HEXCEL CORP /DE/
Form 10-Q
July 25, 2011
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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10–Q

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

**For the Quarterly Period Ended June 30, 2011**

**Or**

**o Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

**For the transition period from to**

**Commission File Number 1-8472**

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# Hexcel Corporation

(Exact name of registrant as specified in its charter)

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

**Two Stamford Plaza**

**281 Tresser Boulevard**

**Stamford, Connecticut 06901-3238**

(Address of principal executive offices and zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant 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 x No o

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

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

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

| **Class** | **Outstanding at July 20, 2011** |
|---|---|
| **COMMON STOCK** | **98,353,680** |

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**HEXCEL CORPORATION AND SUBSIDIARIES**

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## PART I. FINANCIAL INFORMATION

### ITEM 1. Condensed Consolidated Financial Statements (Unaudited)

**Hexcel Corporation and Subsidiaries**

**Condensed Consolidated Balance Sheets**

| (In millions, except per share data) | (Unaudited) June 30, 2011 | December 31, 2010 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 55.9** | $ 117.2 |
| Accounts receivable, net | **207.8** | 173.9 |
| Inventories, net | **207.9** | 169.9 |
| Prepaid expenses and other current assets | **50.8** | 36.7 |
| Total current assets | **522.4** | 497.7 |
| Property, plant and equipment | **1,139.8** | 1,063.9 |
| Less accumulated depreciation | **(502.4)** | (465.6) |
| Property, plant and equipment, net | **637.4** | 598.3 |
| Goodwill and intangible assets | **56.8** | 56.2 |
| Investments in affiliated companies | **21.6** | 19.9 |
| Deferred tax assets | **62.9** | 63.6 |
| Other assets | **18.3** | 22.4 |
| Total assets | **$ 1,319.4** | $ 1,258.1 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Short-term borrowings and current maturities of debt | **$ 9.3** | $ 27.6 |
| Accounts payable | **108.7** | 83.0 |
| Accrued liabilities | **109.1** | 95.3 |
| Total current liabilities | **227.1** | 205.9 |
| Long-term debt | **242.1** | 304.6 |
| Other non-current liabilities | **73.7** | 88.2 |
| Total liabilities | **542.9** | 598.7 |
| Stockholders equity: | | |
| Common stock, $0.01 par value, 200.0 shares authorized, 100.3 and 99.5 shares issued at June 30, 2011 and December 31, 2010, respectively | **1.0** | 1.0 |
| Additional paid-in capital | **573.7** | 552.3 |
| Retained earnings | **212.2** | 148.4 |
| Accumulated other comprehensive income (loss) | **14.4** | (15.1) |
| | **801.3** | 686.6 |
| | **(24.8)** | (27.2) |

| | | | | |
|---|---|---|---|---|
| Less Treasury stock, at cost, 2.0 and 2.2 shares at June 30, 2011 and December 31, 2010, respectively | | | | |
| Total stockholders equity | | **776.5** | | 659.4 |
| | | | | |
| Total liabilities and stockholders equity | **$** | **1,319.4** | **$** | 1,258.1 |

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

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**Hexcel Corporation and Subsidiaries**

**Condensed Consolidated Statements of Operations**

| | (Unaudited) | | | |
|---|---|---|---|---|
| | Quarter Ended June 30, | | Six Months Ended June 30, | |
| **(In millions, except per share data)** | **2011** | **2010** | **2011** | **2010** |
| Net sales | **$ 353.7** | $ 305.1 | **$ 685.3** | $ 568.1 |
| Cost of sales | **266.7** | 226.7 | **515.3** | 423.6 |
| Gross margin | **87.0** | 78.4 | **170.0** | 144.5 |
| | | | | |
| Selling, general and administrative expenses | **29.7** | 29.6 | **62.6** | 61.0 |
| Research and technology expenses | **7.9** | 8.3 | **16.5** | 15.7 |
| Other operating (income) expense | | | **(5.7)** | 3.5 |
| Operating income | **49.4** | 40.5 | **96.6** | 64.3 |
| | | | | |
| Interest expense, net | **2.9** | 7.1 | **7.1** | 13.7 |
| Non-operating expense | | | **4.9** | |
| Income before income taxes and equity in earnings of affiliated companies | **46.5** | 33.4 | **84.6** | 50.6 |
| Provision for income taxes | **9.3** | 10.6 | **21.5** | 12.1 |
| Income before equity in earnings of affiliated companies | **37.2** | 22.8 | **63.1** | 38.5 |
| Equity in earnings of affiliated companies | **0.2** | 0.3 | **0.7** | 0.4 |
| Net income | **$ 37.4** | $ 23.1 | **$ 63.8** | $ 38.9 |
| | | | | |
| Basic net income per common share: | **$ 0.38** | $ 0.24 | **$ 0.65** | $ 0.40 |
| | | | | |
| Diluted net income per common share: | **$ 0.37** | $ 0.23 | **$ 0.63** | $ 0.39 |
| | | | | |
| Weighted average common shares outstanding: | | | | |
| Basic | **98.6** | 97.5 | **98.4** | 97.4 |
| Diluted | **100.7** | 99.7 | **100.5** | 99.6 |

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

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**Hexcel Corporation and Subsidiaries**

**Condensed Consolidated Statements of Cash Flows**

| (In millions) | (Unaudited) Six Months Ended June 30, 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $ **63.8** | $ 38.9 |
| Reconciliation to net cash provided by operating activities: | | |
| Depreciation and amortization | **27.9** | 25.6 |
| Amortization of debt discount and deferred financing costs and call premium expense | **5.9** | 2.4 |
| Deferred income taxes | **6.7** | 4.2 |
| Equity in earnings from affiliated companies | **(0.7)** | (0.4) |
| Stock-based compensation | **8.8** | 8.3 |
| Pension curtailment gain | **(5.7)** | |
| Excess tax benefits on stock-based compensation | **(3.6)** | (0.7) |
| | | |
| Changes in assets and liabilities: | | |
| Increase in accounts receivable | **(25.4)** | (52.3) |
| Increase in inventories | **(31.5)** | (28.9) |
| (Increase) decrease in prepaid expenses and other current assets | **(3.1)** | 0.4 |
| Increase in accounts payable and accrued liabilities | **36.0** | 36.9 |
| Other-net | **(1.8)** | (2.7) |
| Net cash provided by operating activities | **77.3** | 31.7 |
| | | |
| **Cash flows from investing activities** | | |
| Capital expenditures | **(67.8)** | (20.1) |
| Net cash used for investing activities | **(67.8)** | (20.1) |
| | | |
| **Cash flows from financing activities** | | |
| Borrowings from senior secured credit facility | **135.0** | |
| Repayment of 6.75% senior subordinated notes | **(150.0)** | |
| Repayment of senior secured credit facility | **(60.0)** | |
| Call premium payment for 6.75% senior subordinated notes | **(3.4)** | |
| (Repayments) borrowings from credit line | **(3.3)** | 1.7 |
| Repayment of senior secured credit facility - term loan | **(2.5)** | (30.0) |
| Capital lease obligations and other debt, net | **(0.2)** | (0.2) |
| Activity under stock plans | **7.4** | 0.6 |
| Net cash used for financing activities | **(77.0)** | (27.9) |
| Effect of exchange rate changes on cash and cash equivalents | **6.2** | (9.8) |
| Net decrease in cash and cash equivalents | **(61.3)** | (26.1) |
| Cash and cash equivalents at beginning of period | **117.2** | 110.1 |
| Cash and cash equivalents at end of period | **$ 55.9** | $ 84.0 |
| | | |
| **Supplemental data:** | | |
| Accrual basis additions to property, plant and equipment | **$ 55.1** | $ 13.7 |

