies in both the domestic insurance market and the London excess market. At March 31, 2007, a significant portion of this coverage is with insurance companies with whom we have agreements to pay full policy limits based on corresponding Honeywell claims costs. We conduct analyses to determine the

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amount of insurance that we estimate is probable of recovery in relation to payment of current and estimated future claims. While the substantial majority of our insurance carriers are solvent, some of our individual carriers are insolvent, which has been considered in our analysis of probable recoveries. We made judgments concerning insurance coverage that we believe are reasonable and consistent with our historical dealings with our insurers, our knowledge of any pertinent solvency issues surrounding insurers and various judicial determinations relevant to our insurance programs.

In the second quarter of 2006, Travelers Casualty and Insurance Company ( Travelers ) filed a lawsuit against Honeywell and other insurance carriers in the Supreme Court of New York, County of New York, disputing obligations for NARCO-related asbestos claims under high excess insurance coverage issued by Travelers and other insurance carriers. Approximately \$370 million of coverage under these policies is included in our NARCO-related insurance receivable at March 31, 2007. Honeywell believes it is entitled to the coverage at issue and has filed counterclaims in the Superior Court of New Jersey seeking, among other things, declaratory relief with respect to this coverage. Although Honeywell expects to prevail in this matter, an adverse outcome could have a material impact on our results of operations in the period recognized but would not be material to our consolidated financial position or operating cash flows.

Projecting future events is subject to many uncertainties that could cause the NARCO related asbestos liabilities or assets to be higher or lower than those projected and recorded. There is no assurance that a plan of reorganization will be confirmed, that insurance recoveries will be timely or whether there will be any NARCO related asbestos claims beyond 2018. Given the inherent uncertainty in predicting future events, we review our estimates periodically, and update them based on our experience and other relevant factors. Similarly we will reevaluate our projections concerning our probable insurance recoveries in light of any changes to the projected liability or other developments that may impact insurance recoveries.

Friction Products Honeywell's Bendix friction materials (Bendix) business manufactured automotive brake pads that contained chrysotile asbestos in an encapsulated form. There is a group of existing and potential claimants consisting largely of individuals that allegedly performed brake replacements.

From 1981 through March 31, 2007, we have resolved approximately 107,000 Bendix related asbestos claims including trials covering 124 plaintiffs, which resulted in 116 favorable verdicts. Trials covering eight individuals resulted in adverse verdicts; however, two of these verdicts were reversed on appeal, three are or shortly will be on appeal, and the remaining three claims were settled.

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The following tables present information regarding Bendix related asbestos claims activity:

|                                                  | Three Months Ended<br>March 31, 2007 | Year Ended<br>December 31, |             |
|--------------------------------------------------|--------------------------------------|----------------------------|-------------|
|                                                  |                                      | 2006                       | 2005        |
| <b>Claims Activity</b>                           |                                      |                            |             |
| Claims Unresolved at the beginning of period     | 57,108                               | 79,502                     | 76,348      |
| Claims Filed during the period                   | 682                                  | 4,391                      | 7,520       |
| Claims Resolved during the period                | (1,753)                              | (26,785)                   | (4,366) (a) |
| Claims Unresolved at the end of period           | 56,037                               | 57,108                     | 79,502      |
| <b>Disease Distribution of Unresolved Claims</b> |                                      |                            |             |
| Mesothelioma and Other Cancer Claims             | 4,905                                | 4,843                      | 4,810       |
| Other Claims                                     | 51,132                               | 52,265                     | 74,692      |
| Total Claims                                     | 56,037                               | 57,108                     | 79,502      |

(a) Excludes 2,524 claims which were inadvertently included in resolved claims as of December 31, 2005 which had no impact on the recorded values for such claims and has been corrected for purposes of this presentation.

Approximately 45 percent of the approximately 56,000 pending claims at March 31, 2007 are on the inactive, deferred, or similar dockets established in some jurisdictions for claimants who allege minimal or no impairment. The approximately 56,000 pending claims also include claims filed in jurisdictions such as Texas, Virginia, and Mississippi that historically allowed for consolidated filings. In these jurisdictions, plaintiffs were permitted to file complaints against a pre-determined master list of defendants, regardless of whether they have claims against each individual defendant. Many of these plaintiffs may not actually have claims against Honeywell. Based on state rules and prior experience in these jurisdictions, we anticipate that many of these claims will ultimately be dismissed. During 2006 approximately 16,000 cases were dismissed. More than 85 percent of these dismissals occurred in Mississippi as a result of judicial rulings relating to non-resident filings and venue. We anticipate additional dismissals in this jurisdiction.

Honeywell has experienced average resolution values per claim excluding legal costs as follows:

|                     | Years Ended December 31, |           |           |
|---------------------|--------------------------|-----------|-----------|
|                     | 2006                     | 2005      | 2004      |
|                     | (in whole dollars)       |           |           |
| Malignant claims    | \$ 33,000                | \$ 58,000 | \$ 90,000 |
| Nonmalignant claims | \$ 250                   | \$ 600    | \$ 1,600  |

It is not possible to predict whether resolution values for Bendix related asbestos claims will increase, decrease or stabilize in the future.

Our consolidated financial statements reflect an estimated liability for resolution of pending and future Bendix related asbestos claims at March 31, 2007 and December 31, 2006 of \$532 and \$528 million, respectively.

