



Hexcel Corporation 2002 Annual Report

strength  
÷ weight



# Financial Highlights

(In millions, except per share data; year ended Dec. 31)

	2002	2001	2000
Sales	\$ 850.8	\$ 1,009.4	\$ 1,055.7
Gross margin	19.0%	18.9%	21.9%
Operating income	\$ 60.2	\$ (316.2)	\$ 75.4
Net income (loss)	\$ (13.6)	\$ (433.7)	\$ 54.2
Diluted income (loss) per share	\$ (0.35)	\$ (11.54)	\$ 1.32

## About Hexcel

The theme of this year's annual report is "Strength Divided by Weight" – a ratio that describes why our products are so valuable in many applications. Hexcel materials are used in thousands of products, making everyday life easier and safer for millions of people around the world. Engineers and designers often choose our materials because we can help strengthen their products while also making them lighter. From our roots in commercial and military aerospace, we have expanded into surface transportation markets – providing materials for high-speed trains, ferries, trucks and a fast-growing line of materials for automobiles. We are helping make the world a cleaner place through our involvement in the rapidly growing wind-energy business. We are helping make the world safer for military personnel and law enforcement and correctional officers with ballistic materials used in the fabrication of soft body armor and other protective applications. We also help you communicate by producing fiberglass fabrics that are the substrate material for printed wiring boards used in many electronic devices. And we make your free time more fun by producing materials that improve the performance of skis, snowboards, bicycles, golf clubs, hockey sticks and tennis rackets. Hexcel's employees are constantly working with new and existing customers to expand the role of advanced structural materials and to grow our share of applications in markets that offer long-term growth. We are the strength within many of today's lightweight, high-performance products.

### Forward-Looking Statements

#### **Risks, Uncertainties, Other Factors with Respect to "Forward-Looking Statements"**

Certain statements contained in this document constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements that are not of historical fact constitute "forward-looking statements" and, accordingly, involve estimates, assumptions, judgments and uncertainties. There are a number of factors that could cause actual results or outcomes to differ materially from those addressed in the forward-looking statements. Such factors are detailed in the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002 filed with the Securities and Exchange Commission, along with Quarterly Reports on Form 10-Q subsequently filed with the SEC.

## To Our Shareholders

At our 2003 senior management conference held this February, we opened the session with punishing boxing clips from the movie *Rocky*, with the song “Hit me with your best shot!” blaring over the video. For the last two years, it seems like our company has been standing in for Rocky – taking punch after punch, but always coming back for more. In that period, three important markets for our products – commercial aerospace, electronics and space – went into cyclical declines faster and further than any other time in recent memory. But we took the punches, and are still standing strong – maybe stronger than before.

*In this letter one year ago, we suggested that the events of September 11th could cause a 2002 revenue decline of 15%.*

Of course, we were trying to be conservative to prepare for the worst. Unfortunately, this prediction turned out to be more accurate than conservative. Commercial aerospace sales, our biggest market segment, dropped \$147.8 million, over 27% from 2001. Electronics sales declined about another 25% to \$58.3 million. This was a business that generated over \$181 million in revenue in 2000. While it appears to have stabilized since the precipitous drop in early 2001, it now represents only 7% of the company's sales. On the plus side, our sales to military markets increased again in 2002 and the segment we refer to as industrial also grew as our advanced materials gain favor in a diverse range of end uses such as ballistics, wind energy, automotive and recreation. So in total, our 2002 sales were \$850.8 million, down a staggering 15.7% from the prior year.

*Also in this letter last year, we committed to a 20% reduction in cash fixed costs to respond to the sales decline expectation.*

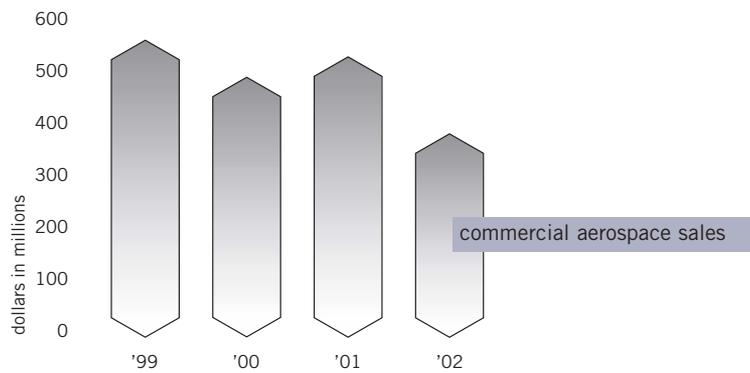


David E. Berges  
Chairman, President and CEO

If we staggered, we were back in control by the end of the first quarter: our broad-based restructuring program exceeded every goal. Against the cash fixed takeout target of \$60 million, we overachieved. We did more, sooner, for less money than we planned. Our 2002 cash fixed costs were down almost 23%, \$66 million from 2001 levels even though the cuts began in 2001, making for some difficult year over year comparisons. In fact, going back to the second quarter of 2001, when our electronics market troubles had just become apparent, and before that dreadful date in September, the Hexcel team has demonstrated a relentless commitment to reshape the company.

