

HEXCEL CORP /DE/  
Form 10-K  
February 08, 2013

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10 K**

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

**For the Fiscal Year Ended December 31, 2012**

**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 1-8472**

**Hexcel Corporation**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of Incorporation)

**94-1109521**  
(I.R.S. Employer Identification No.)

**281 Tresser Boulevard**  
**Stamford, Connecticut 06901**

(Address of principal executive offices and zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

**Title of each class**  
COMMON STOCK

**Name of each exchange on which registered**  
NEW YORK STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$2,521,083,397 based on the reported last sale price of common stock on June 29, 2012, which is the last business day of the registrant's most recently completed second fiscal quarter.

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

Class	Outstanding as of February 5, 2013
COMMON STOCK	100,351,188

**Documents Incorporated by Reference:**

**Proxy Statement for Annual Meeting of Stockholders (to the extent specified herein) Part III.**

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PART I

**ITEM 1. Business.**

**General Development of Business**

Hexcel Corporation, founded in 1946, was incorporated in California in 1948, and reincorporated in Delaware in 1983. Hexcel Corporation and its subsidiaries (herein referred to as Hexcel, the Company, we, us, or our), is a leading advanced composites company. We develop, manufacture, and market lightweight, high-performance structural materials, including carbon fibers, specialty reinforcements, prepregs and other fiber-reinforced matrix materials, honeycomb, adhesives, engineered honeycomb and composite structures, for use in Commercial Aerospace, Space & Defense and Industrial Applications. Our products are used in a wide variety of end applications, such as commercial and military aircraft, space launch vehicles and satellites, wind turbine blades, automotive, bikes, skis and a wide variety of recreational products and other industrial applications.

We serve international markets through manufacturing facilities, sales offices and representatives located in the Americas, Asia Pacific, Europe and Russia. We are also an investor in a joint venture in Malaysia, which manufactures composite structures for Commercial Aerospace applications.

**Narrative Description of Business and Segments**

We are a manufacturer of products within a single industry: Advanced Composites. Hexcel has two reportable segments, Composite Materials and Engineered Products. The Composite Materials segment is comprised of our carbon fiber, specialty reinforcements, resins, prepregs and other fiber-reinforced matrix materials, and honeycomb core product lines. The Engineered Products segment is comprised of lightweight high strength composite structures, molded components and specialty machined honeycomb product lines.

The following summaries describe the ongoing activities related to the Composite Materials and Engineered Products segments as of December 31, 2012.

***Composite Materials***

The Composite Materials segment manufactures and markets carbon fibers, fabrics and specialty reinforcements, prepregs and other fiber-reinforced matrix materials, structural adhesives, honeycomb, molding compounds, tooling materials, polyurethane systems and laminates that are incorporated into many applications, including military and commercial aircraft, wind turbine blades, recreational products, transport (cars, boats, trains) and other industrial applications.



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The following table identifies the principal products and examples of the primary end-uses from the Composite Materials segment:

SEGMENT	PRODUCTS	PRIMARY END-USES
COMPOSITE MATERIALS	Carbon Fibers	<ul style="list-style-type: none"> <li>Raw materials for prepregs, fabrics and specialty reinforcements</li> <li>Filament winding for various aerospace, defense and industrial applications</li> </ul>
	Fabrics and Specialty Reinforcements	<ul style="list-style-type: none"> <li>Raw materials for prepregs and honeycomb</li> <li>Composites and components used in aerospace, defense, wind energy, automotive, recreation and other industrial applications</li> </ul>
	Prepregs, Other Fiber-Reinforced Matrix Materials and Resins	<ul style="list-style-type: none"> <li>Composite structures</li> <li>Commercial and military aircraft components</li> <li>Satellites and launchers</li> <li>Aeroengines</li> <li>Wind turbine and helicopter blades</li> <li>Boats, trains and performance cars</li> <li>Skis, snowboards, hockey sticks, and bicycles</li> </ul>
	Structural Adhesives	<ul style="list-style-type: none"> <li>Bonding of metals, honeycomb and composite materials</li> </ul>
	Honeycomb	<ul style="list-style-type: none"> <li>Composite structures and interiors</li> <li>Impact and shock absorption systems</li> <li>Helicopter blades</li> </ul>

*Carbon Fibers:* HexTow® carbon fibers are manufactured for sale to third-party customers as well as for our own use in manufacturing certain reinforcements and composite materials. Carbon fibers are woven into carbon fabrics, used as reinforcement in conjunction with a resin matrix to produce pre-impregnated composite materials (referred to as prepregs). Carbon fiber is also used in filament winding, hand layup, automatic tape layup and advanced fiber placement to produce finished composite components. Key product applications include structural components for commercial and military aircraft, space launch vehicles, and certain other applications such as recreational and industrial equipment.

*Fabrics and Specialty Reinforcements:* Fabrics and specialty reinforcements are made from a variety of fibers, including carbon, aramid and other high strength polymers, several types of fiberglass, quartz, ceramic and other specialty fibers. These reinforcements are used in the production of prepregs and other matrix materials used in primary and secondary structural aerospace applications such as wing components, horizontal and vertical stabilizer components, fairings, radomes and engine nacelles as well as overhead storage bins and other interior

components. Our reinforcements are also used in the manufacture of a variety of industrial and recreational products such as wind energy blades, automotive components, oil exploration and production equipment, boats, surfboards, skis and other sporting goods equipment.

*Prepregs:* HexPly® prepregs are manufactured for sale to third-party customers and for internal use by our Engineered Products segment in manufacturing composite laminates and monolithic structures, including finished components for aircraft structures and interiors. Prepregs are manufactured by combining high-performance reinforcement fabrics or unidirectional fibers with a resin matrix to form a composite material that, when cured, has exceptional structural properties not present in either of the constituent materials. Prepreg reinforcements include glass, carbon, aramid, quartz, ceramic and other specialty fibers. Resin matrices include bismaleimide, cyanate ester, epoxy, phenolic, polyimide and other specialty resins.

*Other Fiber-Reinforced Matrix Materials:* New fiber reinforced matrix developments include HexMC®, a form of quasi-isotropic carbon fiber prepreg that enables small to medium sized composite components to be mass produced. HexTOOL® is a specialized form of HexMC® for use in the cost-effective construction of high temperature resistant composite tooling. HexFIT® film infusion material is a product that combines resin films and dry fiber reinforcements to save lay-up time in production and enables the manufacture of large contoured composite structures, such as wind turbine blades.

*Resins:* HexFlow® polymer matrix materials are sold in liquid and film form for use in direct process manufacturing of composite parts. Resins can be combined with fiber reinforcements in manufacturing processes such as resin transfer molding (RTM), resin film infusion (RFI) or vacuum assisted resin transfer molding (VARTM) to produce high quality composite components for both aerospace and industrial applications, without the need for customer investment in autoclaves.

*Structural Adhesives:* We manufacture and market a comprehensive range of Redux® film and paste adhesives. These structural adhesives, which bond metal to metal and composites and honeycomb structures, are used in the aerospace industry and for many industrial applications.

*Honeycomb:* HexWeb® honeycomb is a lightweight, cellular structure generally composed of a sheet of nested hexagonal cells. It can also be manufactured in over-expanded and asymmetric cell configurations to meet special design requirements such as contours or complex curvatures. Honeycomb is primarily used as a lightweight core material and acts as a highly efficient energy absorber. When sandwiched between composite or metallic facing skins, honeycomb significantly increases the stiffness of the structure, while adding very little weight.

We produce honeycomb from a number of metallic and non-metallic materials. Most metallic honeycomb is made from aluminum and is available in a selection of alloys, cell sizes and dimensions. Non-metallic materials used in the manufacture of honeycomb include fiberglass, carbon fiber, thermoplastics, non-flammable aramid papers, aramid fiber and other specialty materials.

We sell honeycomb as standard blocks and in slices cut from a block. Honeycomb is also supplied as sandwich panels, with facing skins bonded to either side of the core material. Honeycomb is also used in Acousti-Cap® where a non-metallic permeable cap material is embedded into honeycomb core that is used in aircraft engines to dramatically reduce noise during takeoff and landing without adding a structural weight penalty. Aerospace is the largest market for honeycomb products. We also sell honeycomb for non-aerospace applications including automotive parts, sporting goods, building panels, high-speed trains and mass transit vehicles, energy absorption products, marine vessel compartments, and other industrial uses. In addition, we produce honeycomb for our Engineered Products segment for use in manufacturing finished parts for airframe Original Equipment Manufacturers ( OEMs ).

The following table identifies the key customers and the major manufacturing facilities of the Composite Materials segment:

<b>COMPOSITE MATERIALS KEY CUSTOMERS</b>		
Aernnova	EADS (including Airbus and Eurocopter)	Safran
Alliant Techsystems	Embraer	Spirit Aerosystems
The Boeing Company	FACC	Textron
Bombardier	Finmeccanica	Toray
CFAN	Gamesa	Trek
CTRM Aero Composites	GKN	Triumph
Cytec Engineered Materials	Lockheed Martin	United Technologies
Daher	Northrop Grumman	Vestas
<b>MAJOR MANUFACTURING FACILITIES</b>		
Casa Grande, Arizona	Neumarkt, Austria	



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Dagneux, France	Parla, Spain
Decatur, Alabama	Salt Lake City, Utah
Duxford, England	Seguin, Texas
Illescas, Spain	Stade, Germany
Les Avenieres, France	Tianjin, China
Nantes, France	Windsor, Colorado

Net sales for the Composite Materials segment to third-party customers were \$1,230.9 million in 2012, \$1,074.5 million in 2011, and \$904.5 million in 2010, which represented approximately 78%, of our net sales each year. Net sales for composite materials are highly dependent upon the number of large commercial aircraft produced as further discussed under the captions Significant Customers , Markets and Management s Discussion and Analysis of Financial Condition and Results of Operations . In addition, about 5% of our total production of composite materials in 2012 was used internally by the Engineered Products segment.

### *Engineered Products*

The Engineered Products segment manufactures and markets composite structures and precision machined honeycomb parts for use in the aerospace industry. Composite structures are manufactured from a variety of composite and other materials, including

prepregs, honeycomb, structural adhesives and advanced molding materials, using such manufacturing processes as autoclave processing, multi-axis numerically controlled machining, heat forming, compression molding and other composite manufacturing techniques.

HexMC® molded composite parts are a new form of cost-effective carbon fiber epoxy molding material that has now become baseline for a number of primary structures on commercial airplanes. HexMC® enables complex shapes to be manufactured in series production while providing weight savings that are comparable to those achieved with aerospace carbon/epoxy prepregs.

The following table identifies the principal products and examples of the primary end-uses from the Engineered Products segment:

SEGMENT	PRODUCTS	PRIMARY END-USES
<b>ENGINEERED PRODUCTS</b>	Composite Structures	<ul style="list-style-type: none"> <li>Aircraft structures and finished aircraft components, including wing to body fairings, wing panels, flight deck panels, door liners, helicopter blades, spars and tip caps</li> </ul>
	Engineered Honeycomb	<ul style="list-style-type: none"> <li>Aircraft structural sub-components and semi-finished components used in helicopter blades, engine nacelles, and aircraft surfaces (flaps, wings, elevators and fairings)</li> </ul>
	HexMC® molded composite parts	<ul style="list-style-type: none"> <li>Complex geometric parts for commercial aircrafts to replace traditionally metal parts including window frames, primary structure brackets and fittings as well as for certain industrial applications</li> </ul>

Net sales for the Engineered Products segment to third-party customers were \$347.3 million in 2012, \$317.9 million in 2011, and \$269.1 million in 2010, which represented approximately 22% of our net sales each year.

The Engineered Products segment has a 50% ownership interest in a Malaysian joint venture, Asian Composites Manufacturing Sdn. Bhd. ( ACM ) with Boeing Worldwide Operations Limited. Under the terms of the joint venture agreement, Hexcel and The Boeing Company ( Boeing ) have transferred the manufacture of certain semi-finished composite components to this joint venture. Hexcel purchases the semi-finished composite components from the joint venture, and inspects and performs additional skilled assembly work before delivering them to Boeing. The joint venture also manufactures composite components for other aircraft component manufacturers. ACM had revenue of \$59 million, \$51 million, and \$45 million in 2012, 2011 and 2010, respectively. For additional information on the joint venture investment see Note 5, *Investments in Affiliated Companies*.

The following table identifies the key customers and the major manufacturing facilities of the Engineered Products segment:

ENGINEERED PRODUCTS	
KEY CUSTOMERS	MAJOR MANUFACTURING FACILITIES
The Boeing Company	Kent, Washington
Bombardier	Burlington, Washington
General Dynamics	Pottsville, Pennsylvania

General Electric

Welkenraedt, Belgium

GKN

Alor Setar, Malaysia (JV)

Spirit Aerosystems

United Technologies

### **Financial Information About Segments and Geographic Areas**

Financial information and further discussion of our segments and geographic areas, including external sales and long-lived assets, are contained under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 17 to the accompanying consolidated financial statements of this Annual Report on Form 10-K.

### **Significant Customers**

Approximately 29%, 30% and 31% of our 2012, 2011 and 2010 net sales, respectively, were to Boeing and related subcontractors. Of the 29% of overall sales to Boeing and its subcontractors in 2012, 25% related to Commercial Aerospace market applications and 4% related to Space & Defense market applications. Approximately 28%, 27% and 24% of our 2012, 2011 and 2010

net sales, respectively, were to European Aeronautic Defence and Space Company ( EADS ), including its business division Airbus Industrie ( Airbus ), and its subcontractors. Of the 28% of overall sales to EADS and its subcontractors in 2012, 25% related to Commercial Aerospace market applications and 3% related to Space & Defense market applications.

## Markets

Our products are sold for a broad range of end-uses. The following tables summarize our net sales to third-party customers by market and by geography for each of the three years ended December 31:

	2012	2011	2010
<b>Net Sales by Market</b>			
Commercial Aerospace	60%	59%	55%
Space & Defense	23	22	26
Industrial	17	19	19
Total	100%	100%	100%
<b>Net Sales by Geography (a)</b>			
United States	51%	52%	52%
Europe	49	48	48
Total	100%	100%	100%

(a) Net sales by geography based on the location in which the product sold was manufactured.

	2012	2011	2010
<b>Net Sales to External Customers (b)</b>			
United States	46%	44%	45%
Europe	39	41	41
All Others	15	15	14
Total	100%	100%	100%

(b) Net sales to external customers based on the location to which the product sold was delivered.

### Commercial Aerospace

The Commercial Aerospace industry is our largest user of advanced composites. Commercial Aerospace represented 60% of our 2012 net sales. Approximately 83% of these revenues can be identified as sales to Airbus, Boeing and their subcontractors for the production of commercial aircraft. The remaining 17% of these revenues were for regional and business aircraft. The economic benefits airlines can obtain from weight savings in both fuel economy and aircraft range, combined with the design enhancement that comes from the advantages of advanced composites over traditional materials, have caused the industry to be the leader in the use of these materials. While military aircraft and spacecraft have championed the development of these materials, Commercial Aerospace has had the greater consumption requirements and has commercialized the use of these products. Accordingly, the demand for advanced structural material products is closely correlated to the demand for commercial aircraft.

The use of advanced composites in Commercial Aerospace is primarily in the manufacture of new commercial aircraft. The aftermarket for these products is very small as many of these materials are designed to last for the life of the aircraft. The demand for new commercial aircraft is driven by two principal factors, the first of which is airline passenger traffic (the number of revenue passenger miles flown by the airlines) which affects the required size of airline fleets. The International Air Transport Association (IATA) estimates 2012 revenue passenger miles were 5.3% higher than 2011. Growth in passenger traffic requires growth in the size of the fleet of commercial aircraft operated by airlines worldwide.

A second factor, which is less sensitive to the general economy, is the replacement rates for existing aircraft. The rates of retirement of passenger and freight aircraft, resulting mainly from obsolescence, are determined in part by the regulatory requirements established by various civil aviation authorities worldwide as well as public concern regarding aircraft age, safety and noise. These rates may also be affected by the desire of the various airlines to improve operating costs with higher payloads and more fuel-efficient aircraft (which in turn is influenced by the price of fuel) and by reducing maintenance expense. In addition, there is expected to be

increasing pressure on airlines to replace their aging fleet with more fuel efficient and quieter aircraft to be more environmentally responsible. When aircraft are retired from commercial airline fleets, they may be converted to cargo freight aircraft or scrapped.

An additional factor that may cause airlines to defer or cancel orders is their ability to obtain financing, including leasing, for new aircraft orders. This will be dependent both upon the financial health of the airline operators, as well as the overall availability of financing in the marketplace.

Each new generation of commercial aircraft has used increasing quantities of advanced composites, replacing metals. This follows the trend previously seen in military fighter aircraft where advanced composites may now exceed 50% of the weight of the airframe. Early versions of commercial jet aircraft, such as the Boeing 707, which was developed in the early 1950s, contained almost no composite materials. One of the first commercial aircraft to use a meaningful amount of composite materials, the Boeing 767 entered into service in 1983, and was built with an airframe containing approximately 6% composite materials. The airframe of Boeing's 777 aircraft, which entered service in 1995, is approximately 11% composite. The Airbus A380, which was first delivered in 2007, has approximately 23% composite content by weight. Boeing's latest aircraft, the B787, which entered into service in September 2011, has a content of more than 50% composite materials by weight. In December 2006, Airbus formally launched the A350 XWB (A350) which is also projected to have a composite content of 50% or more by weight. Airbus targets the A350 to enter into service in 2014. In 2011, both Airbus and Boeing announced new versions of their narrow body aircraft which will have new engines. Airbus A320neo is expected to enter service in 2015 and Boeing's B737 MAX in 2017. It is expected that these new aircraft will offer more opportunities for composite materials than their predecessors. We refer to this steady expansion of the use of composites in aircraft as the secular penetration of composites as it increases our average sales per airplane over time.

The impact on Hexcel of Airbus and Boeing's production rate changes is typically influenced by two factors: the mix of aircraft produced and the inventory supply chain effects of increases or reductions in aircraft production. We have products on all Airbus and Boeing planes. The dollar value of our materials varies by aircraft type. Twin aisle aircraft use more of our materials than narrow body aircraft and newer designed aircraft use more of our materials than older generations. On average, for established programs, we deliver products into the supply chain about six months prior to aircraft delivery. Depending on the product, orders placed with us are received anywhere between one and eighteen months prior to delivery of the aircraft to the customer. For aircraft that are in the development or ramp-up stage, such as the A350, we will have sales as much as several years in advance of the delivery. Increased aircraft deliveries combined with the secular penetration of composites resulted in our Commercial Aerospace revenues increasing by approximately 15% in 2012, 28% in 2011 and 16% in 2010.

Set forth below are historical aircraft deliveries as announced by Airbus and Boeing:

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Airbus	229	294	311	325	303	305	320	378	434	453	483	498	510	534	588
Boeing	563	620	491	527	381	281	285	290	398	441	375	481	462	477	601
Total	792	914	802	852	684	586	605	668	832	894	858	979	972	1,011	1,189

Approximately 83% of our Commercial Aerospace revenues can be identified as sales to Airbus, Boeing and their subcontractors for the production of commercial aircraft. Airbus and Boeing combined deliveries in 2012 were 1,189 aircraft, surpassing the previous high of 1,011 in 2011. Based on Airbus and Boeing public estimates, the combined deliveries in 2013 are expected to be over 1,200 planes. In 2012, the combined orders reported by Airbus and Boeing were for 2,036 planes, bringing their backlog at December 31, 2012 to 9,055 planes—the highest in history. The balance of our Commercial Aerospace sales is related to regional and business aircraft manufacture, and other commercial aircraft applications. These applications also exhibit increasing utilization of composite materials with each new generation of aircraft. Regional and business aircraft sales have shown steady recovery over the last several quarters to end 2012 with \$161 million in sales, which was about 7% above 2011 but down from the \$200 million peak in 2008.

*Space & Defense*

The Space & Defense market has historically been an innovator in the use of, and source of significant demand for, advanced composites. The aggregate demand by Space & Defense customers is primarily a function of procurement of military aircraft that utilizes advanced composites by the United States and certain European governments. We are currently qualified to supply materials to a broad range of over 100 helicopter, military aircraft and space programs. The top ten programs by revenues represent about 50% of our Space & Defense revenues and no one program exceeds 15% of our revenues in this segment. Rotocraft accounted for about 60% of Space & Defense sales in 2012. Key programs include the V-22 (Osprey) tilt rotor aircraft, Blackhawk, F-35 (joint strike fighter or JSF), C-17, CH-53 Super Stallion, F/A-18E/F (Hornet), EADS A400M military transport, European Fighter Aircraft

(Typhoon), NH90, S76 and Tiger helicopters. The benefits that we obtain from these programs will depend upon which are funded and the extent of such funding. Space applications for advanced composites include solid rocket booster cases, fairings and payload doors for launch vehicles, and buss and solar arrays for military and commercial satellites.

Another trend providing positive growth for Hexcel is the further penetration of composites in helicopter blades. Numerous new helicopter programs in development, as well as upgrade or retrofit programs, have an increased reliance on Composite Materials products such as carbon fiber, prepregs, and honeycomb core to improve blade performance. In addition, our Engineered Products segment provides specialty value added services such as machining, sub-assembly, and even full blade manufacturing.

Contracts for military and some commercial programs may contain provisions applicable to both U.S. Government contracts and subcontracts. For example, a prime contractor may flow down a termination for convenience clause to materials suppliers such as Hexcel. According to the terms of a contract, we may be subject to U.S. government Federal Acquisition Regulations, the Department of Defense Federal Acquisition Regulations Supplement, Cost Accounting Standards, and associated procurement laws.

#### *Industrial Markets*

The revenue for this market includes applications for our products outside the Commercial Aerospace and Space & Defense markets. A number of these applications represent emerging opportunities for our products. In developing new applications, we seek those opportunities where advanced composites technology offers significant benefits to the end user, often applications that demand high engineering performance. Within this segment, the major end market sub-segments include, in order of size based on our 2012 sales, wind energy, general industrial applications (including those sold through distributors), recreational equipment (e.g., skis and snowboards, bicycles and hockey sticks), and transportation (e.g., automobiles, mass transit and high-speed rail, and marine applications). Our participation in industrial market applications complements our commercial and military aerospace businesses. We are committed to pursuing the utilization of advanced structural material technology where it can generate significant value and we can maintain a sustainable competitive advantage.

Further discussion of our markets, including certain risks, uncertainties and other factors with respect to forward-looking statements about those markets, is contained under the captions Management's Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors .

#### **Backlog**

In recent years, our customers have demanded shorter order lead times and just-in-time delivery performance. While we have many multi-year contracts with our major aerospace customers, most of these contracts specify the proportion of the customers requirements that will be supplied by us and the terms under which the sales will occur, not the specific quantities to be procured. Our Industrial customers have always desired to order their requirements on as short a lead-time as possible. As a result, twelve-month order backlog is not a meaningful trend indicator for us.

#### **Raw Materials and Production Activities**



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Our manufacturing operations are in many cases vertically integrated. We produce carbon fibers, industrial fabrics, composite materials and composite structures as well as sell these materials to third-party customers for their use in the manufacture of their products.

We manufacture high performance carbon fiber from polyacrylonitrile precursor ( PAN ). The primary raw material for PAN is acrylonitrile. All of the PAN we produce is for internal carbon fiber production. We consume approximately two-thirds by value of the carbon fiber we produce and sell the remainder of our output to third-party customers. However, as one of the world's largest consumers of high performance carbon fiber, we also purchase significant quantities of carbon fiber from external sources for our own use. The sources of carbon fiber we can use in any product or application are generally dictated by customer qualifications or certifications. Otherwise we select a carbon fiber based on performance, price and availability. With the increasing demand for carbon fiber, particularly in aerospace applications, we have more than doubled our PAN and carbon fiber capacity over the past several years to serve the growing needs of our customers and our own downstream products and we are continuing to expand our capacity to meet our customers' forecasted requirements. After a new production line starts operating, it can take over a year to be certified for aerospace qualifications. However, these lines can start supplying carbon fiber for many industrial and recreational applications within a shorter time period.

We purchase glass yarn from a number of suppliers in the United States, Europe and Asia. We also purchase aramid and high strength fibers which are produced by only a few companies, and during periods of high demand, can be in short supply. In addition, epoxy and other specialty resins, aramid paper and aluminum specialty foils are used in the manufacture of composite products. A number of these products have only one or two sources qualified for use, so an interruption in their supply could disrupt our ability to meet our customer requirements. When entering into multi-year contracts with aerospace customers, we attempt to get back-to-back commitments from key raw material suppliers.

Our manufacturing activities are primarily based on make-to-order, or demand pull based on customer schedules, and to a lesser extent, make-to-forecast production requirements. We coordinate closely with key suppliers in an effort to avoid raw material shortages and excess inventories. However, many of the key raw materials we consume are available from relatively few sources, and in many cases the cost of product qualification makes it impractical to develop multiple sources of supply. The lack of availability of these materials could under certain circumstances have a material adverse effect on our consolidated results of operations.

### **Research and Technology; Patents and Know-How**

Research and Technology ( R&T ) departments support our businesses worldwide. Through R&T activities, we maintain expertise in precursor and carbon fiber, chemical and polymer formulation and curatives, fabric forming and textile architectures, advanced composite structures, process engineering, application development, analysis and testing of composite materials, computational design, and other scientific disciplines related to our worldwide business base.

Our products rely primarily on our expertise in materials science, textiles, process engineering and polymer chemistry. Consistent with market demand, we have been placing more emphasis on higher performing products and cost effective production processes while seeking to improve the consistency of our products and our capital efficiency. Towards this end, we have entered into formal and informal alliances, as well as licensing and teaming arrangements, with several customers, suppliers, external agencies and laboratories. We believe that we possess unique capabilities to design, develop and manufacture composite materials and structures. We have over 900 patents and pending applications worldwide, and have granted technology licenses and patent rights to several third parties primarily in connection with joint ventures and joint development programs. It is our policy to actively enforce our proprietary rights. We believe that the patents and know-how rights currently owned or licensed by Hexcel are adequate for the conduct of our business. We do not believe that our business would be materially affected by the expiration of any single patent or series of related patents, or by the termination of any single license agreement or series of related license agreements.

We spent \$36.7 million and \$32.6 million and \$30.8 million for R&T in 2012, 2011 and 2010, respectively. Our 2012 spending was 12.6% higher than 2011 as we invested in new products and technology. Our spending on a quarter to quarter basis fluctuates depending upon the amount of new product development and qualification activities, particularly in relation to commercial aircraft applications, that are in progress. These expenditures are expensed as incurred.

### **Environmental Matters**

We are subject to federal, state, local and foreign laws and regulations designed to protect the environment and to regulate the discharge of materials into the environment. We believe that our policies, practices, and procedures are properly designed to prevent unreasonable risk of environmental damage and associated financial liability. To date, environmental control regulations have not had a significant adverse effect on our overall operations.