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

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**HEXCEL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**Note 1 Significant Accounting Policies**

In these notes, the terms Hexcel, the Company, we, us, or our mean Hexcel Corporation and subsidiary companies. The accompanying condensed consolidated financial statements are those of Hexcel Corporation. Refer to Note 1 to the consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2010 for a discussion of our significant accounting policies.

*Basis of Presentation*

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

In the opinion of management, the condensed consolidated financial statements include all normal recurring adjustments as well as any non-recurring adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the interim periods presented. The condensed consolidated balance sheet as of December 31, 2010 was derived from the audited 2010 consolidated balance sheet. Interim results are not necessarily indicative of results expected for any other interim period or for the full year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 10, 2011.

*Investments in Affiliated Companies*

We have a 50% equity ownership investment in an Asian joint venture Asian Composites Manufacturing Sdn. Bhd. 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.

**Note 2 Net Income per Common Share**

| (In millions, except per share data) | Quarter Ended June 30, 2011 | Quarter Ended June 30, 2010 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 |
|---|---|---|---|---|
| ***Basic net income per common share:*** | | | | |
| Net income | **$ 37.4** | $ 23.1 | **$ 63.8** | $ 38.9 |
| Weighted average common shares outstanding | **98.6** | 97.5 | **98.4** | 97.4 |
| Basic net income per common share | **$ 0.38** | $ 0.24 | **$ 0.65** | $ 0.40 |
| ***Diluted net income per common share:*** | | | | |
| Net income | **$ 37.4** | $ 23.1 | **$ 63.8** | $ 38.9 |
| Weighted average common shares outstanding Basic | **98.6** | 97.5 | **98.4** | 97.4 |
| *Plus incremental shares from assumed conversions:* | | | | |
| Restricted stock units | **0.7** | 0.9 | **0.8** | 1.0 |
| Stock options | **1.4** | 1.3 | **1.3** | 1.2 |
| Weighted average common shares outstanding Dilutive | **100.7** | 99.7 | **100.5** | 99.6 |
| Diluted net income per common share | **$ 0.37** | $ 0.23 | **$ 0.63** | $ 0.39 |

Total shares underlying stock options of 1.1 million for the quarter and six months were excluded from the computation of diluted net income per share for the periods ended June 30, 2011, as they were anti-dilutive. Total shares underlying stock options of 0.9 million for the quarter and 1.2 million for the six months were excluded from the computation of diluted net income per share for the periods ended June 30, 2010, as they were anti-dilutive.

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**Note 3 Other Operating (Income) Expense**

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. The six-month period ended June 30, 2010 included a pre-tax charge of $3.5 million for additional environmental reserves primarily to remediate our former Lodi, New Jersey manufacturing facility that was sold in 1986 (see note 13).

**Note 4 Non-Operating Expense**

In February 2011, we redeemed $150 million of our $225 million 6.75% senior subordinated notes at a call premium of 2.25%. 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 $4.9 million.

**Note 5 Inventories, net**

| (In millions) | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Raw materials | **$ 83.3** | $ 71.6 |
| Work in progress | **52.3** | 40.7 |
| Finished goods | **96.0** | 80.4 |
| Total inventories, gross | **$ 231.6** | $ 192.7 |
| Inventory allowances | **(23.7)** | (22.8) |
| Total inventories, net | **$ 207.9** | $ 169.9 |

**Note 6 Retirement and Other Postretirement Benefit Plans**

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

*Defined Benefit Retirement Plans*

*Net Periodic Benefit Costs*

Net periodic benefit costs of our defined benefit retirement plans for the quarters and six months ended June 30, 2011 and 2010 were as follows:

| (In millions) | Quarter Ended June 30, 2011 | 2010 | Six Months Ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| *U.S. Nonqualified Defined Benefit Retirement Plans* | | | | |
| Service cost | **$ 0.3** | $ 0.3 | **$ 0.5** | $ 0.6 |
| Interest cost | **0.2** | 0.2 | **0.5** | 0.5 |
| Net amortization and deferral | **0.3** | 0.3 | **0.6** | 0.4 |
| Net periodic benefit cost | **$ 0.8** | $ 0.8 | **$ 1.6** | $ 1.5 |

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| **Amounts recognized on the balance sheet:** | | |
| Accrued liabilities | **$ 0.9** | $ 0.9 |
| Other non-current liabilities | **27.7** | 26.9 |
| Total accrued benefit | **$ 28.6** | $ 27.8 |

| (In millions) | Quarter Ended June 30, 2011 | 2010 | Six Months Ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| *European Defined Benefit Retirement Plans* | | | | |
| Service cost | **$ 0.2** | $ 0.9 | **$ 0.9** | $ 1.9 |
| Interest cost | **1.8** | 1.9 | **3.6** | 3.8 |
| Expected return on plan assets | **(2.0)** | (1.6) | **(3.9)** | (3.2) |
| Net amortization and deferral | **0.1** | 0.3 | **0.3** | 0.6 |
| Curtailment gain | | | **(5.7)** | |
| Net periodic benefit cost | **$ 0.1** | $ 1.5 | **$ (4.8)** | $ 3.1 |

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| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| **Amounts recognized on the balance sheet:** | | |
| Accrued liabilities | **$ 3.2** | $ 0.5 |
| Other non-current liabilities | **17.8** | 26.7 |
| Total accrued benefit | **$ 21.0** | $ 27.2 |

As discussed in Note 3, effective January 31, 2011 credited service for the participants in our U.K. defined benefit plan was frozen. This change reduced the projected plan obligation by $1.6 million and also resulted in recognizing $5.7 million of prior unrecognized service credits as a curtailment gain. The defined benefit plan was replaced by a defined contribution plan.

*Contributions*

We generally fund our U.S. non-qualified defined benefit retirement plans when benefit payments are incurred. Under the provisions of these non-qualified plans, we expect to contribute $0.9 million in 2011 to cover unfunded benefits. We contributed $0.6 million to our U.S. non-qualified defined benefit retirement plans during the 2010 fiscal year.