The job reductions that drove the cost savings were difficult for everyone, most of all those faithful employees who could no longer be with us.

But the restructuring program was based on a plan that thought about an organization for the new market realities, not simplistic across the board



cuts. We defined an organization that was smaller for sure, but preserved what we needed to accelerate our recovery when markets cooperate.

The plan focused on being lean, not skinny; on taking advantage of the talents of the people closest to our customers and businesses, not defending layers and corporate infrastructure intended for the growth vision of the 90s; on positions that might formerly have been considered fixed, not just variable labor. In the last six quarters, we've eliminated 50% of the top ten senior executive positions, reduced corporate staff by 40%, and total company employment by over 30%. We moved quickly after 9/11, but we didn't stop, nor will we. We know there are more rounds to this fight and continue to look for productivity improvements and opportunities to reduce fixed costs.

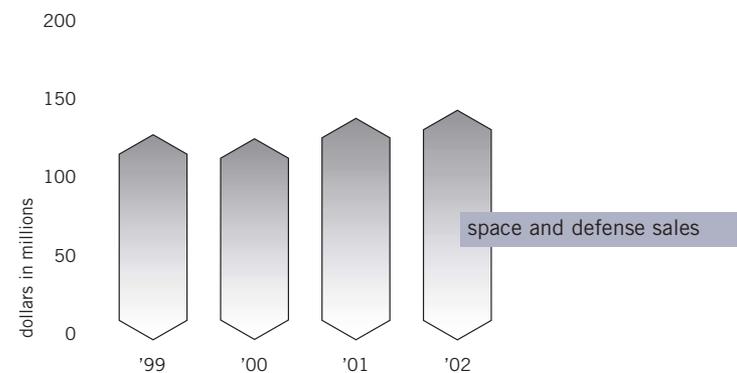
*We also promised to focus on cash flows given a capital structure that could at best be described as fragile under the circumstances.*

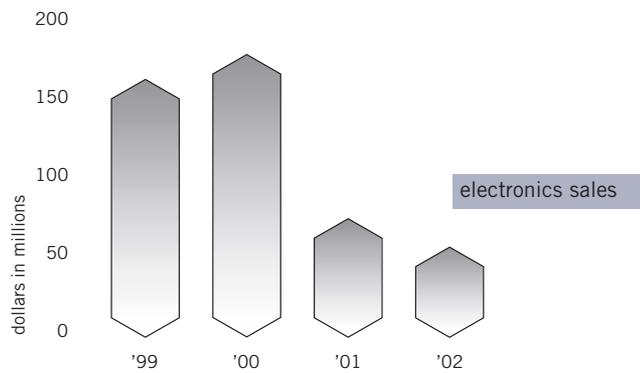
Our cash flow focus resulted in a performance that also exceeded every goal. We had hoped to hold our debt level through the period despite the cash expenses of restructuring. Instead, we reduced net debt by over \$60 million dollars, \$90 million if you return to the summer of 2001 when our markets began their collapse. Over \$24 million in cash restructuring costs were almost covered by a litigation win and partial sale of our interest in a joint venture. Most of the rest of the gains came from operations.

Good operational performance and carefully controlled capital spending played a big role. As for inventories, after a \$32 million reduction in the fourth quarter of 2001, we developed momentum from a broad-based rally to action by our employees. In 2002, additional inventory reductions took us to the lowest levels in six years. These cuts were from lean manufacturing and other initiatives in our plants, between our plants, with our customers and suppliers; and we actually improved our on-time delivery performance in the period. So in what we hope will be the blackest six quarters in Hexcel's history, we reduced our debt by almost 13% with basic blocking and jabbing.

*Finally, we assured our shareholders last year that we would not be deterred from our destiny of long-term growth.*

Organizations supporting growth, such as research and technology, sales and customer service saw far fewer reductions than the company average. A thorough review of the projects of our customers and of our research departments provided us with the information we needed to concentrate our efforts on the best opportunities to better serve our customers, grow our revenues, create more value and provide sustainable competitive advantages for the future. In some areas we increased our investments and staffing.





Airbus selected our new cost-effective M21 carbon fiber prepreg system that will allow them to expand the use of composites on the new Airbus A380. This system becomes Hexcel's new standard for primary structure prepreg, replacing numerous more costly systems and providing the opportunity for standardization and industrialization. We are also working with Boeing to define the products they will utilize on their new programs. Test results on our new NC2 reinforcement materials suggest the promise of mechanical performance close to prepregs when used in conjunction with lower cost composite part production methods such as resin film infusion and resin transfer molding. We introduced a whole new range of adhesives and pastes for aerospace and industrial applications.

