HEXCEL CORP /DE/
Form 10-Q
July 30, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10–Q

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

For the Quarter Ended June 30, 2008

or

o **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 1-8472

Hexcel Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-1109521**
(State of Incorporation)	(I.R.S. Employer Identification No.)

Two Stamford Plaza

281 Tresser Boulevard

Stamford, Connecticut 06901-3238

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: **(203) 969-0666**

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 to such filing requirements for the past 90 days. Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes o No ý

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

Class	**Outstanding at July 28, 2008**
COMMON STOCK	**96,144,878**

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PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements (Unaudited)

Hexcel Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(In millions, except per share data)	(Unaudited) June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	**$ 19.3**	$ 28.1
Accounts receivable, net	**245.4**	192.8
Inventories, net	**207.7**	179.4
Prepaid expenses and other current assets	**47.7**	34.7
Total current assets	**520.1**	435.0
Property, plant and equipment	**954.4**	858.8
Less accumulated depreciation	**(436.8)**	(415.7)
Net property, plant and equipment	**517.6**	443.1
Goodwill and intangible assets, net	**57.1**	56.8
Investments in affiliated companies	**20.0**	17.5
Deferred tax assets	**83.0**	88.7
Other assets	**20.0**	19.4
Total assets	**$ 1,217.8**	$ 1,060.5
Liabilities and Stockholders Equity		
Current liabilities:		
Notes payable and current maturities of capital lease obligations	**$ 1.7**	$ 0.4
Accounts payable	**143.8**	144.2
Accrued liabilities	**87.1**	99.7
Total current liabilities	**232.6**	244.3
Long-term notes payable and capital lease obligations	**393.8**	315.5
Other non-current liabilities	**89.3**	73.1
Total liabilities	**715.7**	632.9
Stockholders equity:		
Common stock, $0.01 par value, 200.0 shares authorized, 98.0 and 97.6 shares issued at June 30, 2008 and December 31, 2007, respectively	**1.0**	1.0
Additional paid-in capital	**523.6**	513.3
Accumulated deficit	**(47.6)**	(97.4)
Accumulated other comprehensive income	**48.3**	32.6
	525.3	449.5
	(23.2)	(21.9)

Less Treasury stock, at cost, 1.9 shares and 1.8 shares at June 30, 2008 and December 31, 2007, respectively				
Total stockholders equity		**502.1**		427.6
Total liabilities and stockholders equity	**$**	**1,217.8**	$	1,060.5

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Hexcel Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

	(Unaudited)			
	Quarter Ended June 30,		Six Months Ended June 30,	
(In millions, except per share data)	2008	2007	2008	2007
Net sales	**$ 359.5**	$ 289.8	**$ 704.0**	$ 572.4
Cost of sales	**283.4**	219.4	**547.8**	430.5
Gross margin	**76.1**	70.4	**156.2**	141.9
Selling, general and administrative expenses	**30.0**	27.4	**62.0**	58.4
Research and technology expenses	**8.0**	8.5	**16.5**	18.0
Business consolidation and restructuring expenses	**1.2**	0.5	**1.8**	1.6
Other operating expenses	**7.6**		**10.2**	
Operating income	**29.3**	34.0	**65.7**	63.9
Interest expense, net	**5.9**	6.0	**10.9**	11.7
Non-operating expense				0.4
Income from continuing operations before income taxes, equity in earnings and discontinued operations	**23.4**	28.0	**54.8**	51.8
(Benefit) Provision for income taxes	**(2.0)**	11.9	**7.5**	21.9
Income from continuing operations before equity in earnings and discontinued operations	**25.4**	16.1	**47.3**	29.9
Equity in earnings of affiliated companies, net of tax	**1.3**	1.4	**2.6**	2.4
Net income from continuing operations	**26.7**	17.5	**49.9**	32.3
Loss from discontinued operations, net of tax		(8.7)		(6.8)
Gain on sale of discontinued operations, net of tax				6.8
Net income	**$ 26.7**	$ 8.8	**$ 49.9**	$ 32.3
Basic net income (loss) per common share:				
Continuing operations	**$ 0.28**	$ 0.18	**$ 0.52**	$ 0.34
Discontinued operations		(0.09)		
Net income	**$ 0.28**	$ 0.09	**$ 0.52**	$ 0.34
Diluted net income (loss) per common share:				
Continuing operations	**$ 0.27**	$ 0.18	**$ 0.51**	$ 0.33
Discontinued operations		(0.09)		
Net income	**$ 0.27**	$ 0.09	**$ 0.51**	$ 0.33
Weighted average common shares outstanding:				
Basic	**96.2**	94.4	**96.2**	94.4
Diluted	**97.8**	96.3	**97.8**	96.3