We contributed $2.5 million and $1.9 million to our European defined benefit retirement plans in the second quarters of 2011 and 2010, respectively. Contributions were $3.9 million and $2.7 million for the six months ended June 30, 2011 and 2010, respectively. We plan to contribute approximately $7.4 million during 2011 to our European plans. We contributed $9.0 million to our European plans during the 2010 fiscal year.

*Postretirement Health Care and Life Insurance Benefit Plans*

Net periodic benefit costs of our postretirement health care and life insurance benefit plans for the quarters and six months ended June 30, 2011 and 2010 were immaterial.

| **(In millions)** | June 30, 2011 | December 31, 2010 |
|---|---|---|
| **Amounts recognized on the balance sheet:** | | |
| Accrued liabilities | **$ 0.8** | $ 0.8 |
| Other non-current liabilities | **8.7** | 8.6 |
| Total accrued benefit | **$ 9.5** | $ 9.4 |

In connection with our postretirement plans, we contributed $0.1 million during each of the second quarters of 2011 and 2010, respectively, and $0.1 million and $0.2 million during the six-month periods ended June 30, 2011 and 2010, respectively. We periodically fund our postretirement plans to pay covered expenses as they are incurred. Under the provisions of these postretirement plans, we expect to contribute approximately $0.8 million in 2011 to cover unfunded benefits. We contributed $0.4 million to our postretirement plans during the 2010 fiscal year.

**Note 7 Debt**

| (In millions) | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Working capital line of credit China | **$ 3.8** | $ 7.1 |
| Current maturities of capital lease and other obligations | **0.5** | 0.5 |
| Current maturities of term loan | **5.0** | 5.0 |
| Current maturities of 6.75% senior subordinated notes due 2015 | | 15.0 |
| Short-term borrowings and current maturities of long-term liabilities | **9.3** | 27.6 |
| | | |
| Senior secured credit facility term loan due 2015 | **90.0** | 92.5 |
| Senior secured credit facility revolving loan due 2015 | **75.0** | |
| 6.75% senior subordinated notes due 2015 | **75.0** | 210.0 |
| Capital lease and other obligations | **2.1** | 2.1 |
| Long-term debt | **242.1** | 304.6 |
| Total debt | **$ 251.4** | $ 332.2 |

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*Estimated Fair Values of Notes Payable*

The approximate, aggregate fair values of our notes payable as of June 30, 2011 and December 31, 2010 were as follows:

| (In millions) | June 30, 2011 | December 31, 2010 |
|---|---|---|
| 6.75% senior subordinated notes, due 2015 | **$ 77** | $ 226 |
| Senior secured credit facility term loan due 2015 | **95** | 98 |

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

**Note 8 Derivative Financial Instruments**

*Interest Rate Swap Agreements*

In the fourth quarter 2010, we entered into an agreement to swap $98 million of a floating rate obligation for a fixed rate obligation at an average of 1.03% against LIBOR in U.S. dollars. The swap is scheduled to mature on March 31, 2014, and was accounted for as a cash flow hedge of our floating rate bank loan. To ensure the swap was highly effective, all the principal terms of the swap matched the terms of the bank loan. The fair value of the interest rate swap was a liability of $0.2 million at June 30, 2011 and an asset of $0.7 million at December 31, 2010.

*Cross Currency Interest Rate Swap Agreement*

In September 2006, we entered into a cross-currency interest rate swap agreement to hedge a portion of our net Euro investment in Hexcel SASU (France). This agreement is accounted for as a hedge of the foreign currency exposure of a net investment in a foreign operation and to the extent it is effective, gains and losses are recorded as an offset in the cumulative translation account ( CTA ), the same account in which translation gains and losses on the investment in Hexcel SASU are recorded. All other changes, including any difference in current interest, are excluded from the assessment of effectiveness and are included in operating income as a component of interest expense. The agreement has a notional value of $63.4 million, a term of five years, and is scheduled to mature on September 20, 2011. We receive interest in U.S. dollars quarterly and pay interest in Euros on the same day. U.S. interest is based on the three month LIBOR. Euro interest is based on the three month EURIBOR. The fair value of the swap at June 30, 2011 and December 31, 2010 was a liability of $8.5 million and $3.0 million, respectively. Net credits to interest expense of $0.2 million related to the excluded portion of the derivative were recorded in the second quarter of 2011. A net credit to interest expense of $0.2 million and a net charge to interest expense of $0.3 million related to the excluded portion of the derivative were recorded in the first six months of 2011 and 2010, respectively. Net charges to interest expense of $0.2 million and $0.1 million related to the interest coupons were recorded during the second quarters of 2011 and 2010, respectively. Net charges to interest expense of $0.3 million and $0.2 million related to the interest coupons were recorded during the first six months of 2011 and 2010, respectively. The net amount of losses included in the CTA adjustment during the second quarter and six-month period of 2011 was $1.5 million and $6.8 million, respectively. The net amount of gains included in the CTA adjustment during the second quarter and six-month period of 2010 were $6.2 million and $10.6 million, respectively. The impact of applying prescribed credit risk adjustments was immaterial.

*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 December 2013. The aggregate notional amount of these contracts was $122.0 million and $124.2 million at June 30, 2011 and December 31, 2010, 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 by currency, thereby reducing our exposure to fluctuations in currency exchange rates. These forward contracts are designated as cash flow hedges of forecasted revenues. The effective portion of the hedges, gains of $2.7 million and $7.5 million, were recorded in other comprehensive income ( OCI ) for the three months and six months ended June 30, 2011, respectively, and losses of $5.2 million and $10.9 million for the three- and six-month periods ended June 30, 2010, respectively. We excluded the forward points from the effectiveness assessment and recorded them as a reduction to interest expense of $0.3 million for the quarter and an increase to interest expense of $0.2 million for the six months ended June 30, 2011, and a reduction to interest expense of $0.3 million for the six months ended June 30, 2010. The carrying amount of these contracts was $5.9 million classified as other assets and $0.2 million classified in other liabilities on the Consolidated Balance Sheet at June 30, 2011 and $2.3 million in other assets and $2.6 million classified in other liabilities at December 31, 2010.

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During the three months ended June 30, 2011 and 2010, we recognized net gains of $1.8 million and net losses of $2.6 million, respectively, recorded in sales and cost of sales. During the six months ended June 30, 2011 and 2010, we recognized net gains of $1.3 million and net losses of $4.1 million, respectively, recorded in sales and cost of sales.

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 quarters ended June 30, 2011 and 2010, we recognized net foreign exchange gains of $2.7 million and net foreign exchange losses of $4.8 million, respectively, in the Consolidated Statements of Operations. During the six-month periods ended June 30, 2011 and 2010, we recognized net foreign exchange gains of $7.7 million and net foreign exchange losses of $7.7 million respectively, in the Consolidated Statements of Operations. Asset and liability derivatives not designated as hedging instruments were not material.