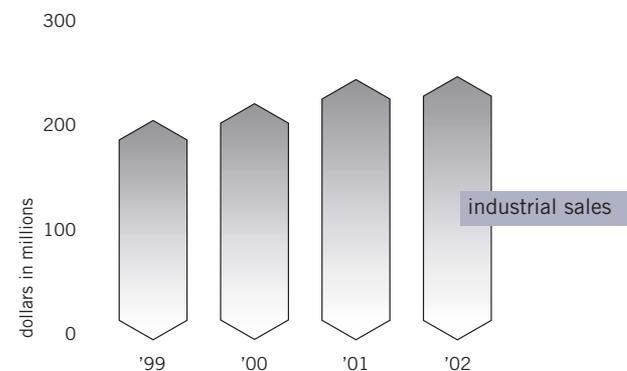
With extensive investment in new resin matrices, reinforcement technologies and manufacturing processes, we expanded our offerings to the wind energy market. Massive wind turbines, dependent on advanced structural materials like ours, are being installed at a rate that is growing about 30% per year. Our advances in "pultrusion" development have allowed us to demonstrate the automated manufacture of a 60-foot carbon fiber composite beam, drawing significant attention from aerospace designers hoping to take weight out of new aircraft. We are developing technology that allows us to produce higher quality, flatter, lightweight substrate materials for printed wiring boards. Our architectural unit has demonstrated a solar screen concept material for office buildings that darkens

when exposed to UV light, much like some modern sunglasses.

The list goes on and on.

### March 2003 Re-capitalization

While we are happy that we met our commitments as laid out last year, we are most pleased that this performance allowed us to go beyond our stretch goals and deal with an issue we didn't have on the short-term agenda, the "gorilla in the room" – our over-leveraged balance sheet and near-term debt maturities. Our strong results in the face of adversity, delivered quarter by quarter, gave us the confidence to advance our plans to deal with these issues. On March 19, 2003, we closed on three transactions to re-capitalize the company. We issued new equity for \$125 million in cash, raised \$125 million through issuing senior secured notes due in 2008, and established a new \$115 million senior secured credit facility, also good to 2008. With the proceeds, we dealt with our 2003 convertible notes as well as refinanced our existing senior credit facility, the largest element of which was to come due in 2004. The result is a further reduction of almost 20% in our debt and a much-improved capital structure that moves all significant scheduled debt maturities out more than four years, well into the recovery of our markets envisioned by even pessimistic analysts. We've now got a helmet to cushion us against any headshots we might encounter.



So in conclusion, we feel good about what we accomplished in 2002.

The cuts we made were painful, but there was widespread employee support for the actions. All understood we were in the fight of our lives and everyone contributed. First we right-sized the company's operations and now we've right-sized the capital structure. The organization has adapted and become confident that we can operate just as effectively, if not more so, than before. Focus, intensity, decision-making processes and intra-company cooperation have, by necessity, improved. There is a spirit of defiant survival like that you can feel in New York City today.

The short-term outlook for some of our markets doesn't appear to offer us any relief. We know we may take a few more punches, but we also know how to respond. We continue to be encouraged that our products are becoming more and more critical in applications with strong long-term growth trends. We have come to believe that this new lean company can get leverage with the first dollar of growth and we don't need to wait for the sales levels of the late 90s.

Rocky lost in the first movie, and Hexcel certainly went down in '01.

But he made a comeback in *Rocky II* and so did we in Hexcel '02.

Given the global uncertainty, we haven't made any public projections for 2003, but for a glimpse at what we're thinking, you might want to rent *Rocky III*.