The estimated liability for future claims represents the estimated value of future asbestos related bodily injury claims expected to be asserted against Bendix over the next five years. In light of the uncertainties inherent in making long-term projections, as well as certain factors unique to friction product asbestos claims, we do not believe that we have a reasonable basis for estimating asbestos claims beyond the next five years under SFAS No. 5, Accounting for Contingencies. The estimate is based upon Bendix historical experience in the tort system for the two years ended December 31, 2006 with respect to claims filing and resolution. The methodology used to estimate the liability for future

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claims has been commonly accepted by numerous courts. It is substantially similar to that used to estimate the future NARCO related asbestos claims liability, with the exception that the valuation methodology for Bendix includes payment rates based on Bendix resolution history, rather than expected trust payment rates.

Honeywell currently has approximately \$1.9 billion of insurance coverage remaining with respect to pending and potential future Bendix related asbestos claims, of which \$307 and \$302 million are reflected as receivables in our consolidated balance sheet at March 31, 2007 and December 31, 2006, respectively. This coverage is provided by a large number of insurance policies written by dozens of insurance companies in both the domestic insurance market and the London excess market. Insurance receivables are recorded in the financial statements simultaneous with the recording of the liability for the estimated value of the underlying asbestos claims. The amount of the insurance receivable recorded is based on our ongoing analysis of the insurance that we estimate is probable of recovery. This determination is based on our analysis of the underlying insurance policies, our historical experience with our insurers, our ongoing review of the solvency of our insurers, our interpretation of judicial determinations relevant to our insurance programs, and our consideration of the impacts of any settlements reached with our issuers. Insurance receivables are also recorded when structured insurance settlements provide for future fixed payment streams that are not contingent upon future claims or other events. Such amounts are recorded at the net present value of the fixed payment stream.

On a cumulative historical basis, Honeywell has recorded insurance receivables equal to approximately 50 percent of the value of the underlying asbestos claims recorded. However, because there are gaps in our coverage due to insurance company insolvencies, certain uninsured periods, and insurance settlements, this rate is expected to decline for any future Bendix related asbestos liabilities that may be recorded. Future recoverability rates may also be impacted by numerous other factors, such as future insurance settlements, insolvencies and judicial determinations relevant to our coverage program, which are difficult to predict. Assuming continued defense and indemnity spending at current levels, we estimate that the cumulative recoverability rate could decline over the next five years to approximately 40 percent.

Honeywell believes it has sufficient insurance coverage and reserves to cover all pending Bendix related asbestos claims and Bendix related asbestos claims estimated to be filed within the next five years. Although it is impossible to predict the outcome of either pending or future Bendix related asbestos claims, we do not believe that such claims would have a material adverse effect on our consolidated financial position in light of our insurance coverage and our prior experience in resolving such claims. If the rate and types of claims filed, the average resolution value of such claims and the period of time over which claim settlements are paid (collectively, the Variable Claims Factors ) do not substantially change, Honeywell would not expect future Bendix related asbestos claims to have a material adverse effect on our results of operations or operating cash flows in any fiscal year. No assurances can be given, however, that the Variable Claims Factors will not change.

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Refractory and friction products - The following tables summarize information concerning NARCO and Bendix asbestos related balances:

## Asbestos Related Liabilities

|                                           | Three Months Ended<br>March 31, 2007 |          |          |
|-------------------------------------------|--------------------------------------|----------|----------|
|                                           | Bendix                               | NARCO    | Total    |
| Beginning of period                       | \$ 528                               | \$ 1,291 | \$ 1,819 |
| Accrual for update to estimated liability | 28                                   |          | 28       |
| Asbestos related liability payments       | (24)                                 | (17)     | (41)     |
| End of period                             | \$ 532                               | \$ 1,274 | \$ 1,806 |

## Insurance Recoveries for Asbestos Related Liabilities

|                                                              | Three Months Ended<br>March 31, 2007 |        |          |
|--------------------------------------------------------------|--------------------------------------|--------|----------|
|                                                              | Bendix                               | NARCO  | Total    |
| Beginning of period                                          | \$ 302                               | \$ 955 | \$ 1,257 |
| Probable insurance recoveries related to estimated liability | 4                                    |        | 4        |
| Insurance receipts for asbestos related liabilities          | (1)                                  | (2)    | (3)      |
| Other                                                        | 2                                    |        | 2        |
| End of period                                                | \$ 307                               | \$ 953 | \$ 1,260 |

NARCO and Bendix asbestos related balances are included in the following balance sheet accounts:

|                                                       | March 31,<br>2007 | December 31,<br>2006 |
|-------------------------------------------------------|-------------------|----------------------|
| Other current assets                                  | \$ 156            | \$ 157               |
| Insurance recoveries for asbestos related liabilities | 1,104             | 1,100                |
|                                                       | \$ 1,260          | \$ 1,257             |
| Accrued liabilities                                   | \$ 557            | \$ 557               |
| Asbestos related liabilities                          | 1,249             | 1,262                |
|                                                       | \$ 1,806          | \$ 1,819             |

## Other Matters

Baton Rouge, LA As previously reported, three incidents occurred during 2003 at Honeywell's Baton Rouge, Louisiana chemical plant, including a release of chlorine, a release of antimony pentachloride (which resulted in an employee fatality), and an employee exposure to hydrofluoric acid. The United States Environmental Protection Agency and the United States Department of Justice have conducted investigations of these incidents, including a federal grand jury convened to investigate the employee fatality. As a result of that investigation, we have signed a plea agreement with the U.S. Attorney under which Honeywell will plead guilty to a misdemeanor charge and pay \$12 million in combined restitution and fines. The plea agreement has been filed, but the plea and the sentence still are subject to Court acceptance, which we expect to receive. Honeywell has been served with several civil lawsuits regarding these incidents, for which we believe we have adequate

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insurance coverage to the extent that there is any liability. We are also engaged in discussions with the Louisiana Department of Environmental Quality (LADEQ) to resolve alleged civil environmental violations at our Baton Rouge and Geismar, Louisiana facilities that, in part, overlap with the subject of the federal investigation.