Our aggregate environmental related accruals at December 31, 2012 and 2011 were \$6.6 million and \$5.0 million, respectively. As of December 31, 2012 and December 31, 2011, \$4.2 million and \$3.3 million, respectively, were included in Other current accrued liabilities, with the remainder included in Other non-current liabilities. As related to certain of our environmental matters, except for the Lodi, New Jersey site, our accruals were estimated at the low end of a range of possible outcomes since there was no better point within the range. If we had accrued for these matters at the high end of the range of possible outcomes, our accruals would have been \$9.2 million and \$6.8 million at December 31, 2012 and 2011, respectively. Environmental remediation spending charged directly to our reserve balance for 2012, 2011 and 2010, was \$3.4 million, \$5.7 million and \$4.8 million, respectively. In addition, our operating costs relating to environmental compliance were \$13.1 million, \$10.3 million and \$9.5 million, for 2012, 2011, and 2010, respectively, and were charged directly to expense. Capital expenditures for environmental matters approximated \$2.4 million, \$4.1 million and \$1.7 million for 2012, 2011 and 2010 respectively.

These accruals can change significantly from period to period due to such factors as additional information on the nature or extent of contamination, the methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties, as well as the impact, if any, of Hexcel being named in a new matter. A

discussion of environmental matters is contained in Item 3, Legal Proceedings, and in Note 14 to the accompanying consolidated financial statements included in this Annual Report on Form 10-K.

### **Sales and Marketing**

A staff of salaried marketing managers, product managers and sales personnel, sell and market our products directly to customers worldwide. We also use independent distributors and manufacturer representatives for certain products, markets and regions. In addition, we operate various sales representation offices in the Americas, Europe, Asia Pacific and Russia.

### **Competition**

In the production and sale of advanced composites, we compete with a number of U.S. and international companies on a worldwide basis. The broad markets for composites are highly competitive, and we have focused on both specific submarkets and specialty products within markets. In addition to competing directly with companies offering similar products, we compete with producers of substitute composites such as structural foam, infusion technology, wood and metal. Depending upon the material and markets, relevant competitive factors include approvals, database of usage, technology, product performance, delivery, service, price and customer preference for sole sourcing.

### **Employees**

As of December 31, 2012, we employed 4,973 full-time employees and contract workers, 2,875 in the United States and 2,098 in other countries. Of the 4,973 full-time employees, less than 17% were represented by collective bargaining agreements. We believe that our relations with employees and unions are good. The number of full-time employees and contract workers as of December 31, 2011 and 2010 was 4,508 and 4,043, respectively.

### **Other Information**

Our internet website is [www.hexcel.com](http://www.hexcel.com). We make available, free of charge through our website, our Form 10-Ks, 10-Qs and 8-Ks, and any amendments to these forms, as soon as reasonably practicable after filing with the Securities and Exchange Commission.

### **ITEM 1A. Risk Factors**

An investment in our common stock or debt securities involves risks and uncertainties. You should consider the following risk factors carefully, in addition to the other information contained in this Annual Report on Form 10-K, before deciding to purchase any of our securities.

**The markets in which we operate can be cyclical, and downturns in them may adversely affect the results of our operations.**

Some of the markets in which we operate have been, to varying degrees, cyclical and have experienced downturns. A downturn in these markets could occur at any time as a result of events that are industry specific or macroeconomic and in the event of a downturn, we have no way of knowing if, when and to what extent there might be a recovery. Any deterioration in any of the cyclical markets we serve could adversely affect our financial performance and operating results.

At December 31, 2012, Airbus and Boeing had a combined backlog of over 9,000 aircraft, which is the highest in history and about eight years of production at current delivery rates. To the extent any significant deferrals, cancellations or reduction in demand results in decreased aircraft build rates, it would reduce net sales for our Commercial Aerospace products and as a result reduce our operating income. Approximately 60% of our net sales for 2012 were derived from sales to the Commercial Aerospace industry, which includes 83% from Airbus and Boeing aircraft and 17% from regional and business aircraft. Reductions in demand for commercial aircraft or a delay in deliveries could result from many factors, including delays in the startup or ramp-up of new programs, changes in the propensity for the general public to travel by air (including as a result of terrorist events and any subsequent military response), a rise in the cost of aviation fuel, a change in technology resulting in the use of alternative materials, consolidation and liquidation of airlines, availability of funding for new aircraft purchases or leases, inventory corrections or disruptions throughout the supply chain and slower macroeconomic growth. Both Airbus and Boeing have experienced various delays in their newest aircraft programs, including the A380, B787, B747-8, A400M, and A350. In the past, these have delayed our expected growth or our effective utilization of capacity installed for such growth. Future delays in these or other major new customer programs could similarly impact our results.

In addition, our customers continue to emphasize the need for cost reduction or other improvements in contract terms throughout the supply chain. In response to these pressures, we may be required to accept increased risk or face the prospects of margin compression on some products in the future. Where possible, we seek to offset or mitigate the impact of such pressures through productivity and performance improvements, index clauses, currency hedging and other actions.

**A significant decline in business with Boeing, EADS, Vestas, or other significant customers could materially impact our business, operating results, prospects and financial condition.**

We have concentrated customers in the Commercial Aerospace and wind energy markets. In the Commercial Aerospace market, approximately 83%, and in the Space & Defense market, approximately 33%, of our 2012 net sales were made to Boeing and EADS (including Airbus) and their related subcontractors. For the years ended December 31, 2012 and December 31, 2011, approximately 29% and 30% of our total consolidated net sales were to Boeing and its related subcontractors, respectively, and approximately 28% and 27% of our total consolidated net sales, respectively, were to EADS, including Airbus and its related subcontractors. In the wind energy market, our primary customer is Vestas Wind Systems A/S. Significant changes in the demand for our customers' end products, program delays, the share of their requirements that is awarded to us or changes in the design or materials used to construct their products could result in a significant loss of business with these customers. The loss of, or significant reduction in purchases by, Boeing, EADS and Vestas or any of our other significant customers could materially impair our business, operating results, prospects and financial condition. The level of purchases by our customers is often affected by events beyond their control, including general economic conditions, demand for their products, business disruptions, disruptions in deliveries, strikes and other factors.

**Reductions in space and defense spending could result in a decline in our net sales.**

The growth in military aircraft production that has occurred in recent years may not be sustained, individual programs important to Hexcel may be cancelled, production may not continue to grow and the increased demand for replacement helicopter blades may not continue. The production of military aircraft depends upon defense budgets and the related demand for defense and related equipment. Approximately 23% of our net sales in 2012 were to the Space & Defense market of which just less than 60% were related to U.S. military programs.

**A decrease in supply, interruptions at key facilities or an increase in cost of raw materials could result in a material decline in our profitability.**

Our profitability depends largely on the price and continuity of supply of raw materials, which may be supplied through a sole source or a limited number of sources. We purchase large volumes of raw materials, such as epoxy and phenolic resins, carbon fiber, fiberglass yarn, aluminum foil and aramid paper. Any restrictions on the supply, or an increase in the cost, of our raw materials could significantly reduce our profit margins. Efforts to mitigate restrictions on the supply or price increases of these raw materials by long-term purchase agreements, productivity improvements or by passing cost increases to our customers may not be successful.

The occurrence of material operational problems, including but not limited to failure of, or interruption to, key equipment or natural disasters, may have a material adverse effect on the productivity and profitability of a particular manufacturing facility. With respect to certain facilities, such events could have a material effect on our company as a whole.

**We have substantial international operations subject to uncertainties which could affect our operating results.**

We believe that revenue from sales outside the U.S. will continue to account for a material portion of our total revenue for the foreseeable future. In 2011, 49% of our production and 54% of our customer sales occurred outside of the United States. Additionally, we have invested significant resources in our international operations and we intend to continue to make such investments in the future. Our international operations are subject to numerous risks, including: (a) general economic and political conditions in the countries where we operate may have an adverse effect on our operations in those countries or not be favorable to our growth strategy; (b) the difficulty of enforcing agreements and collecting receivables through some foreign legal systems; (c) foreign customers may have longer payment cycles than customers in the U.S.; (d) cost of compliance with international trade laws of all of the countries in which we do business, including export control laws, relating to sales and purchases of goods and equipment and transfers of technology; (e) tax rates in some foreign countries may exceed those of the U.S. and foreign earnings may be subject to withholding requirements or the imposition of tariffs, exchange controls or other restrictions; (f) governments may adopt regulations or take other actions that would have a direct or indirect adverse impact on our business and market opportunities; and (g) the potential difficulty in enforcing our intellectual property rights in some foreign countries, and the potential for the intellectual property rights of others to affect our ability to sell product in certain markets. Any one of these could adversely affect our financial condition and results of operations.

In addition, fluctuations in currency exchange rates may influence the profitability and cash flows of our business. For example, our European operations sell a portion of the products they produce in U.S. dollars, yet the labor, overhead costs and portions of material costs incurred in the manufacture of those products are denominated in Euros, British pounds sterling or U.S. dollars. As a result, the local currency margins of goods manufactured with costs denominated in local currency, yet sold in U.S. dollars, will vary with fluctuations in currency exchange rates, reducing when the U.S. dollar weakens against the Euro and British pound sterling. In addition, the reported U.S. dollar value of the local currency financial statements of our foreign subsidiaries will vary with fluctuations in currency exchange rates. While we enter into currency exchange and hedge agreements from time to time to mitigate these types of fluctuations, we cannot remove all fluctuations or hedge all exposures, and our earnings are impacted by changes in currency exchange rates.

We currently do not have political risk insurance in the countries in which we conduct business. While we carefully consider these risks when evaluating our international operations we cannot provide assurance that we will not be materially adversely affected as a result of such risks.

**We could be adversely affected by environmental and safety requirements.**

Our operations require the handling, use, storage and disposal of certain regulated materials and wastes. As a result, we are subject to various laws and regulations pertaining to pollution and protection of the environment, health and safety. These requirements govern, among other things, emissions to air, discharge to waters and the generation, handling, storage, treatment and disposal of waste and remediation of contaminated sites. We have made, and will continue to make, capital and other expenditures in order to comply with these laws and regulations. These laws and regulations are complex, change frequently and could become more stringent in the future.

We have been named as a potentially responsible party under the U.S. Superfund law or similar state laws at several sites requiring clean up. These laws generally impose liability for costs to investigate and remediate contamination without regard to fault. Under certain circumstances liability may be joint and several, resulting in one responsible party being held responsible for the entire obligation. Liability may also include damages to natural resources. We have incurred and likely will continue to incur expenses to investigate and clean up certain of our existing and former facilities, for which we believe we have adequate reserves. The ongoing operation of our manufacturing plants also entails environmental risks, and we may incur material costs or liabilities in the future which could adversely affect us. Although most of our properties have been the subject of environmental site assessments, there can be no assurance that all potential instances of soil and groundwater contamination have been identified, even at those sites where assessments have been conducted. Accordingly, we may discover previously unknown environmental conditions and the cost of remediating such conditions may be material. See *Legal Proceedings* below and Note 14 to the consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

In addition, we may be required to comply with evolving environmental, health and safety laws, regulations or requirements that may be adopted or imposed in the future or to address newly discovered information or conditions that require a response. In particular, climate change is receiving increased attention worldwide, which has led to significant legislative and regulatory efforts to limit greenhouse gas emissions. The U.S. Congress has considered climate change-related legislation and may retake the issue in the near future. Specific policy measures could include cap and trade provisions or a carbon tax. The European Union has instituted the Greenhouse Gas Emission Trading System (EU-ETS). Our manufacturing plants use energy, including electricity and natural gas, and some of our plants may in the future emit amounts of greenhouse gas that could be affected by these legislative and regulatory efforts. Potential consequences could include increased energy, transportation and raw material costs and may require the Company to make additional investments in its facilities and equipment or limit our ability to grow.

**Our forward-looking statements and projections may turn out to be inaccurate.**



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This Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to future prospects, developments and business strategies. These forward-looking statements are identified by their use of terms and phrases such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, should, will, and would, and similar terms and phrases, including references to assumptions. Such statements are based on current expectations, are inherently uncertain, and are subject to changing assumptions.

Such forward-looking statements include, but are not limited to: (a) the estimates and expectations based on aircraft production rates made publicly available by Airbus and Boeing; (b) the revenues we may generate from an aircraft model or program; (c) the impact of the possible push-out in deliveries of the Airbus and Boeing backlog and the impact of delays in the startup or ramp-up of new aircraft programs or the final Hexcel composite material content once the design and material selection has been completed;

(d) expectations of composite content on new commercial aircraft programs and our share of those requirements; (e) expectations of growth in revenues from space and defense applications, including whether certain programs might be curtailed or discontinued; (f) expectations regarding growth in sales for wind energy, recreation and other industrial applications; (g) expectations regarding working capital trends and expenditures; (h) expectations as to the level of capital expenditures and when we will complete the construction and qualification of capacity expansions; (i) our ability to maintain and improve margins in light of the ramp-up of capacity and new facilities and the current economic environment; (j) the outcome of legal matters; (k) our projections regarding the realizability of net operating loss and tax credit carryforwards; and (l) the impact of various market risks, including fluctuations in interest rates, currency exchange rates, environmental regulations and tax codes, fluctuations in commodity prices, and fluctuations in the market price of our common stock, the impact of work stoppages or other labor disruptions and the impact of the above factors on our expectations of 2013 financial results. In addition, actual results may differ materially from the results anticipated in the forward looking statements due to a variety of factors, including but not limited to changing market conditions, increased competition, product mix, inability to achieve planned manufacturing improvements, cost reductions and capacity additions, and conditions in the financial markets.

Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different. Such factors include, but are not limited to, the following: changes in general economic and business conditions; changes in current pricing and cost levels; changes in political, social and economic conditions and local regulations; foreign currency fluctuations; changes in aerospace delivery rates; reductions in sales to any significant customers, particularly Airbus, Boeing or Vestas; changes in sales mix; changes in government defense procurement budgets; changes in military aerospace programs technology; industry capacity; competition; disruptions of established supply channels, particularly where raw materials are obtained from a single or limited number of sources and cannot be substituted by unqualified alternatives; manufacturing capacity constraints; unforeseen vulnerability of our network and systems to interruptions or failures; and the availability, terms and deployment of capital.

If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, actual results may vary materially from those expected, estimated or projected. In addition to other factors that affect our operating results and financial position, neither past financial performance nor our expectations should be considered reliable indicators of future performance. Investors should not use historical trends to anticipate results or trends in future periods. Further, our stock price is subject to volatility. Any of the factors discussed above could have an adverse impact on our stock price. In addition, failure of sales or income in any quarter to meet the investment community's expectations, as well as broader market trends, can have an adverse impact on our stock price. We do not undertake an obligation to update our forward-looking statements or risk factors to reflect future events or circumstances.

#### **ITEM 1B. Unresolved Staff Comments**

None.

#### **ITEM 2. Properties**

We own and lease manufacturing facilities and sales offices located throughout the United States and in other countries, as noted below. The corporate offices and principal corporate support activities are located in leased facilities in Stamford, Connecticut. Our research and technology administration and principal laboratories are located in Dublin, California; Duxford, England; Les Avenieres, France; and Decatur, Alabama.



The following table lists our manufacturing facilities by geographic location, related segment, and principal products manufactured. This table does not include the manufacturing facility owned by ACM.

### Manufacturing Facilities

Facility Location	Segment	Principal Products
United States:		
Decatur, Alabama	Composite Materials	PAN Precursor (used to produce Carbon Fibers)
Salt Lake City, Utah	Composite Materials	Carbon Fibers; Prepregs
Seguin, Texas	Composite Materials	Industrial Fabrics; Specialty Reinforcements
Casa Grande, Arizona	Composite Materials	Honeycomb and Honeycomb Parts
Windsor, Colorado	Composite Materials	Prepregs
Kent, Washington	Engineered Products	Composite structures
Pottsville, Pennsylvania	Engineered Products	Engineered Honeycomb Parts
Burlington, Washington	Engineered Products	Engineered Honeycomb Parts
International:		
Dagneux, France	Composite Materials	Prepregs
Nantes, France	Composite Materials	Prepregs
Les Avenieres, France	Composite Materials	Industrial Fabrics; Specialty Reinforcements
Illescas, Spain	Composite Materials	Carbon Fibers
Parla, Spain	Composite Materials	Prepregs
Neumarkt, Austria	Composite Materials	Prepregs
Duxford, England	Composite Materials	Prepregs; Adhesives; Honeycomb and Honeycomb Parts
Stade, Germany	Composite Materials	Prepregs
Welkenraedt, Belgium	Engineered Products	Engineered Honeycomb Parts
Tianjin, China	Composite Materials	Prepregs

We lease the land and buildings in Nantes, France; Stade, Germany and Tianjin, China; and the land on which the Burlington, Washington facility is located. We also lease portions of the facilities located in Casa Grande, Arizona and Les Avenieres, France. We own all other remaining facilities. In connection with our credit facility, we have granted mortgages on the facilities located in Casa Grande, Arizona; Decatur, Alabama; Dublin, California; Kent, Washington; Salt Lake City, Utah; and Seguin, Texas. For further information, refer to

Management's Discussion and Analysis of Financial Condition and Results of Operations and to Note 7 to the accompanying consolidated financial statements of this Annual Report on Form 10-K.

### ITEM 3. Legal Proceedings

We are involved in litigation, investigations and claims arising out of the normal conduct of our business, including those relating to commercial transactions, environmental, employment, health and safety matters. We estimate and accrue our liabilities resulting from such matters based on a variety of factors, including the stage of the proceeding; potential settlement value; assessments by internal and external counsel; and assessments by environmental engineers and consultants of potential environmental liabilities and remediation costs. Such estimates are not discounted to reflect the time value of money due to the uncertainty in estimating the timing of the expenditures, which may extend over several years.

While it is impossible to ascertain the ultimate legal and financial liability with respect to certain contingent liabilities and claims, we believe, based upon our examination of currently available information, our experience to date, and advice from legal counsel, that the individual and

aggregate liabilities resulting from the ultimate resolution of these contingent matters, after taking into consideration our existing insurance coverage and amounts already provided for, will not have a material adverse impact on our consolidated results of operations, financial position or cash flows.

*Environmental Matters*

We are subject to various U.S. and international federal, state and local environmental, and health and safety laws and regulations. We are also subject to liabilities arising under the Federal Comprehensive Environmental Response, Compensation and Liability Act ( CERCLA or Superfund ), the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, and similar state and international laws and regulations that impose responsibility for the control, remediation and abatement of air, water and soil pollutants and the manufacturing, storage, handling and disposal of hazardous substances and waste.

We have been named as a potentially responsible party ( PRP ) with respect to several hazardous waste disposal sites that we do not own or possess, which are included on, or proposed to be included on, the Superfund National Priority List of the U.S. Environmental Protection Agency ( EPA ) or on equivalent lists of various state governments. Because CERCLA allows for joint and several liability in certain circumstances, we could be responsible for all remediation costs at such sites, even if we are one of many PRPs. We believe, based on the amount and nature of our waste, and the number of other financially viable PRPs, that our liability in connection with such matters will not be material.

*Lodi, New Jersey Site*

Pursuant to the New Jersey Industrial Site Recovery Act, Hexcel entered into an Administrative Consent Order for the environmental remediation of a manufacturing facility we own and formerly operated in Lodi, New Jersey. We have not operated this site since 1986. We have been remediating this site in accordance with a State approved plan and continue to do so under the New Jersey Licensed Site Remediation Professional program. The primary remediation activities have been completed and we now believe that the remediation has removed most of the contamination. However, there are still select contaminated areas that we will have to continue remediating using alternative methods. As a result, to complete the remediation, in the second quarter of 2012 we accrued additional charges of \$4.4 million. The accrual was \$4.4 million at December 31, 2012.

*Lower Passaic River Study Area*

In October 2003, we received, along with 66 other entities, a directive from the New Jersey Department of Environmental Protection ( NJDEP ) that requires the entities to assess whether operations at various New Jersey sites, including our former manufacturing site in Lodi, New Jersey, caused damage to natural resources in the Lower Passaic River watershed. The NJDEP later dismissed us from the Directive. In February 2004, Hexcel, and other entities, received a general notice letter from the EPA which requested that the entities consider helping to finance an estimated \$10 million towards an EPA study of environmental conditions in the Lower Passaic River watershed. In May 2005, we voluntarily signed into an agreement with the EPA to participate (resulting in 43 participating entities) in financing such a study up to \$10 million, in the aggregate. Since May 2005, a number of additional PRPs have joined into the agreement with the EPA. In October 2005, we along with the other EPA notice recipients were advised by the EPA that the notice recipients' share of the costs of the EPA study was expected to significantly exceed the earlier EPA estimate. While we and the other recipients were not obligated by our agreement to share in such excess, a Group of notice recipients (73 companies including Hexcel) negotiated an agreement with the EPA to assume responsibility for the study pursuant to an Administrative Order on Consent. We believe we have viable defenses to the EPA claims and expect that other as yet unnamed parties will also receive notices from the EPA. In June 2007, the EPA issued a draft Focused Feasibility Study ( FFS ) that considers interim remedial options for the lower eight miles of the river, in addition to a no action option. The estimated costs for the six options ranged from \$900 million to \$2.3 billion. The PRP Group provided comments to the EPA on the FFS; the EPA has not yet taken further action. The Administrative Order on Consent regarding the study does not cover work contemplated by the FFS. In June 2012, without admitting liability, we along with 69 other PRPs entered into a further agreement with EPA to remove and cap contaminated sediments near River Mile 10.9 of the Lower Passaic River at an approximate cost of \$20 million. We accrued \$0.5 million in the second quarter of 2012 for our expected allocation of these costs. Furthermore, the Federal Trustee for natural resources have indicated their intent to perform a natural resources damage assessment on the river and invited the PRPs to participate in the development and performance of this assessment. The PRP Group, including Hexcel, has not agreed to participate in the assessment at this time.

On February 4, 2009, Tierra Solutions ( Tierra ) and Maxus Energy Corporation ( Maxus ) filed a third party complaint in New Jersey Superior Court against us and over 300 other entities in an action brought against Tierra and Maxus (and other entities) by the State of New Jersey. New Jersey's suit against Tierra and Maxus relates to alleged discharges of contaminants by Tierra and Maxus to the Passaic River and seeks payment of all past and future costs the State has and will incur regarding cleanup and removal of contaminants, investigation of the Passaic River and related water bodies, assessment of natural resource injuries and other specified injuries. The third party complaint seeks contribution from us for all or part of the damages that Tierra and Maxus may owe to the State. We filed our answer to the complaint and served our initial

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disclosures, and have produced initial documents to Tierra and Maxus, pursuant to an order of the court. The court's trial plan and subsequent orders contemplate multiple trial tracks involving third-party defendants (including Hexcel). The scope of Hexcel's involvement in the various trial tracks is uncertain at this time. On October 2, 2012, the Court stayed all third-party litigation until December 20, 2012 to allow for settlement discussions between the State and third-party defendants. The stay has since been extended until further order of the Court. Our ultimate liability for investigatory costs, remedial costs and/or natural resource damages in connection with the Lower Passaic River cannot be determined at this time.

*Kent, Washington Site*

We were party to a cost-sharing agreement regarding the operation of certain environmental remediation systems necessary to satisfy a post-closure care permit issued to a previous owner of our Kent, Washington site by the EPA. Under the terms of the cost-sharing agreement, we were obligated to reimburse the previous owner for a portion of the cost of the required remediation activities. Recently, the previous owner, who also continues to own an adjacent site, has installed certain remediation and isolation technologies and is operating those in accordance with an order agreed with the State of Washington. This isolation is expected to prevent further migration of contaminants to our site and enable us to perform a cleanup of our site. We and the Washington Department of Ecology have reached an agreed order to perform certain cleanup activities on our site by certain deadlines, and we are in full compliance with the order as modified. The total accrued liability related to this matter was \$1.1 million at December 31, 2012.

*Omega Chemical Corporation Superfund Site, Whittier, CA*

We are a potentially responsible party at a former chemical waste site in Whittier, CA. The PRPs at Omega have established a PRP Group, the Omega PRP Group, and are currently investigating and remediating soil and groundwater at the site pursuant to a Consent Decree with the EPA. The Omega PRP Group has attributed approximately 1.07% of the waste tonnage sent to the site to Hexcel. In addition to the Omega site specifically, the EPA is investigating the scope of regional groundwater contamination in the vicinity of the Omega site and recently issued a Record of Decision; the Omega PRP Group members have been noticed by the EPA as PRPs who will be required to be involved in the remediation of the regional groundwater contamination in that vicinity as well. As a member of the Omega PRP group, Hexcel will incur costs associated with the investigation and remediation of the Omega site and the regional groundwater remedy, but our ultimate liability, if any, in connection with this matter cannot be determined at this time.

Environmental remediation reserve activity for the three years ended December 31, 2012 was as follows:

(In millions)	For the year ended December 31,				
	2012	2011	2010	2009	2008
Beginning remediation accrual balance	\$ 5.0	\$ 7.3	\$ 8.3	\$ 3.8	\$ 1.7
Current period expenses	5.0	3.4	3.8	2.4	2.4
Cash expenditures	(3.4)	(5.7)	(4.8)	(3.4)	(2.4)
Ending remediation accrual balance	\$ 6.6	\$ 5.0	\$ 7.3	\$ 3.8	\$ 1.7
Capital expenditures for environmental matters	\$ 2.4	\$ 4.1	\$ 1.7	\$ 1.7	\$ 1.7

*Environmental Summary*

Our estimate of liability as a PRP and our remaining costs associated with our responsibility to remediate the Lodi, New Jersey; Kent, Washington; and other sites are accrued in the consolidated balance sheets. As of December 31, 2012 and 2011, our aggregate environmental related accruals were \$6.6 million and \$5.0 million, respectively. As of December 31, 2012 and 2011, \$4.2 million and \$3.3 million, respectively, were included in current other accrued liabilities, with the remainder included in other non-current liabilities. As related to certain environmental matters, except for the Lodi site, the accruals were estimated at the low end of a range of possible outcomes since no amount within the range is a better estimate than any other amount. If we had accrued for these matters at the high end of the range of possible outcomes, our accrual would have been \$9.2 million and \$6.8 million at December 31, 2012 and 2011, respectively.



These accruals can change significantly from period to period due to such factors as additional information on the nature or extent of contamination, the methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties, or the impact, if any, of being named in a new matter.

Environmental remediation spending charged directly to our reserve balance was \$3.4 million and \$5.7 million for the years ended December 31, 2012 and 2011, respectively. In addition, our operating costs relating to environmental compliance charged directly to expense were \$13.1 million and \$10.3 million for the years ended December 31, 2012 and 2011. Capital expenditures for environmental matters were \$2.4 million and \$4.1 million for the years ended December 31, 2012 and 2011, respectively.

*Litigation*

*Gurit Infringement Claim*

On October 8, 2012 Gurit (UK) Limited filed suit against the Company in U.S. District Court (Delaware District), Civil Action No. 12-1297, seeking unspecified monetary damages and injunctive relief by alleging that certain preform moulding materials made, sold, used or imported by the Company infringe Gurit patent U.S. 8 088 470. The materials are used in wind turbine manufacture. The Company will vigorously contest these allegations on several grounds including that the patent was licensed to the Company and its affiliates by Gurit in 2010.

**ITEM 4. Mine Safety Disclosure**

Not applicable.

**PART II**

**ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters**

Hexcel common stock is traded on the New York Stock Exchange. The range of high and low sales prices of our common stock on the New York Stock Exchange is contained in Note 21 to the accompanying consolidated financial statements of this Annual Report on Form 10-K and is incorporated herein by reference.