David E. Berges

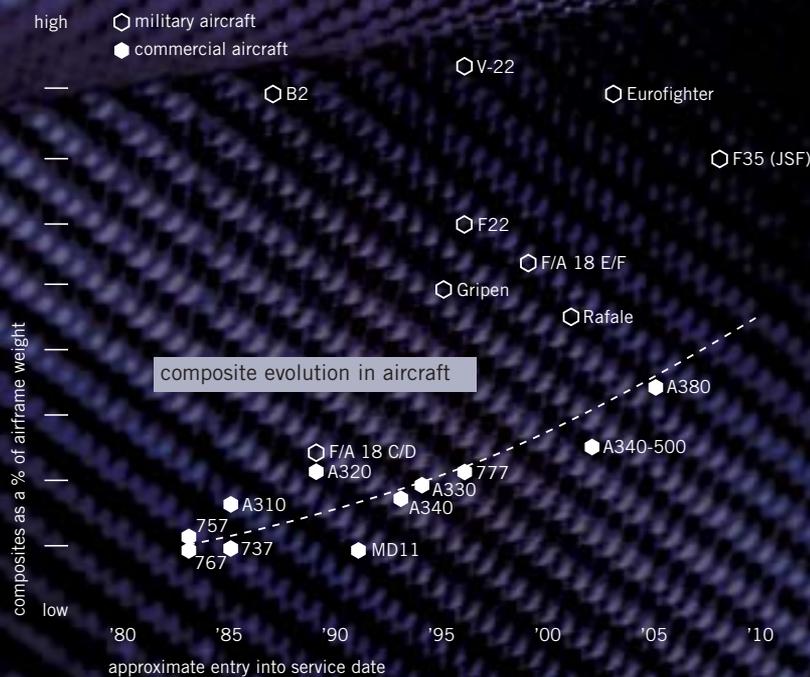
Chairman, President and CEO

## introduction

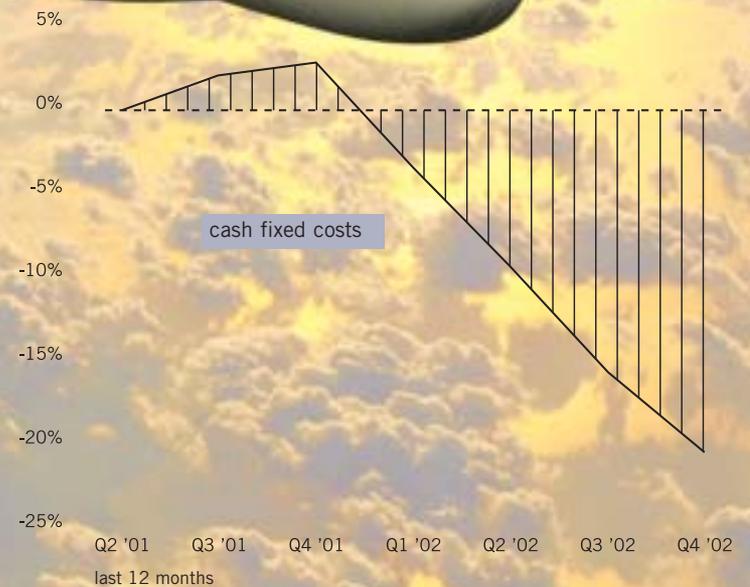
Hexcel's materials have unique properties that make them special and therefore desirable to engineers in a variety of industries. These properties create materials that are lighter, stronger and resistant to corrosion and fatigue, stiffer under stress and longer lived than the traditional materials they have been replacing. In the last year, we've come to believe that Hexcel as a corporation has become like our products – doing more with less, lean and agile, long-lived and resilient. Both our materials and our corporation create value by being stronger with less weight (strength/weight). In the pages that follow, we will explore the analogy as we talk about “*our advanced materials*” and the advances “*our company*” has made in the last year.

## lighter

Hexcel materials can dramatically reduce weight without reducing the strength of a product. Our start was in honeycomb, a revolutionary product in the 1940s that dramatically reduced the weight of military bombers. Today honeycomb is still used to reduce the weight of both commercial and military aircraft but we also supply prepregs, reinforcement fabrics and fibers that have replaced metals due to their superior strength and lighter weight. Additionally we weave reinforcements that are used as the substrate in complex printed wiring boards required for many of today's electronic devices.



composite evolution in aircraft



## lower fixed costs

Hexcel as an organization has dramatically reduced its cash fixed costs since November of 2001. Cash fixed costs have declined by approximately \$66 million in 2002 or about 23%. This was primarily accomplished by making the company "lighter" i.e. employing less people. But Hexcel is as strong as ever, and we continue to produce high quality products to meet our customers' needs and remain a leader in the development of new advanced composites.

woven carbon fabric | a reinforcement fabric used in production of prepreps for structural applications.

A380 | computer-simulated photo of the new Airbus A380, which will be the largest commercial aircraft when it enters service in 2006. Hexcel materials will be used extensively in this aircraft.



stiffness

strength

- fly fishing rods
- satellites missiles
- carbon fiber applications
- aircraft primary structure rockets
- sporting goods aircraft secondary structure
- automotive industrial