Brunswick, GA Honeywell has reached settlements with Glynn County, Georgia and with a group of private individuals who own or owned properties near the Allied Chemical (a predecessor company) chlor-alkali plant, in Brunswick, Georgia in various related cases. The plaintiffs had alleged that mercury and PCB discharges from the plant devalued their property, and caused them loss of use and enjoyment of that property. They were seeking compensatory, injunctive and punitive damages. The settlement with Glynn County was for \$25 million and that

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amount has been paid. The settlement with the private property owners was also for \$25 million and the money has been placed into the plaintiffs' attorney trust account pending confirmation that none of the private landowners have opted out of the settlement and allocation of the proceeds among the parties by a special master appointed by the court. The court approved the settlement on April 6, 2007. The settlement will be final once the court-appointed special master allocates the proceeds among the parties.

**Allen, et. al. v. Honeywell Retirement Earnings Plan** This represents a class action lawsuit in which plaintiffs seek unspecified damages relating to allegations that, among other things, Honeywell impermissibly reduced the pension benefits of employees of Garrett Corporation (a predecessor entity) when the plan was amended in 1983 and failed to calculate certain benefits in accordance with the terms of the plan. In the third quarter of 2005, the U.S. District Court for the District of Arizona ruled in favor of the plaintiffs on these claims and in favor of Honeywell on virtually all other claims. We strongly disagree with, and intend to appeal, the Court's adverse ruling. A class was certified by the Court in September 2006. In light of the merits of our arguments on appeal and our substantial affirmative defenses which have not yet been considered by the Court, we continue to expect to prevail in this matter. Accordingly, we do not believe that a liability is probable of occurrence and reasonably estimable and have not recorded a provision for this matter in our financial statements. Given the uncertainty inherent in litigation and the wide range of potential remedies, it is not possible to estimate the range of possible loss that might result from an adverse resolution of this matter. Although we expect to prevail in this matter, an adverse outcome could have a material adverse effect on our results of operations or operating cash flows in the periods recognized or paid. We do not believe that an adverse outcome in this matter would have a material adverse effect on our consolidated financial position.

We are subject to a number of other lawsuits, investigations and disputes (some of which involve substantial amounts claimed) arising out of the conduct of our business, including matters relating to commercial transactions, government contracts, product liability, prior acquisitions and divestitures, employee benefit plans, and health and safety matters. We recognize a liability for any contingency that is probable of occurrence and reasonably estimable. We continually assess the likelihood of adverse judgments of outcomes in these matters, as well as potential ranges of probable losses (taking into consideration any insurance recoveries), based on a careful analysis of each matter with the assistance of outside legal counsel and, if applicable, other experts.

Given the uncertainty inherent in litigation, we do not believe it is possible to develop estimates of the range of reasonably possible loss in excess of current accruals for these matters. Considering our past experience and existing accruals, we do not expect the outcome of these matters, either individually or in the aggregate, to have a material adverse effect on our consolidated financial position. Because most contingencies are resolved over long periods of time, potential liabilities are subject to change due to new developments, changes in settlement strategy or the impact of evidentiary requirements, which could cause us to pay damage awards or settlements (or become subject to equitable remedies) that could have a material adverse effect on our results of operations or operating cash flows in the periods recognized or paid.

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### Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareowners  
of Honeywell International Inc.

We have reviewed the accompanying consolidated balance sheet of Honeywell International Inc. and its subsidiaries as of March 31, 2007, and the related consolidated statement of operations for each of the three-month periods ended March 31, 2007 and 2006 and the consolidated statement of cash flows for the three-month periods ended March 31, 2007 and 2006. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2006, and the related consolidated statements of operations, of shareowners' equity, and of cash flows for the year then ended, management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 and the effectiveness of the Company's internal control over financial reporting as of December 31, 2006; and in our report dated February 15, 2007 we expressed unqualified opinions thereon. The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

PricewaterhouseCoopers LLP

Florham Park, New Jersey  
April 20, 2007

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The Report of Independent Registered Public Accounting Firm included above is not a report or part of a Registration Statement prepared or certified by an independent accountant within the meetings of Sections 7 and 11 of the Securities Act of 1933, and the accountants' Section 11 liability does not extend to such report.

## ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)

(Dollars in millions, except per share amounts)

The following MD&A is intended to help the reader understand the results of operations and financial condition of Honeywell International Inc. (Honeywell) for the three months ended March 31, 2007. The financial information as of March 31, 2007 should be read in conjunction with the financial statements for the year ended December 31, 2006 contained in our Form 10-K filed on February 16, 2007.

A. RESULTS OF OPERATIONS - FIRST QUARTER 2007 COMPARED WITH FIRST QUARTER 2006
Net Sales

|                                     | First Quarter |          |
|-------------------------------------|---------------|----------|
|                                     | 2007          | 2006     |
| Net sales                           | \$ 8,041      | \$ 7,241 |
| % change compared with prior period | 11%           |          |

The increase in net sales in the first quarter of 2007 compared with the first quarter of 2006 is attributable to the following:

|                            |       |
|----------------------------|-------|
| Acquisitions/ Divestitures | 2%    |
| Price                      | 1     |
| Volume                     | 6     |
| Foreign Exchange           | 2     |
|                            | <hr/> |
|                            | 11%   |

A discussion of net sales by reportable segment can be found in the Review of Business Segments section of this MD&A.