Hexcel did not declare or pay any dividends in 2012, 2011 or 2010. The payment of dividends is limited under the terms of certain of our debt agreements. Hexcel does not intend to pay dividends in the foreseeable future, as cash generated from operations will be used primarily to support capital expenditures or pay down debt. In December 2012, the Company announced a program to repurchase up to \$50 million of common stock. No amounts have been repurchased yet.

On February 4, 2013 there were 936 holders of record of our common stock.

The following chart provides information regarding repurchases of Hexcel common stock:

<b>Period</b>	<b>(a) Total Number</b>	<b>(b) Average Price</b>	<b>(c) Total Number of</b>	<b>(d) Maximum Number (or</b>
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		of Shares (or Units) Purchased	Paid per Share (or Unit)	Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1	October 31, 2012	0	\$ NA	0	0
November 1	November 30, 2012	0		NA	0
December 1	December 31, 2012	20,946		25.59	0
Total		20,946(1)	\$	25.59	0

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(1) All Shares were delivered by employees in payment of the exercise price of non-qualified stock options.

**ITEM 6. Selected Financial Data**

The information required by Item 6 is contained on page 25 of this Annual Report on Form 10-K under the caption **Selected Financial Data** and is incorporated herein by reference.

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

The information required by Item 7 is contained on pages 26 to 38 of this Annual Report on Form 10-K under **Management's Discussion and Analysis of Financial Condition and Results of Operations** and is incorporated herein by reference.

**ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk**

The information required by Item 7A is contained under the heading **Market Risks** on pages 36 to 38 of this Annual Report on Form 10-K and is incorporated herein by reference.

**ITEM 8. Financial Statements and Supplementary Data**

The information required by Item 8 is contained on pages 42 to 72 of this Annual Report on Form 10-K under **Consolidated Financial Statements and Supplementary Data** and is incorporated herein by reference. The Report of Independent Registered Public Accounting Firm is contained on page 41 of this Annual Report on Form 10-K under the caption **Report of Independent Registered Public Accounting Firm** and is incorporated herein by reference.

**ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**ITEM 9A. Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures as of December 31, 2012 and have concluded that these disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer and Chief Financial Officer have concluded that there have not been any changes in our internal control over financial reporting during the fourth quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's report on our internal control over financial reporting is contained on page 40 of this Annual Report on Form 10-K and is incorporated herein by reference.

**ITEM 9B. Other Information**

None.

### **PART III**

#### **ITEM 10. Directors, Executive Officers and Corporate Governance**

The information required by Item 10 will be contained in our definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2012. Such information is incorporated herein by reference.

#### **ITEM 11. Executive Compensation**

The information required by Item 11 will be contained in our definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2012. Such information is incorporated herein by reference.

#### **ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by Item 12 will be contained in our definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2012. Such information is incorporated herein by reference.

**ITEM 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by Item 13 will be contained in our definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2012. Such information is incorporated herein by reference.

**ITEM 14. Principal Accountant Fees and Services**

The information required by Item 14 will be contained in our definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2012. Such information is incorporated herein by reference.

**PART IV**

**ITEM 15. Exhibits and Financial Statement Schedules**

(a) Financial Statements, Financial Statement Schedules and Exhibits

(1) Financial Statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2012 and 2011

Consolidated Statements of Operations for each of the three years ended December 31, 2012, 2011 and 2010

Consolidated Statements of Comprehensive Income for each of the three years ended December 31, 2012, 2011 and 2010

Consolidated Statements of Stockholders' Equity for each of the three years ended December 31, 2012, 2011 and 2010

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Consolidated Statements of Cash Flows for each of the three years ended December 31, 2012, 2011 and 2010

Notes to the Consolidated Financial Statements

(2) Financial Statement Schedule for the three years ended December 31, 2012, 2011 and 2010:

Schedule II Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

(3) Exhibits:

The following list of exhibits includes exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings.

<b>Exhibit No.</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation of Hexcel Corporation (incorporated herein by reference to Exhibit 1 to Hexcel's Registration Statement on Form 8-A dated July 9, 1996, Registration No. 1-08472).
3.2	Certificate of Amendment of the Restated Certificate of Incorporation of Hexcel Corporation (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).

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- 3.3 Amended and Restated Bylaws of Hexcel Corporation (incorporated by reference to Exhibit 3 to Hexcel's Current Report on Form 8-K dated May 8, 2012).
- 10.1 Credit Agreement, dated as of July 9, 2010, entered into by and among Hexcel Corporation, Hexcel Holdings SASU, the financial institutions from time to time party thereto, Banc of America Securities LLC, as a joint book manager and as a joint lead arranger, RBS Citizens, N.A., as syndication agent, as a joint book manager and as a joint lead arranger, HSBC Bank USA, National Association, as a documentation agent, TD Bank, N.A., as a documentation agent, Wells Fargo Bank, National Association, as a documentation agent and Bank of America, N.A., as administrative agent for the lenders. Confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission with a request for confidential treatment pursuant to Rule 24b-2. The location of an omitted portion is indicated by a set of asterisks within brackets ( [\*\*\*] ) (incorporated by reference to Exhibit 99.1 to Hexcel's Current Report on Form 8-K dated July 14, 2010).
- 10.1(a) Amendment No. 1 to Credit Agreement, dated as of January 19, 2012, entered into by and among Hexcel Corporation, Hexcel Holdings SASU, Bank of America, N.A., in its capacity as administrative agent for the Lenders and each of the Lenders signatory thereto (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated January 25, 2012).
- 10.1(b) Amendment No. 2 to Credit Agreement, dated as of May 25, 2012, entered into by and among Hexcel Corporation, Hexcel Holdings SASU, Bank of America, N.A., in its capacity as administrative agent for the Lenders and each of the Lenders signatory thereto (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated May 30, 2012).
- 10.1(c) Amendment No. 3 to Credit Agreement, dated as of October 16, 2012, entered into by and among Hexcel Corporation, Hexcel Holdings SASU, Bank of America, N.A., in its capacity as administrative agent for the Lenders and each of the Lenders signatory thereto.
- 10.2 Security Agreement, dated as of July 9, 2010, by and among Hexcel Corporation, each of the direct and indirect subsidiaries of Hexcel Corporation listed on the signature pages thereto, and each additional grantor that may become a party thereto after the date thereof in accordance with Section 21 thereof, and Bank of America, N.A., as administrative agent for each of the Secured Parties (as defined in the Credit Agreement). Confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission with a request for confidential treatment pursuant to Rule 24b-2. The location of an omitted portion is indicated by a set of asterisks within brackets ( [\*\*\*] ) (incorporated by reference to Exhibit 99.2 to Hexcel's Current Report on Form 8-K dated July 14, 2010).
- 10.3 Subsidiary Guaranty, dated as of July 9, 2010, by the parties listed on the signature pages thereto in favor of and for the benefit of Bank of America, N.A., as administrative agent for each of the Secured Parties (as defined in the Credit Agreement) (incorporated by reference to Exhibit 99.3 to Hexcel's Current Report on Form 8-K dated July 14, 2010).
- 10.4 Company Guaranty, dated as of July 9, 2010, by Hexcel Corporation in favor of and for the benefit of Bank of America, N.A., as administrative agent for each of the Secured Parties (as defined in the Credit Agreement)(incorporated by reference to Exhibit 99.4 to Hexcel's Current Report on Form 8-K dated July 14, 2010).
- 10.5 Special Warranty Deed made and entered into January 20, 2012, by and between the United States of America, as Grantor, acting by and through its legal agent, the Tennessee Valley Authority, and Hexcel Corporation, as Grantee (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K dated January 25, 2012).
- 10.6\* Hexcel Corporation 2003 Incentive Stock Plan (incorporated herein by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.6(a)\* Hexcel Corporation 2003 Incentive Stock Plan as amended and restated December 11, 2003 (incorporated herein by reference to Exhibit 10.3(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003).
- 10.6(b)\* Hexcel Corporation 2003 Incentive Stock Plan as amended and restated May 19, 2005 (incorporated herein by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K dated May 24, 2005).



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- 10.6(c)\* Hexcel Corporation 2003 Incentive Stock Plan as amended and restated December 31, 2008 (incorporated herein by reference to Exhibit 99.12 to the Company's Current Report on Form 8-K dated January 7, 2009).
- 10.6(d)\* Hexcel Corporation 2003 Incentive Stock Plan, as amended and restated as of May 7, 2009 (incorporated herein by reference to Exhibit 10.4(d) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009).
- 10.7\* Hexcel Corporation Incentive Stock Plan, as amended and restated on January 30, 1997, and further amended on December 10, 1997 and March 25, 1999 (incorporated herein by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed on July 26, 1999).
- 10.7(a)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on January 30, 1997, and further amended on December 10, 1997, March 25, 1999 and December 2, 1999 (incorporated by reference to Exhibit 10.3(c) of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.7(b)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on February 3, 2000 (incorporated herein by reference to Annex A of the Company's Proxy Statement dated March 31, 2000).
- 10.7(c)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on December 19, 2000 (incorporated herein by reference to Exhibit 10.3(e) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.7(d)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on December 19, 2000 and further amended on January 10, 2002 (incorporated herein by reference to Exhibit 10.3(f) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.8\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan (incorporated herein by reference to Exhibit 4.3 of the Company's Form S-8 filed on June 19, 1998, Registration No. 333-57223).
- 10.8(a)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000 (incorporated by reference to Exhibit 10.1 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 2000).
- 10.8(b)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001 (incorporated herein by reference to Exhibit 10.4(b) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.8(c)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001 and January 10, 2002 (incorporated herein by reference to Exhibit 10.4(c) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.8(d)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001, January 10, 2002 and December 12, 2002 (incorporated herein by reference to Exhibit 10.4(d) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.9\* Hexcel Corporation Management Incentive Compensation Plan, as Amended and Restated on January 24, 2011 (incorporated herein by reference to Annex A to the Company's Proxy Statement dated March 18, 2011).
- 10.10\* Hexcel Corporation Long-Term Incentive Plan (incorporated herein by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.11\* Form of Employee Option Agreement (2012 and 2013) (incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011).
- 10.12\* Form of Employee Option Agreement (2010) (incorporated herein by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009).
- 10.13\* Form of Employee Option Agreement (2009) (incorporated herein by reference to Exhibit 10.10 to the Company's



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Annual Report on Form 10-K for the fiscal year ended December 31, 2008).

- 10.14\* Modification to Option Agreements (incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008).
- 10.15\* Form of Employee Option Agreement (2008) (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007)
- 10.16\* Form of Employee Option Agreement (2007) (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006)
- 10.17\* Form of Employee Option Agreement (2005 and 2006) (incorporated herein by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated January 12, 2005).
- 10.18\* Form of Employee Option Agreement (2004) (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003).
- 10.19\* Form of Employee Option Agreement (2003) (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.22\* Form of Restricted Stock Unit Agreement (2012 and 2013) (incorporated herein by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011).
- 10.23\* Form of Restricted Stock Unit Agreement (2010) (incorporated herein by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009).
- 10.24\* Form of Restricted Stock Unit Agreement (2009) (incorporated herein by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008).
- 10.25\* Form of Performance Based Award Agreement (2012) (incorporated herein by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated January 26, 2012).
- 10.26\* Form of Performance Based Award Agreement (2010) (incorporated herein by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009).
- 10.28\* Hexcel Corporation Nonqualified Deferred Compensation Plan, Effective as of January 1, 2005, Amended and Restated as of December 31, 2008 (incorporated herein by reference to Exhibit 99.14 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.29\* Amended and Restated Employment Agreement between Hexcel Corporation and David E. Berges, dated December 31, 2008 (incorporated herein by reference to Exhibit 99.1 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.30(c)\* Amended and Restated Supplemental Executive Retirement Agreement dated December 31, 2008, between David E. Berges and Hexcel Corporation (incorporated herein by reference to Exhibit 99.2 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.30(d)\* Letter Agreement dated August 1, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(e) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.30(e)\* Letter Agreement dated August 28, 2001 between Hexcel Corporation and David E. Berges (incorporated herein by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001).
- 10.31\* Supplemental Executive Retirement Agreement dated October 28, 2009, between Nick L. Stanage and Hexcel Corporation (incorporated herein by reference to Exhibit 99.1 to Hexcel's Current Report on Form 8-K dated October 28, 2009).
- 10.31(a)\* Employment and Severance Agreement between Hexcel Corporation and Nick L. Stanage, dated October 28, 2009



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(incorporated herein by reference to Exhibit 99.2 to Hexcel's Current Report on Form 8-K dated October 28, 2009).

- 10.31(c)\* Letter Agreement, dated October 28, 2009, by and between Hexcel Corporation and Nick L. Stange (incorporated herein by reference to Exhibit 99.4 to Hexcel's Current Report on Form 8-K dated October 28, 2009).
- 10.32\* Amended and Restated Executive Severance Agreement between Hexcel Corporation and Wayne C. Pensky, dated December 31, 2008 (incorporated herein by reference to Exhibit 99.4 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.32(a)\* Amended and Restated Executive Deferred Compensation Agreement between Hexcel Corporation and Wayne C. Pensky, dated December 31, 2007 (incorporated herein by reference to Exhibit 99.3 to Hexcel's Current Report on Form 8-K dated January 7, 2008).
- 10.33\* Amended and Restated Executive Severance Agreement between Hexcel Corporation and Ira J. Krakower, dated December 31, 2008 (incorporated herein by reference to Exhibit 99.5 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.33(a)\* Amended and Restated Supplemental Executive Retirement Agreement dated December 31, 2008, between Ira J. Krakower and Hexcel Corporation (incorporated herein by reference to Exhibit 99.3 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.34\* Amended and Restated Executive Severance Agreement between Hexcel Corporation and Robert G. Hennemuth, dated December 31, 2008 (incorporated herein by reference to Exhibit 99.6 to Hexcel's Current Report on Form 8-K dated January 7, 2009).
- 10.34(a)\* Amended and Restated Executive Deferred Compensation Agreement between Hexcel Corporation and Robert G. Hennemuth, dated December 31, 2007 (incorporated herein by reference to Exhibit 99.4 to Hexcel's Current Report on Form 8-K dated January 7, 2008).
- 10.35\* Director Compensation Program, as of June 30, 2010 (incorporated by reference to Exhibit 10.38 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010).
- 10.36\* Hexcel Corporation 2009 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.39 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009).
- 21 Subsidiaries of the Company.
- 23 Consent of Independent Registered Public Accounting Firm.
- 24 Power of Attorney (included on signature page).
- 31.1 Certification of Chief Executive Officer, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following materials from the Hexcel Corporation Annual Report on Form 10-K for the year ended December 31, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Operations, (ii) Consolidated Statements of Comprehensive Income (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Cash Flows, and (v) related notes.

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\* Indicates management contract or compensatory plan or arrangement.



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

## Hexcel Corporation

February 8, 2013  
(Date)

/s/ DAVID E. BERGES  
David E. Berges  
Chief Executive Officer

KNOWN TO ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints each of David E. Berges, Wayne C. Pensky and Ira J. Krakower, individually, his attorney-in-fact, with the power of substitution, for him in any and all capacities, to sign any amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ DAVID E. BERGES (David E. Berges)	Chairman of the Board of Directors and Chief Executive Officer <b>(Principal Executive Officer)</b>	February 8, 2013
/s/ WAYNE PENSKY (Wayne Pensky)	Senior Vice President and Chief Financial Officer <b>(Principal Financial Officer)</b>	February 8, 2013
/s/ KIMBERLY HENDRICKS (Kimberly Hendricks)	Vice President, Corporate Controller and Chief Accounting Officer <b>(Principal Accounting Officer)</b>	February 8, 2013
/s/ JOEL S. BECKMAN (Joel S. Beckman)	Director	February 8, 2013
/s/ LYNN BRUBAKER (Lynn Brubaker)	Director	February 8, 2013
/s/ JEFFREY C. CAMPBELL (Jeffrey C. Campbell)	Director	February 8, 2013
/s/ SANDRA L. DERICKSON (Sandra L. Derickson)	Director	February 8, 2013

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/s/ W. KIM FOSTER (W. Kim Foster)	Director	February 8, 2013
/s/ THOMAS A. GENDRON (Thomas A. Gendron)	Director	February 8, 2013
/s/ JEFFREY A. GRAVES (Jeffrey A. Graves)	Director	February 8, 2013
/s/ DAVID C. HILL (David C. Hill)	Director	February 8, 2013
/s/ DAVID L. PUGH (David L. Pugh)	Director	February 8, 2013



**Selected Financial Data**

The following table summarizes selected financial data as of and for the five years ended December 31:

<b>Results of Operations:</b>										
Net sales	\$	<b>1,578.2</b>	\$	1,392.4	\$	1,173.6	\$	1,108.3	\$	1,324.9
Cost of sales		<b>1,171.5</b>		1,050.3		891.0		859.8		1,035.7
Gross margin		<b>406.7</b>		342.1		282.6		248.5		289.2
Selling, general and administrative expenses		<b>130.7</b>		120.5		118.5		107.2		112.9
Research and technology expenses		<b>36.7</b>		32.6		30.8		30.1		31.4
Business consolidation and restructuring expenses										3.8
Other (income) expense, net		<b>(9.5)</b>		(3.0)		3.5		7.5		10.2
Operating income		<b>248.8</b>		192.0		129.8		103.7		130.9
Interest expense, net		<b>10.0</b>		11.6		23.2		26.1		20.2
Non-operating expense, net		<b>1.1</b>		4.9		6.8				
Income before income taxes and equity in earnings		<b>237.7</b>		175.5		99.8		77.6		110.7
Provision for income taxes		<b>74.1</b>		41.6		22.9		22.0		15.6
Income before equity in earnings		<b>163.6</b>		133.9		76.9		55.6		95.1
Equity in earnings from and gain on sale of investments in affiliated companies		<b>0.7</b>		1.6		0.5		0.7		16.1
Net income	\$	<b>164.3</b>	\$	135.5	\$	77.4	\$	56.3	\$	111.2
Basic net income per common share	\$	<b>1.64</b>	\$	1.37	\$	0.79	\$	0.58	\$	1.15
Diluted net income per common share	\$	<b>1.61</b>	\$	1.35	\$	0.77	\$	0.57	\$	1.14
<b>Weighted-average shares outstanding:</b>										
Basic		<b>100.2</b>		98.8		97.6		96.9		96.4
Diluted		<b>102.0</b>		100.7		99.9		98.2		97.6
<b>Financial Position:</b>										
Total assets	\$	<b>1,603.1</b>	\$	1,376.1	\$	1,258.1	\$	1,246.6	\$	1,210.3
Working capital	\$	<b>340.4</b>	\$	276.8	\$	291.8	\$	259.4	\$	256.5
Long-term notes payable and capital lease obligations	\$	<b>240.0</b>	\$	238.3	\$	304.6	\$	358.8	\$	392.5
Stockholders' equity (a)	\$	<b>994.1</b>	\$	802.2	\$	659.4	\$	575.6	\$	509.2
<b>Other Data:</b>										
Depreciation	\$	<b>57.2</b>	\$	55.3	\$	53.2	\$	46.6	\$	43.9
Accrual basis capital expenditures	\$	<b>241.3</b>	\$	184.5	\$	60.7	\$	85.7	\$	177.3
Shares outstanding at year-end, less treasury stock		<b>99.9</b>		98.8		97.4		96.6		96.4

(a) No cash dividends were declared per share of common stock during any of the five years ended December 31, 2012.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Business Overview

Net sales	\$	1,578.2	\$	1,392.4	\$	1,173.6
Gross margin %		25.8%		24.6%		24.1%
Other (income) expense, net	\$	(9.5)	\$	(3.0)	\$	3.5
Operating income (a)	\$	248.8	\$	192.0	\$	129.8
Operating income %		15.8%		13.8%		11.1%
Interest expense, net	\$	10.0	\$	11.6	\$	23.2
Non-operating other expenses	\$	1.1	\$	4.9	\$	6.8
Provision for income taxes	\$	74.1	\$	41.6	\$	22.9
Equity in earnings from investments in affiliated companies	\$	0.7	\$	1.6	\$	0.5
Net income (a)	\$	164.3	\$	135.5	\$	77.4
Diluted net income per common share	\$	1.61	\$	1.35	\$	0.77

(a) The Company uses non-GAAP financial measures, including sales measured in constant dollars, operating income adjusted for items included in other (income) expense, net, net income adjusted for items included in non-operating expenses, the effective tax rate adjusted for certain out of period items and free cash flow. Management believes these non-GAAP measurements are meaningful to investors because they provide a view of Hexcel with respect to ongoing operating results and comparisons to prior periods. These adjustments represent significant charges or credits that are important to an understanding of Hexcel's overall operating results in the periods presented. Such non-GAAP measurements are not determined in accordance with generally accepted accounting principles and should not be viewed as an alternative to GAAP measures of performance. Reconciliations to adjusted operating income, adjusted net income and free cash flow are provided below:

<b>GAAP operating income</b>	\$	248.8	\$	192.0	\$	129.8
Other (income) expense, net (1)		(9.5)		(3.0)		3.5
<b>Adjusted operating income (Non-GAAP)</b>	\$	239.3	\$	189.0	\$	133.3
<b>Adjusted operating income % of sales (Non-GAAP)</b>		15.2%		13.6%		11.4%

<b>GAAP net income</b>	\$	164.3	\$	135.5	\$	77.4
Other (income) expense, net of tax (1)		(6.0)		(2.3)		2.2
Non-operating expense, net of tax (2)		0.7		3.0		4.3
Tax adjustments (3)				(11.3)		(6.4)
<b>Adjusted net income (Non-GAAP)</b>	\$	159.0	\$	124.9	\$	77.5
<b>Adjusted diluted net income per share (Non-GAAP)</b>	\$	1.56	\$	1.24	\$	0.78

<b>Net cash provided by operating activities</b>	\$	232.4	\$	170.5	\$	126.5
		(263.7)		(158.0)		(48.8)

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Capital expenditures and deposits for capital purchases

<b>Free cash flow</b>	\$	(31.3)	\$	12.5	\$	77.7
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(1) Other (income) expense, net for the year ended December 31, 2012 included income from a \$9.6 million business interruption insurance settlement related to a prior year claim, a \$4.9 million gain on the sale of land and a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986. Other (income) expense, net for the year ended December 31, 2011 included a \$5.7 million benefit from the curtailment of a pension plan and other expense of \$2.7 million for the increase in environmental reserves primarily for remediation of a manufacturing facility sold in 1986. Other (income) expense, net for the year ended December 31, 2010 included a \$3.5 million increase in environmental reserves primarily for remediation of a manufacturing facility sold in 1986.

(2) Non-operating expense, net of tax, in 2012 and 2011 included \$0.7 million and \$3.0 million for the accelerated amortization of deferred financing costs and expensing of the call premium from redeeming \$73.5 million in June 2012 and \$150 million in February 2011 of the Company's 6.75% senior subordinated notes. Non-operating expense, net of tax, in 2010 included \$4.3 million after tax expense related to the acceleration of deferred financing costs due to the refinancing of our Senior Secured Credit Facility.

(3) Tax adjustments in 2011 included a \$5.8 million benefit from the reversal of valuation allowances against net operating loss and foreign tax credit carryforwards and a tax benefit from the release of \$5.5 million of reserves primarily for uncertain tax positions as a result of an audit settlement. Tax adjustments in 2010 included a \$2.9 million benefit from the reversal of valuation allowances against U.S. deferred tax assets and a \$3.5 million benefit from New Clean Energy Manufacturing Tax Credits awarded in January 2010 for qualifying capital investments made in our U.S. wind energy facility in 2009. See Note 9 in the accompanying consolidated financial statements for further detail.

### Business Trends

Our total sales in 2012 increased 15% in constant currency over 2011. In constant currency and by market, our Commercial Aerospace sales increased 16%, Space & Defense sales increased 13%, and our Industrial sales increased 16%. The Commercial Aerospace market represents 60% of our sales, followed by Space & Defense at 23% and Industrial at 17%.

- In 2012, our Commercial Aerospace sales increased by 15% (16% in constant currency). Sales to Airbus and Boeing and their subcontractors, which comprised 83% of our Commercial Aerospace sales, were up over 16% with new program sales (A380, A350, B787 and B787-8) up over 25% and legacy aircraft related sales up more than 10%. Almost all of our Commercial Aerospace sales are for new aircraft as we have only nominal aftermarket sales.

- Airbus and Boeing combined deliveries in 2012 were a record 1,189 aircraft, compared to the previous record of 1,011 in 2011. The demand for new commercial aircraft is principally driven by two factors. The first is airline passenger traffic (measured by revenue passenger miles) and the second is the replacement rate for existing aircraft. The International Air Transport Association (IATA) estimates 2012 revenue passenger miles were 5.3% higher than 2011. Combined orders for 2012 were 2,036 planes, compared to 2,220 orders for 2011. Backlog at the end of 2012 increased to 9,055 planes, almost eight years of backlog at the current delivery pace. Based on Airbus and Boeing announced projections, 2013 deliveries are estimated to be over 1,200 aircraft.

- Overall the Commercial Aerospace industry continues to utilize a greater proportion of advanced composite materials with each new generation of aircraft. These new programs include the A380, A350, B787, and the B747-8. As of December 2012, Airbus had recorded 262 orders for its A380 aircraft, including 97 of which have been delivered (30 deliveries in 2012). The A380 has 23% composite content by weight and has more Hexcel material used in its production than any aircraft currently in service, over \$3 million per plane. Hexcel has been awarded a contract to supply carbon fiber composite materials for major primary structures for the A350, which Airbus has indicated will have more than 50% composite content by weight. In addition, there will be opportunities for additional Hexcel products for the plane which we are actively pursuing. We expect that our total content of materials per A350 will exceed \$4 million per aircraft and will be our largest program for both revenue per aircraft and total program. As of December 31, 2012, Airbus has received 582 orders for the A350, which it projects will enter into service in the second half of 2014. The B787 has about 52% composite content by weight, including composite wings and fuselage, compared to the 11% composite content used in the construction of its B777 aircraft and 6% for the B767 the aircraft it is primarily replacing. The B787 entered into service in September 2011. Hexcel has \$1.3 million to \$1.6 million of content per plane, depending upon which engines are used. As of December 31, 2012, Boeing had recorded 848 orders for its B787 aircraft, including 49 of which have been delivered. While the B747-8 is structurally an aluminum intensive aircraft, new engines and nacelles provide Hexcel with the opportunity for significant additional revenues. The freighter version of the B747-8 went into service in October 2011 and the passenger version in June 2012. The B747-8 has slightly more

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Hexcel content per plane than the B787. Our sales on these four new programs comprised more than 30% of our total Commercial Aerospace sales and we expect them to represent an increasing percent of our Commercial Aerospace sales in the future.

- In addition to the new programs discussed above, both Airbus and Boeing have announced new versions of their narrowbody planes that will have new engines. Airbus A320neo is expected to enter service in 2015, while the Boeing s B737 MAX is expected to enter service in 2017. Both of these aircraft are expected to provide opportunities for Hexcel to increase its content on these new programs up to 50% higher than on the current models of the A320 and B737.