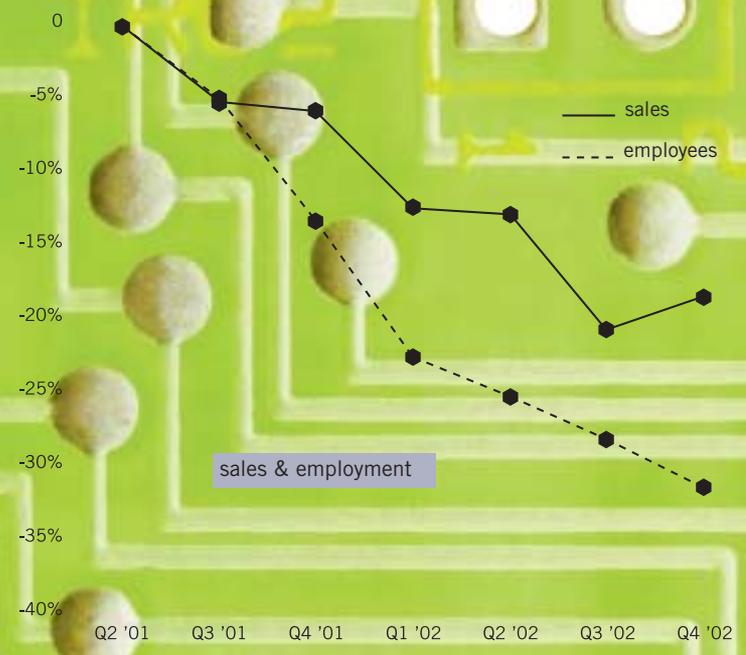
## tailored

Hexcel materials can be uniquely tailored to meet the design needs of our customers. We can specially weave and treat an aramid fabric to produce the critical materials used in the fabrication of soft body armor. We can also tailor the properties in fabrics and resins to produce prepregs that can bear loads differently than metals or adjust the materials used in honeycombs to vary both their strength and impact resistance. Best of all, the tailorability of our materials doesn't sacrifice their lightweight properties.

carbon fiber | fiber produced by carbonizing our PAN (polyacrylonitrile) precursor and used in structural applications.

## adaptable

Hexcel has been able to adapt to constantly changing economic pressures by participating in several core markets to diversify our exposure. The company continuously tailors its production capacity, allocation of resources and its research energies to best support the core market that is either growing or about to re-enter a growth phase. This is evident today in the benefits we are capturing in the defense market from past investments in carbon fiber technology, and it will become evident in the years to come as investments in reinforcement and prepreg technologies take greater prominence in commercial aerospace and industrial applications.