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Hexcel Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In millions)	(Unaudited) Six Months Ended June 30, 2008	2007
Cash flows from operating activities		
Net income from continuing operations	**$ 49.9**	$ 32.3
Reconciliation to net cash provided by (used for) operating activities:		
Depreciation and amortization	**22.4**	19.6
Amortization of debt discount and deferred financing costs	**0.8**	0.9
Deferred income taxes	**(3.5)**	14.6
Business consolidation and restructuring expenses	**1.8**	1.6
Business consolidation and restructuring payments	**(3.2)**	(8.6)
Equity in earnings of affiliated companies	**(2.6)**	(2.4)
Share-based compensation	**6.9**	6.7
Excess tax benefits on share-based compensation	**(1.0)**	(3.1)
Loss on early retirement of debt		0.4
Changes in assets and liabilities:		
Increase in accounts receivable	**(42.9)**	(19.6)
Increase in inventories	**(20.9)**	(14.2)
Decrease in prepaid expenses and other current assets	**1.9**	0.3
(Decrease) increase in accounts payable and accrued liabilities	**(21.9)**	8.8
Changes in other non-current assets and long-term liabilities	**6.8**	(10.3)
Net cash provided by (used for) operating activities continuing operations	**(5.5)**	27.0
Cash flows from investing activities		
Capital expenditures	**(86.2)**	(46.0)
Net proceeds from sale of discontinued operations		25.0
Investment in affiliated companies		(2.1)
Net cash (used for) investing activities continuing operations	**(86.2)**	(23.1)
Cash flows from financing activities		
Proceeds from senior secured credit facility term C loan	**79.6**	
Proceeds from senior secured credit facility revolver, net		28.0
Repayments of senior secured credit facility term B loan		(36.2)
Repayments on capital lease obligations and other debt, net	**(0.2)**	(0.2)
Activity under stock plans, including excess tax benefits on stock-based compensation	**1.8**	7.6
Net cash provided by (used for) financing activities continuing operations	**81.2**	(0.8)
Net cash provided by operating activities, discontinued operations		7.9
Net cash used for investing activities, discontinued operations		(1.6)
Effect of exchange rate changes on cash and cash equivalents	**1.7**	0.9
Net (decrease) increase in cash and cash equivalents	**(8.8)**	10.3
Cash and cash equivalents at beginning of period	**28.1**	25.7
Cash and cash equivalents at end of period	**$ 19.3**	$ 36.0

The accompanying notes are an integral part of these condensed consolidated financial statements.

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HEXCEL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Significant Accounting Policies

In these notes, the terms Hexcel , we, us, or our mean Hexcel Corporation and subsidiary companies. The accompanying condensed consolidate financial statements are those of Hexcel Corporation. Refer to Note 1 to the consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2007 for a discussion of our significant accounting policies.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared from the unaudited records of Hexcel pursuant to rules and regulations of the Securities and Exchange Commission (SEC) and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and footnote disclosures normally included in financial statements have been omitted pursuant to rules and regulations of the SEC.

In the opinion of management, the condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the interim periods presented. The condensed consolidated balance sheet as of December 31, 2007 was derived from the audited 2007 consolidated balance sheet. Interim results are not necessarily indicative of results expected for any other interim period or for the full year. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis and the financial statements and notes thereto included in the Hexcel Corporation s 2007 Annual Report on Form 10-K.

Certain prior period amounts in the condensed consolidated financial statements and accompanying notes have been reclassified to conform to the 2008 presentation.

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations (SFAS 141(R)   )*, which replaces SFAS No. 141, *Business Combinations*. SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the application of the acquisition method in a number of significant aspects. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS 141(R) amends SFAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is not permitted. The effect of adopting this new statement will depend on future acquisitions.