- The regional and business aircraft market, which accounts for 17% of Commercial Aerospace sales, increased 7% for the year to \$161 million in 2012.
- Our Space & Defense constant currency sales increased 13% over 2012. Rotorcraft sales continue to be strong and we continue to benefit from our extensive qualifications to supply composite materials and structures. New helicopter programs in development, as well as upgrade or retrofit programs, have an increased reliance on Composite Materials products such as carbon fiber, prepregs, and honeycomb core to improve blade performance. Key programs include the V-22 (Osprey) tilt rotor aircraft, Blackhawk, F-35 (joint strike fighter or JSF), C-17, CH-53 Super Stallion, F/A-18E/F (Hornet), European Fighter Aircraft (Typhoon), NH90, S76, Tiger helicopters, and EADS A400M military transport. In addition, our Engineered Products segment provides specialty value added services such as machining, sub-assembly, and even full blade manufacturing.
- Our Industrial sales increased by 11% (16% in constant currency) in 2012 from 2011. Industrial sales include wind energy, recreation, and transportation and general industrial applications, with wind being the largest submarket. Excluding wind energy sales, the rest of the Industrial sales declined about 3% in constant currency as compared to 2011.
- Wind energy revenues for 2012 were up about 30% in constant currency over 2011, driven by the strong sales in the first half of 2012. We expect a 15% - 20% decline in our wind energy revenues in 2013 due primarily to a much weaker U.S market.

We are well positioned for 2013 with large backlogs at the end of 2012 for our key customers. Our current expectations are that total revenues for 2013 will be in the range of \$1,640 million to \$1,740 million, on a constant currency basis, generating diluted earnings per share of \$1.66 to \$1.78. We expect free cash flow to be \$20 million to \$60 million with accrual basis capital expenditures to be \$180 million to \$200 million.

## Results of Operations

2012 was another record performance year for the company. Our sales of \$1,578 million were \$185.8 million, or 13%, (15% in constant currency) higher than 2011 and our operating income of \$248.8 million (or 15.8% of sales) was 30% higher than 2011. Other operating income for the year ended December 31, 2012 includes income from a \$9.6 million business interruption insurance settlement related to a prior year claim, a \$4.9 million gain on the sale of land and a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986. Other operating income for the year ended December 31, 2011 includes a \$5.7 million benefit from the curtailment of a pension plan and an increase in environmental reserves of \$2.7 million primarily for remediation of a manufacturing facility sold in 1986. Our net income of \$164.3 million was 21% higher than 2011 of \$135.5 million. Net income in 2012 and 2011 include, non-operating expense of \$0.7 (net of tax) and \$3.0 million (net of tax) for the accelerated amortization of deferred financing costs and expensing of the call premium from redeeming \$73.5 million in June 2012 and \$150 million in February 2011 of the Company's 6.75% senior subordinated notes. Net income for 2011 also includes tax benefits from the release of \$11.3 million of reserves primarily for uncertain tax positions as a result of an audit settlement and the reversal of valuation allowances.

We have two reportable segments: Composite Materials and Engineered Products. Although these segments provide customers with different products and services, they often overlap within three end business markets: Commercial Aerospace, Space & Defense and Industrial. Therefore, we also find it meaningful to evaluate the performance of our segments through the three end business markets. Further discussion and additional financial information about our segments may be found in Note 17 to the accompanying consolidated financial statements of this

Annual Report on Form 10-K.

**Net Sales:** Consolidated net sales of \$1,578.2 million for 2012 were \$185.8 million higher than the \$1,392.4 million of net sales for 2011. The sales increase in 2012 reflects increased volume in Commercial Aerospace driven by new aircraft programs and increased build rates. Consolidated net sales of \$1,392.4 million for 2011 were \$218.8 million higher than the \$1,173.6 million of net sales for 2010, due to volume increases in Commercial Aerospace. Had the same U.S. dollar, British Pound Sterling and Euro exchange rates applied in 2011 as in 2012 ( in constant currency ), consolidated net sales for 2012 would have been \$206.5 million, or 15.1%, higher than 2012. In constant currency, consolidated net sales for 2011 would have been \$203.4 million, or 17.1% higher than 2010 net sales.

The following table summarizes net sales to third-party customers by segment and end market segment in 2012, 2011 and 2010:



**2012 Net Sales**

Composite Materials	\$	685.7	\$	268.7	\$	276.5	\$	1,230.9
Engineered Products		258.4		88.3		0.6		347.3
Total	\$	944.1	\$	357.0	\$	277.1	\$	1,578.2
		60%		23%		17%		100%

**2011 Net Sales**

Composite Materials	\$	586.1	\$	241.3	\$	247.1	\$	1,074.5
Engineered Products		237.4		78.1		2.4		317.9
Total	\$	823.5	\$	319.4	\$	249.5	\$	1,392.4
		59%		23%		18%		100%

**2010 Net Sales**

Composite Materials	\$	459.4	\$	229.3	\$	215.8	\$	904.5
Engineered Products		185.3		81.2		2.6		269.1
Total	\$	644.7	\$	310.5	\$	218.4	\$	1,173.6
		55%		26%		19%		100%

**Commercial Aerospace:** Net sales to the Commercial Aerospace market segment increased \$120.6 million or 14.6% to \$944.1 million for 2012 as compared to net sales of \$823.5 million for 2011; 2011 net sales increased by \$178.8 million as compared to net sales of \$644.7 million for 2010. In constant currency, net sales to the Commercial Aerospace market segment increased \$126.8 million, or 15.5% in 2012 and increased \$175.7 million or 27.1% in 2011. Net sales of the Composite Materials segment to the Commercial Aerospace market were \$99.6 million higher, up 17.0% from 2011 and up \$126.7 million from 2010 to 2011. Net sales of the Engineered Products segment to the Commercial Aerospace market increased by \$21.0 million or 8.8% to \$258.4 million in 2012 and increased by \$52.1 million or 28.1% to \$237.4 million in 2011.

In 2012, sales for Airbus and Boeing programs increased 16% over the prior year, with new aircraft programs (A380, A350, B787 and B747-8) sales up over 25% and legacy related sales up more than 10%. Sales for the regional and business aircraft market increased 7% over 2011.

The growth in 2011 over 2010, in Commercial Aerospace sales, primarily came from new aircraft programs and growth in legacy programs. Sales for Boeing programs increased 19% and Airbus program sales increased 35% over the prior year. Sales for the regional and business aircraft market increased 34% in 2011 as compared to 2010.

**Space & Defense:** Net sales of \$357.0 million for 2012 increased 11.8% as compared to \$319.4 million for 2011; 2011 net sales increased by 2.9% as compared to \$310.5 million in 2010. In 2012, net sales in constant currency, increased \$42.4 million or 13.5%; in 2011 the increase was \$6.2 million or 2.0%. We continue to benefit from our ability to supply composite materials and, in some cases, composite structures to a broad range of military aircraft and rotorcraft programs. About 60% of our Space & Defense sales are comprised of rotorcraft programs, including commercial and military programs from the Americas, Europe and Asia Pacific.

**Industrial:** Net sales of \$277.1 million for 2012 increased by \$27.6 million, or 11.1%, compared to net sales of \$249.5 million for 2011. In constant currency, net sales to the Industrial market segment increased \$37.3 million or 15.6% in 2012 and \$21.5 million or 9.4% in 2011. Wind energy, the largest submarket in this segment, sales increased about 30% in 2012 compared to 2011. This submarket increased more than 15% in constant currency in 2011 as compared to 2010. Sales to automotive, recreation and other general industrial markets were down about 3% in constant currency in 2012 as compared to 2011, after modest growth in 2011 over 2010.

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**Gross Margin:** Gross margin for 2012 was \$406.7 million or 25.8% of net sales as compared to \$342.1 million or 24.6% of net sales in 2011. The increase reflected higher volume and continued improvements in operating performance. Exchange rates contributed about 30 basis points and 40 basis points to the gross margin percentage improvement in 2012 and 2011, respectively, as compared to the prior year. Gross margin for 2010 was \$282.6 million, or 24.1% of net sales.

**Selling, General and Administrative ( SG&A ) Expenses:** SG&A expenses were \$130.7 million or 8.3% of net sales for 2012 and \$120.5 million, or 8.7% of net sales for 2011, and \$118.5 million or 10.1% of net sales for 2010. The increase in SG&A spending in 2012 reflects the increase in infrastructure to support our growth. SG&A spending in 2011 remained relatively flat compared to 2010 as inflation and modest headcount increases were offset by lower legal and other expenses.

**Research and Technology ( R&T ) Expenses:** R&T expenses for 2012 were \$36.7 million or 2.3% of net sales, \$32.6 million or 2.3% of net sales in 2011 and \$30.8 million, or 2.6% of 2010 net sales. Spending has increased moderately over the past couple of years as we invest in new products and technology.

**Other (Income) Expense, Net:** Other operating income for the year ended December 31, 2012 included income from a \$9.6 million business interruption insurance settlement related to a prior year claim, a \$4.9 million gain on the sale of land and a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986. Other

operating income, net for the year ended December 31, 2011 includes a \$5.7 million benefit from the curtailment of a pension plan, partially offset by other expense of \$2.7 million for the increase in environmental reserves primarily for remediation of a manufacturing facility sold in 1986. Other operating expense of \$3.5 million in 2010 was for additional environmental reserves related to a manufacturing facility sold in 1986.

**Operating Income:** Operating income for 2012 was \$248.8 million compared with operating income of \$192.0 million for 2011 and \$129.8 million for 2010. Operating income as a percent of sales was 15.8%, 13.8% and 11.1% in 2012, 2011 and 2010, respectively. Higher sales volume and good cost control drove the increase in operating margin in 2012 and 2011.

One of the Company's performance measures is operating income adjusted for other (income) expense, which is a non-GAAP measure. Adjusted operating income for the years ended December 31, 2012, 2011 and 2010 was \$239 million, \$189 million and \$133 million or 15.2%, 13.6% and 11.4%, as a percentage of net sales, respectively. A reconciliation from operating income to adjusted operating income is provided on page 26.

Almost all of the Company's sales and costs are either in U.S. dollars, Euros or GBP, with approximately one-quarter of our sales are in Euros or GBP. In addition, much of our European Commercial Aerospace business has sales denominated in dollars and costs denominated in all three currencies. The net impact is that as the dollar weakens against the Euro and the GBP, sales will increase while operating income will decrease. We have an active hedging program to minimize the impact on operating income, but our operating income as a percentage of net sales is affected. Our 2012 and 2011 operating income percentages were approximately 30 basis points and 40 basis points better than the comparable prior year due to exchange rates.

Operating income for the Composite Materials segment increased \$62.8 million or 32.2% to \$257.3 million, as compared to \$194.5 million for 2011, driven by productivity leverage and good leverage on higher sales volume. Operating income for Composite Materials, in 2012 and 2011, included \$14.5 million and \$5.7 million of other operating income as discussed above. Operating income for the Engineered Products segment decreased by \$1.0 million compared with 2011 to \$50.6 million, as higher sales volume was offset by unfavorable product mix and costs related to the start-up of new programs. Operating income for the year ended December 31, 2011 for the Composite Materials segment increased \$54.9 million or 39.3% to \$194.5 million, as compared to \$139.6 million for 2010, due to higher volume, favorable sales mix and factory productivity and cost reduction initiatives. Operating income for the Engineered Products segment increased by \$5.9 million compared with 2010 to \$51.6 million, due to the higher sales volume.

We did not allocate corporate net operating expenses of \$59.1 million, \$54.1 million and \$55.5 million to segments in 2012, 2011, and 2010, respectively. Corporate and Other included \$5.0 million, \$2.7 million, and \$3.5 million in 2012 and 2011 and 2010, respectively, of other expenses, as discussed above.

**Interest Expense:** Interest expense was \$10.0 million for 2012, \$11.6 million for 2011, and \$23.2 million for 2010. The sequential decrease in interest expense over the three years is due primarily to lower interest rates, primarily as a result of the redemption of \$73.5 million in June 2012 and \$150 million in February 2011 of the Company's 6.75% senior subordinated notes.

**Provision for Income Taxes:** Our 2012, 2011 and 2010 tax provision was \$74.1 million, \$41.6 million and \$22.9 million for an effective tax rate of 31.2%, 23.7% and 22.9%, respectively. The 2011 provision includes benefits of \$11.3 million from the reversal of valuation allowances against net operating loss and foreign tax credit carryforwards and from the release of reserves primarily for uncertain tax positions as a result of an audit settlement. The 2010 provision includes a \$2.9 million benefit from the reversal of valuation allowances against U.S. deferred tax

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assets and a \$3.5 million benefit from New Clean Energy Manufacturing tax credits for qualifying investments made in 2009 in our U.S wind energy facility. Excluding these items, the 2011 and 2010 effective tax rates were 30.1% and 29.4%, respectively. We believe the adjusted effective tax rate, which is a non-GAAP measure, is meaningful since it provides insight to the tax rate of ongoing operations.

**Equity in Earnings from Affiliated Companies:** Equity in earnings represents our portion of the earnings from our joint venture in Malaysia. For additional information, see Note 5 to the accompanying consolidated financial statements of this Annual Report on Form 10-K.

**Net Income:** Net income was \$164.3 million, or \$1.61 per diluted share for the year ended December 31, 2012 compared to \$135.5 million, or \$1.35 per diluted common share for 2011 and \$77.4 million, or \$0.77 per diluted share for 2010. Strong sales volume, particularly in the commercial aerospace market, coupled with good cost control led the growth in earnings from 2010 through 2012. Also see the above table for a reconciliation of GAAP net income from continuing operations to our adjusted Non-GAAP measure.

## Significant Customers

Approximately 29%, 30% and 31% of our 2012, 2011 and 2010 net sales, respectively, were to Boeing and related subcontractors. Of the 29% of overall sales to Boeing and its subcontractors in 2012, 25% related to Commercial Aerospace market applications and 4% related to Space & Defense market applications. Approximately 28%, 27% and 24% of our 2012, 2011 and 2010 net sales, respectively, were to European Aeronautic Defence and Space Company ( EADS ), including its business division Airbus Industrie ( Airbus ), and its subcontractors. Of the 28% of overall sales to EADS and its subcontractors in 2012, 25% related to Commercial Aerospace market applications and 3% related to Space & Defense market applications.

## Financial Condition

In 2012, we ended the year with total debt, net of cash, of \$224.0 million and used \$31.3 million of free cash flow (cash provided by operating activities less cash paid for capital expenditures). In 2013, we expect our capital spending to be in the range of \$180 million to \$200 million as we expand capacity in line with our outlook, resulting in expected positive free cash flow of \$20 million to \$60 million. We expect our typical use of cash in the first half of 2013, which will be funded by our available borrowings under our credit facility. In December 2012, the Company announced a \$50 million share repurchase program.

We have a portfolio of derivatives related to currencies and interest rates. We monitor our counterparties and we only use those rated A- or better.

## Liquidity

Our cash on hand at December 31, 2012 was \$32.6 million and we had \$192.8 million borrowings available under our credit facility. In 2012, we redeemed the remaining \$73.5 million of our 6.75% senior subordinated notes at a call premium of 1.125%. The redemption was funded solely from a \$75 million add-on to our revolving loan portion of our senior credit facility. In 2011, we redeemed \$150 million of our 6.75% senior subordinated notes at a call premium of 2.25%. The redemption was funded from a \$135 million add-on to our senior credit facility and from cash on hand.

Our total debt as of December 31, 2012 was \$256.6 million, an increase of \$5.7 million from the December 31, 2011 balance. The level of available borrowing capacity fluctuates during the course of the year due to factors including capital expenditures, interest and variable compensation payments, changes to working capital, as well as timing of receipts and disbursements within the normal course of business.

Short-term liquidity requirements consist primarily of normal recurring operating expenses and working capital needs, capital expenditures and debt service requirements. We expect to meet our short-term liquidity requirements through net cash from operating activities, cash on hand and, if necessary, our revolving credit facility. As of December 31, 2012, long-term liquidity requirements consist primarily of obligations under our long-term debt obligations. The term loan is scheduled to be repaid at a current rate of approximately \$2.5 million per quarter, with two payments of \$10.0 million in September 2014 and December 2014 and two final \$25.0 million payments in March and June 2015.

**Credit Facilities:** At December 31, 2012, the Company had a \$460 million Senior Secured Credit Facility (the Facility ) consisting of a \$360 million revolving loan and a \$100 million term loan. The Company had expanded the Facility by \$75 million and \$135 million in 2012 and 2011, respectively, to repay the 6.75% senior subordinated notes, as discussed above. At December 31, 2012, the amounts outstanding under the Facility were \$165 million on the revolving loan and \$85 million on the term loan. The Facility matures on July 9, 2015. The interest rate on the Facility is LIBOR plus 2.75% and ranges down to LIBOR plus 2% depending upon the leverage ratio. Beginning in 2011 our leverage ratio was less than 1.75, accordingly in 2012 and 2011 the margin paid on our borrowing rate was 2%. The term loan is scheduled to be repaid at a current rate of approximately \$2.5 million per quarter, with two payments of \$10.0 million in September 2014 and December 2014 and two final \$25.0 million payments in March and June 2015.

The Facility permits us to issue letters of credit up to an aggregate amount of \$40 million and allows us to draw up to \$75 million in Euros. Amounts drawn in Euros or any outstanding letters of credit reduce the amount available for borrowing under the revolving loan. As of December 31, 2012, we had issued letters of credit totaling \$2.2 million under the Facility.

The credit agreement contains financial and other covenants, including, but not limited to, restrictions on the incurrence of debt and the granting of liens, as well as the maintenance of an interest coverage ratio and a leverage ratio, and limitations on capital expenditures. In accordance with the terms of the 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 Facility. In addition, the Facility contains other terms

and conditions such as customary representations and warranties, additional covenants and customary events of default. As of December 31, 2012, we were in compliance with all debt covenants and expect to remain in compliance. Terms of the Facility are further discussed in Note 6 to the accompanying financial statements.

We have a \$12.0 million borrowing facility for working capital needs of our Chinese entity with an outstanding balance of \$4.8 million at December 31, 2012. It contains a \$10.0 million revolving line of credit and a \$2.0 million factoring facility. The factoring facility was not used in 2012. These funds can only be used locally and, accordingly, we do not include this facility in our borrowing capacity disclosures. The borrowing facility expires on September 6, 2013 and is guaranteed by Hexcel Corporation.

**Operating Activities:** We generated \$232.4 million in cash from operating activities during 2012, an increase of \$61.9 million from 2011 primarily from higher earnings and lower working capital usage. Cash generated from operating activities during 2011 was \$170.5 million, an increase of \$44.0 million from 2010 primarily from higher earnings.

**Investing Activities:** Cash used for investing activities, primarily for capital expenditures, was \$258.4 million in 2012 compared to \$163.2 million in 2011 and \$48.8 million in 2010. We have increased our capital spending to expand capacity in line with our outlook, after delaying spending during 2010.

**Financing Activities:** Financing activities were a source of \$8.2 million of cash as compared with a use of \$74.4 million in 2011 and a use of \$65.2 million in 2010. In 2012 and 2011, we redeemed \$73.5 million and \$150 million of our \$225 million 6.75% senior subordinated notes at a call premium of 1.125% and 2.25%, respectively. The redemptions were principally funded by the add-ons to our senior secured credit facility, discussed above. As a result of the redemptions, we accelerated the unamortized financing costs of the senior subordinated notes and expensed the call premium incurring a pretax charge of \$1.1 million (after tax of \$0.01 per diluted share and \$4.9 million (after tax of \$0.03 per diluted share) in 2012 and 2011, respectively. We repaid \$57 million of the \$135 million add on in 2011 using cash on hand.

In June 2012 and in 2010, we entered into agreements to swap \$75 million and \$98 million, respectively, of floating rate obligations for fixed rate obligations at 0.6725% and 1.03% against LIBOR in U.S. dollars. Both swaps are scheduled to mature in March 2014, and were accounted for as cash flow hedges of our floating rate bank loans. To ensure the swaps were highly effective, all the principal terms of the swaps matched the terms of the bank loans. The fair value of both interest rate swaps was a liability of \$1.2 million at December 31, 2012 and the fair value of the \$98 million interest rate swap was a liability \$0.6 million at December 31, 2011.

In 2010, we refinanced our Facility. At the time of the 2010 refinancing, the new borrowings plus cash on hand were used to repay \$134.1 million of term loans existing under the previous facility and \$3.7 million of debt issuance costs related to the refinancing. During 2010, we paid \$1.4 million of debt issuance costs related to the add-on to our revolving credit facility and repaid \$30.0 million of our previous Facility with cash on hand. This repayment included a \$26.4 million mandatory prepayment based on 50% of the cash flow generated in 2010, as defined in the old agreement. In addition we borrowed \$3.9 million from a line of credit associated with our operations in China.

**Financial Obligations and Commitments:** As of December 31, 2012, current maturities of notes payable and capital lease obligations were \$16.6 million. The next significant scheduled debt maturity will not occur until 2015, the year the senior secured credit facility matures. We have a capital lease for a building which expires in 2021. In addition, certain sales and administrative offices, data processing equipment and manufacturing equipment and facilities are leased under operating leases.

Total letters of credit issued and outstanding under the Senior Secured Credit Facility were \$2.2 million as of December 31, 2012.

The following table summarizes the scheduled maturities as of December 31, 2012 of financial obligations and expiration dates of commitments for the years ended 2013 through 2017 and thereafter.



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(In millions)	2013	2014	2015	2016	2017	Thereafter	Total
Senior secured credit facility term loan due 2015	\$ 10.0	\$ 25.0	\$ 50.0	\$	\$	\$	\$ 85.0
Senior secured credit facility Revolver due 2015			165.0				165.0
Working capital facility	4.8						4.8
Capital leases and other	1.8						1.8
<b>Subtotal</b>	<b>16.6</b>	<b>25.0</b>	<b>215.0</b>				<b>256.6</b>
Operating leases	9.2	5.8	3.0	2.2	1.9	10.9	33.0
<b>Total financial obligations</b>	<b>\$ 25.8</b>	<b>\$ 30.8</b>	<b>\$ 218.0</b>	<b>\$ 2.2</b>	<b>\$ 1.9</b>	<b>\$ 10.9</b>	<b>\$ 289.6</b>
Letters of credit	\$	\$	\$ 2.2	\$	\$	\$	\$ 2.2
Interest payments	7.6	7.0	3.4				18.0
Estimated benefit plan contributions	4.8	7.8	29.1	7.3	10.7	23.5	83.2
Other (a)	4.2	1.0	0.7	0.7			6.6
<b>Total commitments</b>	<b>\$ 42.4</b>	<b>\$ 46.6</b>	<b>\$ 253.4</b>	<b>\$ 10.2</b>	<b>\$ 12.6</b>	<b>\$ 34.4</b>	<b>\$ 399.6</b>

(a) Other represents estimated spending for environmental matters at known sites.

As of December 31, 2012, we had \$32.6 million of unrecognized tax benefits. This represents tax benefits associated with various tax positions taken, or expected to be taken, on domestic and international tax returns that have not been recognized in our financial statements due to uncertainty regarding their resolution. The resolution or settlement of these tax positions with the taxing authorities is at various stages. We are unable to make a reliable estimate of the eventual cash flows of the \$32.6 million of unrecognized tax benefits.

For further information regarding our financial obligations and commitments, see Notes 6, 7, 8, 13 and 14 to the accompanying consolidated financial statements of this Annual Report on Form 10-K.

### Critical Accounting Policies

Our consolidated financial statements are prepared based upon the selection and application of accounting principles generally accepted in the United States of America, which require us to make estimates and assumptions about future events that affect amounts reported in our financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be significant to the financial statements. The accounting policies below are those we believe are the most critical to the preparation of our financial statements and require the most difficult, subjective and complex judgments. Our other accounting policies are described in the accompanying notes to the consolidated financial statements of this Annual Report on Form 10-K.

#### *Deferred Tax Assets*

As of December 31, 2012 we have \$62.6 million in net deferred tax assets consisting of deferred tax assets of \$170.5 million offset by deferred tax liabilities of \$58.5 million and a valuation allowance of \$49.4 million (primarily related to net operating loss carryforwards in certain foreign jurisdictions). As of December 31, 2011, we had \$76.8 million in net deferred tax assets consisting of deferred tax assets of \$157.2 million offset by deferred tax liabilities of \$41.0 million and a valuation allowance of \$39.4 million.

The determination of the required valuation allowance and the amount, if any, of deferred tax assets to be recognized involves significant estimates regarding the timing and amount of reversal of taxable temporary differences, future taxable income and the implementation of tax planning strategies. In particular, we are required to weigh both positive and negative evidence in determining whether a valuation allowance is required. Positive evidence would include, for example, a strong earnings history, an event that will increase our taxable income through a continuing reduction in expenses, and tax planning strategies indicating an ability to realize deferred tax assets. Negative evidence would include, for example, a history of operating losses and losses expected in future years.

The valuation allowance as of December 31, 2012 relates to certain net operating loss carryforwards of our foreign subsidiaries, and state net operating loss carryforwards for which we have determined, based upon historical results and projected future book and taxable income levels, that a valuation allowance should continue to be maintained.

*Uncertain Tax Positions*

Included in the unrecognized tax benefits of \$32.6 million at December 31, 2012 was \$32.3 million of tax benefits that, if recognized, would impact our annual effective tax rate. In addition, we recognize interest accrued related to unrecognized tax benefits as a component of interest expense and penalties as a component of income tax expense in the consolidated statements of operations. The Company recognized \$0.1 million, (\$0.1) million, (\$1.4) million of interest expense (income) related to the above unrecognized

tax benefits in 2012, 2011 and 2010, respectively. The Company had accrued interest of approximately \$0.9 million and \$0.8 million as of December 31, 2012 and 2011, respectively. During 2012 and 2011, we reversed interest of \$0.1 million and \$0.2 million respectively related to the unrecognized tax benefits.

We are subject to taxation in the U.S. and various states and foreign jurisdictions. The U.S. federal statute of limitations remains open for prior years; however the U.S. tax returns have been audited through 2007. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from 3 to 5 years. Years still open to examination by foreign tax authorities in major jurisdictions include Austria (2006 onward), Belgium (2010 onward), France (2010 onward), Spain (2004 onward) and UK (2010 onward). We are currently under examination in certain of the foreign jurisdictions.

As of December 31, 2012, we had uncertain tax positions for which it is reasonably possible that amounts of unrecognized tax benefits could significantly change over the next year. These uncertain tax positions relate to our tax returns from 2004 onward, some of which are currently under examination by certain European tax authorities. During 2011, we recognized \$5.5 million of uncertain tax benefits as a result of a favorable settlement in one of the foreign tax jurisdictions. As of December 31, 2012, the Company has not classified any of the unrecognized tax benefits as a current liability as it does not expect to settle any of the tax positions under examinations in various jurisdictions within the next twelve months.

We expect that the amount of unrecognized tax benefits will continue to change in the next twelve months as a result of ongoing tax deductions, the resolution of audits and the passing of the statute of limitations.

#### *Retirement and Other Postretirement Benefit Plans*

We maintain qualified defined benefit retirement plans covering certain current and former European employees, as well as nonqualified defined benefit retirement plans and retirement savings plans covering certain eligible U.S. and European employees, and participate in a union sponsored multi-employer pension plan covering certain U.S. employees with union affiliations. In addition, we provide certain postretirement health care and life insurance benefits to eligible U.S. retirees.