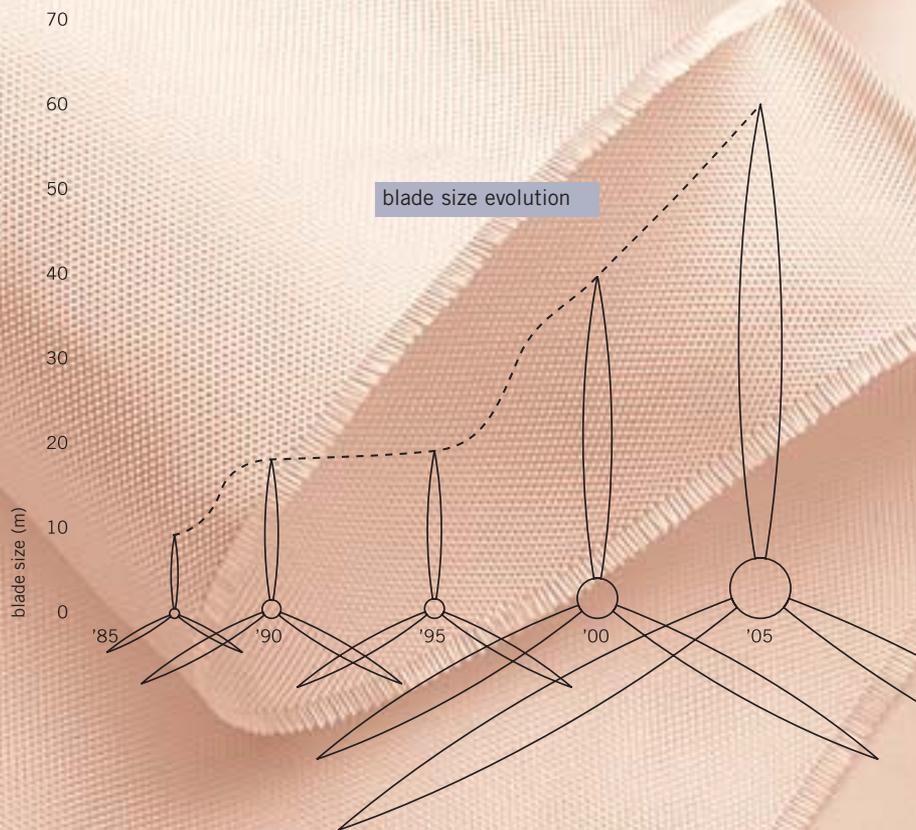


sales & employment

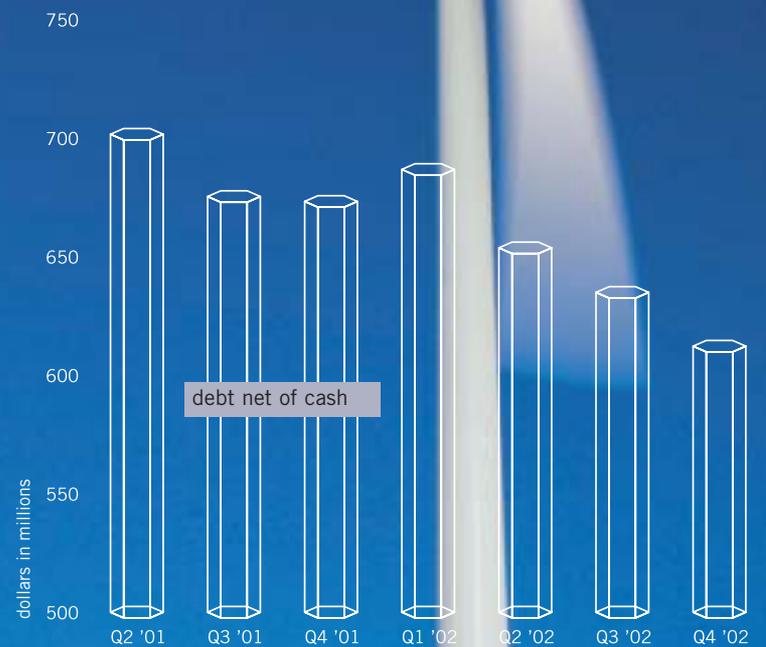
printed wiring board | Hexcel produces fiberglass fabric substrates used for complex printed wiring boards.

## strong

Hexcel materials can be extremely strong, bearing significantly higher loads than comparable amounts of traditional materials. Our materials can also be strong enough to stop a bullet or a knife, and provide protection from explosive fragments. Most impressive is that this strength is usually accompanied by light weight.



woven fiberglass | a reinforcement fabric used in printed wiring board substrates, prepregs and other composite applications.



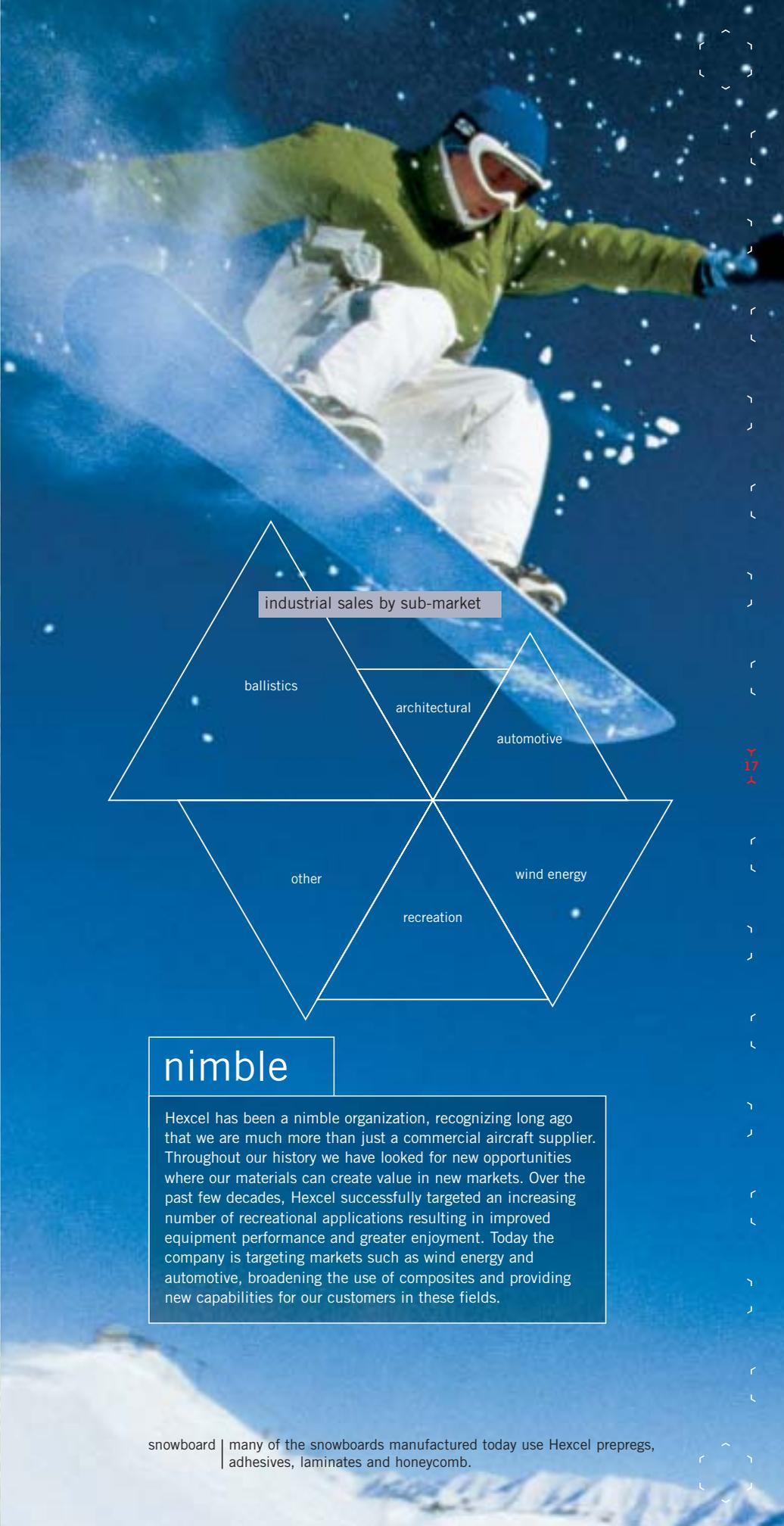
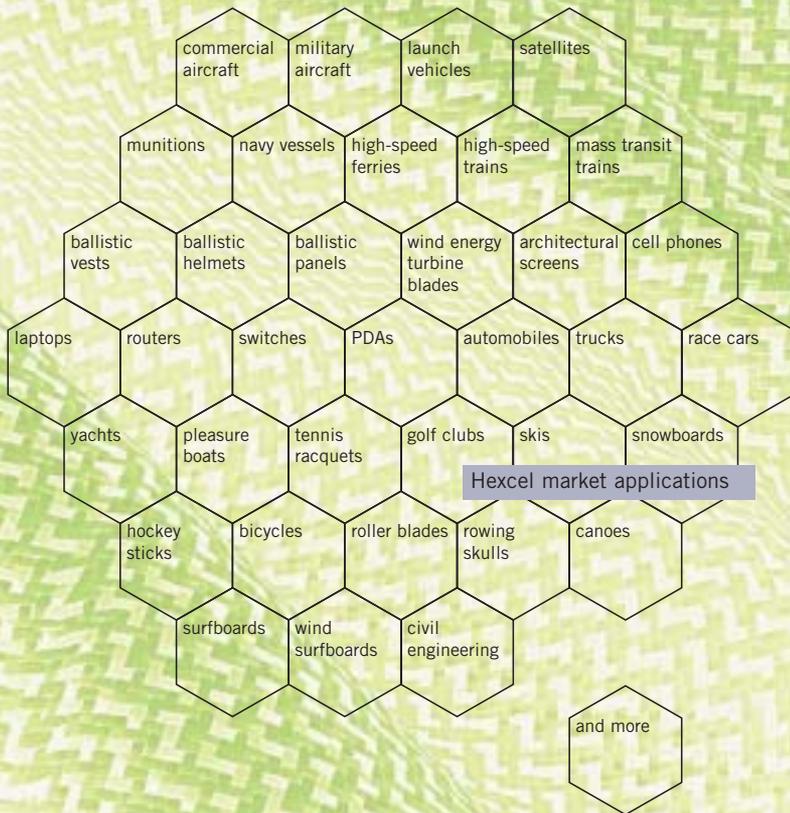
## fortitude