Cost of Products and Services Sold

|                                    | First Quarter |          |
|------------------------------------|---------------|----------|
|                                    | 2007          | 2006     |
| Cost of products and services sold | \$ 6,150      | \$ 5,600 |
| Gross Margin %                     | 23.5%         | 22.7%    |

Gross margin increased in the first quarter of 2007 compared with the first quarter of 2006 by 0.8 percentage points due primarily to higher margins in our Specialty Materials segment (primarily as a result of higher project sales at UOP), slightly higher margins in our Aerospace segment and lower pension expense offsetting higher repositioning costs in our Corporate segment.

Selling, General and Administrative Expenses

|                                              | First Quarter |          |
|----------------------------------------------|---------------|----------|
|                                              | 2007          | 2006     |
| Selling, general and administrative expenses | \$ 1,089      | \$ 1,002 |
| Percent of sales                             | 13.5%         | 13.8%    |

Selling, general and administrative expenses as a percentage of sales decreased by 0.3 percentage points due primarily to productivity savings in our Aerospace and Specialty Materials segments, partially offset by higher expense in our Automation and Control Solutions segment (primarily selling costs) and higher repositioning expense.



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## Pension and Other Postretirement Benefits

|                                                                                                                                                          | First Quarter |        |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|--------|
|                                                                                                                                                          | 2007          | 2006   |
| Pension and other postretirement benefits (OPEB) expense included in cost of products and services sold and selling, general and administrative expenses | \$ 74         | \$ 126 |
| Decrease compared with prior period                                                                                                                      | \$ (52)       |        |

Pension and OPEB expense decreased by \$52 million in the first quarter of 2007 compared with the first quarter of 2006 due principally to a decrease of \$47 million in pension expense. The decrease in pension expense is primarily due to a decrease in the amortization of net losses in our U.S. plans resulting from an increase in the discount rate at December 31, 2006 and actual plan asset returns higher than the expected rate of return in 2004 and 2006.

## Other (Income) Expense

|                                                            | First Quarter |         |
|------------------------------------------------------------|---------------|---------|
|                                                            | 2007          | 2006    |
| Equity (income) /loss of affiliated companies              | \$ 2          | \$ 2    |
| Loss (gain) on sale of non-strategic businesses and assets |               | (16)    |
| Interest income                                            | (19)          | (19)    |
| Foreign exchange                                           | 5             | 1       |
| Other (net)                                                | 1             | 7       |
|                                                            | \$ (11)       | \$ (25) |

Other income decreased by \$14 million, primarily due to the \$16 million gain on the sale of land in our Specialty Materials segment recognized in the first quarter of 2006.

## Interest and Other Financial Charges

|                                      | First Quarter |       |
|--------------------------------------|---------------|-------|
|                                      | 2007          | 2006  |
| Interest and other financial charges | \$ 97         | \$ 89 |
| % change compared with prior period  | 9%            |       |

Interest and other financial charges increased by \$8 million, or 9 percent in the first quarter of 2007 compared with the first quarter of 2006 due principally to higher debt balances and higher borrowing costs.

## Tax Expense

|                    | First Quarter |        |
|--------------------|---------------|--------|
|                    | 2007          | 2006   |
| Tax expense        | \$ 190        | \$ 144 |
| Effective tax rate | 26.5%         | 25.0%  |

The effective tax rate increased by 1.5 percentage points in the first quarter of 2007 compared to the first quarter of 2006 due principally to the favorable resolution of a non-U.S. tax audit in the first quarter of 2006. The effective tax rate was lower than the statutory rate of 35 percent due in part to the increase in foreign earnings and the benefits from the domestic manufacturing deduction and tax planning strategies.



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## Income from Continuing Operations

|                                                                                                                                                                                                                                                                                                                                                        | First Quarter |         |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------|
|                                                                                                                                                                                                                                                                                                                                                        | 2007          | 2006    |
| Income from continuing operations                                                                                                                                                                                                                                                                                                                      | \$ 526        | \$ 431  |
| Earnings per share of common stock assuming dilution                                                                                                                                                                                                                                                                                                   | \$ 0.66       | \$ 0.51 |
| The increase of \$0.15 per share in the first quarter of 2007 compared with the first quarter of 2006 relates primarily to increased segment profit, reduced pension expense and a reduction in the number of shares outstanding due to the Company's stock repurchase program, partially offset by higher repositioning spending (largely severance). |               |         |

## Income from Discontinued Operations

|                                                                                                                                                                           | First Quarter |         |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------|
|                                                                                                                                                                           | 2007          | 2006    |
| Income from discontinued operations                                                                                                                                       | \$            | \$ 5    |
| Earnings per share of common stock assuming dilution                                                                                                                      | \$            | \$ 0.01 |
| Income from discontinued operations of \$5 million, or \$0.01 per share, in the first quarter of 2006 relates to the operating results of Indalex, sold in February 2006. |               |         |