Under the retirement savings plans, eligible U.S. employees can contribute up to 75% of their compensation to an individual 401(k) retirement savings account. We make matching contributions equal to 50% of employee contributions, not to exceed 3% of employee compensation.

We have defined benefit retirement plans in the United Kingdom, Belgium, France and Austria covering certain employees of our subsidiaries in those countries. The defined benefit plan in the United Kingdom (the U.K. Plan), the largest of the European plans, was terminated in 2011 and replaced with a defined contribution plan. We recorded a curtailment gain of \$5.7 million (after tax gain of \$0.04 per diluted share) to recognize previously unrecognized prior service credits. As of December 31, 2012, 57% of the total assets in the U.K. Plan were invested in equities. Equity investments are made with the objective of achieving a return on plan assets consistent with the funding requirements of the plan, maximizing portfolio return and minimizing the impact of market fluctuations on the fair value of the plan assets. As a result of an annual review of historical returns and market trends, the expected long-term weighted average rate of return for the U.K. Plan for the 2013 plan year will be 6.5% and for the other European Plans as a group it will be 4.0% to 4.5%.

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We use actuarial models to account for our pension and postretirement plans, which require the use of certain assumptions, such as the expected long-term rate of return, discount rate, rate of compensation increase, healthcare cost trend rates, and retirement and mortality rates, to determine the net periodic costs of such plans. These assumptions are reviewed and set annually at the beginning of each year. In addition, these models use an attribution approach that generally spreads individual events, such as plan amendments and changes in actuarial assumptions, over the service lives of the employees in the plan. That is, employees render service over their service lives on a relatively smooth basis and therefore, the income statement effects of retirement and postretirement benefit plans are earned in, and should follow, the same pattern.

We use our actual return experience, future expectations of long-term investment returns, and our actual and targeted asset allocations to develop our expected rate of return assumption used in the net periodic cost calculations of our funded European defined benefit retirement plans. Due to the difficulty involved in predicting the market performance of certain assets, there will almost always be a difference in any given year between our expected return on plan assets and the actual return. Following the attribution approach, each year's difference is amortized over a number of future years. Over time, the expected long-term returns are designed to approximate the actual long-term returns and therefore result in a pattern of income and expense recognition that more closely matches the pattern of the services provided by the employees.

We annually set our discount rate assumption for retirement-related benefits accounting to reflect the rates available on high-quality, fixed-income debt instruments. The discount rate assumption used to calculate net periodic retirement related costs for the European funded plans was 4.73% for 2012, 5.27% for 2011 and 5.66% for 2010, respectively. The rate of compensation increase, which is another significant assumption used in the actuarial model for pension accounting, is determined by us based upon our long-term plans for such increases and assumed inflation. For the postretirement health care and life insurance benefits plan, we review external data and its historical trends for health care costs to determine the health care cost trend rates. Retirement and mortality rates are based primarily on actual plan experience.

Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect the net periodic costs and recorded obligations in such future periods. While we believe that the assumptions used are appropriate, significant changes in economic or other conditions, employee demographics, retirement and mortality rates, and investment performance may materially impact such costs and obligations.

For more information regarding our pension and other postretirement benefit plans, see Note 8 to the accompanying consolidated financial statements of this Annual Report on Form 10-K.

#### *Long-Lived Assets and Goodwill*

We have significant long-lived assets. We review these assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The assessment of possible impairment is based upon our ability to recover the carrying value of the assets from the estimated undiscounted future net cash flows, before interest and taxes, of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires estimates of these cash flows and fair value. The calculation of fair value is determined based on discounted cash flows. In determining fair value a considerable amount of judgment is required to determine discount rates, market premiums, financial forecasts, and asset lives.

In addition, we review goodwill for impairment at the reporting unit level at least annually, and whenever events or changes in circumstances indicate that goodwill might be impaired. We have four reporting units within the Composite Materials segment, each of which are components that constitute a business for which discrete financial information is available and for which appropriate management regularly reviews the operating results. Within the Engineered Products segment, the reporting unit is the segment as it comprises only a single component. In 2012, the Company performed a qualitative assessment and determined that it was more likely than not that the fair values of our reporting units were not less than their carrying values and it was not necessary to perform the currently prescribed two-step goodwill impairment test.

As of October 1, 2012 we reassessed the estimated useful lives of certain machinery and equipment. We increased the useful lives of certain machinery and equipment from 20 years to 25 years, and increased the useful lives of certain other machinery and equipment from 10 years - 12 years to 20 years. We determined that this adjustment to the useful lives of certain assets is a change in accounting estimate and we accounted for the change prospectively; i.e. the accounting change impacts the three months ended December 31, 2012 and future periods. For the quarter and year ended December 31, 2012, the change in accounting estimate lowered depreciation expense by approximately \$1.25 million (pre-tax), which was reflected in Gross Margin, or by approximately \$0.01 earnings per basic and diluted common share.

#### *Commitments and Contingencies*

We are involved in litigation, investigations and claims arising out of the normal conduct of our business, including those relating to commercial transactions, environmental, employment, health and safety matters. We estimate and accrue our liabilities resulting from such matters based upon a variety of factors, including the stage of the proceeding; potential settlement value; assessments by internal and external counsel; and assessments by environmental engineers and consultants of potential environmental liabilities and remediation costs. We believe we have adequately accrued for these potential liabilities; however, facts and circumstances may change, such as new developments, or a change in approach, including a change in settlement strategy or in an environmental remediation plan, that could cause the actual liability to exceed the estimates, or may require adjustments to the recorded liability balances in the future.

Our estimate of liability as a potentially responsible party ( PRP ) and our remaining costs associated with our responsibility to remediate the Lodi, New Jersey; Kent, Washington; and other sites are accrued in the consolidated balance sheets. As of December 31, 2012 and 2011, our aggregate environmental related accruals were \$6.6 million and \$5.0 million, respectively. As of December 31, 2012 and 2011, \$4.2 million and \$3.3 million, respectively, was included in current other accrued liabilities, with the remainder included in other non-current liabilities. As related to certain environmental matters, except for the Lodi site, the accrual

was estimated at the low end of a range of possible outcomes since no amount within the range is a better estimate than any other amount. In 2012, if we had accrued for these matters at the high end of the range of possible outcomes, our accrual would have been \$9.2 million at December 31, 2012.

These accruals can change significantly from period to period due to such factors as additional information on the nature or extent of contamination, the methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties, or the impact, if any, of being named in a new matter.

Environmental remediation reserve activity for the three years ended December 31, 2012 was as follows:

(In millions)	December 31, 2012	For the year ended December 31, 2011	December 31, 2010
Beginning remediation accrual balance	\$ 5.0	7.3	\$ 8.3
Current period expenses	5.0	3.4	3.8
Cash expenditures	(3.4)	(5.7)	(4.8)
Ending remediation accrual balance	\$ 6.6	\$ 5.0	\$ 7.3
Capital expenditures for environmental matters	\$ 2.4	\$ 4.1	\$ 1.7

### Market Risks

As a result of our global operating and financing activities, we are exposed to various market risks that may affect our consolidated results of operations and financial position. These market risks include, but are not limited to, fluctuations in interest rates, which impact the amount of interest we must pay on certain debt instruments, and fluctuations in currency exchange rates, which impact the U.S. dollar value of transactions, assets and liabilities denominated in foreign currencies. Our primary currency exposures are in Europe, where we have significant business activities. To a lesser extent, we are also exposed to fluctuations in the prices of certain commodities, such as electricity, natural gas, aluminum, acrylonitrile and certain chemicals.

We attempt to net individual exposures, when feasible, taking advantage of natural offsets. In addition, we employ or may employ interest rate swap agreements, cross-currency swap agreements and foreign currency forward exchange contracts for the purpose of hedging certain specifically identified interest rates and net currency exposures. The use of these financial instruments is intended to mitigate some of the risks associated with fluctuations in interest rates and currency exchange rates, but does not eliminate such risks. We do not use financial instruments for trading or speculative purposes.

### Interest Rate Risks

Our long-term debt bears interest at variable rates. From time to time we have entered into interest rate swap agreements to change the underlying mix of variable and fixed interest rate debt. These interest rate swap agreements have modified the percentage of total debt that is exposed to changes in market interest rates. Assuming a 10% favorable and a 10% unfavorable change in the underlying weighted average interest rates of our variable rate debt and swap agreements, interest expense for 2012 of \$10.0 million would have decreased to \$9.7 million and

increased to \$10.3 million, respectively.

*Interest Rate Swaps*

We have entered into approximately \$173 million of interest rate swaps, with a remaining balance of \$160 million at December 31, 2012, that trade the LIBOR on our bank loan for a fixed rate at an average rate of 0.8625%. These interest rate swaps are designated as cash flow hedges to our term loan and expire by March 2014. The fair value of interest rate swap agreements is recorded in other assets or other long-term liabilities with a corresponding amount to Other Comprehensive Income.

*Foreign Currency Exchange Risks*

We operate nine manufacturing facilities in Europe, which generated approximately 47% of our 2012 consolidated net sales. Our European business activities primarily involve three major currencies – the U.S. dollar, the British pound, and the Euro. We also conduct business and sell products to customers throughout the world, including a joint venture interest in Malaysia. Most of the sales



in these countries are denominated in U.S. dollars and they have local currency expenses. Currency risk for these locations is not considered material.

In 2012, our European subsidiaries had third-party sales of \$749 million of which approximately 52% were denominated in U.S. dollars, 44% were denominated in Euros and 4% were denominated in British pounds. While we seek to reduce the exposure of our European subsidiaries to their sales in non-functional currencies through the purchase of raw materials in the same currency as that of the product sale, the net contribution of these sales to cover the costs of the subsidiary in its functional currency will vary with changes in foreign exchange rates, and as a result, so will vary the European subsidiaries' percentage margins and profitability. For revenues denominated in the functional currency of the subsidiary, changes in foreign currency exchange rates increase or decrease the value of these revenues in U.S. dollars but do not affect the profitability of the subsidiary in its functional currency. The value of our investments in these countries could be impacted by changes in currency exchange rates over time, and could impact our ability to profitably compete in international markets.

We attempt to net individual functional currency positions of our various European subsidiaries, to take advantage of natural offsets and reduce the need to employ foreign currency forward exchange contracts. We attempt to hedge some, but not necessarily all, of the net exposures of our European subsidiaries resulting from sales they make in non-functional currencies. The benefit of such hedges varies with time and the foreign exchange rates at which the hedges are set. For example, when the Euro strengthened against the U.S. dollar, the benefit of new hedges placed was much less than the value of hedges they replaced that were entered into when the U.S. dollar was stronger. We seek to place additional foreign currency hedges when the dollar strengthens against the Euro or British pound. We do not seek to hedge the value of our European subsidiaries' functional currency sales and profitability in U.S. dollars. We also enter into short-term foreign currency forward exchange contracts, usually with a term of ninety days or less, to hedge net currency exposures resulting from specifically identified transactions. Consistent with the nature of the economic hedge provided by such contracts, any unrealized gain or loss would be offset by corresponding decreases or increases, respectively, of the underlying transaction being hedged.

We have performed a sensitivity analysis as of December 31, 2012 using a modeling technique that measures the changes in the fair values arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to the U.S. dollar with all other variables held constant. The analysis covers all of our foreign currency hedge contracts. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would have about a \$2 million impact on our results. However, it should be noted that over time as the adverse movement (in our case a weaker dollar as compared to the Euro or the GBP) continues and new hedges are layered in at the adverse rate, the impact would be more significant. For example, had we not had any hedges in place for 2012, a 10% adverse movement would have reduced our operating income by about \$15 million.

#### *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 March 2015. The aggregate notional amount of these contracts was \$201.2 million and \$168.9 million at December 31, 2012 and 2011, respectively. 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. For the three years ended December 31, 2012, hedge ineffectiveness was immaterial. Cash flows associated with these contracts are classified within net cash provided by operating activities of continuing operations.

The activity in accumulated other comprehensive income (loss) related to foreign currency forward exchange contracts for the years ended December 31, 2012, 2011 and 2010 was as follows:

(In millions)	2012		2011		2010	
<b>Unrealized losses at beginning of period</b>	\$	(4.5)	\$	(0.2)	\$	(1.4)
Gains (losses) reclassified to net sales		2.4		(2.2)		3.9
Increase (decrease) in fair value, net of tax		4.5		(2.1)		(2.7)
<b>Unrealized gains (losses) at end of period</b>	\$	2.4	\$	(4.5)	\$	(0.2)

Unrealized gains of \$0.7 million recorded in accumulated other comprehensive income, net of tax, as of December 31, 2012 are expected to be reclassified into earnings over the next twelve months as the hedged sales are recorded. The impact of credit risk adjustments was immaterial for the three years.

In addition, non-designated foreign exchange forward contracts are used to hedge balance sheet exposures. The notional amounts outstanding at December 31, 2012 were U.S. \$165.0 million against EUR, and GBP 4.0 million against EUR and at December 31, 2011 were U.S. \$149.0 million against EUR. Any changes in fair value of these forward contracts are recorded in the consolidated statements of operations and were immaterial for the years 2012, 2011 and 2010.

#### *Utility Price Risks*

We have exposure to utility price risks as a result of volatility in the cost and supply of energy and in natural gas. To minimize the risk, from time to time we enter into fixed price contracts at certain of our manufacturing locations for a portion of our energy usage. Although these contracts would reduce the risk to us during the contract period, future volatility in the supply and pricing of energy and natural gas could have an impact on our future consolidated results of operations.

#### **Recently Issued Accounting Standards**

##### *New Accounting Pronouncements*

*ASU 2012-02 Testing Indefinite Lived Intangible Assets for Impairment (Topic 350)*: In July 2012, the FASB issued ASU No. 2012-02, which allows an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. ASU 2012-02 was effective for years beginning after September 15, 2012 although early adoption was permitted.

**Consolidated Financial Statements and Supplementary Data**

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**Management's Responsibility for Consolidated Financial Statements**

Hexcel management has prepared and is responsible for the consolidated financial statements and the related financial data contained in this report. These financial statements, which include estimates, were prepared in accordance with accounting principles generally accepted in the United States of America. Management uses its best judgment to ensure that such statements reflect fairly the consolidated financial position, results of operations and cash flows of the Company.

The Audit Committee of the Board of Directors reviews and monitors the financial reports and accounting practices of Hexcel. These reports and practices are reviewed regularly by management and by our independent registered public accounting firm, PricewaterhouseCoopers LLP, in connection with the audit of our consolidated financial statements. The Audit Committee, composed solely of outside directors, meets periodically, separately and jointly, with management and the independent registered public accounting firm.

**Management's Report on Internal Control Over Financial Reporting**

Hexcel management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Hexcel management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on our assessment, management concluded that, as of December 31, 2012, our internal control over financial reporting was effective.

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The effectiveness of Hexcel's internal control over financial reporting, as of December 31, 2012, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report that appears on page 41.

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and

Stockholders of Hexcel Corporation

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Hexcel Corporation and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

*/s/ PricewaterhouseCoopers LLP*

Stamford, Connecticut

February 8, 2013



**Hexcel Corporation and Subsidiaries****Consolidated Balance Sheets**

As of December 31,

(In millions, except per share data)	2012	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 32.6	\$ 49.5
Accounts receivable, net	229.0	199.3
Inventories, net	232.8	215.7
Prepaid expenses and other current assets	81.3	59.8
Total current assets	575.7	524.3
Property, plant and equipment, net	914.4	722.1
Goodwill and other intangible assets	57.8	57.4
Investments in affiliated companies	22.6	21.7
Deferred tax assets	15.4	33.0
Other assets	17.2	17.6
Total assets	\$ 1,603.1	\$ 1,376.1
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	\$ 16.6	\$ 12.6
Accounts payable	115.7	141.7
Accrued compensation and benefits	58.8	57.5
Other accrued liabilities	44.2	35.7
Total current liabilities	235.3	247.5
Long-term notes payable and capital lease obligations	240.0	238.3
Long-term retirement obligations	81.3	68.5
Other non-current liabilities	52.4	19.6
Total liabilities	609.0	573.9
Commitments and contingencies (see Note 14)		
Stockholders' equity:		
Common stock, \$0.01 par value, 200.0 shares of stock authorized, 102.4 and 101.0 shares of stock issued at December 31, 2012 and 2011, respectively	1.0	1.0
Additional paid-in capital	617.0	589.2
Retained earnings	448.2	283.9
Accumulated other comprehensive loss	(31.9)	(39.8)
	1,034.3	834.3
Less: Treasury stock, at cost, 2.5 and 2.2 shares at December 31, 2012 and 2011, respectively	(40.2)	(32.1)
Total stockholders' equity	994.1	802.2
Total liabilities and stockholders' equity	\$ 1,603.1	\$ 1,376.1

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



**Hexcel Corporation and Subsidiaries****Consolidated Statements of Operations****For the Years Ended December 31,**

(In millions, except per share data)	2012	2011	2010
Net sales	\$ 1,578.2	\$ 1,392.4	\$ 1,173.6
Cost of sales	1,171.5	1,050.3	891.0
Gross margin	406.7	342.1	282.6
Selling, general and administrative expenses	130.7	120.5	118.5
Research and technology expenses	36.7	32.6	30.8
Other (income) expense, net	(9.5)	(3.0)	3.5
Operating income	248.8	192.0	129.8
Interest expense, net	10.0	11.6	23.2
Non-operating expense	1.1	4.9	6.8
Income before income taxes and equity in earnings	237.7	175.5	99.8
Provision for income taxes	74.1	41.6	22.9
Income before equity in earnings	163.6	133.9	76.9
Equity in earnings from investments in affiliated companies	0.7	1.6	0.5
Net income	\$ 164.3	\$ 135.5	\$ 77.4
Basic net income per common share:	\$ 1.64	\$ 1.37	\$ 0.79
Diluted net income per common share:	\$ 1.61	\$ 1.35	\$ 0.77
Weighted average common shares outstanding:			
Basic	100.2	98.8	97.6
Diluted	102.0	100.7	99.9

**Hexcel Corporation and Subsidiaries****Consolidated Statements of Comprehensive Income****For the Years Ended December 31,**

(In millions)	2012	2011	2010
Net income	\$ 164.3	\$ 135.5	\$ 77.4
Currency translation adjustments	11.7	(10.1)	(17.1)
Net unrealized pension and other benefit actuarial losses and prior service credits, net of tax	(10.8)	(5.0)	7.3
Net unrealized gains (losses) on financial instruments, net of tax	7.0	(9.6)	1.7
Other comprehensive income (loss)	7.9	(24.7)	(8.1)
Comprehensive income	\$ 172.2	\$ 110.8	\$ 69.3

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



## Hexcel Corporation and Subsidiaries

## Consolidated Statements of Stockholders Equity

For the Years Ended December 31, 2012, 2011 and 2010

(In millions)	Par	Common Stock Additional Paid-In Capital	Accumulated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Total Stockholders Equity
<b>Balance, December 31, 2009</b>	\$ 1.0	\$ 535.3	\$ 71.0	\$ (7.0)	\$ (24.7)	\$ 575.6
Net income			77.4			77.4
Currency translation adjustments				(17.1)		(17.1)
Net unrealized gain on financial instruments, net of tax				1.7		1.7
Change in post-retirement benefit plans, net of tax				7.3		7.3
Comprehensive income						
Activity under stock plans		17.0			(2.5)	14.5
<b>Balance, December 31, 2010</b>	\$ 1.0	\$ 552.3	\$ 148.4	\$ (15.1)	\$ (27.2)	\$ 659.4
Net income			135.5			135.5
Currency translation adjustments				(10.1)		(10.1)
Net unrealized loss on financial instruments, net of tax				(9.6)		(9.6)
Change in post-retirement benefit plans, net of tax				(5.0)		(5.0)
Comprehensive income						
Activity under stock plans		36.9			(4.9)	32.0
<b>Balance, December 31, 2011</b>	\$ 1.0	\$ 589.2	\$ 283.9	\$ (39.8)	\$ (32.1)	\$ 802.2
Net income			164.3			164.3
Currency translation adjustments				11.7		11.7
Net unrealized gain on financial instruments, net of tax				7.0		7.0
Change in post-retirement benefit plans, net of tax				(10.8)		(10.8)
Comprehensive income						
Activity under stock plans		27.8			(8.1)	19.7
<b>Balance, December 31, 2012</b>	\$ 1.0	\$ 617.0	\$ 448.2	\$ (31.9)	\$ (40.2)	\$ 994.1

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

## Hexcel Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

For the Years Ended December 31,

(In millions)	2012	2011	2010
<b>Cash flows from operating activities</b>			
Net income	\$ 164.3	\$ 135.5	\$ 77.4
Reconciliation to net cash provided by operating activities:			
Depreciation	57.2	55.3	53.2
Amortization of debt discount and deferred financing costs	3.1	7.1	10.3
Deferred income taxes	30.9	23.4	16.1
Share-based compensation	15.8	13.9	12.4
Excess tax benefits on share-based compensation	(6.8)	(8.5)	(2.3)
Gain on sale of surplus real estate	(4.9)		
Equity in earnings from investments in affiliated companies	(0.7)	(1.6)	(0.5)
Pension curtailment gain		(5.7)	
Changes in assets and liabilities:			
Decrease in accounts receivable	(28.1)	(28.2)	(22.5)
Decrease in inventories	(15.2)	(48.8)	(16.7)
Decrease (increase) in prepaid expenses and other current assets	0.7	(1.1)	(0.2)
Increase in accounts payable and accrued liabilities	20.3	34.1	4.5
Decrease in other, net	(4.2)	(4.9)	(5.2)
Net cash provided by operating activities	232.4	170.5	126.5
<b>Cash flows from investing activities</b>			
Proceeds from sale of surplus real estate	5.3		
Capital expenditures and deposits for capital purchases	(263.7)	(158.0)	(48.8)
Settlement of foreign currency hedge		(5.2)	
Net cash used for investing activities	(258.4)	(163.2)	(48.8)
<b>Cash flows from financing activities</b>			
Borrowings from senior secured credit facility	87.0	135.0	
Capital lease obligations and other debt, net	(0.5)	(3.0)	3.4
Issuance costs related to debt	(0.6)		(5.1)
Call premium payment for 6.75% senior subordinated notes	(0.8)	(3.4)	
Repayment of senior secured credit agreement term loan	(7.5)	(5.0)	(2.5)
Repayment of 6.75% senior subordinated notes	(73.5)	(151.5)	
Repayment of senior secured credit facility		(57.0)	
Proceeds from senior secured credit facility term loan			100.0
Repayment of senior secured credit agreement term B and C loans			(164.1)
Activity under stock plans and other	4.1	10.5	3.1
Net cash provided by (used for) financing activities	8.2	(74.4)	(65.2)
Effect of exchange rate changes on cash and cash equivalents	0.9	(0.6)	(5.4)
Net (decrease) increase in cash and cash equivalents	(16.9)	(67.7)	7.1
Cash and cash equivalents at beginning of year	49.5	117.2	110.1
Cash and cash equivalents at end of year	\$ 32.6	\$ 49.5	\$ 117.2
Supplemental information (See Note 15):			
Accrual basis additions to property, plant and equipment	\$ 241.3	\$ 184.5	\$ 60.7

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 Significant Accounting Policies

#### *Nature of Operations*

Hexcel Corporation and its subsidiaries (herein referred to as Hexcel, the Company, we, us, or our), is a leading advanced composites company. We develop, manufacture, and market lightweight, high-performance structural materials, including carbon fibers, specialty reinforcements, prepregs and other fiber-reinforced matrix materials, honeycomb, adhesives, engineered honeycomb and composite structures, for use in Commercial Aerospace, Space & Defense and Industrial Applications. Our products are used in a wide variety of end applications, such as commercial and military aircraft, space launch vehicles and satellites, wind turbine blades, automotive, bikes, skis and a wide variety of recreational products and other industrial applications.

We serve international markets through manufacturing facilities, sales offices and representatives located in the Americas, Europe, Asia Pacific and Russia. We are also an investor in a joint venture, which manufactures composite structures for commercial aerospace.

#### *Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Hexcel Corporation and its subsidiaries after elimination of all intercompany accounts, transactions and profits. An investment in an affiliated company, in which our interest is 50% and where we do not have the ability to exercise control over financial or operating decisions, nor are we the primary beneficiary, is accounted for using the equity method of accounting.

#### *Use of Estimates*

Preparation of the accompanying consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand and all highly liquid investments with an original maturity of three months or less when purchased. Our cash equivalents are held in prime money market investments with strong sponsor organizations which are monitored on a



continuous basis.

*Inventories*

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out and average cost methods. Inventory is reported at its estimated net realizable value based upon our historical experience with inventory becoming obsolete due to age, changes in technology and other factors.

*Property, Plant and Equipment*

Property, plant and equipment, including capitalized interest applicable to major project expenditures, is recorded at cost. Asset and accumulated depreciation accounts are eliminated for dispositions, with resulting gains or losses reflected in earnings. Depreciation of plant and equipment is provided using the straight-line method over the estimated useful lives of the various assets. The estimated useful lives range from 10 to 40 years for buildings and improvements and from 3 to 25 years for machinery and equipment. Repairs and maintenance are expensed as incurred, while major replacements and betterments are capitalized and depreciated over the remaining useful life of the related asset.

As of October 1, 2012, we reassessed the estimated useful lives of certain machinery and equipment. We increased the useful lives of this machinery and equipment from 20 years to 25 years, and increased the useful lives of other certain machinery and equipment from 10 years - 12 years to 20 years. We determined that this adjustment to the useful lives of certain assets is a change in accounting estimate and we accounted for the change prospectively; i.e. the accounting change impacts the three months ended December 31, 2012 and future periods. See Note 3.

*Goodwill and Other Intangible Assets*

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets of an acquired business. Goodwill is tested for impairment at the reporting unit level annually, or when events or changes in circumstances indicate that goodwill might be impaired. The Company's annual test for goodwill impairment was performed in the fourth quarter. The Company performed a qualitative assessment and determined that it was more likely than not that the fair values of our reporting units were not less than their carrying values and it was not necessary to perform the currently prescribed two-step goodwill impairment test.

We amortize the cost of other intangibles over their estimated useful lives unless such lives are deemed indefinite. Indefinite lived intangibles are tested annually for impairment, or when events or changes in circumstances indicate the potential for impairment. If the carrying amount of the indefinite lived intangible exceeds the fair value, the intangible asset is written down to its fair value. Fair value is calculated using discounted cash flows.

*Impairment of Long-Lived Assets*

The Company reviews long-lived assets, including property, plant and equipment and identifiable intangible assets, for impairment whenever changes in circumstances or events may indicate that the carrying amounts are not recoverable. These indicators include: a significant decrease in the market price of a long-lived asset, a significant change in the extent or manner in which a long-lived asset is used or its physical condition, a significant adverse change in legal factors or business climate that could affect the value of a long-lived asset, an accumulation of costs significantly in excess of the amount expected for the acquisition or construction of a long-lived asset, a current period operating or cash flow loss combined with a history of losses associated with a long-lived asset and a current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated life.