The change in fair value of our foreign currency forward exchange contracts under hedge designations recorded, net of tax, within accumulated other comprehensive income for the quarters and six months ended June 30, 2011 and 2010 was as follows:

| | Quarter Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **2011** | **2010** |
| Unrealized gains (losses) at beginning of period, net of tax | **$ 3.8** | $ (4.5) | **$ (0.2)** | $ (1.4) |
| (Gains) losses reclassified to net sales | **(1.5)** | 2.0 | **(1.1)** | 3.1 |
| Increase (decrease) in fair value | **2.4** | (4.2) | **6.0** | (8.4) |
| Unrealized gains (losses) at end of period, net of tax | **$ 4.7** | $ (6.7) | **$ 4.7** | $ (6.7) |

As of June 30, 2011, unrealized gains recorded in accumulated other comprehensive income, net of tax, were $4.7 million, of which $3.4 million are expected to be reclassified into earnings over the next twelve months as the hedged sales are recorded.

**Note 9 Income Taxes**

The income tax provisions for the quarter and six months ended June 30, 2011 were $9.3 million and $21.5 million, respectively. The effective tax rate for the quarter and six months ended June 30, 2011 was 20.0% and 25.4%, respectively. The effective tax rates for the quarter and six months of 2011 reflects the release of $5.5 million of reserves primarily for uncertain tax positions as a result of an audit settlement. Excluding this benefit, the effective tax rates would have been 31.8% and 31.9% for the current quarter and six-month periods. The effective tax rate for the quarter and six months ended June 30, 2010 was 31.7% and 23.9%, respectively. The lower effective rate in the six months of 2010 reflects $3.5 million of New Clean Energy Manufacturing Tax Credits awarded to us in January 2010 for qualifying capital investments incurred at our Colorado facility in 2009. Excluding this credit, our effective tax rate would have been 30.8%.

**Note 10 Comprehensive Income**

Comprehensive income represents net income and other gains and losses affecting stockholders equity that are not reflected in the condensed consolidated statements of operations. The components of comprehensive income for the quarters and six months ended June 30, 2011 and 2010 were as follows:

| (In millions) | Quarter Ended June 30, 2011 | 2010 | Six Months Ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| Net income | **$ 37.4** | $ 23.1 | **$ 63.8** | $ 38.9 |
| Currency translation adjustments | **6.6** | (19.3) | **24.4** | (36.5) |
| Pension and other postretirement obligations | **0.2** | 0.1 | **0.9** | 1.5 |
| Net unrealized (losses) gains on financial instruments | **(1.1)** | (2.2) | **4.2** | (5.2) |
| Comprehensive income (loss) | **$ 43.1** | $ 1.7 | **$ 93.3** | $ (1.3) |

**Note 11 Fair Value Measurements**

The authoritative guidance for fair value measurements establishes a hierarchy for observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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

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

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

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 counterparty credit risk in our assessment of fair value.

We do not have any significant assets or liabilities that utilize Level 3 inputs. In addition, we have no assets or liabilities that utilize Level 1 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 the credit standing of Hexcel when the derivative is in a net liability position. The fair values of these assets and liabilities were approximately $7.5 million and $9.3 million, respectively, at June 30, 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 of liability was $0.2 million at June 30, 2011.

- Cross-currency interest rate swap derivative liabilities valued using LIBOR and EURIBOR yield curves and quoted forward foreign exchange prices at the reporting date. Fair value at June 30, 2011 was a liability of $8.5 million.

- Foreign exchange derivative assets and liabilities valued using quoted forward foreign exchange prices at the reporting date. Fair value of assets and liabilities at June 30, 2011 was $7.5 million and $0.6 million, respectively.

Counterparties to the above contracts are highly rated financial institutions, none of which experienced any significant downgrades in the six months ended June 30, 2011 that would reduce the receivable amount owed, if any, to the Company.

- Money market funds considered available-for-sale, and classified as cash equivalents. Fair value at June 30, 2011 was $10.6 million, the same as book value.

**Note 12 Segment Information**

The financial results for our operating segments are prepared using a management approach, which is consistent with the basis and manner in which we internally segregate financial information for the purpose of assisting in making internal operating decisions. We evaluate the performance of our operating segments based on operating income, and generally account for intersegment sales based on arm s length prices. Corporate and certain other expenses are not allocated to the operating segments, except to the extent that the expense can be directly attributable to the business segment.

Financial information for our business segments for the quarters and six months ended June 30, 2011 and 2010 is as follows:

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| (In millions) | Composite Materials (a) | Engineered Products | Corporate & Other (b) | Total |
|---|---|---|---|---|
| | | (Unaudited) | | |
| **Second Quarter 2011** | | | | |
| Net sales to external customers: | | | | |
| Commercial aerospace | **$ 150.9** | **$ 56.9** | **$** | **$ 207.8** |
| Space and defense | **62.5** | **19.2** | | **81.7** |
| Industrial | **63.4** | **0.8** | | **64.2** |
| Net sales to external customers | **276.8** | **76.9** | | **353.7** |
| Intersegment sales | **13.9** | **0.2** | **(14.1)** | |
| Total sales | **290.7** | **77.1** | **(14.1)** | **353.7** |
| | | | | |
| Operating income | **48.5** | **11.9** | **(11.0)** | **49.4** |
| Depreciation and amortization | **12.8** | **1.0** | | **13.8** |
| Stock-based compensation expense | **0.9** | **0.1** | **1.4** | **2.4** |
| Accrual basis additions to capital expenditures | **28.4** | **1.5** | | **29.9** |
| | | | | |
| **Second Quarter 2010** | | | | |
| Net sales to external customers: | | | | |
| Commercial aerospace | $ 113.9 | $ 47.1 | $ | $ 161.0 |
| Space and defense | 60.7 | 18.7 | | 79.4 |
| Industrial | 64.3 | 0.4 | | 64.7 |
| Net sales to external customers | 238.9 | 66.2 | | 305.1 |
| Intersegment sales | 11.5 | 0.3 | (11.8) | |
| Total sales | 250.4 | 66.5 | (11.8) | 305.1 |
| | | | | |
| Operating income | 42.8 | 10.7 | (13.0) | 40.5 |
| Depreciation and amortization | 12.7 | 0.9 | | 13.6 |
| Stock-based compensation expense | 1.1 | 0.2 | 1.3 | 2.6 |
| Accrual basis additions to capital expenditures | 6.2 | 0.5 | 0.1 | 6.8 |
| | | | | |
| **Six Months Ended June 30, 2011** | | | | |
| Net sales to external customers | | | | |
| Commercial aerospace | **$ 294.1** | **$ 111.3** | **$** | **$ 405.4** |
| Space and defense | **122.4** | **39.0** | | **161.4** |
| Industrial | **116.6** | **1.9** | | **118.5** |
| Net sales to external customers | **533.1** | **152.2** | | **685.3** |
| Intersegment sales | **27.8** | **0.5** | **(28.3)** | |
| Total sales | **560.9** | **152.7** | **(28.3)** | **685.3** |
| | | | | |
| Operating income (a) | **98.3** | **24.4** | **(26.1)** | **96.6** |
| Depreciation and amortization | **25.7** | **2.1** | **0.1** | **27.9** |
| Stock-based compensation expense | **2.5** | **0.4** | **5.9** | **8.8** |
| Other operating (income) expense | **(5.7)** | | | **(5.7)** |
| Accrual basis additions to capital expenditures | **52.7** | **2.4** | | **55.1** |
| | | | | |
| **Six Months Ended June 30, 2010** | | | | |
| Net sales to external customers | | | | |
| Commercial aerospace | $ 223.2 | $ 89.8 | $ | $ 313.0 |
| Space and defense | 113.8 | 38.1 | | 151.9 |
| Industrial | 102.3 | 0.9 | | 103.2 |
| Net sales to external customers | 439.3 | 128.8 | | 568.1 |
| Intersegment sales | 20.4 | 0.3 | (20.7) | |
| Total sales | 459.7 | 129.1 | (20.7) | 568.1 |
| | | | | |
| Operating income (b) | 73.3 | 22.1 | (31.1) | 64.3 |
| Depreciation and amortization | 23.6 | 1.9 | 0.1 | 25.6 |