In December 2007, the FASB issued Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements   an amendment of ARB No. 51*. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with earlier adoption prohibited. This statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. It also amends certain of ARB No. 51 s consolidation procedures for consistency with the requirements of SFAS 141(R). This statement also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. We are currently evaluating this new statement and anticipate that the statement will not have a significant impact on the reporting of our results of operations.

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In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161).* SFAS 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. SFAS 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 has been applied, and the impact that hedges have on an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently evaluating the impact that this new statement will have on our financial statements.

Note 2 - Inventories, net

(In millions)		June 30, 2008		December 31, 2007
Raw materials	$	92.8	$	86.6
Work in progress		62.8		45.4
Finished goods		71.5		66.9
Total inventories, gross	$	227.1	$	198.9
Inventory allowances		(19.4)		(19.5)
Total inventories, net	$	207.7	$	179.4

Note 3 Retirement and Other Postretirement Benefit Plans

We maintain qualified and nonqualified defined benefit retirement plans covering certain current and former U.S. and European employees, retirement savings plans covering eligible U.S. employees and certain postretirement health care and life insurance benefit plans covering eligible U.S. retirees. We also participate in a union sponsored multi-employer pension plan covering certain U.S. employees with union affiliations. In December 2006, our Board of Directors voted to terminate the U.S. qualified defined benefit plan as of April 1, 2007. As of June 30, 2008 we have settled all U.S. qualified defined benefit plan pension obligations. Refer to our 2007 Annual Report on Form 10-K for further information regarding these plans.

Defined Benefit Retirement Plans

Net Periodic Benefit Costs

Net periodic benefit costs of our defined benefit retirement plans for the quarters and six-months ended June 30, 2008 and 2007 were as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
(In millions)	2008	2007	2008	2007
U.S. Qualified and Nonqualified Defined Benefit Retirement Plans				

Service cost	**$**	**0.4**	$	0.2	**$**	**0.8**	$	0.5
Interest cost		**0.2**		0.5		**0.5**		1.0
Expected return on plan assets				(0.2)				(0.4)
Net amortization and deferral				0.4				0.8
Sub-total		**0.6**		0.9		**1.3**		1.9
Curtailment and settlement loss				0.6		**2.7**		0.8
Net periodic benefit cost	**$**	**0.6**	$	1.5	**$**	**4.0**	$	2.7
European Defined Benefit Retirement Plans								
Service cost	**$**	**1.0**	$	0.9	**$**	**2.1**	$	1.8
Interest cost		**1.9**		1.7		**3.8**		3.4
Expected return on plan assets		**(2.1)**		(1.9)		**(4.2)**		(3.8)
Net amortization and deferral				0.2		**(0.1)**		0.4
Net periodic benefit cost	**$**	**0.8**	$	0.9	**$**	**1.6**	$	1.8

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Contributions

We contributed $0.8 million and $1.7 million to our U.S. qualified and nonqualified defined benefit retirement plans during the second quarters of 2008 and 2007, respectively. Contributions were $7.5 million and $2.0 million for the six-months ended June 30, 2008 and 2007, respectively. Of the total contributed during 2008, $7.1 million was for final settlement of the U.S. qualified plan s remaining benefit obligations, bringing the total contribution for final settlement to $10.4 million. We recorded a pre-tax loss of $2.7 million during the six months ended June 30, 2008 on the final settlement, bringing the total U.S. qualified plan settlement loss to $12.1 million.

We generally fund our U.S. non-qualified defined benefit retirement plans when benefit payments are incurred. Under the provisions of these non-qualified plans, we expect to contribute $1.0 million in 2008 to cover unfunded benefits. We contributed $0.3 million to our U.S. non-qualified defined benefit retirement plans during the 2007 fiscal year. Accrued benefit costs for the U.S. non-qualified defined benefit retirement plans as of June 30, 2008 were $15.7 million, of which $1.0 million is included within accrued liabilities and $14.7 million is included within other non-current liabilities. Accrued benefit costs for the U.S. qualified and non-qualified defined benefit retirement plans as of December 31, 2007 were $21.7 million, of which $7.8 million is included within current accrued liabilities and $13.9 million is included within other non-current liabilities.