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Review of Business Segments

|                                                | Three Months Ended<br>March 31, |          |
|------------------------------------------------|---------------------------------|----------|
|                                                | 2007                            | 2006     |
| <b>Net Sales</b>                               |                                 |          |
| Aerospace                                      | \$ 2,840                        | \$ 2,629 |
| Automation and Control Solutions               | 2,801                           | 2,365    |
| Specialty Materials                            | 1,199                           | 1,152    |
| Transportation Systems                         | 1,201                           | 1,095    |
| Corporate                                      |                                 |          |
|                                                | \$ 8,041                        | \$ 7,241 |
| <b>Segment Profit</b>                          |                                 |          |
| Aerospace                                      | \$ 500                          | \$ 440   |
| Automation and Control Solutions               | 274                             | 221      |
| Specialty Materials                            | 192                             | 162      |
| Transportation Systems                         | 156                             | 142      |
| Corporate                                      | (43)                            | (45)     |
| Total Segment Profit                           | 1,079                           | 920      |
| Other income (expense)                         | 11                              | 25       |
| Interest and other financial charges           | (97)                            | (89)     |
| Stock option expense                           | (24)                            | (25)     |
| Pension and other postretirement expense (A)   | (74)                            | (126)    |
| Repositioning and other charges (A)            | (179)                           | (130)    |
| Income from continuing operations before taxes | \$ 716                          | \$ 575   |

(A) Amounts included in cost of products and services sold and selling, general and administrative expenses in the Consolidated Statement of Operations.

Aerospace

|                                     | First Quarter |          |
|-------------------------------------|---------------|----------|
|                                     | 2007          | 2006     |
| Net sales                           | \$ 2,840      | \$ 2,629 |
| % change compared with prior period | 8%            |          |
| Segment profit                      | \$ 500        | \$ 440   |
| % change compared with prior period | 14%           |          |

Aerospace sales by major customer end-markets for the three months ended March 31, 2007 and 2006 were as follows:

| % of Aerospace<br>Sales | % Changes<br>in Sales |
|-------------------------|-----------------------|
|-------------------------|-----------------------|

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| Customer End-Markets                             | 2007 | 2006 | 2007<br>Versus<br>2006 |
|--------------------------------------------------|------|------|------------------------|
| Commercial:                                      |      |      |                        |
| Air transport and regional original equipment    | 16%  | 17%  | 8%                     |
| Air transport and regional aftermarket           | 23   | 22   | 9                      |
| Business and general aviation original equipment | 11   | 10   | 12                     |
| Business and general aviation aftermarket        | 10   | 10   | 11                     |
| Defense and Space                                | 40   | 41   | 6                      |
|                                                  |      |      |                        |
| Total                                            | 100% | 100% | 8%                     |

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Aerospace sales increased by 8 percent in the first quarter of 2007 compared with the first quarter of 2006. Details regarding the increase in sales by customer end-markets are as follows:

Air transport and regional original equipment (OE) sales increased by 8 percent primarily driven by increased deliveries to our air transport customers due to higher aircraft production rates.

Air transport and regional aftermarket sales increased by 9 percent as a result of increased sales of spare parts and maintenance activity relating to an approximately 6 percent increase in global flying hours.

Business and general aviation OE sales increased by 12 percent due primarily to an increase in new business jet deliveries due to continued strong demand in the business jet end-market.

Business and general aviation aftermarket sales increased by 11 percent due to higher engine utilization, increased sales of spare parts and increased maintenance events.

Defense and space sales increased by 6 percent, primarily due to higher sales of surface systems, as well as increased space sales, including engineering activity relating to the new Orion (CEV) program.

Aerospace segment profit increased by 14 percent in the first quarter of 2007 compared with the first quarter of 2006 due primarily to sales volume growth, increased prices, productivity savings and a one-time reimbursement of certain research and development costs, partially offset by inflation.

### Automation and Control Solutions

|                                     | First Quarter |          |
|-------------------------------------|---------------|----------|
|                                     | 2007          | 2006     |
| Net sales                           | \$ 2,801      | \$ 2,365 |
| % change compared with prior period | 18%           |          |
| Segment profit                      | \$ 274        | \$ 221   |
| % change compared with prior period | 24%           |          |

Automation and Control Solutions ( ACS ) sales increased by 18 percent in the first quarter of 2007 compared with the first quarter of 2006, with 12 percent organic growth (including 3 percent of favorable foreign exchange impact) and growth from acquisitions (net of divestitures) of 6 percent. All ACS businesses contributed to the continued growth in the quarter.

Organic sales in the ACS products businesses grew by 9 percent primarily due to increased sales of our fire systems, sensors and gas detection products, increased sales, primarily to customers in Europe and Asia for our environmental and combustion products, and the favorable impact of foreign exchange.

Organic sales in our solutions businesses increased by 18 percent, driven by strong conversion to sales from our order backlog, increased sales in our European and Asia-Pacific markets and the favorable impact of foreign exchange.

Growth in sales from acquisitions, net of divestitures was \$148 million in the first quarter of 2007, largely representing revenues from our acquisitions of First Technology plc (gas detection) and Gardiner Groupe (security distribution) in March 2006 and May 2006, respectively.

ACS segment profit increased by 24 percent in the first quarter of 2007 compared with the first quarter of 2006 due principally to increased sales and productivity savings that offset inflation and a change in mix resulting from

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stronger sales in our solutions business (in particular, our Building Solutions business) that typically have lower margins than our products businesses. In the first quarter of 2006, segment profit was also negatively impacted by a contract loss experienced on a Building Solutions project.