| | | | | |
|---|---|---|---|---|
| Stock-based compensation expense | 2.7 | 0.5 | 5.1 | 8.3 |
| Other operating (income) expense | | | 3.5 | 3.5 |
| Accrual basis additions to capital expenditures | 13.0 | 0.6 | 0.1 | 13.7 |

(a) First six months 2011 operating income for Composite Materials includes a $5.7 million gain resulting from the curtailment of our U.K. pension plan.

(b) First six months 2010 operating income for Corporate & Other includes a $3.5 million charge to the environmental reserves primarily for remediation at a manufacturing facility sold in 1986.

*Goodwill and Intangible Assets*

The carrying amount of goodwill and intangible assets by segment is as follows:

| **(In millions)** | **June 30, 2011** | **December 31, 2010** |
|---|---|---|
| Composite Materials | **$ 40.8** | $ 40.1 |
| Engineered Products | **16.0** | 16.1 |
| Goodwill and intangible assets | **$ 56.8** | $ 56.2 |

No impairments have been recorded against these amounts.

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**Note 13 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, and health and safety matters. We estimate and accrue our liabilities when a loss becomes probable and estimable. These judgments take into consideration 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 ( RCRA ), and the Toxic Substances Control Act ( TSCA ) and similar state, federal, 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. For a number of such sites, we do not currently possess sufficient information to reasonably estimate the amount of liabilities to be recorded. However, we believe, based on the amount and the 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 commenced remediation of this site in accordance with an approved plan. In the first quarter of 2010, we made a decision to enhance the remediation system to accelerate completion of the remediation and the system is currently operating. The additional cost associated with this enhancement is included in our accrual for this liability, which at June 30, 2011 is $1.9 million.

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*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. In May 2005, the NJDEP dismissed us from the Directive. In February 2004, 42 entities including Hexcel, 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 signed into an agreement with the EPA to participate (bringing the total number of participating entities to 43) 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. 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. Finally, 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. We expect additional discovery and litigation activities to occur during 2011. The court has issued a trial plan that contemplates a liability trial for third-party defendants (including Hexcel) in April 2013, with additional proceedings if necessary to allocate costs between third-party defendants in January 2014. 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. Management has determined that the cost-sharing agreement terminated in December 1998; however, the other party disputes this determination. The Washington Department of Ecology ( Ecology ) has issued a unilateral Enforcement Order to us requiring us to (a) maintain the interim remedial system and to perform system separation, (b) to conduct a focused remedial investigation and (c) to conduct a focused feasibility study to develop recommended long term remedial measures. We asserted defenses against performance of the order, particularly objecting to the remediation plan proposed by the previous owner, who still owns the adjacent contaminated site. However, we are currently complying with the order, with one exception, without withdrawing our defenses. As a result of a dispute resolution procedure, Hexcel and Ecology have reached an agreement to modify certain work requirements and to extend certain deadlines, and we are in full compliance with the order as modified. The total accrued liability related to this matter was $1.5 million at June 30, 2011.

*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. Hexcel contributed approximately 1.07% of the waste tonnage sent to the site during its operations. In addition to the Omega site specifically, the EPA is investigating the scope of regional groundwater contamination in the area and is preparing a proposed remedial action for the regional groundwater contamination. While the EPA has not finalized its Record of Decision as of this date, the Omega PRP Group members have been noticed by the EPA as potentially responsible parties who will be required to be involved in the remediation of the regional groundwater contamination as well. Hexcel will likely incur costs

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associated with the regional investigation and remediation as a member of the Omega Group, our ultimate liability, if any, in connection with this matter cannot be determined at this time.

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 June 30, 2011, our aggregate environmental related accruals were $4.7 million, of which $3.2 million was included in accrued liabilities with the remainder included in non-current liabilities. 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 $2.1 million and $1.7 million for the quarters ended June 30, 2011 and 2010, respectively, and $3.5 million and $2.4 million for the six months ended June 30, 2011 and 2010. In addition, our operating costs relating to environmental compliance charged directly to expenses were $2.5 million and $2.4 million for the quarters ended June 30, 2011 and 2010, respectively and $4.8 million and $4.7 million for the six-month periods ended June 30, 2011 and 2010, respectively. Capital expenditures for environmental matters were $0.1 million and $0.2 million for the quarters ended June 30, 2011 and 2010, respectively and $0.3 million and $0.4 million for the six-month periods ended June 30, 2011 and 2010, respectively.

*Litigation*

*Seemann Composites, Inc. v. Hexcel Corporation*

Seemann Composites, Inc., (SCI) sued us in the United States District Court, Southern District of Mississippi (Civil Action No. 1:09-cv-00675-HSO-JMR), filed September 16, 2009. SCI alleged that we supplied the wrong or a defective finished fabric to them, through one of our distributors, and sought unspecified compensatory damages and $10.0 million in punitive damages. This matter has now been settled with no material impact to the Company s results of operations.

*Product Warranty*

We provide for an estimated amount of product warranty expense at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience. In addition, we periodically review our warranty accrual and record any adjustments as deemed appropriate. Warranty expense for the six months ended June 30, 2011, and accrued warranty cost included in accrued liabilities in the condensed consolidated balance sheets at June 30, 2011 and December 31, 2010, was as follows:

| **(In millions)** | | **Product Warranties** |
|---|---|---|
| **Balance as of December 31, 2010** | $ | 4.3 |
| Warranty expense | | 0.7 |

| | | |
|---|---|---|
| **Balance as of March 31, 2011** | | 5.0 |
| Warranty expense | | |
| Deductions and other | | **(0.1)** |
| **Balance as of June 30, 2011** | **$** | **4.9** |

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**ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**

**Business Overview**

Hexcel Corporation and its subsidiaries, is a leading advanced composites company. We develop, manufacture, and market lightweight, high-performance composites, including carbon fibers, reinforcements, prepregs, honeycomb, matrix systems, adhesives and composite structures, for use in commercial aerospace, space and 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 and a wide variety of recreational equipment and other industrial applications.