We at Hexcel have always considered ourselves a strong company based on our manufacturing know-how and managerial expertise. We have used our strength to grow by acquisition throughout our history and to pay off the debts associated with these purchases. Since June of 2001, we have reduced our total net debt by \$90.7 million (12.9%) despite major declines in two key markets and a major restructuring of our workforce through strong operational management and sales of non-core assets. Further, in 2003 we attracted new equity investment reducing our total debt by approximately another 20%. We have also refinanced our senior credit facility, significantly reducing scheduled debt amortization.

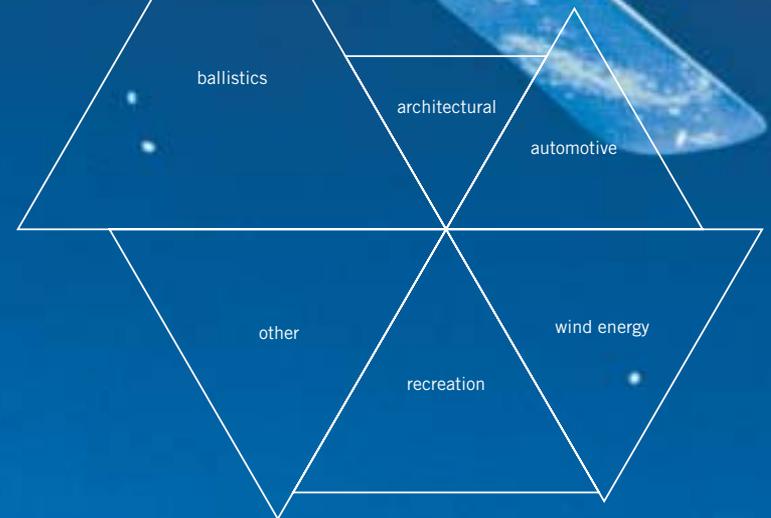
wind turbine | a modern wind turbine currently in service in Europe. Hexcel materials are used in the fabrication of the blades, which can be 30 to 60 meters in length.

## modalable

Hexcel materials can be molded or shaped into countless forms or structures. Our products can serve many markets because they are so adaptable. Yet their core properties remain unchanged: stronger, lighter and stiffer than traditional materials. We provide enabling technology for a diversity of applications ranging from the vertical stabilizer on an aircraft to satellite structures to mobile phones and hockey sticks.