In addition, we contributed $1.4 million and $0.7 million to our European defined benefit retirement plans in the second quarters of 2008 and 2007, respectively. Total contributions were $2.2 million and $1.3 million for the six-months ended June 30, 2008 and 2007, respectively. Meeting governing requirements, we plan to contribute approximately $2.8 million during 2008 to our European plans. We contributed $4.5 million to our European plans during the 2007 fiscal year. Accrued benefit costs for the European defined benefit retirement plans as of June 30, 2008 were $18.2 million, of which $2.8 million is included within accrued liabilities and $15.4 million is included within other non-current liabilities. Accrued benefit costs for the European defined benefit retirement plans as of December 31, 2007 were $11.7 million which is included within other non-current liabilities.

Postretirement Health Care and Life Insurance Benefit Plans

Net periodic benefit costs of our postretirement health care and life insurance benefit plans were $0.1 million, consisting of interest costs for both second quarters of 2008 and 2007. For the six-months ended June 30, 2008 and 2007, net periodic postretirement benefit costs were $0.2 million and $0.3 million, respectively. In connection with our postretirement plans , we contributed $0.4million and $0.3 million during the second quarters of 2008 and 2007, respectively and $0.6 million during both six-months ended June 30, 2008 and 2007. We periodically fund our postretirement plans to pay covered expenses as they are incurred. Under the provisions of these postretirement plans, we expect to contribute approximately $1.3 million in 2008 to cover unfunded benefits. We contributed $0.8 million to our postretirement plans during the 2007 fiscal year. Accrued benefit costs for the postretirement plans as of June 30, 2008 were $11.3 million, of which $1.3 million is included within accrued liabilities and $10.0 million is included within other non-current liabilities. Accrued benefit costs for the postretirement plans as of December 31, 2007 were $11.4 million, of which $1.3 million were included with current liabilities.

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Note 4 - Business Consolidation and Restructuring Programs

The Company s current restructuring activities are minimal. Reserves associated with the remaining restructuring programs include certain expected severance payments associated with 2001 and 2006 reorganizations. Costs associated with the closure of our Livermore facility are for remediation and preparation of the property for sale, which are expensed as incurred. The aggregate business consolidation and restructuring liabilities as of June 30, 2008 and December 31, 2007, consisted of the following:

(In millions)		Employee Severance		Facility & Equipment		Total
Balance as of December 31, 2007	$	3.1	$	0.3	$	3.4
Business consolidation and restructuring expenses		0.1		0.5		0.6
Cash expenditures		(0.9)		(0.6)		(1.5)
Currency translation adjustments		0.2				0.2
Balance as of March 31, 2008	$	2.5	$	0.2	$	2.7
Business consolidation and restructuring expenses				**1.2**		**1.2**
Cash expenditures		**(0.4)**		**(1.3)**		**(1.7)**
Currency translation adjustments						
Balance as of June 30, 2008	**$**	**2.1**	**$**	**0.1**	**$**	**2.2**

Note 5 - Notes Payable and Capital Lease Obligations

(In millions)		June 30, 2008		December 31, 2007
Senior secured credit facility - term B loan due 2012		**87.5**		87.5
Senior secured credit facility - term C loan due 2012		**79.6**		
European credit and overdraft facilities				
6.75% senior subordinated notes due 2015		**225.0**		225.0
Total notes payable		**392.1**		312.5
Capital lease obligations		**3.4**		3.4
Total notes payable and capital lease obligations	**$**	**395.5**	$	315.9
Notes payable and current maturities of long-term liabilities	**$**	**1.7**	$	0.4
Long-term notes payable and capital lease obligations, less current maturities		**393.8**		315.5
Total notes payable and capital lease obligations	**$**	**395.5**	$	315.9

Senior Secured Credit Facility

On May 30, 2008, Hexcel Corporation and its lenders entered into the second amendment to its Senior Secured Credit Facility pursuant to which Hexcel borrowed $80 million of additional term loans designated as term C loans. The net proceeds were used to pay down the revolving loan balance under the credit facility to restore availability under the revolver. All other terms of the credit facility, including the collateral package, subsidiary guarantees and financial and other covenants, remain unchanged.