### Specialty Materials

|                                     | First Quarter |          |
|-------------------------------------|---------------|----------|
|                                     | 2007          | 2006     |
| Net sales                           | \$ 1,199      | \$ 1,152 |
| % change compared with prior period | 4%            |          |
| Segment profit                      | \$ 192        | \$ 162   |
| % change compared with prior period | 19%           |          |

Specialty Materials sales increased by 4 percent in the first quarter of 2007 compared with the first quarter of 2006. This organic sales growth was primarily due to higher sales in our UOP business which increased by 21 percent, driven by strong performance in our projects business (including equipment sales and royalties) offset by lower sales of catalysts. Specialty Products sales increased by 2 percent primarily due to higher sales to our customers in the semi-conductor industry. Fluorine Product sales decreased by 11 percent primarily due to lower prices for refrigerants and lower industry demand for household appliances and insulating materials as a result of the weak U.S housing market. Organic sales in our Resins and Chemicals business decreased by 6 percent primarily due to lower production as a result of raw material supply.

Specialty Materials segment profit increased by 19 percent in the first quarter of 2007 compared with the first quarter of 2006 due principally to the strength of our UOP business, (including higher royalty revenues from the UOP projects business compared to the first quarter of 2006), and increased pricing and productivity actions that more than offset the impact of raw material inflation.

### Transportation Systems

|                                     | First Quarter |          |
|-------------------------------------|---------------|----------|
|                                     | 2007          | 2006     |
| Net sales                           | \$ 1,201      | \$ 1,095 |
| % change compared with prior period | 10%           |          |
| Segment profit                      | \$ 156        | \$ 142   |
| % change compared with prior period | 10%           |          |

Transportation Systems sales increased by 10 percent in the first quarter of 2007 compared with the first quarter of 2006, primarily due to increased sales in our Turbo business and Consumer Products Group and the impact of favorable foreign exchange impact.

Turbo sales increased by 9 percent compared to the first quarter of 2006 primarily due to strong sales to European light vehicle manufacturers and the impact of favorable foreign exchange, offset by lower sales to Class 8 engine manufacturers.

Consumer Products Group sales increased by 11 percent due to higher volume growth across all our brands.

Transportation Systems segment profit increased by 10 percent in the first quarter of 2007 compared with the first quarter of 2006 primarily due to productivity and increased prices partially offset by the impact of inflation, primarily relating to nickel components, and the cost of new product launches.

# Repositioning and Other Charges

A summary of repositioning and other charges follows:

|                                                             | Three Months Ended<br>March 31, |        |
|-------------------------------------------------------------|---------------------------------|--------|
|                                                             | 2007                            | 2006   |
| Severance                                                   | \$ 74                           | \$ 24  |
| Asset impairments                                           | 6                               |        |
| Exit costs                                                  | 5                               | 2      |
| Adjustments                                                 | (4)                             | (2)    |
| Total net repositioning charge                              | 81                              | 24     |
| Asbestos related litigation charges, net of insurance       | 24                              | 28     |
| Probable and reasonably estimable environmental liabilities | 60                              | 62     |
| Business impairment charges                                 |                                 | 9      |
| Other                                                       | 14                              | 7      |
| Total net repositioning and other charges                   | \$ 179                          | \$ 130 |

The following table summarizes the pretax distribution of total net repositioning and other charges by income statement classification:

|                                              | Three Months Ended<br>March 31, |        |
|----------------------------------------------|---------------------------------|--------|
|                                              | 2007                            | 2006   |
| Cost of products and services sold           | \$ 159                          | \$ 130 |
| Selling, general and administrative expenses | 20                              |        |
|                                              | \$ 179                          | \$ 130 |

The following table summarizes the pretax impact of total net repositioning and other charges by reportable segment:

|                                  | Three Months Ended<br>March 31, |        |
|----------------------------------|---------------------------------|--------|
|                                  | 2007                            | 2006   |
| Aerospace                        | \$ 26                           | \$ 1   |
| Automation and Control Solutions | 41                              | 9      |
| Specialty Materials              | 5                               | 7      |
| Transportation Systems           | 31                              | 42     |
| Corporate                        | 76                              | 71     |
|                                  | \$ 179                          | \$ 130 |

In the first quarter of 2007, we recognized a net repositioning charge of \$81 million primarily for severance costs related to workforce reductions of 1,335 manufacturing and administrative positions associated with the rationalization of manufacturing capacity and infrastructure

and plant closures, principally in our Automation and Control Solutions and Aerospace segments.

In the first quarter of 2006, we recognized a net repositioning charge of \$24 million primarily for severance costs related to workforce reductions of 526 manufacturing and administrative positions in our Automation and Control Solutions, Transportation Systems and Aerospace reportable segments.

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Our repositioning actions are expected to generate incremental pretax savings of approximately \$115 million in 2007 compared with 2006 principally from planned workforce reductions. Cash expenditures for severance and other exit costs necessary to execute these actions were \$28 million in the three months ended March 31, 2007 and were funded through operating cash flows. Cash expenditures for severance and other exit costs necessary to execute the remaining actions will approximate \$140 million in 2007 and will be funded through operating cash flows.

In the first quarter of 2007, we recognized a charge of \$60 million for environmental liabilities deemed probable and reasonably estimable in the quarter. We recognized a charge of \$24 million representing an update to our estimated liability for the resolution of Bendix related asbestos claims as of March 31, 2007, net of probable insurance recoveries. We also recognized other charges of \$14 million for a business sale tax related to a prior divestiture (\$8 million) and for a contemplated settlement of a legal matter (\$6 million).