We serve international markets through manufacturing facilities and sales offices located in the United States, Europe and Asia, and through sales representation offices located in Asia, Australia and South America. We also hold a 50% interest in Asian Composites Manufacturing Sdn. Bhd., located in Malaysia, which manufactures composite structures for commercial aerospace applications.

Hexcel has two segments, Composite Materials and Engineered Products. The Composite Materials segment manufactures and markets carbon fibers, fabrics and specialty reinforcements, prepregs, structural adhesives, honeycomb, composite panels, molding compounds, polyurethane systems and laminates that are incorporated into many applications, including military and commercial aircraft, wind turbine blades, recreational products and other industrial applications. The Engineered Products segment manufactures and markets composite structures and precision machined honeycomb parts for use primarily 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.

Net sales for the quarter were $353.7 million, 15.9% higher (11.9% in constant currency) than the $305.1 million reported for the second quarter of 2010. Year to date net sales were 18.4% higher in constant currency. The growth was led by both an increase in legacy commercial aerospace build rates and the ramp-up of new programs in the commercial aerospace market.

Commercial aerospace sales increased 29.1% (26.7% in constant currency) for the quarter as compared to the second quarter of 2010 and increased 29.5% (28.3% in constant currency) for the six-month period as compared to 2010. Revenues attributed to new aircraft programs (A380, A350, B787, and B747-8) were up more than 30% versus the same period last year and comprise more than 25% of Commercial Aerospace sales. Airbus and Boeing legacy aircraft related sales for the quarter were up over 25% as compared to the second quarter of 2010.

Sales to other commercial aerospace, which includes regional and business aircraft customers, were also up over 20% for the quarter and essentially the same as the first quarter 2011.

Space and Defense sales of $81.7 million were 2.9% higher (0.2% higher in constant currency) than the second quarter of 2010 and year to date

sales were 6.3% higher (4.9% higher in constant currency) than last year s comparable period. We continue to benefit from rotorcraft related growth.

Industrial sales of $64.2 million for the second quarter of 2011 were flat (lower by 8.9% in constant currency) as compared to the second quarter of 2010. Year to date sales were 14.8% higher (9.0% in constant currency) than a year ago. Wind sales for the quarter declined about 10% year over year, but were up more than 10% sequentially and remained in line with the average of the last twelve months. Industrial sales other than wind were modestly above the second quarter of 2010.

Gross margin was 24.6% of net sales for the quarter as compared to 25.7% in the same period last year. Although the quarter benefited from higher sales than last year, this year s results include increased spending for new line start ups, higher acrylonitrile costs (raw material commodity input for carbon fiber) and the disruption caused by April s Decatur, Alabama tornado. Adjusted operating income increased from 13.3% in the second quarter of 2010 to 14.0% in the second quarter of 2011. Higher sales volume combined with good cost control resulted in the higher operating margin. Gross margin was 24.8% for the first six months of 2011as compared to 25.4% in the same period last year. The impact for exchange rates on the quarter was nominal.

We expect to spend $150 to $175 million on capital additions in 2011, as we ramp-up for the expected growth ahead. Accrual basis additions to capital expenditures were $55.1 million in the first six months of 2011 as compared to $13.7 million during the first six months of 2010.

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Free cash flow (defined as cash provided by operating activities less capital expenditures) for the first six months was $9.5 million as compared to $11.6 million for the same period of 2010 primarily due to higher capital expenditures in 2011, offset by higher earnings and lower working capital increases.

Given the strong performance in the first half of the year and our current outlook, we are increasing our adjusted diluted EPS guidance for 2011 to $1.05 - $1.12 (from $0.95 - $1.05). We are also raising our sales guidance for the year to $1,325 million - $1,375 million from $1,275 million - $1,350 million.

**Second Quarter and Six-Month Results**

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions, except per share data)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| Net sales | $ 353.7 | $ 305.1 | 15.9% | $ 685.3 | $ 568.1 | 20.6% |
| Net sales change in constant currency | | | 11.9% | | | 18.4% |
| Operating income | 49.4 | 40.5 | 22.0% | 96.6 | 64.3 | 50.2% |
| Net income | 37.4 | 23.1 | 61.9% | 63.8 | 38.9 | 64.0% |
| Diluted net income per common share | $ 0.37 | $ 0.23 | | $ 0.63 | $ 0.39 | |
| | | | | | | |
| *Non-GAAP measures:* | | | | | | |
| Adjusted operating income | $ 49.4 | $ 40.5 | 22.0% | $ 90.9 | $ 67.8 | 34.1% |
| *As a percentage of net sales* | *14.0%* | *13.3%* | | *13.3%* | *11.9%* | |
| Adjusted net income | $ 31.9 | $ 23.1 | 38.1% | $ 57.2 | $ 37.6 | 52.1% |
| *Adjusted diluted earnings per share* | $ 0.32 | $ 0.23 | | $ 0.57 | $ 0.38 | |

The Company s performance measurements include operating and net income adjusted for special items, both of which are non-GAAP measures. Management believes these non-GAAP measurements are meaningful to investors because they provide a view of Hexcel with respect to ongoing operating results. Special items represent significant charges or credits that are important to understanding Hexcel s overall operating results in the periods presented. Such non-GAAP measurements are not recognized in accordance with generally accepted accounting principles and should not be viewed as an alternative to GAAP measures of performance. The following is a reconciliation from GAAP to non-GAAP amounts.

| | Quarter Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **(In millions, except per share data)** | **2011** | **2010** | **2011** | **2010** |
| Operating income | $ 49.4 | $ 40.5 | $ 96.6 | $ 64.3 |
| Other operating (income) expense (a) | | | (5.7) | 3.5 |
| Adjusted operating income | $ 49.4 | $ 40.5 | $ 90.9 | $ 67.8 |
| | | | | |
| Net income | $ 37.4 | $ 23.1 | $ 63.8 | $ 38.9 |
| Other operating (income) expense, net of tax (a) | | | (4.1) | 2.2 |
| Non-operating expense, net of tax (b) | | | 3.0 | |
| Benefit from tax audit settlement (c) | (5.5) | | (5.5) | |
| Tax credits (d) | | | | (3.5) |
| Adjusted net income | $ 31.9 | $ 23.1 | $ 57.2 | $ 37.6 |

(a) Other operating income for the six months ended June 30, 2011 is a benefit from the curtailment of our U.K. pension plan. In 2010, other operating expense is the increase in environmental reserves primarily for remediation of a manufacturing facility sold in 1986.

(b) Non-operating expense is the accelerated amortization of deferred financing costs and expensing of the call premium from the redemption of $150 million of 6.75% senior subordinated notes.