The term C loans under the facility mature on April 1, 2012, one month after maturity of the existing terms loans under the credit facility. Principal payments on the new term loans are due quarterly in similar proportion to the existing term loans, with substantially all of the principal due in the second half of 2011 and the first half of 2012. Any voluntary or mandatory prepayments of term loans by Hexcel will be applied pro rata among the previously existing term loans and the new term loans. The interest rate for the new term loans is based on LIBOR plus a margin, and was determined based on current market pricing. In accordance with the terms of the credit facility regarding the borrowing of additional loans, the interest rate margin on the existing term loans was increased as well, to a level slightly below that of the new term loans.

Term loan B borrowings under the Senior Secured Credit Facility bear interest at a floating rate based on the agent s defined prime rate plus a margin that can vary from 0.875% to 1.125% or LIBOR plus a margin that can vary from 1.875% to 2.125%. Term loan C borrowings under the Senior Secured Credit Facility bear

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interest at a floating rate based on the agent s defined prime rate plus a margin that can vary from 1.25% to 1.50% or LIBOR plus a margin that can vary from 2.25% to 2.50%. Revolving loan borrowings under the Senior Secured Credit Facility bear interest at a floating rate based on either the agent s defined prime rate plus a margin that can vary from 0.25% to 1.00%, or LIBOR plus a margin that can vary from 1.25% to 2.00%. The margin in effect for a borrowing at any given time depends on our consolidated leverage ratio. The weighted average interest rate for the actual borrowings on the Senior Secured Credit Facility was 4.67% for the quarter ended June 30, 2008. Borrowings made under the LIBOR option during the quarter ended June 30, 2008 were made at interest rates ranging from 3.875% to 5.1875%.

In accordance with the terms of the Senior Secured Credit Facility, we are required to maintain a minimum interest coverage ratio of 4.00 (based on the ratio of EBITDA, as defined in the credit agreement, to interest expense) and may not exceed a maximum leverage ratio of 3.00 (based on the ratio of total debt to EBITDA) throughout the term of the Senior Secured Credit Facility. The Senior Secured Credit Facility also contains limitations on, among other things, incurring debt, granting liens, making investments, making restricted payments (including dividends), making capital expenditures, entering into transactions with affiliates and prepaying subordinated debt. In addition, the Senior Secured Credit Facility contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default.

The Senior Secured Credit Facility permits us to issue letters of credit up to an aggregate amount of $40.0 million. Any outstanding letters of credit reduce the amount available for borrowing under the revolving loan. As of June 30, 2008, we had issued letters of credit totaling $13.5 million under the Senior Secured Credit Facility. The Company had no letters of credit outstanding outside the Senior Secured Credit Facility as of June 30, 2008. Total undrawn availability under the Senior Secured Credit Facility as of June 30, 2008 was $111.5 million.

6.75% Senior Subordinated Notes, due 2015

The senior subordinated notes are unsecured senior subordinated obligations of Hexcel Corporation. Interest accrues at the rate of 6.75% per annum and is payable semi-annually in arrears on February 1 and August 1, beginning on August 1, 2005. The senior subordinated notes mature on February 1, 2015. We may not redeem the senior subordinated notes prior to February 1, 2010. We will have the option to redeem all or a portion of the senior subordinated notes at any time during the one-year period beginning February 1, 2010 at 103.375% of principal plus accrued and unpaid interest. This percentage decreases to 102.25% for the one-year period beginning February 1, 2011, to 101.125% for the one-year period beginning February 1, 2012 and to 100.0% any time on or after February 1, 2013. In the event of a change of control (as defined in the indenture), we are generally required to make an offer to all note holders to purchase all outstanding senior subordinated notes at 101% of the principal amount plus accrued and unpaid interest.

The indenture contains various customary covenants including, but not limited to, restrictions on incurring debt, making restricted payments (including dividends), the use of proceeds from certain asset dispositions, entering into transactions with affiliates, and merging or selling all or substantially all of our assets. The indenture also contains many other customary terms and conditions, including customary events of default, some of which are subject to grace and notice periods.