In the first quarter of 2006, we recognized a charge of \$62 million for environmental liabilities deemed probable and reasonably estimable in the quarter. We recognized a charge of \$28 million for Bendix related asbestos claims filed and defense costs incurred during the first quarter of 2006, net of probable insurance recoveries. We also recognized business impairment charges of \$9 million related primarily to the write-down of property, plant and equipment held for sale in our Specialty Materials reportable segment, and other charges of \$7 million related primarily to a property damage litigation matter in our Corporate segment.

### B. LIQUIDITY AND CAPITAL RESOURCES

The Company continues to manage its businesses to maximize operating cash flows as the primary source of liquidity. We supplement operating cash with short-term debt from the commercial paper market and long-term borrowings. We continue to balance our cash and financing uses through investment in our existing core businesses, acquisition activity, share repurchases and dividends.

We continuously assess the relative strength of each business in our portfolio as to strategic fit, market position, profit and cash flow contribution in order to upgrade our combined portfolio and identify business units that will most benefit from increased investment. We identify acquisition candidates that will further our strategic plan and strengthen our existing core businesses. We also identify business units that do not fit into our long-term strategic plan based on their market position, relative profitability or growth potential. These business units are considered for potential divestiture, restructuring or other repositioning actions subject to regulatory constraints.

#### Cash Flow Summary

##### Cash Flow Summary

Our cash flows from operating, investing and financing activities, as reflected in the Consolidated Statement of Cash Flows for the three months ended March 31, 2007 and 2006, are summarized as follows:

|                                                      | <u>2007</u>   | <u>2006</u>   |
|------------------------------------------------------|---------------|---------------|
| Cash provided by (used for):                         |               |               |
| Operating activities                                 | \$ 578        | \$ 239        |
| Investing activities                                 | (91)          | 334           |
| Financing activities                                 | (337)         | (364)         |
| Effect of exchange rate changes on cash              | 4             | (1)           |
| Net increase (decrease) in cash and cash equivalents | <u>\$ 154</u> | <u>\$ 208</u> |

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Cash provided by operating activities increased by \$339 million during the first three months of 2007 compared with the first three months of 2006 primarily due to increased earnings, lower cash tax payments of \$100 million, lower pension and other postretirement payments of \$70 million, and working capital improvement of \$2 million, primarily due to increased accounts payable balances and an improvement in inventory, partially offset by higher accounts receivable balances as a result of higher sales. In addition, in the first quarter of 2006 there was a receipt of \$100 million from the sale of an insurance receivable.

Cash used for investing activities decreased by \$425 million during the first three months of 2007 compared with the first three months of 2006 due primarily to the sale of Indalex in February 2006 for \$425 million.

Cash used for financing activities decreased by \$27 million during the first quarter of 2007 compared with the first quarter of 2006 primarily due to an increase in net proceeds from debt of \$736 million, a \$209 million reduction in the payment of debt assumed with acquisitions, offset by increases in the repurchases of common stock of \$861 million and decreased proceeds from the issuance of common stock primarily related to stock option exercises of \$55 million.

### Liquidity

In March 2007, the Company issued \$400 million 5.30% Senior Notes due 2017 and \$600 million 5.70% Senior Notes due 2037 (collectively, the Notes). The Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of \$1 billion, offset by \$12 million in debt issuance costs. Proceeds from the notes were used to repay commercial paper and debt.

### C. OTHER MATTERS

#### Litigation

We are subject to a number of lawsuits, investigations and claims (some of which involve substantial amounts) arising out of the conduct of our business. See a discussion of environmental, asbestos and other litigation matters in Note 14 of our Financial Statements.

#### Critical Accounting Policies

The financial information as of March 31, 2007 should be read in conjunction with the financial statements for the year ended December 31, 2006 contained in our Form 10-K filed on February 16, 2007.

For a discussion of the Company's critical accounting policies, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K filed on February 16, 2007.

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### Recent Accounting Pronouncements

See Note 2 of Notes to Financial Statements for a discussion of recent accounting pronouncements, including discussion of the impact of adopting FIN 48: Uncertain Tax Positions on January 1, 2007.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See our 2006 Annual Report on Form 10-K (Item 7A). As of March 31, 2007, there has been no material change in this information.

### ITEM 4. CONTROLS AND PROCEDURES

Honeywell management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that such disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q in alerting them on a timely basis to material information relating to Honeywell required to be included in Honeywell's periodic filings under the Exchange Act. There have been no changes that have materially affected, or are reasonably likely to materially affect, Honeywell's internal control over financial reporting that have occurred during the period covered by this Quarterly Report on Form 10-Q.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

#### General Legal Matters

We are subject to a number of lawsuits, investigations and claims (some of which involve substantial amounts) arising out of the conduct of our business. See a discussion of environmental, asbestos and other litigation matters in Note 15 of Notes to Financial Statements.

#### Environmental Matters Involving Potential Monetary Sanctions in Excess of \$100,000

As previously reported, three incidents occurred during 2003 at Honeywell's Baton Rouge, Louisiana chemical plant, including a release of chlorine, a release of antimony pentachloride (which resulted in an employee fatality), and an employee exposure to hydrofluoric acid. The United States Environmental Protection Agency and the United States Department of Justice have conducted investigations of these incidents, including a federal grand jury convened to investigate the employee fatality. As a result of that investigation, we have signed a plea agreement with the U.S. Attorney under which Honeywell will plead guilty to a misdemeanor charge and pay \$12 million in combined restitution and fines. The plea agreement has been filed, but the plea and the sentence still are subject to Court acceptance, which we expect to receive. Honeywell has been served with several civil lawsuits regarding these incidents, for which we believe we have adequate insurance coverage to the extent that there is any liability. We are also engaged in discussions with the Louisiana Department of Environmental Quality (LADEQ) to resolve alleged civil environmental violations at our Baton Rouge and Geismar, Louisiana facilities that, in part, overlap with the subject of the federal investigation.