(c) Provision for income taxes includes a release of $5.5 million in the second quarter of 2011 of reserves primarily for uncertain to positions as a result of an audit settlement.

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(d) New Clean Energy Manufacturing Tax Credits awarded in the first quarter of 2010 for qualifying capital investments made in our U.S. wind energy facility in 2009.

## Net Sales

Net sales increased for the quarter and six months ended June 30, 2011 over the same periods in 2010, primarily reflecting higher sales volume in the commercial aerospace markets. On a constant currency basis, sales for the quarter ended June 30, 2011 were 11.9% higher than the same quarter in 2010 (15.9% increase at actual rates) and sales for the six months ended June 30, 2011 were 18.4% higher than the six months ended June 30, 2010 (20.6% increase at actual rates).

The following table summarizes net sales to third-party customers by segment and end market for the quarters and six months ended June 30, 2011 and 2010:

| (In millions) | Quarter Ended June 30, 2011 | 2010 | % Change | Six Months Ended June 30, 2011 | 2010 | % Change |
|---|---|---|---|---|---|---|
| **Consolidated Net Sales** | **$ 353.7** | **$ 305.1** | **15.9%** | **$ 685.3** | **$ 568.1** | **20.6%** |
| Commercial Aerospace | 207.8 | 161.0 | 29.1% | 405.4 | 313.0 | 29.5% |
| Space & Defense | 81.7 | 79.4 | 2.9% | 161.4 | 151.9 | 6.3% |
| Industrial | 64.2 | 64.7 | (0.8)% | 118.5 | 103.2 | 14.8% |
| | | | | | | |
| **Composite Materials** | **$ 276.8** | **$ 238.9** | **15.9%** | **$ 533.1** | **$ 439.3** | **21.4%** |
| Commercial Aerospace | 150.9 | 113.9 | 32.5% | 294.1 | 223.2 | 31.8% |
| Space & Defense | 62.5 | 60.7 | 3.0% | 122.4 | 113.8 | 7.6% |
| Industrial | 63.4 | 64.3 | (1.4)% | 116.6 | 102.3 | 14.0% |
| | | | | | | |
| **Engineered Products** | **$ 76.9** | **$ 66.2** | **16.2%** | **$ 152.2** | **$ 128.8** | **18.2%** |
| Commercial Aerospace | 56.9 | 47.1 | 20.8% | 111.3 | 89.8 | 23.9% |
| Space & Defense | 19.2 | 18.7 | 2.7% | 39.0 | 38.1 | 2.4% |
| Industrial | 0.8 | 0.4 | 100% | 1.9 | 0.9 | 111% |

Commercial Aerospace: Net sales increased $46.8 million, or 29.1% (26.7% on a constant currency basis), to $207.8 million for the second quarter of 2011. Net sales for the six months ended June 30, 2011 increased $92.4 million or 29.5% (28.3% on a constant currency basis) to $405.4 million over the six months ended June 30, 2010. For the quarter, Airbus and Boeing related sales were up over 25%, as both new and legacy program sales were strong. Revenues attributed to new aircraft programs (A380, A350, B787, and B747-8) represented more than 25% of commercial aerospace sales. Sales to other commercial aerospace, which includes regional and business aircraft customers, were up over 20% compared to the same period last year and essentially the same as the first quarter of 2011 in constant currency.

Space & Defense: Net sales increased $2.3 million, or 2.9% (0.2% on a constant currency basis), to $81.7 million for the second quarter of 2011. Net sales of $161.4 million for the six months ended June 30, 2011 increased $9.5 million or 6.3% (4.9% on a constant currency basis), above the prior year level as sales from rotorcraft grew as new programs and blade retrofit programs are increasingly composite based.

Industrial: Net sales for the second quarter of 2011 were flat (a decrease of 8.9% on a constant currency basis) as compared to the second quarter of 2010. Net sales for the six months ended June 30, 2011 increased $15.3 million or 14.8% (an increase of 9.0% on constant currency basis) to $118.5 million. Industrial sales other than wind were up modestly in the quarter but this was offset by the year-on-year decline in wind sales for the quarter. However, wind sales experienced double-digit sales growth sequentially and remained in line with the average of the last twelve months.

Gross Margin

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| Gross margin | $ 87.0 | $ 78.4 | 11.0% | $ 170.0 | $ 144.5 | 17.6% |
| Percentage of sales | 24.6% | 25.7% | | 24.8% | 25.4% | |

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The increase in gross margin of $8.6 million for the second quarter of 2011 and $25.5 million for the first six months of 2011 resulted from higher sales volume. This year s results include increased spending for new line start ups, staffing and training, as well as higher acrylonitrile costs (raw material commodity input for carbon fiber). Foreign exchange rates had a nominal impact.

Depreciation and amortization expense, on a constant currency basis, included in cost of sales during the quarter was $12.3 million, $0.3 million higher than the second quarter 2010.

Selling, General and Administrative Expenses ( SG&A )

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| SG&A expense | $ 29.7 | $ 29.6 | 0.3% | $ 62.6 | $ 61.0 | 2.6% |
| Percentage of sales | 8.4% | 9.7% | | 9.1% | 10.7% | |

On a constant currency basis, SG&A expenses for the second quarter were 4% lower than last year and for the six-month period they were up modestly over last year.

Research and Technology Expenses ( R&T )

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| R&T expense | $ 7.9 | $ 8.3 | (4.8)% | $ 16.5 | $ 15.7 | 5.1% |
| Percentage of sales | 2.2% | 2.7% | | 2.4% | 2.8% | |

On a constant currency basis, R&T expenses for the quarter were down modestly and for the six months ended June 30, 2011 they were slightly higher than last year.

Operating Income

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| **Consolidated operating income** | **$ 49.4** | **$ 40.5** | **22.0%** | **$ 96.6** | **$ 64.3** | **50.2%** |
| *Operating margin* | *14.0%* | *13.3%* | | *14.1%* | *11.3%* | |
| | | | | | | |
| Composite Materials | 48.5 | 42.8 | 13.3% | 98.3 | 73.3 | 34.1% |
| *Operating margin* | *16.7%* | *17.1%* | | *17.5%* | *15.9%* | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Engineered Products | 11.9 | 10.7 | 11.2% | 24.4 | 22.1 | 10.4% |
| *Operating margin* | *15.4%* | *16.1%* | | *16.0%* | *17.1%* | |
| Corporate & Other | (11.0) | (13.0) | (15.4)% | (26.1) | (31.1) | (16.1)% |

The 14% operating margin for the second quarter was the highest in Hexcel history, this was driven by good cost control and higher sales volume. Corporate and other, for the six-month period ended June 30, 2010, included $3.5 million of additional environmental reserves. Foreign exchange rates had a nominal impact on the results.