Note 6 - Derivative Financial Instruments

Cross-Currency Interest Rate Swap Agreement

In September 2006, we entered into a cross-currency interest rate swap agreement to hedge a portion of our net Euro investment in Hexcel France SA. To the extent it is effective, gains and losses are recorded as an offset in the cumulative translation account, the same account in which translation gains and losses on the investment in Hexcel France SA are recorded. All other changes, including any difference in current interest, are excluded from the assessment of effectiveness and are thereby included in operating income as a component of interest expense. The impact to interest expense for the quarter and six months ended June 30, 2008 was a net

increase of $0.9 million and a net reduction of $0.1 million, respectively. This agreement has a notional value of $63.4 million, a term of five years, and is scheduled to mature on September 20, 2011. We receive interest in U.S. dollars quarterly and pay interest in Euros on the same day. U.S. interest is based on the three month LIBOR rate. Euro interest is based on the three month EURIBOR. The fair value of the swap at June 30, 2008 and December 31, 2007 was a liability of $15.1 million and $10.6 million, respectively. The fair value at June 30, 2008 was estimated under the provisions of SFAS 157.

Foreign Currency Forward Exchange Contracts

A number of our European subsidiaries are exposed to the impact of exchange rate volatility between the U.S. dollar and the subsidiaries functional currencies, being either the Euro or the British Pound Sterling. We entered into contracts to exchange U.S. dollars for Euros and British Pound Sterling through 2010. The aggregate notional amount of these contracts was $92.5 million at June 30, 2008. The purpose of these contracts is to hedge a portion of the forecasted transactions of European subsidiaries under long-term sales contracts with certain customers. These contracts are expected to provide us with a more balanced matching of future cash receipts and expenditures by currency, thereby reducing our exposure to fluctuations in currency exchange rates. We exclude the forward points from the effectiveness assessment. For the quarters and six-months ended June 30, 2008 and 2007, hedge ineffectiveness was immaterial.

The change in fair value of our foreign currency forward exchange contracts under hedge designations recorded within accumulated other comprehensive income for the quarters and six-months ended June 30, 2008 and 2007 was as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
(In millions)	**2008**	**2007**	**2008**	**2007**
Unrealized gains at beginning of period	**$ 4.7**	$ 3.4	**$ 3.2**	$ 3.9
(Gains) Losses reclassified to net sales	**(0.9)**	(0.9)	**(1.8)**	(1.7)
(Decrease) increase in fair value	**(0.1)**	0.8	**2.3**	1.1
Unrealized gains at end of period	**$ 3.7**	$ 3.3	**$ 3.7**	$ 3.3

As of June 30, 2008, unrealized gains recorded in accumulated other comprehensive income, net of tax, total $4.0 million, of which $3.2 million are expected to be reclassified into earnings over the next twelve months as the hedged sales are recorded.

Note 7 Other Expense

During the second quarter of 2008, the Company increased it environmental accruals for the Lodi, New Jersey site by $7.6 million due to new information that more fully identified the extent of the required remediation, as further discussed in Note 15 to the condensed consolidated financial statements. During the first quarter of 2008, in connection with the termination of our U.S. Qualified Defined Benefit Retirement Plan, as described in Note 3 to the condensed consolidated financial statements, we recorded expense of $2.7 million for the settlement of pension obligations.

Note 8 Income Taxes

The income tax provision, for the second quarter and six months of 2008, includes a benefit for the reinstatement of $14.7 million and $17.2 million, respectively, of U.S. deferred tax assets which had previously been written off. The reinstatement of the deferred tax assets was the result of the implementation of tax planning strategies which increased our ability to utilize certain U.S. net operating loss carryforwards previously limited under Section 382 of the Internal Revenue Code. The amount of allowable net operating losses available was limited following a change in ownership in 2003. The tax strategies involved a change in the Company s approach to measuring the value of the Company for use in the calculation of limitations on the NOL s and capitalization of certain research and development expenses under an IRC Section 59(e)

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election. This election effectively converts pre-change of control limited NOL s into post change of control unlimited NOL s.

In addition, primarily as a result of the elimination of our U.S. defined pension plan, a $3.6 million tax provision (previously included in other comprehensive income) was recognized in the second quarter. Excluding these benefits, the effective tax rate for the six months ended June 30, 2008 was 38.5%, as compared to the effective tax rate for the six months ended June 30, 2007 from continuing operations of 42.0%.

Note 9 Discontinued Operations

EBGI

On August 6, 2007, we completed the sale of the U.S. electronics, ballistics and general industrial product lines (EBGI) portion of our previously reported reinforcements segment. The sale of EBGI included the sale of the design, manufacturing, and selling activities and the related property, plant and equipment and working capital. Revenues associated with the EBGI business were $45.7 million and $91.8 million for the quarter and six-months ended June 30, 2007, respectively. Pre-tax loss associated with the discontinued operation was $13.5 million and $10.8 million for the quarter and six-months ended June 30, 2007, respectively. In accordance with the provisions of SFAS 144, the operations of the EBGI business have been reported as a discontinued operation in our accompanying condensed consolidated financial statements.