Although we cannot predict the outcome of the matters described below, we believe that sufficient provisions have been made in our financial statements for

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these matters. We do not believe that the matters described below will have a material adverse effect on our consolidated financial position, results of operations or operating cash flows.

Honeywell is a defendant in a lawsuit filed by the Arizona Attorney General's office on behalf of the Arizona Department of Environmental Quality (ADEQ). The complaint alleges failure to make required disclosures, as well as unrelated environmental violations. ADEQ's most significant allegations have been dismissed with prejudice over the course of the proceedings. The state has voluntarily dismissed its remaining claims without prejudice pending consideration of an appeal of its previously dismissed claims.

In February 2007, ADEQ demanded penalties for alleged violations by Honeywell of the state's underground storage tank regulations at the aircraft engines plant in Phoenix, Arizona. ADEQ subsequently added claims relating to other alleged environmental violations at the aircraft engines plant and has made a demand to resolve all alleged violations which we are evaluating. Negotiations regarding the penalty are ongoing.

In the third quarter of 2006, Honeywell was advised that the State of Arizona intended to seek penalties for alleged failures of a facility located in Kingman, Arizona to comply with various provisions of the Resource Conservation and Recovery Act. We have resolved this matter with the State for a payment of \$500,000.

Honeywell received Notices of Violation from the Maricopa County Air Quality Department in July 2006 with respect to various air permitting compliance matters at one of its facilities located in Phoenix, Arizona. Honeywell believes it has taken appropriate corrective and preventive actions to address the concerns raised by the County.

The State of Illinois has brought a claim against Honeywell for penalties and past costs relating to releases of chlorinated solvents at a facility owned by a third party. The State claims that a predecessor company to Honeywell delivered solvents to the third party from 1969 until 1992; that spills occurred during those deliveries; and that Honeywell should pay a share of the penalties and state response costs connected with those spills. Honeywell believes it has strong defenses to the State's claims (including that the contamination arose primarily from releases unrelated to the predecessor's deliveries). We are engaged in discussions with the State regarding a negotiated resolution of this matter.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

The following table summarizes Honeywell's purchases of its common stock, par value \$1 per share, for the three months ended March 31, 2007:

| Period        | Issuer Purchases of Equity Securities                |                                               |                                                                                                            |                                                                                                                                      |
|---------------|------------------------------------------------------|-----------------------------------------------|------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
|               | (a)<br><br>Total<br>Number of<br>Shares<br>Purchased | (b)<br><br>Average<br>Price Paid<br>per Share | (c)<br><br>Total Number<br>of Shares<br>Purchased as<br>Part of Publicly<br>Announced Plans<br>or Programs | (d)<br><br>Approximate Dollar<br>Value of Shares that<br>May Yet be Purchased<br>Under Plans or<br>Programs<br>(Dollars in millions) |
| January 2007  | 2,160,000                                            | \$ 45.38                                      | 2,160,000                                                                                                  | (1)                                                                                                                                  |
| February 2007 | 7,440,000                                            | \$ 46.85                                      | 7,440,000                                                                                                  | (1)                                                                                                                                  |
| March 2007    | 15,725,000                                           | \$ 47.01                                      | 15,725,000                                                                                                 | \$ 2,523                                                                                                                             |

(1) As previously reported, in February 2007, the Company's Board of Directors authorized the repurchase of an additional \$3 billion of its common stock, which the Company started to utilize in March 2007.

ITEM 6. EXHIBITS

- (a) Exhibits. See the Exhibit Index on page 40 of this Quarterly Report on Form 10-Q.

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SIGNATURES

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

Date: April 20, 2007

Honeywell International Inc.

By: /s/ David J. Anderson

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David J. Anderson  
Senior Vice President and Chief Financial  
Officer (on behalf of the Registrant and as the  
Registrant's Principal Accounting Officer)

**EXHIBIT INDEX**

| <b><u>Exhibit Number</u></b> | <b><u>Description</u></b>                                                                                                                                              |
|------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2                            | Omitted (Inapplicable)                                                                                                                                                 |
| 3                            | Omitted (Inapplicable)                                                                                                                                                 |
| 4                            | Omitted (Inapplicable)                                                                                                                                                 |
| 10                           | Omitted (Inapplicable)                                                                                                                                                 |
| 11                           | Computation of Per Share Earnings (1)                                                                                                                                  |
| 12                           | Computation of Ratio of Earnings to Fixed Charges (filed herewith)                                                                                                     |
| 15                           | Independent Accountants Acknowledgment Letter as to the incorporation of their report relating to unaudited interim financial statements (filed herewith)              |
| 18                           | Omitted (Inapplicable)                                                                                                                                                 |
| 19                           | Omitted (Inapplicable)                                                                                                                                                 |
| 22                           | Omitted (Inapplicable)                                                                                                                                                 |
| 23                           | Omitted (Inapplicable)                                                                                                                                                 |
| 24                           | Omitted (Inapplicable)                                                                                                                                                 |
| 31.1                         | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)                                                |
| 31.2                         | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)                                                |
| 32.1                         | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 32.2                         | Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 99                           | Omitted (Inapplicable)                                                                                                                                                 |

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(1) Data required by Statement of Financial Accounting Standards No. 128, Earnings per Share, is provided in Note 7 to the consolidated financial statements in this report.