The Company also tests indefinite-lived intangible assets, consisting of purchased emissions credits, for impairment at least annually as of November 30th. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

*Software Development Costs*

Costs incurred to develop software for internal-use are accounted for under Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. All costs relating to the preliminary project stage and the post-implementation/operation stage are expensed as incurred. Costs incurred during the application development stage are capitalized and amortized over the useful life of the software. The amortization of capitalized costs commences when functionality of the computer software is achieved.

*Investments*

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We have a 50% equity ownership investment in an Asian joint venture Asian Composites Manufacturing Sdn. Bhd. In accordance with ASC 810 we have determined that this investment is not a variable interest entity. As such, we account for our share of the earnings of this affiliated company using the equity method of accounting. The Company continues to evaluate to make certain that the facts and circumstances associated with this investment have not changed with respect to accounting for a variable interest entity.

### *Debt Financing Costs*

Debt financing costs are deferred and amortized to interest expense over the life of the related debt. At December 31, 2012 and 2011, deferred debt financing costs, net of accumulated amortization, were \$4.6 million and \$6.1 million.

### *Share-Based Compensation*

The fair value of Restricted Stock Units (RSUs) is equal to the market price of our stock at date of grant and is amortized to expense ratably over the vesting period. Performance restricted stock units (PRSUs) are a form of RSUs in which the number of shares ultimately received depends on the extent to which we achieve a specified performance target. The fair value of the PRSU is based on the closing market price of the Company's common stock on the date of grant and is amortized straight-line over the total vesting period. A change in the performance measure expected to be achieved is recorded as an adjustment in the period in which the change occurs. We use the Black-Scholes model to value compensation expense for all option-based payment awards made to employees and directors based on estimated fair values on the grant date. The value of the portion of the award that is ultimately

expected to vest is recognized as expense on a straight-line basis over the requisite service periods in our consolidated statements of operations. The value of RSU s and Non-qualifying options awards for retirement eligible employees is expensed on the grant date as they are fully vested.

#### *Currency Translation*

The assets and liabilities of international subsidiaries are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. Cumulative currency translation adjustments are included in accumulated other comprehensive income (loss) in the stockholders' equity section of the consolidated balance sheets. Gains and losses from foreign currency transactions are not material.

#### *Revenue Recognition*

Our revenue is predominately derived from sales of inventory, and is recognized when persuasive evidence of an arrangement exists, title and risk of loss passes to the customer, the sales price is fixed or determinable and collectability is reasonably assured. However, from time to time we enter into contractual arrangements for which other specific revenue recognition guidance is applied.

Recognition of revenue on bill and hold arrangements occurs only when risk of ownership has passed to the buyer, a fixed written commitment has been provided by the buyer, the goods are complete and ready for shipment, the goods are segregated from inventory, no performance obligations remain and a schedule for delivery of goods has been established. Revenues derived from design and installation services are recognized when the service is provided. Revenues derived from long-term construction-type contracts are accounted for using the percentage-of-completion method, and progress is measured on a cost-to-cost basis. If at any time expected costs exceed the value of the contract, the loss is recognized immediately.

#### *Product Warranty*

We provide for an estimated amount of product warranty at the point a claim is probable and estimable. This estimated amount is provided by product and based on current facts, circumstances and historical warranty experience. Warranty expense was \$2.2 million, \$2.0 million and \$1.9 million for the years ended December 31, 2012, 2011 and 2010 respectively.

#### *Research and Technology*

Significant costs are incurred each year in connection with research and technology ( R&T ) programs that are expected to contribute to future earnings. Such costs are related to the development and, in certain instances, the qualification and certification of new and improved products and their uses. R&T costs are expensed as incurred.

*Income Taxes*

We provide for income taxes using the liability approach. Under the liability approach, deferred income tax assets and liabilities reflect tax net operating loss and credit carryforwards and the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets require a valuation allowance when it is more likely than not, based on the evaluation of positive and negative evidence, that some portion of the deferred tax assets may not be realized. The realization of deferred tax assets is dependent upon the timing and magnitude of future taxable income prior to the expiration of the deferred tax assets' attributes. When events and circumstances so dictate, we evaluate the realizability of our deferred tax assets and the need for a valuation allowance by forecasting future taxable income. Investment tax credits are recorded on a flow-through basis, which reflects the credit in net income as a reduction of the provision for income taxes in the same period as the credit is realized for federal income tax purposes. In addition, we recognize interest accrued related to unrecognized tax benefits as a component of interest expense and penalties as a component of income tax expense in the consolidated statements of operations.

*Concentration of Credit Risk*

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of trade accounts receivable. Two customers and their related subcontractors accounted for more than half of our annual net sales in 2012, 2011 and 2010. Refer to Note 17 for further information on significant customers. We perform ongoing credit evaluations of our customers' financial condition but generally do not require collateral or other security to support customer receivables. We establish an allowance for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends and other financial information. As of December 31, 2012 and 2011, the allowance for doubtful accounts was \$1.8 million and \$1.2 million, respectively. Bad debt expense was immaterial for all years presented.

*Derivative Financial Instruments*

We use various financial instruments, including foreign currency forward exchange contracts and interest rate swap agreements, to manage our exposure to market fluctuations by generating cash flows that offset, in relation to their amount and timing, the cash flows of certain foreign currency denominated transactions or underlying debt instruments. We mark our foreign exchange forward contracts to fair value. The change in the fair value is recorded in current period earnings. When the derivatives qualify, we designate our foreign currency forward exchange contracts as cash flow hedges against forecasted foreign currency denominated transactions and report the effective portions of changes in fair value of the instruments in accumulated other comprehensive income (loss) until the underlying hedged transactions affect income. We designate our interest rate swap agreements as fair value or cash flow hedges against specific debt instruments and recognize interest differentials as adjustments to interest expense as the differentials may occur. We do not use financial instruments for trading or speculative purposes.

In accordance with accounting guidance, we recognize all derivatives as either assets or liabilities on our balance sheet and measure those instruments at fair value.

*Self-insurance*

We are self-insured up to specific levels for certain medical and health insurance and workers' compensation plans. Accruals are established based on actuarial assumptions and historical claim experience, and include estimated amounts for incurred but not reported claims.

*New Accounting Pronouncements*

ASU 2012-02 *Testing Indefinite Lived Intangible Assets for Impairment (Topic 350)*: In July 2012, the FASB issued ASU No. 2012-02, which allows an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. ASU 2012-02 was effective for years beginning after September 15, 2012 although early adoption was permitted.

**Note 2 Inventories**

(In millions)	December 31,	
	2012	2011
Raw materials, net	\$ 95.0	\$ 86.4
Work in progress, net	51.2	48.4
Finished goods, net	86.6	80.9
Total net inventories	\$ 232.8	\$ 215.7

**Note 3 Net Property, Plant and Equipment**

(In millions)	December 31,	
	2012	2011
Land	\$ 41.9	\$ 35.4
Buildings	298.3	278.7
Equipment	783.4	732.0
Construction in progress	335.6	177.4
Property, plant and equipment	1,459.2	1,223.5
Less accumulated depreciation	(544.8)	(501.4)
Net property, plant and equipment	\$ 914.4	\$ 722.1

Depreciation expense related to property, plant and equipment for the years ended December 31, 2012, 2011 and 2010, was \$57.2 million, \$55.3 million, and \$53.2 million, respectively. Capitalized interest of \$3.1 million and \$2.0 million for 2012 and 2011, respectively, was included in construction in progress and is associated with our carbon fiber expansion programs. Capitalized costs associated with software developed for internal use were \$2.8 million and \$1.1 million for 2012 and 2011, respectively.

As of October 1, 2012 we reassessed the estimated useful lives of certain machinery and equipment. We increased the useful lives of certain machinery and equipment from 20 years to 25 years, and increased the useful lives of certain other machinery and equipment from 10

years - 12 years to 20 years. We determined that this adjustment to the useful lives of certain assets is a change in accounting estimate and we accounted for the change prospectively; i.e. the accounting change impacts the three months ended December 31, 2012 and future periods. For the quarter and year ended December 31, 2012, the change in accounting estimate lowered depreciation expense by approximately \$1.25 million (pre-tax), which was reflected in Gross Margin, or by approximately \$0.01 earnings per basic and diluted common share.

#### Note 4 Goodwill and Purchased Intangible Assets

Changes in the carrying amount of gross goodwill and other purchased intangibles for the years ended December 31, 2012 and 2011, by segment, are as follows:

(In millions)	Composite Materials	Engineered Products	Total
Balance as of December 31, 2010	\$ 40.1	\$ 16.1	\$ 56.2
Current year additions	1.3		1.3
Currency translation adjustments and other	(0.1)		(0.1)
Balance as of December 31, 2011	\$ 41.3	\$ 16.1	\$ 57.4
Currency translation adjustments and other	0.4		0.4
<b>Balance as of December 31, 2012</b>	<b>\$ 41.7</b>	<b>\$ 16.1</b>	<b>\$ 57.8</b>

We performed our annual impairment review of goodwill as of November 30, 2012 and determined that it was more likely than not that the fair values of our reporting units were not less than their carrying values. The goodwill and intangible asset balances as of December 31, 2012 include \$3.6 million of indefinite-lived intangible assets and \$54.2 million of goodwill.

#### Note 5 Investments in Affiliated Companies

As of December 31, 2012, we have a 50% equity ownership investment in an Asian joint venture Asian Composites Manufacturing Sdn. Bhd. ( ACM ). In accordance with accounting standards we have determined that this investment is not a variable interest entity. As such, we account for our share of the operating performance of this affiliated company using the equity method of accounting.

#### Note 6 - Debt

(In millions)	December 31, 2012	December 31, 2011
Foreign operation s working capital line of credit	\$ 4.8	\$ 4.8
Current maturities of capital lease and other obligations	1.8	0.3
Current maturities of term loan	10.0	7.5
Short-term borrowings and current maturities of long-term debt	16.6	12.6
Senior secured credit facility term loan due 2015	75.0	85.0
Senior secured credit facility revolving loan due 2015	165.0	78.0
6.75% senior subordinated notes due 2015		73.5



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Capital lease and other obligations		1.8
Long-term notes payable and capital lease obligations	240.0	238.3
Total debt	\$ 256.6	\$ 250.9

*Estimated Fair Values of Notes Payable*

The approximate, aggregate fair value of our notes payable as of December 31, 2012 and 2011 were as follows:

(In millions)	December 31, 2012	December 31, 2011
6.75% senior subordinated notes, due 2015	\$	\$ 74.0
Senior secured credit facility term loan due 2015	\$ 85.0	\$ 93.0

The aggregate fair values of the notes payable were estimated on the basis of quoted market prices.

*Senior Secured Credit Facility*

Hexcel Corporation has a \$460 million senior secured credit facility (the Facility), consisting of a \$360 million revolving loan and a \$100 million term loan. The facility was increased by \$75 million in 2012 to fund the repurchase of the remaining 6.75% Senior Subordinated Notes due in 2015. The Facility matures on July 9, 2015. The interest rate on the Facility is LIBOR plus 2.75% and ranges down to LIBOR plus 2% depending upon the leverage ratio. For the years ended December 31, 2012 and 2011, our leverage ratio was less than 1.75; accordingly in 2012 and 2011 the margin paid on our borrowing rate was 2%. The term loan was borrowed at closing and once repaid cannot be reborrowed. The term loan is scheduled to be repaid at a current rate of \$2.5 million per quarter, with two payments of \$10.0 million in September 2014 and December 2014 and two final \$25.0 million payments in March and June 2015.

The Facility permits us to issue letters of credit up to an aggregate amount of \$40 million and allows us to draw up to \$75 million in Euros. Amounts drawn in Euros or any outstanding letters of credit reduce the amount available for borrowing under the revolving loan. As of December 31, 2012, we had \$165.0 million of borrowings under the revolving loan and we had issued letters of credit totaling \$2.2 million under the Facility. Total undrawn availability under the Senior Secured Credit Facility as of December 31, 2012 was \$192.8 million.

The credit agreement contains financial and other covenants including, but not limited to, restrictions on the incurrence of debt and the granting of liens, as well as the maintenance of an interest coverage ratio and a leverage ratio, and limitations on capital expenditures. In accordance with the terms of the 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 Facility. In addition, the Facility contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default. A violation of any of these covenants could result in a default under the credit agreement, which would permit the lenders to accelerate the payment of all borrowings and to terminate the credit agreement. In addition, such a default could, under certain circumstances, permit the holders of other outstanding unsecured debt to accelerate the repayment of such obligations. As of December 31, 2012, we were in compliance with all debt covenants and expect to remain in compliance.

Additionally, at December 31, 2012 we have interest rate swaps totaling approximately \$160 million that expire in March 2014. These interest rate swaps are designated as cash flow hedges to our term loan. The interest rate swaps trade LIBOR for a fixed rate at an average rate of 0.8625%.

*6.75% Senior Subordinated Notes, due 2015*

On February 1, 2005, we issued \$225 million of 6.75% senior subordinated notes due 2015. As of June 2012, all of the outstanding notes were redeemed. The notes were unsecured senior subordinated obligations of Hexcel Corporation. Interest accrued at the rate of 6.75% per annum and were payable semi-annually in arrears on February 1 and August 1.

In June 2012 and February 2011, we redeemed \$73.5 million and \$150 million of these notes at a call premium of 1.125% and 2.25%, respectively. The redemptions were primarily funded by a \$75 million and \$135.0 million add-on to the Facility in 2012 and December 2010. As a result of the redemptions, we accelerated the unamortized financing costs of the senior subordinated notes being redeemed and expensed the call premium incurring a pretax charge of \$1.1 million (after tax of \$0.01 per diluted share) and \$4.9 million (after tax of \$0.03 per diluted share) in 2012 and 2011, respectively.

*Other Credit Facility*

We have a \$12.0 million borrowing facility for working capital needs of our Chinese entity with an outstanding balance of \$4.8 million on December 31, 2012. The facility contains a \$10.0 million revolving credit line and a \$2.0 million factoring facility. The factoring facility was not used in 2012. These funds can only be used locally, and accordingly, we do not include this facility in our borrowing capacity disclosures. The facility expires on September 6, 2013 and is guaranteed by Hexcel Corporation.

*Aggregate Maturities of Debt*

The table below reflects aggregate scheduled maturities of notes payable, excluding capital lease obligations, as of December 31, 2012. See Note 7 for capital lease obligation maturities.

Payable during the years ending December 31:	(In millions)	
2013	\$	14.8
2014		25.0
2015		215.0
2016		
2017		
Total debt	\$	254.8

#### Note 7 - Leasing Arrangements

We have a capital lease for a building, with an obligation of \$1.8 million as of December 31, 2012 that contains a purchase option which was exercised on February 1, 2013. We have a contract to sell the building in March 2013. The expected gain of the sale will not be material. The related assets, accumulated depreciation, and related liability balances under capital leasing arrangements, as of December 31, 2012 and 2011, were:

(In millions)	2012		2011	
Property, plant and equipment	\$	3.7	\$	3.7
Less accumulated depreciation		(1.6)		(1.6)
Net property, plant and equipment	\$	2.1	\$	2.1
Capital lease obligations	\$	1.8	\$	2.0
Less current maturities		(1.8)		(0.2)
Long-term capital lease obligations, net	\$		\$	1.8

In addition to the capital lease above, certain sales and administrative offices, data processing equipment and manufacturing facilities are leased under operating leases. We recognize rental expense on operating leases straight-line over the term of a lease. Total rental expense was \$15.4 million in 2012, \$15.2 million in 2011 and \$15.0 million in 2010.

Scheduled future minimum lease payments as of December 31, 2012 were:

(In millions)	Type of Lease			
Payable during the years ending December 31:	Capital		Operating	
2013	\$	1.8	\$	9.1
2014				5.8
2015				2.9
2016				2.2
2017				1.9
Thereafter				10.5
Total minimum lease payments		1.8	\$	32.4
Less amounts representing interest				
Present value of future minimum capital lease payments	\$	1.8		

#### Note 8 Retirement and Other Postretirement Benefit Plans

We maintain qualified defined benefit retirement plans covering certain current and former European employees, as well as nonqualified defined benefit retirement plans and retirement savings plans covering certain eligible U.S. and European employees, and participate in a union sponsored multi-employer pension plan covering certain U.S. employees with union affiliations. In addition, we provide certain postretirement health care and life insurance benefits to eligible U.S. retirees.

Accounting standards require the use of certain assumptions, such as the expected long-term rate of return, discount rate, rate of compensation increase, healthcare cost trend rates, and retirement and mortality rates, to determine the net periodic costs of such plans. These assumptions are reviewed and set annually at the beginning of each year. In addition, these models use an attribution approach that generally spreads individual events, such as plan amendments and changes in actuarial assumptions, over the service lives of the employees in the plan. That is, employees render service over their service lives on a relatively smooth basis and therefore, the income statement effects of retirement and postretirement benefit plans are earned in, and should follow, the same pattern.

We use our actual return experience, future expectations of long-term investment returns, and our actual and targeted asset allocations to develop our expected rate of return assumption used in the net periodic cost calculations of our funded European defined benefit retirement plans. Due to the difficulty involved in predicting the market performance of certain assets, there will be a difference in any given year between our expected return on plan assets and the actual return. Following the attribution approach, each year's difference is amortized over a number of future years. Over time, the expected long-term returns are designed to approximate the actual long-term returns and therefore result in a pattern of income and expense recognition that more closely matches the pattern of the services provided by the employees.

We annually set our discount rate assumption for retirement-related benefits accounting to reflect the rates available on high-quality, fixed-income debt instruments. The rates used have dropped over the past three years and are expected to remain stable for 2013. The rate of compensation increase for nonqualified pension plans, which is another significant assumption used in the actuarial model for pension accounting, is determined by us based upon our long-term plans for such increases and assumed inflation. For the postretirement health care and life insurance benefits plan, we review external data and its historical trends for health care costs to determine the health care cost trend rates. Retirement and termination rates are based primarily on actual plan experience. The mortality table used for the U.S. plans is based on the RP2000 Mortality Table projected to 2019 and for the U.K. Plans the S1NA table with CMI2011 projections (1.5% p.a. future improvements).

Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect the net periodic costs and recorded obligations in such future periods. While we believe that the assumptions used are appropriate, significant changes in economic or other conditions, employee demographics, retirement and mortality rates, and investment performance may materially impact such costs and obligations.

#### *U.S. Defined Benefit Retirement Plans*

We have nonqualified defined benefit retirement plans covering certain current and former U.S. employees that are funded as benefits are incurred. Under the provisions of these plans, we expect to contribute approximately \$0.2 million in 2013 to cover unfunded benefits.

#### *Multi-Employer Plan*

The Company is party to a multi-employer pension plan covering certain U.S. employees with union affiliations. The plan is the Western Metal Industry Pension Fund, (the Plan). The Plan's employer identification number is 91-6033499; the Plan number is 001. In 2011, the Plan again reported Hexcel Corporation as being an employer that contributed greater than 5% of the Plan's total contributions. The expiration date of the collective bargaining agreement and minimum funding arrangements is September 30, 2015. The Plan has been listed in critical status and has been operating in accordance with a Rehabilitation Plan since 2010. This amendment reduced the adjustable benefits of the participants and levied a surcharge on employer contributions. We expect the Company's contribution to be about \$1.0 million in 2013 and remain at that level over the next few years.

#### *U.S. Retirement Savings Plan*

Under the retirement savings plan, eligible U.S. employees can contribute up to 75% of their annual compensation to an individual 401(k) retirement savings account. The Company makes matching contributions equal to 50% of employee contributions, not to exceed 3% of

employee compensation each year. We also contribute an additional 2% to 4% of each eligible employee's salary to an individual 401(k) retirement savings account, depending on the employee's age. This increases the maximum contribution to individual employee savings accounts to between 5% and 7% per year, before any profit sharing contributions that are made when we meet or exceed certain performance targets that are set annually. These profit sharing contributions are made at the Company's discretion and are targeted at 3% of an eligible employee's pay, with a maximum of 4.5%.

*U.S. Postretirement Plans*

In addition to defined benefit and retirement savings plan benefits, we also provide certain postretirement health care and life insurance benefits to eligible U.S. retirees. Depending upon the plan, benefits are available to eligible employees who retire after meeting certain age and service requirements and were employed by Hexcel as of February 1996. Our funding policy for the postretirement health care and life insurance benefit plans is generally to pay covered expenses as they are incurred. Under the provisions of these plans, we expect to contribute approximately \$0.6 million in 2013 to cover unfunded benefits.

*European Defined Benefit Retirement Plans*

We have defined benefit retirement plans in the United Kingdom, Belgium, France and Austria covering certain employees of our subsidiaries in those countries. The defined benefit plan in the United Kingdom (the U.K. Plan), the largest of the European plans, was terminated in 2011 and replaced with a defined contribution plan. We recorded a curtailment gain of \$5.7 million (after tax gain of \$0.04 per diluted share) to recognize previously unrecognized prior service credits. As of December 31, 2012, 57% of the total assets in the U.K. Plan were invested in equities. Equity investments are made with the objective of achieving a return on plan assets consistent with the funding requirements of the plan, maximizing portfolio return and minimizing the impact of market fluctuations on the fair value of the plan assets. As a result of an annual review of historical returns and market trends, the expected long-term weighted average rate of return for the U.K. Plan for the 2013 plan year will be 6.5% and 4.0% to 4.5% for the other European Plans as a group.

*UK Defined Contribution Pension Plan*

Under the Defined Contribution Section, eligible UK employees can belong to the Deferred Contribution Plan on a non-participatory basis or can elect to contribute 3%, 5% or 7% of their pensionable salary. The Company will contribute 5%, 9% and 13% respectively. The plan also provides life insurance and disability insurance benefits for members.

*Retirement and Other Postretirement Plans - France*

The employees of our French subsidiaries are entitled to receive a lump-sum payment upon retirement subject to certain service conditions under the provisions of the national chemicals and textile workers collective bargaining agreements. The amounts attributable to the French plans have been included within the total expense and obligation amounts noted for the European plans.

*Net Periodic Pension Expense*

Net periodic expense for our U.S. and European qualified and nonqualified defined benefit pension plans and our retirement savings plans for the three years ended December 31, 2012 is detailed in the table below.

<b>(In millions)</b>	<b>2012</b>		<b>2011</b>		<b>2010</b>	
Defined benefit retirement plans	\$	5.4	\$	(0.3)	\$	9.0
Union sponsored multi-employer pension plan		1.2		0.9		0.7
Retirement savings plans-matching contributions		3.3		2.9		2.5
Retirement savings plans-profit sharing contributions		7.6		8.0		6.5
Net periodic expense	\$	17.5	\$	11.5	\$	18.7

*Defined Benefit Retirement and Postretirement Plans*



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Net periodic cost of our defined benefit retirement and postretirement plans for the three years ended December 31, 2012, were:

Service cost	\$	1.3	\$	1.5	\$	1.2	\$	0.5	\$	1.1	\$	3.7
Interest cost		1.1		1.1		1.0		6.6		7.2		7.3
Expected return on plan assets								(7.3)		(7.8)		(6.3)
Net amortization		2.3		1.6		0.9		0.9		0.7		1.2
Curtailement gain										(5.7)		
Net periodic pension cost (income)	\$	4.7	\$	4.2	\$	3.1	\$	0.7	\$	(4.5)	\$	5.9

(In millions)

U.S. Postretirement Plans	2012	2011	2010
Service cost	\$	\$	\$
Interest cost	0.3	0.4	0.5
Net amortization and deferral	(0.5)	(0.3)	(0.2)
Net periodic postretirement benefit (income) cost	\$	0.1	\$
	(0.2)		0.4

(In millions)	Defined Benefit Retirement Plans					
	U.S. Plans		European Plans		Postretirement Plans	
	2012	2011	2012	2011	2012	2011
<b>Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income</b>						
Net loss (gain)	\$ 3.1	\$ 3.3	\$ 12.1	\$ 7.9	\$ 0.1	\$ (1.6)
Amortization of actuarial losses	(2.2)	(1.5)	(0.9)	(0.9)		
Amortization of prior service credit (cost)	(0.1)	(0.1)		5.9	0.5	0.4
Effect of foreign exchange			1.9	(0.6)		
Total recognized in other comprehensive income (pre-tax)	\$ 0.8	\$ 1.7	\$ 13.1	\$ 12.3	\$ 0.6	\$ (1.2)

The Company expects to recognize \$3.3 million of net actuarial loss and an immaterial net prior service cost as a component of net periodic pension cost in 2013 for its defined benefit plans. The recognition of net prior service credit and net actuarial gain as a component of net periodic postretirement benefit cost in 2013 is expected to be immaterial.

The benefit obligation, fair value of plan assets, funded status, and amounts recognized in the consolidated financial statements for our defined benefit retirement plans and postretirement plans, as of and for the years ended December 31, 2012 and 2011, were:

(In millions)	Defined Benefit Retirement Plans					
	U.S. Plans		European Plans		Postretirement Plans	
	2012	2011	2012	2011	2012	2011
<b>Change in benefit obligation:</b>						
Benefit obligation - beginning of year	\$ 33.4	\$ 27.8	\$ 139.8	\$ 134.1	\$ 8.0	\$ 9.4
Service cost	1.3	1.5	0.5	1.1		
Interest cost	1.1	1.1	6.6	7.2	0.3	0.4
Plan participants' contributions			0.1	0.1	0.1	0.3
Actuarial loss (gain)	3.1	3.3	15.2	4.5	0.1	(1.5)
Benefits and expenses paid	(0.3)	(0.3)	(3.7)	(4.7)	(0.4)	(0.6)
Curtailment and settlements				(1.7)		
Currency translation adjustments			6.3	(0.8)		
Benefit obligation - end of year	\$ 38.6	\$ 33.4	\$ 164.8	\$ 139.8	\$ 8.1	\$ 8.0
<b>Change in plan assets:</b>						
Fair value of plan assets - beginning of year	\$	\$	\$ 110.8	\$ 106.9	\$	\$
Actual return on plan assets			10.3	2.7		
Employer contributions	0.3	0.3	5.7	6.2	0.3	0.3
Plan participants' contributions			0.1	0.1	0.1	0.3
Benefits and expenses paid	(0.3)	(0.3)	(3.7)	(4.7)	(0.4)	(0.6)
Currency translation adjustments			5.1	(0.4)		
Fair value of plan assets - end of year	\$	\$	\$ 128.3	\$ 110.8	\$	\$
<b>Amounts recognized in Consolidated Balance Sheets:</b>						
Current liabilities	\$ 0.3	\$ 0.3	\$ 0.4	\$ 0.4	\$ 0.6	\$ 0.7
Non-current liabilities	38.3	33.1	36.1	28.6	7.5	7.3

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Total Liabilities	\$	<b>38.6</b>	\$	33.4	\$	<b>36.5</b>	\$	29.0	\$	<b>8.1</b>	\$	8.0
<b>Amounts recognized in Accumulated Other Comprehensive Income:</b>												
Actuarial net (loss) gain	\$	<b>(10.2)</b>	\$	(9.4)	\$	<b>(49.7)</b>	\$	(36.6)	\$	<b>3.1</b>	\$	3.7
Prior service cost		<b>(0.2)</b>		(0.2)		<b>(0.1)</b>		(0.1)				
Total amounts recognized in accumulated other comprehensive (loss) income	\$	<b>(10.4)</b>	\$	(9.6)	\$	<b>(49.8)</b>	\$	(36.7)	\$	<b>3.1</b>	\$	3.7

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The measurement date used to determine the benefit obligations and plan assets of the defined benefit retirement and postretirement plans was December 31, 2012.