Architectural Business

On February 28, 2007, we completed the sale of our European Architectural business. The Architectural business sold included the design, manufacturing and selling activities and the related property, plant and equipment and working capital. Net cash proceeds from the sale were $25.0 million, resulting in a net after-tax gain of $6.5 million, including a loss of $0.3 million recorded in the third quarter of 2007. In accordance with the provisions of SFAS 144*,* the operations of the Architectural business, including the net after-tax gain on the sale, have been reported as a discontinued operation in our accompanying condensed consolidated financial statements.

Revenues associated with the Architectural business were $4.4 million for the six-months ended June 30, 2007. Pre-tax income associated with the discontinued operation was $10.8 million (including a pre-tax gain on the sale of the business of $10.5 million) for the six-months ended June 30, 2007.

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Note 10 - Net Income per Common Share

(In millions, except per share data)	Quarter Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Basic net income per common share:				
Net income from continuing operations	**$ 26.7**	$ 17.5	**$ 49.9**	$ 32.3
Loss from discontinued operations		(8.7)		
Net income	**$ 26.7**	$ 8.8	**$ 49.9**	$ 32.3
Weighted average common shares outstanding	**96.2**	94.4	**96.2**	94.4
Net income from continuing operations per common share	**$ 0.28**	$ 0.18	**$ 0.52**	$ 0.34
Loss from discontinued operations per common share		(0.09)		
Basic net income per common share	**$ 0.28**	$ 0.09	**$ 0.52**	$ 0.34
Diluted net income per common share:				
Net income from continuing operations	**$ 26.7**	$ 17.5	**$ 49.9**	$ 32.3
Loss from discontinued operations		(8.7)		
Net income	**$ 26.7**	$ 8.8	**$ 49.9**	$ 32.3
Weighted average common shares outstanding Basic	**96.2**	94.4	**96.2**	94.4
Plus incremental shares from assumed conversions:				
Restricted stock units	**0.3**	0.3	**0.3**	0.4
Stock options	**1.3**	1.6	**1.3**	1.5
Weighted average common shares outstanding Dilutive	**97.8**	96.3	**97.8**	96.3
Net income from continuing operations per common share	**$ 0.27**	$ 0.18	**$ 0.51**	$ 0.33
Loss from discontinued operations per common share		(0.09)		
Diluted net income per common share	**$ 0.27**	$ 0.09	**$ 0.51**	$ 0.33

Total shares underlying stock options of 0.5 million and 0.7 million were excluded from the computation of diluted net income per share for both the quarter and six-months ended June 30, 2008 and June 30, 2007, respectively, as they were anti-dilutive.

Note 11 - Comprehensive Income

Comprehensive income represents net income and other gains and losses affecting stockholders equity that are not reflected in the condensed consolidated statements of operations. The components of comprehensive income for the quarters and six-months ended June 30, 2008 and 2007 were as follows:

(In millions)	Quarter Ended June 30, 2008	2007	Six-Months Ended June 30, 2008	2007
Net income from continuing operations	**$ 26.7**	$ 17.5	**$ 49.9**	$ 32.3

Currency translation adjustments	**0.6**	2.1	**9.8**	3.6
Pension and other postretirement obligations	**3.7**	0.4	**5.7**	0.8
Net unrealized (losses) gains on financial instruments	**(1.2)**	(0.2)	**0.2**	(0.9)
Comprehensive income from continuing operations	**$ 29.8**	$ 19.8	**$ 65.6**	$ 35.8

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Note 12 Investments in Affiliated Companies

We have equity ownership investments in two Asian joint ventures. In connection therewith, we have considered the accounting and disclosure requirements of FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*, and believe that these investments would be considered variable interest entities. However, we also believe that we are not the primary beneficiary of such entities, and therefore, are not required to consolidate these entities.

BHA Aero Composite Parts Co., Ltd.