Interest Expense

| | Quarter Ended June 30, | | | Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **% Change** | **2011** | **2010** | **% Change** |
| Interest expense, net | $ 2.9 | $ 7.1 | (59.2)% | $ 7.1 | $ 13.7 | (48.2)% |
| Percentage of sales | 0.8% | 2.3% | | 1.0% | 2.4% | |

The decrease in interest expense for the quarter and six-month period of 2011was primarily due to the lower borrowing rate as a result of the July 2010 refinancing and the February 2011 bond redemption, as well as lower outstanding debt.

Provision for Income Taxes

| | Quarter Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **(In millions)** | **2011** | **2010** | **2011** | **2010** |
| Income tax (benefit) expense | $ 9.3 | $ 10.6 | $ 21.5 | $ 12.1 |
| Effective tax rate | 20.0% | 31.7% | 25.4% | 23.9% |

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The income tax provision was $9.3 million for the second quarter of 2011, an effective tax rate of 20%. The current quarter and six-month period include $5.5 million of benefit resulting primarily from the release of reserves for uncertain tax positions as a result of an audit settlement. Excluding this benefit, our effective tax rates would have been 31.8% for the quarter and 31.9% for the six months. Last year s second quarter tax provision was $10.6 million, a 31.7% effective tax rate. The income tax provision for the six months ended June 30, 2010 included $3.5 million of the New Clean Energy Manufacturing Tax Credits awarded in January 2010 for qualifying capital investments made in our U.S. wind energy facility in 2009. The effective tax rate excluding these credits would have been 30.8%.

**Financial Condition**

***Liquidity:*** As of June 30, 2011, we had cash and cash equivalents of $55.9 million. Aggregate borrowings as of June 30, 2011 under the Senior Secured Credit Facility (the Facility ) consisted of $170.0 million. The Facility permits us to issue letters of credit up to an aggregate amount of $40.0 million. Outstanding letters of credit reduce the amount available for borrowing under our revolving loan. As of June 30, 2011, we had issued letters of credit under the Facility totaling $2.0 million, resulting in undrawn availability under the Facility as of June 30, 2011 of $208.0 million. In addition, we borrowed $3.8 million from the credit line established in China associated with our operations there. Our total debt, net of cash, as of June 30, 2011 was $195.5 million, a decrease of $19.5 million from December 31, 2010.

The Facility 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 June 30, 2011, we were in compliance with all debt covenants and expect to remain in compliance.

We expect to meet our short-term liquidity requirements (including capital expenditures) through net cash from operating activities, cash on hand and our revolving credit facility. As of June 30, 2011, long-term liquidity requirements consist primarily of obligations under our long-term debt obligations. We do not have any significant required debt repayments until September 2014. Our term loan requires repayments at a rate of approximately $1.3 million per quarter through June 2012 and increasing to $2.5 million per quarter until June 2014. Our next required payment of $1.3 million is due in September 2011. Our revolver facility expires in July 2015.

***Operating Activities:*** Net cash provided by operating activities was $77.3 million in the first six months of 2011, as compared to net cash provided by operating activities of $31.7 million in the first six months of 2010 primarily from strong accounts receivable collections and higher earnings.

***Investing Activities:*** Net cash used for investing activities of $67.8 million in the first six months of 2011 was for capital expenditures. This compares to capital expenditures of $20.1 million during the first six months of 2010. The increase in capital spending in 2011 primarily reflects capacity expansions to meet the anticipated aerospace demand. We continue to expect accrual basis capital expenditures to be $150 to $175 million in 2011.

***Financing Activities:*** Financing activities used $77.0 million of net cash in the first six months of 2011 compared with using $27.9 million in the same period of 2010. On February 1, 2011, we redeemed $150 million of our $225 million 6.75% senior subordinated notes at a call premium of 2.25%. The redemption was primarily funded by a $135 million add-on to our senior secured credit facility that was completed in December 2010, of which $60 million was repaid in the first six months of 2011 using cash on hand. Last year, we repaid $30 million of our Senior Secured Credit Facility with cash on hand.

As a result of the redemption in 2011, we accelerated the unamortized financing costs of the senior subordinated notes being redeemed and expensed the call premium incurring a pretax charge of $4.9 million (after tax of $0.03 per diluted share) in the first quarter of 2011.

***Financial Obligations and Commitments:*** As of June 30, 2011, current maturities of notes payable and capital lease obligations were $9.3 million. The next significant scheduled debt maturity will not occur until 2014, in the amount of $10.0 million. Remaining debt and capital lease maturities in 2011 are approximately $2.8 million (refer to MD&A in our 2010 Annual Report on Form 10-K for further details regarding our financial obligations and commitments). We have one capital lease for a building which expires in 2021. In addition, certain sales and administrative offices, data processing equipment and manufacturing facilities are leased under operating leases.

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The loans under the Senior Secured Credit Facility are scheduled to mature in July of 2015. Our senior subordinated notes mature on February 1, 2015.

**Critical Accounting Estimates**

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. In connection with the preparation of our financial statements, we are required to make assumptions and estimates about future events, and apply judgments that affect reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors management believes to be relevant at the time our condensed consolidated financial statements are prepared. On a regular basis, management reviews accounting policies, assumptions, estimates and judgments to ensure our financial statements are presented fairly and in accordance with U.S. GAAP. However, because future events and their effects cannot be determined with certainty, actual results may differ from our assumptions and estimates, and such differences could be material.

We describe our significant accounting policies and critical accounting estimates in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. There were no significant changes in our accounting policies and estimates since the end of fiscal 2010.

**Forward-Looking Statements**

Certain statements contained in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute 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 , would , estimate , expect , intend , may , plan , predict , project , should , will , and similar ter 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 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, commodity prices, and in the market price of our common stock; and the impact of the above factors on our expectations of 2011 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 and cost reductions, supply chain disruptions 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, particularly in Asia and Europe; 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; 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

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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 3. Quantitative and Qualitative Disclosures about Market Risk**

There are no material changes in market risk from the information provided in the Company s 2010 Annual Report on Form 10-K.

**ITEM 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures as of June 30, 2011 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 second quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

The information required by Item 1 is contained within Note 13 on pages 13 through 15 of this Form 10-Q and is incorporated herein by reference.

**ITEM 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. In addition, future uncertainties may increase the magnitude of these adverse effects or give rise to additional material risks not now contemplated.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**(c)**

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| April 1 April 30, 2011 | 0 | $ N/A | 0 | 0 |
| May 1 May 31, 2011 | 20,215 | 21.83 | 0 | 0 |
| June 1 June 30, 2011 | 21,853 | 19.22 | 0 | 0 |
| Total | 42,068(1) | $ 20.47 | 0 | 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. Exhibits**

| Exhibit No. | Description |
|---|---|
| 10.1 | Revised Form of Employee Option Agreement (2011). |
| 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 Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations, (ii) Condensed Consolidated Balance Sheets, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) related notes. |

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Signature

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

Hexcel Corporation

July 25, 2011
(Date)

/s/ Kimberly A. Hendricks
Kimberly A. Hendricks
Vice President, Corporate Controller and
Chief Accounting Officer

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EXHIBIT INDEX

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