The total accumulated benefit obligation ( ABO ) for the U.S. defined benefit retirement plans was \$38.0 million and \$33.0 million as of December 31, 2012 and 2011, respectively. The European Plans ABO exceeded plan assets as of December 31, 2012 and 2011, by \$32.3 million and \$25.8 million, respectively. These plans ABO was \$160.6 million and \$136.6 million as of December 31, 2012 and 2011, respectively.

As of December 31, 2012 and 2011, the accrued benefit costs for the defined benefit retirement plans and postretirement benefit plans included within accrued compensation and benefits was \$1.3 million and \$1.4 million, respectively, and within other non-current liabilities was \$81.9 million and \$69.0 million, respectively, in the accompanying consolidated balance sheets.

Benefit payments for the plans are expected to be as follows:

(In millions)	U.S. Plans	European Plans	Postretirement Plans
2013	\$ 0.2	\$ 3.9	\$ 0.6
2014	3.3	3.7	0.9
2015	24.3	4.0	0.8
2016	1.6	4.9	0.7
2017	4.2	5.9	0.7
2018-2022	5.9	35.2	3.0
	\$ 39.5	\$ 57.6	\$ 6.7

*Fair Values of Pension Assets*

The following table presents pension assets measured at fair value at December 31, 2012 and 2011 utilizing the fair value hierarchy discussed in Note 20:

(In millions) Description	December 31, 2012		Fair Value Measurements at December 31, 2012	
	Level 1	Level 2	Level 3	
Equity funds	\$ 70.0	\$ 70.0		
Active corporate bond fund	52.1	52.1		
Diversified investment funds	3.1	0.3		2.8
Insurance contracts	3.1			3.1
Total assets	\$ 128.3	\$ 122.4		\$ 5.9

December 31,

Fair Value Measurements at December 31, 2011

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Description	2011	Level 1	Level 2	Level 3
Equity funds	\$ 59.7	\$	\$ 59.7	\$
Active corporate bond fund	45.6		45.6	
Diversified investment funds	2.9		0.4	2.5
Insurance contracts	2.6			2.6
Total assets	\$ 110.8	\$	\$ 105.7	\$ 5.1

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(In millions)	Balance at January 1, 2012	Actual return on plan assets	Purchases, sales and settlements	Changes due to exchange rates	Balance at December 31, 2012
<b>Reconciliation of Level 3 Assets</b>					
Diversified investment funds	\$ 2.5	\$ 0.2	\$ 0.1	\$	\$ 2.8
Insurance contracts	2.6	0.2	0.2	0.1	3.1
Total level 3 assets	\$ 5.1	\$ 0.4	\$ 0.3	\$ 0.1	\$ 5.9

	Balance at January 1, 2011	Actual return on plan assets	Purchases, sales and settlements	Changes due to exchange rates	Balance at December 31, 2011
<b>Reconciliation of Level 3 Assets</b>					
Diversified investment funds	\$ 2.8	\$	\$ (0.3)	\$	\$ 2.5
Insurance contracts	2.7	0.1	(0.1)	(0.1)	2.6
Total level 3 assets	\$ 5.5	\$ 0.1	\$ (0.4)	\$ (0.1)	\$ 5.1

Plan assets are invested in a number of unit linked pooled funds by an independent asset management group. Equity funds are split 51/49 between U.K. and overseas equity funds (North America, Japan, Asia Pacific and Emerging Markets). The asset management firm uses quoted prices in active markets to value the assets.

The Bond Allocation is invested in a number of Active Corporate Bond funds which are pooled funds. The Corporate Bond funds primarily invest in corporate fixed income securities denominated in British Pounds Sterling with credit ratings of BBB- and above. We use quoted prices in active markets to value the assets.

Diversified investment funds are invested in an external pension fund which in turn invests in a range of asset classes including equities and government and corporate bonds, hedge funds and private equity. The fair value of the assets is equal to the fair value of the assets as of January 1, 2012, as provided by the external pension fund, adjusted for cash flows over the year and the estimated investment return on underlying assets over the year.

Insurance contracts contain a minimum guaranteed return. The fair value of the assets is equal to the total amount of all individual technical reserves plus the non-allocated employer's financing fund reserves at the valuation date. The individual technical and financing fund reserves are equal to the accumulated paid contributions taking into account the insurance tariffication and any allocated profit sharing return.

The actual allocations for the pension assets at December 31, 2012 and 2011, and target allocations by asset class, are as follows:

Asset Class	Percentage Of Plan Assets 2012	Target Allocations 2012	Percentage Of Plan Assets 2011	Target Allocations 2011
U.K. Equity Fund	28.0%	28.6%	27.8%	31.0%
Overseas Equity Fund	26.6	28.6	26.1	31.0
Active Corporate Bond Funds	40.6	38.2	41.1	32.9
Insurance Contracts	2.4	2.4	2.4	2.6
Diversified Investment Funds	2.4	2.2	2.6	2.5
Total	100%	100%	100%	100%

*Assumptions*

The assumed discount rate for pension plans reflects the market rates for high-quality fixed income debt instruments currently available. We used the Mercer Yield Curve to set our discount rate for the European plans, the U.S. non-qualified plans and the U.S. postretirement plans. We believe that the timing and amount of cash flows related to these instruments is expected to match the estimated defined benefit payment streams of our plans.

Salary increase assumptions are based on historical experience and anticipated future management actions. For the postretirement health care and life insurance benefit plans, we review external data and our historical trends for health care costs to determine the health care cost trend rates. Retirement rates are based primarily on actual plan experience and on rates from previously mentioned mortality tables. Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect the net periodic costs and recorded obligations in such future periods. While we believe that the assumptions used are appropriate, significant changes in economic or other conditions, employee demographics, retirement and mortality rates, and investment performance may materially impact such costs and obligations.

Assumptions used to estimate the actuarial present value of benefit obligations at December 31, 2012, 2011 and 2010 are shown in the following table. These year-end values are the basis for determining net periodic costs for the following year.

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	2012	2011	2010
<b>U.S. defined benefit retirement plans:</b>			
Discount rates	2.0%	3.2%	3.7%
Rate of increase in compensation	3.0% - 5.8%	3.0%	3.5%
Expected long-term rate of return on plan assets	N/A	N/A	N/A
<b>European defined benefit retirement plans:</b>			
Discount rates	3.25% - 4.5%	4.5% - 4.75%	5.0% - 5.3%
Rates of increase in compensation	3.0%	3.0%	3.0% - 4.25%
Expected long-term rates of return on plan assets	4.0% 6.5%	4.25% 6.5%	4.5% 7.0%
<b>Postretirement benefit plans:</b>			
Discount rates	2.75%	3.85%	4.45%

The following table presents the impact that a one-percentage-point increase and a one-percentage-point decrease in the expected long-term rate of return and discount rate would have on the 2013 pension expense, and the impact on our retirement obligation as of December 31, 2012 for a one-percentage-point change in the discount rate:

(In millions)	Non-Qualified Pension Plans	Retiree Medical Plans	U.K. Retirement Plan
<b>Periodic pension expense</b>			
<b>One-percentage-point increase:</b>			
Expected long-term rate of return	\$ N/A	\$ N/A	\$ (1.1)
Discount rate	\$ (0.1)	\$ 0.1	\$ (0.7)
<b>One-percentage-point decrease:</b>			
Expected long-term rate of return	\$ N/A	\$ N/A	\$ 1.2
Discount rate	\$ 0.1	\$ (0.1)	\$ 0.8
<b>Retirement obligation</b>			
One-percentage-point increase in discount rate	\$ (1.3)	\$ (0.5)	\$ (28.1)
One-percentage-point decrease in discount rate	\$ 1.4	\$ 0.5	\$ 34.5

The annual rate of increase in the per capita cost of covered health care benefits is assumed to be 7.1% for medical and 5.0% for dental and vision for 2013. The medical rates are assumed to gradually decline to 4.5% by 2025, whereas dental and vision rates are assumed to remain constant at 5.0%. A one-percentage-point increase and a one-percentage-point decrease in the assumed health care cost trend would have an insignificant impact on the total of service and interest cost components, and would have an unfavorable and a favorable impact of approximately \$0.2 million and \$0.2 million on the postretirement benefit obligation for both 2012 and 2011, respectively.

**Note 9 - Income Taxes**

Income before income taxes and the provision for income taxes, for the three years ended December 31, 2012, were as follows:

(In millions)	2012	2011	2010
<b>Income before income taxes:</b>			
U.S.	\$ 137.4	\$ 106.3	\$ 54.3



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International		<b>100.3</b>		69.2		45.5
Total income before income taxes	\$	<b>237.7</b>	\$	175.5	\$	99.8
Provision for income taxes:						
Current:						
U.S.	\$	<b>36.9</b>	\$	10.6	\$	1.1
International		<b>20.7</b>		7.6		5.7
Current provision for income taxes		<b>57.6</b>		18.2		6.8
Deferred:						
U.S.		<b>10.4</b>		24.4		15.1
International		<b>6.1</b>		(1.0)		1.0
Deferred provision for income taxes		<b>16.5</b>		23.4		16.1
Total provision for income taxes	\$	<b>74.1</b>	\$	41.6	\$	22.9

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A reconciliation of the provision for income taxes at the U.S. federal statutory income tax rate of 35% to the effective income tax rate, for the three years ended December 31, 2012, is as follows:

(In millions)	2012	2011	2010
Provision for taxes at U.S. federal statutory rate	\$ 83.2	\$ 61.5	\$ 34.9
State and local taxes, net of federal benefit	2.2	2.2	1.8
Foreign effective rate differential	(10.3)	(8.4)	(7.3)
Other		1.3	1.4
Foreign Tax Credit Carryforwards	(0.7)	(2.4)	(3.2)
U.S. Research & Development Tax Credits	0.5	(1.0)	(1.3)
Tax Settlement	0.2	(5.5)	
Wind Energy Tax Credit		(0.1)	(3.5)
Change in valuation allowance	(1.0)	(6.0)	0.1
Total provision for income taxes	\$ 74.1	\$ 41.6	\$ 22.9

We have not included a benefit for U.S. Research & Development Tax Credit ( R&D credit ) in our 2012 tax provision due to the expiration of the tax credit at December 31, 2011. On January 2, 2013, the American Taxpayer Relief Act of 2012 (HR 8) was signed, which reinstated the R&D credit for the years ended December 31, 2012 and 2013. Since the law was signed in 2013, the full year credit for 2012 will be included as a discrete catch-up adjustment in the Company's tax provision for the first quarter ended March 31, 2013.

Included in the 2011 provision were certain tax benefits relating to the reversal of valuation allowances on net operating losses in certain foreign jurisdictions and U.S. foreign tax credit carryforwards as it became more likely than not that these deferred tax assets would be realized. The 2011 provision also reflects the favorable impact of a tax audit settlement in one of the foreign jurisdictions. These benefits totaled \$11.3 million.

As of December 31, 2012 and 2011, we do not have a U.S. income tax provision for undistributed earnings of international subsidiaries. We do not currently have any specific plans to repatriate funds from our international subsidiaries, however we may do so in the future if a dividend can be remitted with no material tax impact. Such earnings are considered to be permanently reinvested. Estimating the tax liability that would result if these earnings were repatriated is not practicable at this time.

*Deferred Income Taxes*

Deferred income taxes result from tax attributes including foreign tax credits, net operating loss carryforwards and temporary differences between the recognition of items for income tax purposes and financial reporting purposes. Principal components of deferred income taxes as of December 31, 2012 and 2011 are:

(In millions)	2012	2011
<b>Assets</b>		
Net operating loss carryforwards	\$ 56.2	\$ 64.2
Unfunded pension liability and other postretirement obligations	15.3	13.8
Advanced payments from foreign affiliates	22.3	18.8
Tax credit carryforwards	35.4	21.0
Stock based compensation	12.6	11.3

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Other comprehensive income		<b>14.0</b>		13.4
Reserves and other		<b>14.7</b>		14.7
Subtotal		<b>170.5</b>		157.2
Valuation allowance		<b>(49.4)</b>		(39.4)
Total assets	\$	<b>121.1</b>	\$	117.8
<b>Liabilities</b>				
Accelerated depreciation		<b>(50.1)</b>		(39.4)
Accelerated amortization		<b>(8.2)</b>		(1.2)
Other		<b>(0.2)</b>		(0.4)
Total liabilities	\$	<b>(58.5)</b>	\$	(41.0)
Net deferred tax asset	\$	<b>62.6</b>	\$	76.8

Deferred tax assets and deferred tax liabilities as presented in the consolidated balance sheets as of December 31, 2012 and 2011 are as follows and are recorded in prepaid expenses and other current assets, deferred tax assets, other accrued liabilities and other non-current liabilities in the consolidated balance sheets:

(In millions)	2012		2011	
Current deferred tax assets, net	\$	62.5	\$	45.1
Current deferred tax liability, net		(0.2)		(0.1)
Long-term deferred tax assets, net		15.4		33.0
Long-term deferred tax liability, net		(15.1)		(1.2)
Net deferred tax assets	\$	62.6	\$	76.8

The deferred tax assets for the respective periods were assessed for recoverability and, where applicable, a valuation allowance was recorded to reduce the total deferred tax asset to an amount that will, more likely than not, be realized in the future. The net change in the total valuation allowance for the years ended December 31, 2012 and 2011 was an increase of \$10.0 million and an increase of \$2.9 million, respectively. The valuation allowance as of December 31, 2012 and 2011 relates primarily to net operating loss carryforwards of our foreign subsidiaries, and certain state net operating loss carryforwards for which we have determined, based upon historical results and projected future book and taxable income levels, that a valuation allowance should continue to be maintained.

Although realization is not assured, we have concluded that it is more-likely-than-not that the deferred tax assets, for which a valuation allowance was determined to be unnecessary, will be realized in the ordinary course of operations based on the available positive and negative evidence, including scheduling of deferred tax liabilities and projected income from operating activities. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if actual future income or income tax rates are lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable or deductible temporary differences.

#### *Net Operating Loss & Tax Credit Carryforwards*

At December 31, 2012, we had tax credit carryforwards for U.S. tax purposes of \$35.4 million available to offset future income taxes. These credits will begin to expire if not utilized in 2013.

We also have net operating loss carryforwards for foreign income tax purposes of \$194.8 million, for which there are valuation allowances of \$172.3 million as of December 31, 2012. Our foreign net operating losses can be carried forward without limitation in Belgium, Luxembourg and UK. The carryforward period in Spain and China is limited to 18 and 5 years, respectively. We have a full valuation allowance against certain foreign net operating losses for which the Company believes it is not more likely than not that the net operating losses will be utilized.

#### *Uncertain Tax Positions*

Our unrecognized tax benefits at December 31, 2012, relate to various Foreign and U.S. jurisdictions.

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The following table summarizes the activity related to our unrecognized tax benefits:

(In millions)	Unrecognized Tax Benefits					
		2012		2011		2010
Balance as of January 1,	\$	12.5	\$	20.1	\$	19.4
Additions based on tax positions related to the current year		1.7		1.5		2.6
Additions/(Reductions) for tax positions of prior years		19.0		(1.1)		
Decreases relating to settlements with tax authorities				(6.7)		
Expiration of the statute of limitations for the assessment of taxes		(0.8)		(1.6)		(0.5)
Other, including currency translation		0.2		0.3		(1.4)
<b>Balance as of December 31,</b>	<b>\$</b>	<b>32.6</b>	<b>\$</b>	<b>12.5</b>	<b>\$</b>	<b>20.1</b>

Included in the unrecognized tax benefits of \$32.6 million at December 31, 2012 was \$32.3 million of tax benefits that, if recognized, would impact our annual effective tax rate. In addition, we recognize interest accrued related to unrecognized tax benefits as a component of interest expense and penalties as a component of income tax expense in the consolidated statements of operations.

The Company recognized \$0.1 million, (\$0.1) million, (\$1.4) million of interest expense (income) related to the above unrecognized tax benefits in 2012, 2011 and 2010, respectively. The Company had accrued interest of approximately \$0.9 million and \$0.8 million as of December 31, 2012 and 2011, respectively. During 2012 and 2011, we reversed interest of \$0.1 million and \$0.2 million respectively related to the unrecognized tax benefits.

We are subject to taxation in the U.S. and various states and foreign jurisdictions. The U.S. federal statute of limitations remains open for prior years; however the U.S. tax returns have been audited through 2007. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from 3 to 5 years. Years still open to examination by foreign tax authorities in major jurisdictions include Austria (2006 onward), Belgium (2010 onward), France (2010 onward), Spain (2004 onward) and UK (2010 onward). We are currently under examination in certain of the foreign jurisdictions.

As of December 31, 2012, we had uncertain tax positions for which it is reasonably possible that amounts of unrecognized tax benefits could significantly change over the next year. These uncertain tax positions relate to our tax returns from 2004 onward, some of which are currently under examination by certain European tax authorities. During 2011, the Company settled an audit with foreign tax authorities in one of the jurisdictions under examination. The favorable settlement resulted in a reduction of uncertain tax benefits of approximately \$5.5 million which was recognized in 2011. As of December 31, 2012, the Company has not classified any of the unrecognized tax benefits as a current liability as it does not expect to settle any of the tax positions under examinations in various jurisdictions within the next twelve months.

We expect that the amount of unrecognized tax benefits will continue to change in the next twelve months as a result of ongoing tax deductions, the resolution of audits and the passing of the statute of limitations. We are unable to make a reliable estimate of the eventual cash flows of the \$32.6 million of unrecognized tax benefits.

#### Note 10 - Capital Stock

##### *Common Stock Outstanding*

Common stock outstanding as of December 31, 2012, 2011 and 2010 was as follows:

(Number of shares in millions)	2012	2011	2010
<b>Common stock:</b>			
Balance, beginning of year	101.0	99.5	98.6
Activity under stock plans	1.4	1.5	0.9
Balance, end of year	102.4	101.0	99.5
<b>Treasury stock:</b>			
Balance, beginning of year	2.2	2.2	2.0
Issued under stock plans		(0.5)	
Repurchased	0.3	0.5	0.2
Balance, end of year	2.5	2.2	2.2
Common stock outstanding	99.9	98.8	97.3

**Note 11 Stock-Based Compensation**

The following table details the stock-based compensation expense by type of award for the years ended December 31, 2012, 2011 and 2010:

<b>(In millions, except per share data)</b>	<b>Year Ended December 31,</b>					
	<b>2012</b>		<b>2011</b>		<b>2010</b>	
Non-qualified stock options	\$	<b>4.5</b>	\$	4.1	\$	3.9
Restricted stock, service based ( RSUs )		<b>6.5</b>		5.0		4.9
Restricted stock, performance based ( PRSUs )		<b>4.6</b>		4.7		3.5
Employee stock purchase plan		<b>0.2</b>		0.1		0.1
Stock-based compensation expense	\$	<b>15.8</b>	\$	13.9	\$	12.4
Tax benefit from stock options exercised during the period	\$	<b>6.8</b>	\$	8.5	\$	3.9

*Non-Qualified Stock Options*

Non-qualified stock options have been granted to our employees and directors under our stock compensation plan. Options granted generally vest over three years and expire ten years from the date of grant.

A summary of option activity under the plan for the three years ended December 31, 2012 is as follows:

	Number of Options (In millions)	Weighted- Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)
<b>Outstanding at December 31, 2009</b>	4.1	\$ 10.67	5.06
Options granted	0.9	\$ 10.92	
Options exercised	(0.4)	\$ 8.54	
Options expired or forfeited	(0.1)	\$ 14.68	
<b>Outstanding at December 31, 2010</b>	4.5	\$ 10.84	5.16
Options granted	0.6	\$ 19.19	
Options exercised	(1.6)	\$ 8.17	
Options expired or forfeited	(0.1)	\$ 12.93	
<b>Outstanding at December 31, 2011</b>	3.4	\$ 13.55	6.45
Options granted	0.5	\$ 25.03	
Options exercised	(0.6)	\$ 10.41	
Options expired or forfeited		\$ 21.82	
<b>Outstanding at December 31, 2012</b>	3.3	\$ 15.67	6.26

(In millions, except weighted average exercise price)	Year Ended December 31,	
	2012	2011
Aggregate intrinsic value of outstanding options	\$ 37.4	\$ 38.0
Aggregate intrinsic value of exercisable options	\$ 29.5	\$ 21.9
Total intrinsic value of options exercised	\$ 9.1	\$ 22.7
Total number of options exercisable	2.2	2.1
Weighted average exercise price of options exercisable	\$ 13.57	\$ 13.38
Total unrecognized compensation cost on nonvested options (a)	\$ 2.1	\$ 2.1

(a) Unrecognized compensation cost relates to nonvested stock options and is expected to be recognized over the remaining vesting period ranging from one year to three years.

The following table summarizes information about non-qualified stock options outstanding as of December 31, 2012:

Range of Exercise Prices	Number of Options Outstanding (a)	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Life (in Years)	Weighted Average Exercise Price	Number of Options Exercisable (a)	Weighted Average Exercise Price
\$ 6.68 10.90	1.4	6.30	\$ 9.35	1.1	\$ 8.98



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	14.51						
\$	21.11	1.3	5.66	\$	18.44	0.9	\$ 17.71
	22.00						
\$	25.84	0.6	7.41	\$	24.18	0.2	\$ 22.03
\$	6.68 25.84	3.3	6.26	\$	15.67	2.2	\$ 13.57

(a) in millions

*Valuation Assumptions in Estimating Fair Value*

We estimated the fair value of stock options at the grant date using the Black-Scholes option pricing model with the following assumptions for the years ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Risk-free interest rate	0.83%	1.88%	2.40%
Expected option life (in years) Executive	5.44	4.84	5.51
Expected option life (in years) Non-Executive	4.45	4.71	4.40
Dividend yield	%	%	%
Volatility	45.76%	44.08%	49.20%
Weighted-average fair value per option granted	\$ 10.24	\$ 7.65	\$ 4.95

We determine the expected option life for each grant based on ten years of historical option activity for two separate groups of employees (executive and non-executive). The weighted-average expected life ( W A E L ) is derived from the average midpoint between the vesting and the contractual term and considers the effect of both the inclusion and exclusion of post-vesting cancellations during the ten-year period. Expected volatility is calculated based on a blend of both historic volatility of our common stock and implied volatility of our traded options. We weigh both volatility inputs equally and utilize the average as the volatility input for the Black-Scholes calculation. The risk-free interest rate for the expected term is based on the U.S. Treasury yield curve in effect at the time of grant and corresponding to the expected term. No dividends were paid in either period; furthermore, we do not plan to pay any dividends in the future.

*Restricted Stock Units Service Based*

As of December 31, 2012, a total of 840,280 shares of service based restricted stock ( RSUs ) were outstanding, which vest based on years of service under the 2003 incentive stock plan. RSUs are granted to key employees, executives and directors of the Company. The fair value of the RSU is based on the closing market price of the Company s common stock on the date of grant and is amortized on a straight line basis over the requisite service period. The stock-based compensation expense recognized is based on an estimate of shares ultimately expected to vest, and therefore it has been reduced for estimated forfeitures.

The table presented below provides a summary of the Company s RSU activity for the years ended December 31, 2012, 2011 and 2010:

	Number of RSUs (In millions)	Weighted- Average Grant Date Fair Value
<b>Outstanding at December 31, 2009</b>	0.9	\$ 12.21
RSUs granted	0.4	\$ 11.41
RSUs issued	(0.3)	\$ 12.91
<b>Outstanding at December 31, 2010</b>	1.0	\$ 11.76
RSUs granted	0.3	\$ 20.63
RSUs issued	(0.4)	\$ 12.51
<b>Outstanding at December 31, 2011</b>	0.9	\$ 14.49
RSUs granted	<b>0.3</b>	<b>\$ 25.26</b>
RSUs issued	<b>(0.4)</b>	<b>\$ 12.10</b>
<b>Outstanding at December 31, 2012</b>	<b>0.8</b>	<b>\$ 18.90</b>

As of December 31, 2012, there was total unrecognized compensation cost related to nonvested RSUs of \$4.9 million, which is to be recognized over the remaining vesting period ranging from one year to three years.

*Restricted Stock Units Performance Based*

As of December 31, 2012, a total of 508,319 shares of performance based restricted stock ( PRSUs ) were outstanding under the 2003 incentive stock plan. The total amount of PRSUs that will ultimately vest is based on the achievement of various financial performance targets set forth by the Company s Compensation Committee on the date of grant. PRSUs are based on a three year performance period. Based on current projections and performance targets, it is estimated that an additional 0.4 million performance shares may be issuable for the 2010, 2011 and 2012 awards. The fair value of the PRSU is based on the closing market price of the Company s common stock on the date of grant and is

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amortized straight-line over the total three year period. A change in the performance measure expected to be achieved is recorded as an adjustment in the period in which the change occurs.

The table presented below provides a summary, of the Company's PRSU activity, at original grant amounts, for the years ended December 31, 2012, 2011 and 2010:

	Number of PRSU (In millions)	Weighted- Average Grant Date Fair Value
<b>Outstanding at December 31, 2009</b>	0.5	\$ 11.18
PRSU granted	0.3	\$ 10.95
PRSU issued	(0.1)	\$ 17.03
PRSU forfeited	(0.1)	\$ 7.37
<b>Outstanding at December 31, 2010</b>	0.6	\$ 9.77
PRSU granted	0.1	\$ 19.02
<b>Outstanding at December 31, 2011</b>	0.7	\$ 11.53
PRSU granted	<b>0.1</b>	<b>\$ 25.03</b>
PRSU additional performance shares	<b>0.2</b>	<b>\$ 8.00</b>
PRSU issued	<b>(0.5)</b>	<b>\$ 8.28</b>
<b>Outstanding at December 31, 2012</b>	<b>0.5</b>	<b>\$ 16.93</b>

As of December 31, 2012, there was total unrecognized compensation cost related to nonvested PRSUs of \$3.9 million, which is to be recognized over the remaining vesting period ranging from one year to three years. The final amount of compensation cost to be recognized is dependent upon our financial performance.

*Stock-Based Compensation Cash Activity*

During 2012, cash received from stock option exercises and from employee stock purchases was \$5.5 million. We used \$8.0 million in cash related to the shares withheld to satisfy employee tax obligations for NQOs exercised and RSUs converted during the year ended December 31, 2012. We realized a tax benefit of \$6.8 million in connection with stock options exercised and RSUs converted during 2012.

We classify the cash flows resulting from these tax benefits as financing cash flows. We either issue new shares of our common stock or utilize treasury shares upon the exercise of stock options or the conversion of stock units.

*Shares Authorized for Grant*

As of December 31, 2012, an aggregate of 1.2 million shares were authorized for future grant under our stock plan, which covers stock options, RSUs, PRSUs and at the discretion of Hexcel, could result in the issuance of other types of stock-based awards.

*Employee Stock Purchase Plan ( ESPP )*

The Company offers an ESPP, which allows for eligible employees to contribute up to 10% of their base earnings toward the quarterly purchase of our common stock at a purchase price equal to 85% of the fair market value of the common stock. There were 31,448 and 30,585 ESPP shares purchased in 2012 and 2011, respectively.