In 1999, Hexcel, Boeing International Holdings, Ltd. (Boeing International) and China Aviation Industry Corporation I (AVIC) formed a joint venture, BHA Aero Composite Parts Co., Ltd. (BHA Aero). This joint venture is located in Tianjin, China, and manufactures composite parts for secondary structures and interior applications for commercial aircraft. Our ownership interest was 40.48% as of June 30, 2008 and 2007. On July 18, 2008 we sold our interest in BHA Aero as further described in Note 16 to the condensed consolidated financial statements - Subsequent Event.

Asian Composites Manufacturing Sdn. Bhd.

In 1999, we formed another joint venture, Asian Composites Manufacturing Sdn. Bhd. (Asian Composites), with Boeing Worldwide Operations Limited, Sime Link Sdn. Bhd., and Malaysia Helicopter Services Bhd. (now known as Naluri Berhad), to manufacture composite parts for secondary structures for commercial aircraft. Our initial ownership interest in this joint venture, which is located in Alor Setar, Malaysia, was 25%. During the first quarter of 2007 we paid $2.1 million to increase our ownership interest to 33.33%.

Note 13 Fair Value Measurements

Effective January 1, 2008, we adopted the Financial Accounting Standards Board (FASB) Statement No. 157, Fair Value Measurements (SFAS 157), for financial assets and liabilities. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. The statement indicates, among other things, that a fair value measurement assumes a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. In accordance with FASB Staff Positions (FSP) 157-2, we will defer adoption of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until January 1, 2009. The company is currently assessing the impact of SFAS 157 for nonfinancial assets and liabilities on our consolidated financial position and results of operations.

In order to increase consistency and comparability in fair value measurements, SFAS No. 157 establishes a hierarchy for observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

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In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

For derivative assets and liabilities that utilize Level 2 inputs we prepare estimates of future cash flows of our derivatives, which are discounted to a net present value. The estimated cash flows and the discount factors used in the valuation model are based on observable inputs, and incorporate non-performance risk (the credit standing of the counterparty when the derivative is in a net asset position, and the credit standing of Hexcel when the derivative is in a net liability position). Below is a summary of valuation techniques for all Level 2 financial assets and liabilities:

- Cross-Currency interest rate swap derivative liabilities valued using LIBOR and EURIBOR yield curves at the reporting date. Counterparties to these contracts are highly rated financial institutions none of which experienced any significant downgrades in the three months ended June 30, 2008 that would reduce the receivable amount owed, if any, to the Company.

- Foreign exchange derivative assets and liabilities valued using quoted forward foreign exchange prices at the reporting date. Counterparties to these contracts are highly rated financial institutions none of which experienced any significant downgrades in the three months ended June 30, 2008 that would reduce the receivable amount owed, if any, to the Company.

- Money market funds considered available-for-sale, and classified as cash equivalents. The adoption of SFAS 157 does not have a material effect on these investments.

The following table presents assets and liabilities measured at fair value at June 30, 2008:

(In millions) **Description**	**June 30,** **2008**	**Fair Value Measurements at June 30, 2008** **Level 1**	**Level 2**	**Level 3**
Money market funds	$ **9.8**	$	$ **9.8**	$
Foreign currency exchange contracts	**3.7**		**3.7**	
Total assets	$ **13.5**	$	$ **13.5**	$
Foreign currency exchange contracts	$ **0.8**	$	$ **0.8**	$
Cross-currency interest rate swaps	**15.1**		**15.1**	
Total liabilities	$ **15.9**	$	$ **15.9**	$

Note 14 - Segment Information

The financial results for our operating segments are prepared using a management approach, which is consistent with the basis and manner in which we internally segregate financial information for the purpose of assisting in making internal operating decisions. We evaluate the performance of our operating segments based on operating income, and generally account for intersegment sales based on arm s length prices.

Corporate and certain other expenses are not allocated to the operating segments, except to the extent that the expense can be directly attributable to the business segment.

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Financial information for our business segments for the quarters and six-months ended June 30, 2008 and 2007 is as follows:

	Unaudited			
(In millions)	**Composite Materials**	**Engineered Products**	**Corporate & Other**	**Total**
Second Quarter 2008				
Net sales to external customers:				
Commercial aerospace	$ **148.1**	$ **50.6**	$	$ **198.7**
Industrial	**84.7**	**1.1**		**85.8**
Space and defense	**59.7**	**15.3**		