**Note 12 - Net Income Per Common Share**

Computations of basic and diluted net income per common share for the years ended December 31, 2012, 2011 and 2010, are as follows:

(In millions, except per share data)	2012	2011	2010
Net income	\$ 164.3	\$ 135.5	\$ 77.4
<b>Basic net income per common share:</b>			
Weighted average common shares outstanding	100.2	98.8	97.6

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Basic net income per common share	\$	1.64	\$	1.37	\$	0.79
<b>Diluted net income per common share:</b>						
Weighted average common shares outstanding	Basic	100.2		98.8		97.6
<i>Plus incremental shares from assumed conversions:</i>						
Restricted stock units		0.8		0.9		1.0
Stock options		1.0		1.0		1.3
Weighted average common shares outstanding	Diluted	102.0		100.7		99.9
Diluted net income per common share	\$	1.61	\$	1.35	\$	0.77
Anti-dilutive shares outstanding, excluded from computation		0.5		0.3		0.8

**Note 13 Derivative Financial Instruments***Interest Rate Swap Agreements*

In June 2012 and in 2010, we entered into agreements to swap \$75 million and \$98 million, respectively, of floating rate obligations for fixed rate obligations at 0.6725% and 1.03% against LIBOR in U.S. dollars. Both swaps are scheduled to mature in March 2014, and were accounted for as cash flow hedges of our floating rate bank loans. To ensure the swaps were highly effective, all the principal terms of the swaps matched the terms of the bank loans. The remaining balance of the swaps at December 31, 2012 was approximately \$160 million. The fair value of both interest rate swaps was a liability of \$1.0 million at December 31, 2012 and the fair value of the \$98 million interest rate swap was a liability \$0.6 million at December 31, 2011.

*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 March 2015. The aggregate notional amount of these contracts was \$201.2 million and \$168.9 million at December 31, 2012 and December 31, 2011, respectively. 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. The effective portion of the hedges was a gain of \$6.4 million, \$2.9 million and \$3.9 million, for the years ended December 31, 2012, 2011 and 2010, respectively and are recorded in other comprehensive income ( OCI ). At December 31, 2012, \$3.6 million of the carrying amount of these contracts was classified in other assets and \$1.6 million in other liabilities on the consolidated balance sheets and \$0.6 million in other assets and \$6.1 million classified in other liabilities at December 31, 2011. During the years ended December 31, 2012, 2011 and 2010, we recognized a net loss of \$3.1 million, a net gain of \$3.1 million and a net loss of \$5.7 million, respectively, recorded in gross margin. For the three years ended December 31, 2012, 2011 and 2010, hedge ineffectiveness was immaterial.

In addition, we enter into foreign exchange forward contracts which are not designated as hedges. These are used to provide an offset to transactional gains or losses arising from the remeasurement of non-functional monetary assets and liabilities such as accounts receivable. The change in the fair value of the derivatives is recorded in the statement of operations. There are no credit contingency features in these derivatives. During the years ended December 31, 2012 and 2011, we recognized a net foreign exchange gain of \$5.3 million and a loss of \$4.8 million, respectively, in the consolidated statements of operations and no gain or loss in 2010. The carrying amount of the contracts for asset and liability derivatives not designated as hedging instruments was \$3.1 million classified in other assets and \$0.1 million in other liabilities and \$0.1 million classified in other assets and \$3.8 million in other liabilities on the December 31, 2012 and 2011 consolidated balance sheets, respectively.

The activity in accumulated other comprehensive income (loss) related to foreign currency forward exchange contracts for the years ended December 31, 2012, 2011 and 2010 was as follows:

(In millions)	2012	2011	2010
<b>Unrealized losses at beginning of period</b>	\$ (4.5)	\$ (0.2)	\$ (1.4)
Gains (losses) reclassified to net sales	2.4	(2.2)	3.9

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Increase (decrease) in fair value, net of tax		<b>4.5</b>	(2.1)	(2.7)
<b>Unrealized gains (losses) at end of period</b>	\$	<b>2.4</b>	\$ (4.5)	\$ (0.2)

Unrealized gains of \$0.7 million recorded in accumulated other comprehensive gain, net of tax, as of December 31, 2012 are expected to be reclassified into earnings over the next twelve months as the hedged sales are recorded. The impact of credit risk adjustments was immaterial for the three years.

**Note 14 Commitments and Contingencies**

We are involved in litigation, investigations and claims arising out of the normal conduct of our business, including those relating to commercial transactions, environmental, employment, health and safety matters. We estimate and accrue our liabilities resulting from such matters based on a variety of factors, including the stage of the proceeding; potential settlement value; assessments by internal and external counsel; and assessments by environmental engineers and consultants of potential environmental liabilities and remediation costs. Such estimates are not discounted to reflect the time value of money due to the uncertainty in estimating the timing of the expenditures, which may extend over several years.

While it is impossible to ascertain the ultimate legal and financial liability with respect to certain contingent liabilities and claims, we believe, based upon our examination of currently available information, our experience to date, and advice from legal counsel, that the individual and aggregate liabilities resulting from the ultimate resolution of these contingent matters, after taking into consideration our existing insurance coverage and amounts already provided for, will not have a material adverse impact on our consolidated results of operations, financial position or cash flows.

#### *Environmental Matters*

We are subject to various U.S. and international federal, state and local environmental, and health and safety laws and regulations. We are also subject to liabilities arising under the Federal Comprehensive Environmental Response, Compensation and Liability Act ( CERCLA or

Superfund ), the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, and similar state and international laws and regulations that impose responsibility for the control, remediation and abatement of air, water and soil pollutants and the manufacturing, storage, handling and disposal of hazardous substances and waste.

We have been named as a potentially responsible party ( PRP ) with respect to several hazardous waste disposal sites that we do not own or possess, which are included on, or proposed to be included on, the Superfund National Priority List of the U.S. Environmental Protection Agency ( EPA ) or on equivalent lists of various state governments. Because CERCLA allows for joint and several liability in certain circumstances, we could be responsible for all remediation costs at such sites, even if we are one of many PRPs. We believe, based on the amount and nature of our waste, and the number of other financially viable PRPs, that our liability in connection with such matters will not be material.

#### *Lodi, New Jersey Site*

Pursuant to the New Jersey Industrial Site Recovery Act, Hexcel entered into an Administrative Consent Order for the environmental remediation of a manufacturing facility we own and formerly operated in Lodi, New Jersey. We have not operated this site since 1986. We have been remediating this site in accordance with a State approved plan and continue to do so under the New Jersey Licensed Site Remediation Professional program. The primary remediation activities have been completed and we now believe that the remediation has removed most of the contamination. However, there are still select contaminated areas that we will have to continue remediating using alternative methods. As a result, to complete the remediation, in the second quarter of 2012 we accrued additional charges of \$4.4 million. The accrual is \$4.4 million at December 31, 2012.

#### *Lower Passaic River Study Area*

In October 2003, we received, along with 66 other entities, a directive from the New Jersey Department of Environmental Protection ( NJDEP ) that requires the entities to assess whether operations at various New Jersey sites, including our former manufacturing site in Lodi, New Jersey, caused damage to natural resources in the Lower Passaic River watershed. The NJDEP later dismissed us from the Directive. In February 2004, Hexcel, and other entities, received a general notice letter from the EPA which requested that the entities consider helping to finance an estimated \$10 million towards an EPA study of environmental conditions in the Lower Passaic River watershed. In May 2005, we voluntarily signed into an agreement with the EPA to participate (resulting in 43 participating entities ) in financing such a study up to \$10 million, in the aggregate. Since May 2005, a number of additional PRPs have joined into the agreement with the EPA. In October 2005, we along with the other EPA notice recipients were advised by the EPA that the notice recipients share of the costs of the EPA study was expected to significantly exceed the earlier EPA estimate. While we and the other recipients were not obligated by our agreement to share in such excess, a Group of



notice recipients (73 companies including Hexcel) negotiated an agreement with the EPA to assume responsibility for the study pursuant to an Administrative Order on Consent. We believe we have viable defenses to the EPA claims and expect that other as yet unnamed parties will also receive notices from the EPA. In June 2007, the EPA issued a draft Focused Feasibility Study ( FFS ) that considers interim remedial options for the lower eight miles of the river, in addition to a no action option. The estimated costs for the six options ranged from \$900 million to \$2.3 billion. The PRP Group provided comments to the EPA on the FFS; the EPA has not yet taken further action. The Administrative Order on Consent regarding the study does not cover work contemplated by the FFS. In June 2012, without admitting liability, we along with 69 other PRPs entered into a further agreement with EPA to remove and cap contaminated sediments near River Mile 10.9 of the Lower Passaic River at an approximate cost of \$20 million. We accrued \$0.5 million in the second quarter of 2012 for our expected allocation of these costs. Furthermore, the Federal Trustee for natural resources have indicated their intent to perform a natural resources damage assessment on the river and invited the PRPs to participate in the development and performance of this assessment. The PRP Group, including Hexcel, has not agreed to participate in the assessment at this time.

On February 4, 2009, Tierra Solutions ( Tierra ) and Maxus Energy Corporation ( Maxus ) filed a third party complaint in New Jersey Superior Court against us and over 300 other entities in an action brought against Tierra and Maxus (and other entities) by the

State of New Jersey. New Jersey's suit against Tierra and Maxus relates to alleged discharges of contaminants by Tierra and Maxus to the Passaic River and seeks payment of all past and future costs the State has and will incur regarding cleanup and removal of contaminants, investigation of the Passaic River and related water bodies, assessment of natural resource injuries and other specified injuries. The third party complaint seeks contribution from us for all or part of the damages that Tierra and Maxus may owe to the State. We filed our answer to the complaint and served our initial disclosures, and have produced initial documents to Tierra and Maxus, pursuant to an order of the court. The court's trial plan and subsequent orders contemplate multiple trial tracks involving third-party defendants (including Hexcel). The scope of Hexcel's involvement in the various trial tracks is uncertain at this time. On October 2, 2012, the Court stayed all third-party litigation until December 20, 2012 to allow for settlement discussions between the State and third-party defendants. The stay has since been extended until further order of the Court. Our ultimate liability for investigatory costs, remedial costs and/or natural resource damages in connection with the Lower Passaic River cannot be determined at this time.

*Kent, Washington Site*

We were party to a cost-sharing agreement regarding the operation of certain environmental remediation systems necessary to satisfy a post-closure care permit issued to a previous owner of our Kent, Washington site by the EPA. Under the terms of the cost-sharing agreement, we were obligated to reimburse the previous owner for a portion of the cost of the required remediation activities. Recently, the previous owner, who also continues to own an adjacent site, has installed certain remediation and isolation technologies and is operating those in accordance with an order agreed with the State of Washington. This isolation is expected to prevent further migration of contaminants to our site and enable us to perform a cleanup of our site. We and the Washington Department of Ecology have reached an agreed order to perform certain cleanup activities on our site by certain deadlines, and we are in full compliance with the order as modified. The total accrued liability related to this matter was \$1.1 million at December 31, 2012.

*Omega Chemical Corporation Superfund Site, Whittier, CA*

We are a potentially responsible party at a former chemical waste site in Whittier, CA. The PRPs at Omega have established a PRP Group, the Omega PRP Group, and are currently investigating and remediating soil and groundwater at the site pursuant to a Consent Decree with the EPA. The Omega PRP Group has attributed approximately 1.07% of the waste tonnage sent to the site to Hexcel. In addition to the Omega site specifically, the EPA is investigating the scope of regional groundwater contamination in the vicinity of the Omega site and recently issued a Record of Decision; the Omega PRP Group members have been noticed by the EPA as PRPs who will be required to be involved in the remediation of the regional groundwater contamination in that vicinity as well. As a member of the Omega PRP group, Hexcel will incur costs associated with the investigation and remediation of the Omega site and the regional groundwater remedy, but our ultimate liability, if any, in connection with this matter cannot be determined at this time.

Environmental remediation reserve activity for the three years ended December 31, 2012 was as follows:

(In millions)	For the year ended December 31,		
	2012	2011	2010
Beginning remediation accrual balance	\$ 5.0	\$ 7.3	\$ 8.3
Current period expenses	5.0	3.4	3.8
Cash expenditures	(3.4)	(5.7)	(4.8)
Ending remediation accrual balance	\$ 6.6	\$ 5.0	\$ 7.3
Capital expenditures for environmental matters	\$ 2.4	\$ 4.1	\$ 1.7

*Environmental Summary*

Our estimate of liability as a PRP and our remaining costs associated with our responsibility to remediate the Lodi, New Jersey; Kent, Washington; and other sites are accrued in the consolidated balance sheets. As of December 31, 2012 and 2011, our aggregate environmental related accruals were \$6.6 million and \$5.0 million, respectively. As of December 31, 2012 and 2011, \$4.2 million and \$3.3 million, respectively, were included in current other accrued liabilities, with the remainder included in other non-current liabilities. As related to certain environmental matters, except for the Lodi site, the accruals were estimated at the low end of a range of possible outcomes since no amount within the range is a better estimate than any other amount. If we had accrued for these matters at the high end of the range of possible outcomes, our accrual would have been \$9.2 million and \$6.8 million at December 31, 2012 and 2011, respectively.

These accruals can change significantly from period to period due to such factors as additional information on the nature or extent of contamination, the methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties, or the impact, if any, of being named in a new matter.

Environmental remediation spending charged directly to our reserve balance was \$3.4 million and \$5.7 million for the years ended December 31, 2012 and 2011, respectively. In addition, our operating costs relating to environmental compliance charged directly to expense were \$13.1 million and \$10.3 million for the years ended December 31, 2012 and 2011. Capital expenditures for environmental matters were \$2.4 million and \$4.1 million for the years ended December 31, 2012 and 2011, respectively.

*Litigation*

*Gurit Infringement Claim*

On October 8, 2012 Gurit (UK) Limited filed suit against the Company in U.S. District Court (Delaware District), Civil Action No. 12-1297, seeking unspecified monetary damages and injunctive relief by alleging that certain preform moulding materials made, sold, used or imported by the Company infringe Gurit patent U.S. 8 088 470). The materials are used in wind turbine manufacture. The Company will vigorously contest these allegations on several grounds including that the patent was licensed to the Company and its affiliates by Gurit in 2010.

These accruals can change significantly from period to period due to such factors as additional information on the nature or extent of contamination, the methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties, or the impact, if any, of being named in a new matter.

*Product Warranty*

Warranty expense for the years ended December 31, 2012, 2011 and 2010, and accrued warranty cost, included in other accrued liabilities in the consolidated balance sheets were as follows:

(In millions)		Product Warranties
<b>Balance as of December 31, 2009</b>	\$	3.7
Warranty expense		1.9
Deductions and other		(1.3)
<b>Balance as of December 31, 2010</b>	\$	4.3
Warranty expense		2.0
Deductions and other		(0.6)
<b>Balance as of December 31, 2011</b>	\$	5.7
Warranty expense		2.2
Deductions and other		(2.8)
<b>Balance as of December 31, 2012</b>	\$	5.1

**Note 15 Supplemental Cash Flow**

Supplemental cash flow information, for the years ended December 31, 2012, 2011 and 2010, consisted of the following:

(In millions)	2012	2011	2010
Cash paid for:			
Interest	\$ 12.6	\$ 15.5	\$ 23.5
Taxes	\$ 23.4	\$ 10.2	\$ (1.5)

**Note 16 Accumulated Other Comprehensive Loss**

Comprehensive income represents net income and other gains and losses affecting stockholders' equity that are not reflected in the consolidated statements of operations. The components of accumulated other comprehensive income (loss) as of December 31, 2012 and 2011 were as follows:

(In millions)	2012	2011
Currency translation adjustments (a)	\$ 7.1	\$ (4.6)
Net unrealized gains (losses) on financial instruments, net of tax (b)	2.2	(4.8)
Pension obligation adjustment, net of tax (c)	(41.2)	(30.4)
Accumulated other comprehensive loss	\$ (31.9)	\$ (39.8)

- (a) The currency translation adjustments are not currently adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.
- (b) (Increased) reduced by the tax impact of (\$0.1) million and \$2.1 million at December 31, 2012 and 2011, respectively.
- (c) Reduced by the tax impact of \$16.0 million and \$12.3 million at December 31, 2012 and 2011, respectively.

### Note 17 Segment Information

The financial results for our 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 segments based on operating income, and generally account for intersegment sales based on arm's length prices. We report two segments, Composite Materials and Engineered Products. Corporate and certain other expenses are not allocated to the segments, except to the extent that the expense can be directly attributable to the segment. Corporate & Other is shown to reconcile to Hexcel's consolidated results.

In addition to the product line-based segmentation of our business, we also monitor sales into our principal end markets as a means to understanding demand for our products. Therefore, for each segment, we have also reported disaggregated sales by end market.

The following table presents financial information on our segments as of December 31, 2012, 2011 and 2010, and for the years then ended.

(In millions)	Composite Materials	Engineered Products	Corporate & Other	Total
<b>Third-Party Sales</b>				
<b>2012</b>	\$ 1,230.9	\$ 347.3	\$	\$ 1,578.2
2011	1,074.5	317.9		1,392.4
2010	904.5	269.1		1,173.6
<b>Intersegment sales</b>				
<b>2012</b>	\$ 56.8	\$ 2.0	\$ (58.8)	\$
2011	53.8	1.6	(55.4)	
2010	38.7	0.6	(39.3)	
<b>Operating income (loss)</b>				
<b>2012</b>	\$ 257.3	\$ 50.6	\$ (59.1)	\$ 248.8
2011	194.5	51.6	(54.1)	192.0
2010	139.6	45.7	(55.5)	129.8
<b>Depreciation</b>				
<b>2012</b>	\$ 52.6	\$ 4.5	\$ 0.1	\$ 57.2
2011	50.8	4.3	0.2	55.3
2010	49.1	3.9	0.2	53.2
<b>Equity in earnings from affiliated companies</b>				
<b>2012</b>	\$	\$ 0.7	\$	\$ 0.7
2011		1.6		1.6
2010		0.5		0.5

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Other (income) expense, net					
<b>2012</b>	\$	<b>(14.5)</b>	\$	<b>5.0</b>	\$ <b>(9.5)</b>
2011		(5.7)		2.7	(3.0)
2010				3.5	3.5
Segment assets					
<b>2012</b>	\$	<b>1,295.4</b>	\$	<b>215.2</b>	\$ <b>92.5</b> \$ <b>1,603.1</b>
2011		1,076.0		192.3	107.8 1,376.1
2010		919.9		176.8	161.4 1,258.1
Investments in affiliated companies					
<b>2012</b>	\$		\$	<b>22.6</b>	\$ <b>22.6</b>
2011				21.7	21.7
2010				19.9	19.9
Accrual basis additions to property, plant and equipment					
<b>2012</b>	\$	<b>228.6</b>	\$	<b>12.5</b>	\$ <b>0.2</b> \$ <b>241.3</b>
2011		176.6		6.9	1.0 184.5
2010		57.3		3.3	0.1 60.7

*Geographic Data*

Net sales and long-lived assets, by geographic area, consisted of the following for the three years ended December 31, 2012, 2011 and 2010:

(In millions)	2012	2011	2010
<b>Net sales by Geography (a):</b>			
United States	\$ 801.4	\$ 721.5	\$ 614.8
International			
France	302.9	257.6	208.8
Spain	150.6	142.6	111.0
United Kingdom	114.7	102.1	85.9
Austria	105.0	95.5	91.4
Other	103.6	73.1	61.7
Total international	776.8	670.9	558.8
Total consolidated net sales	\$ 1,578.2	\$ 1,392.4	\$ 1,173.6
<b>Net Sales to External Customers (b):</b>			
United States	\$ 719.4	\$ 615.7	\$ 528.1
International			
France	144.4	132.3	107.5
Germany	128.2	87.7	76.5
Spain	123.9	120.8	95.6
United Kingdom	82.2	80.2	67.9
Other	380.1	355.7	298.0
Total international	858.8	776.7	645.5
<b>Total</b>	\$ 1,578.2	\$ 1,392.4	\$ 1,173.6
<b>Long-lived assets (c):</b>			
United States	\$ 733.5	\$ 568.2	\$ 467.8
International			
United Kingdom	83.8	68.4	53.7
Spain	68.2	60.5	58.4
France	37.9	36.0	36.3
Other	48.8	46.4	38.3
Total international	238.7	211.3	186.7
Total consolidated long-lived assets	\$ 972.2	\$ 779.5	\$ 654.5

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- (a) Net sales by geography based on the location in which the product sold was manufactured.
- (b) Net sales to external customers based on the location to which the product sold was delivered.
- (c) Long-lived assets primarily consist of property, plant and equipment, net and goodwill.

*Significant Customers and Suppliers*

Boeing and its subcontractors accounted for approximately 29%, 30% and 31% of 2012, 2011 and 2010 net sales, respectively. Similarly, EADS, including Airbus and its subcontractors, accounted for approximately 28%, 27% and 24% of 2012, 2011 and 2010 net sales,



respectively. In the Composites Materials segment approximately 19%, 20% and 22% of sales for 2012, 2011 and 2010, respectively, were to Boeing and its subcontractors. Approximately 34%, 33% and 29% of sales for 2012, 2011 and 2010, respectively were to EADS and its subcontractors. In the Engineered Products segment approximately 66%, 64% and 62% of sales for 2012, 2011 and 2010, respectively were to Boeing and its subcontractors.

A significant decline in business with Boeing, or EADS could materially impact our business, operating results, prospects and financial condition.

Certain key raw materials we consume are available from relatively few sources, and in many cases the cost of product qualification makes it impractical to develop multiple sources of supply. The lack of availability of these materials could under certain circumstances materially impact our consolidated results of operations.

**Note 18 Other (Income) Expense, net**

Other (income) expense, net for the three years ended December 31, 2012, consisted of the following:

(In millions)	2012	2011	2010
Business interruption insurance settlement	\$ (9.6)	\$	\$
Gain on sale of land	(4.9)		
Pension curtailment gain		(5.7)	
Environmental expense	5.0	2.7	3.5
<b>Other (income) expense, net</b>	<b>\$ (9.5)</b>	<b>\$ (3.0)</b>	<b>\$ 3.5</b>

In 2012, the company settled a business interruption insurance claim resulting from tornado damage in 2011 and recorded operating income of \$9.6 million. Also in 2012, the Company recorded a pre-tax gain of \$4.9 million on the sale of land from a previously closed manufacturing facility and \$5.0 million of charges primarily for additional remediation of a manufacturing facility sold in 1986.

Effective January 31, 2011, credited service for the participants in our U.K. plan was frozen. This resulted in recognizing \$5.7 million of prior unrecognized service credits as a curtailment gain and also reduced the projected plan obligation by \$1.6 million. Also in 2011, the Company recorded an additional \$2.7 million in expense for additional environmental reserves primarily to remediate our former Lodi, New Jersey manufacturing facility that was sold in 1986 as further discussed in Note 14 to the consolidated financial statements.

In 2010, the Company made a decision to enhance the remediation system to accelerate completion of the remediation and increased its environmental accruals for additional remediation of a manufacturing facility sold in 1986 by \$3.5 million.

**Note 19 Non-operating Expense**

In June 2012 and February 2011, we redeemed \$73.5 million and \$150 million of our 6.75% senior subordinated notes at a call premium of 1.125% and 2.25%, respectively. As a result of the redemption, we accelerated the unamortized financing costs of the senior subordinated notes redeemed and expensed the call premium incurring a pretax charge of \$1.1 million and \$4.9 million, in 2012 and 2011, respectively.

In connection with the Company's refinancing of its Senior Secured Credit Facility in July 2010, we recorded a charge of \$6.8 million for the acceleration of amortization of deferred financing costs and the write-off of the remaining original issue discount associated with the previous agreement.

**Note 20 Fair Value Measurements**

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The fair values of our financial instruments are classified in one of the following categories:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable inputs other than quoted prices in 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.

In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as consider our own and counterparty credit risk. At December 31, 2012 and 2011, we did not have any assets or liabilities that utilize Level 3 inputs.

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). The fair value of these assets and liabilities was approximately \$6.6 million and \$2.7 million, and approximately \$0.6 million and \$10.4 million respectively at December 31, 2012 and 2011.

Below is a summary of valuation techniques for all Level 2 financial assets and liabilities:

- Interest rate swap valued using LIBOR yield curves at the reporting date. Fair value was a liability of \$1.0 million at December 31, 2012.
- Foreign exchange derivative assets and liabilities valued using quoted forward foreign exchange prices at the reporting date. Fair value of assets and liabilities at December 31, 2012 was \$6.6 million and \$1.7 million, respectively.
- Senior secured facility term loan - Fair value at December 31, 2012 was \$85.0 million, the same as book value.

Counterparties to the above contracts are highly rated financial institutions, none of which experienced any significant downgrades in 2012 that would reduce the receivable amount owed, if any, to the Company.

**Note 21 - Quarterly Financial and Market Data (Unaudited)**

Quarterly financial and market data for the years ended December 31, 2012 and 2011 were:

(In millions)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2012</b>				
Net sales	\$ 400.1	\$ 399.2	\$ 391.6	\$ 387.3
Gross margin	106.4	105.5	99.2	95.6
Other (income) expense, net		(9.5)		
Operating income	60.6	73.9	60.0	54.3
Net income	39.6	48.0	39.8	36.9
Net income per common share:				
Basic	\$ 0.40	\$ 0.48	\$ 0.40	\$ 0.37
Diluted	\$ 0.39	\$ 0.47	\$ 0.39	\$ 0.36
Market price:				
High	\$ 26.71	\$ 27.80	\$ 26.49	\$ 27.29
Low	\$ 23.42	\$ 23.05	\$ 22.53	\$ 23.55
<b>2011</b>				
Net sales	\$ 331.6	\$ 353.7	\$ 351.8	\$ 355.3
Gross margin	83.0	87.0	86.5	85.6
Other (income) expense, net	(5.7)		2.7	
Operating income	47.2	49.4	46.0	49.4
Net income	26.4	37.4	32.2	39.5

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Net income per common share:							
Basic	\$	0.27	\$	0.38	\$	0.33	\$ 0.40
Diluted	\$	0.26	\$	0.37	\$	0.32	\$ 0.39
Market price:							
High	\$	20.69	\$	21.90	\$	24.23	\$ 25.84
Low	\$	17.58	\$	18.78	\$	18.07	\$ 21.34

## Schedule II

## Hexcel Corporation and Subsidiaries

## Valuation and Qualifying Accounts

(In millions)	Balance at beginning of year	Charged to expense/(recovery)	Deductions and other	Balance at end of year
<b>Year ended December 31, 2012</b>				
Allowance for doubtful accounts	\$ 1.2	\$ 1.1	\$ (0.5)	\$ 1.8
Valuation allowance for deferred tax assets	39.4	9.0	1.0	49.4
<b>Year ended December 31, 2011</b>				
Allowance for doubtful accounts	\$ 1.5	\$	\$ (0.3)	\$ 1.2
Valuation allowance for deferred tax assets	36.5	10.5	(7.6)	39.4
<b>Year ended December 31, 2010</b>				
Allowance for doubtful accounts	\$ 1.9	\$ (0.1)	\$ (0.3)	\$ 1.5
Valuation allowance for deferred tax assets	30.8	11.2	(5.5)	36.5