## industrial sales by sub-market

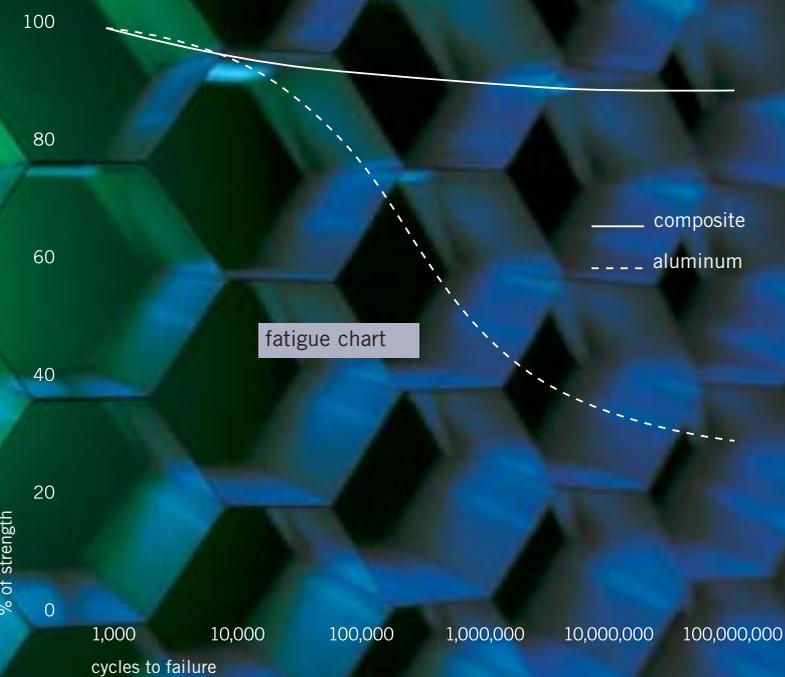


## nimble

Hexcel has been a nimble organization, recognizing long ago that we are much more than just a commercial aircraft supplier. Throughout our history we have looked for new opportunities where our materials can create value in new markets. Over the past few decades, Hexcel successfully targeted an increasing number of recreational applications resulting in improved equipment performance and greater enjoyment. Today the company is targeting markets such as wind energy and automotive, broadening the use of composites and providing new capabilities for our customers in these fields.

hybrid fabric | a reinforcement material used in structural or decorative applications.

snowboard | many of the snowboards manufactured today use Hexcel prepregs, adhesives, laminates and honeycomb.



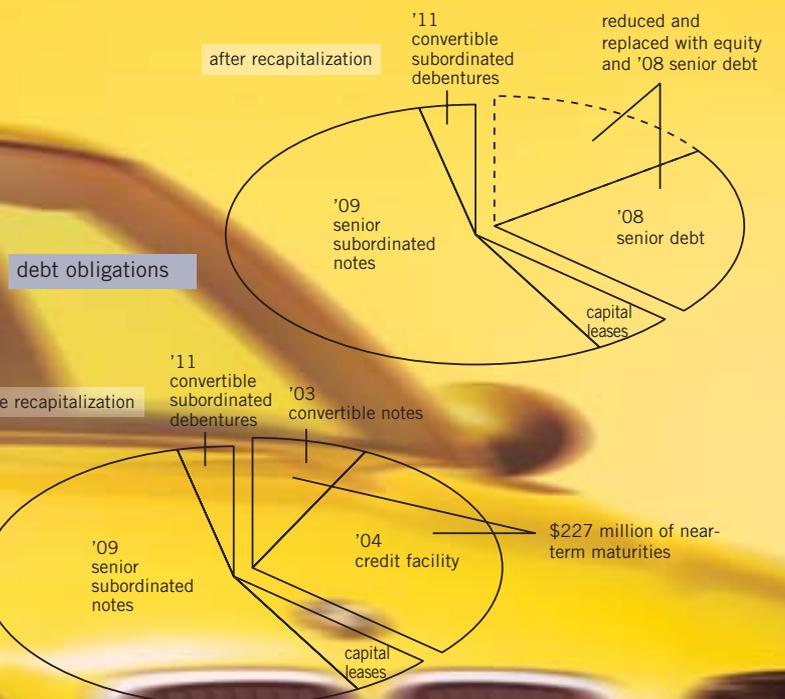
## long life

Hexcel materials do not corrode or fatigue like traditional materials. Our composites can be exposed to numerous mechanical cycles whether in the sky or out in space and they don't break down. Resistance to corrosion and fatigue are just two more of the key advantages composites have over traditional metals.

honeycomb | a unique, lightweight, cellular structure made from either metallic or non-metallic sheet materials and formed into hexagonal nested cells.

## resilient

Hexcel serves cyclical OEM markets: aerospace, electronics, transportation. As a result we have seen a number of good times and bad times. The company has been resilient, riding out each down draft to soar even higher in the next, inevitable upturn. Recently, Hexcel restructured its capital structure so that we can better weather the current down cycle. As you can see in the charts below, the company's major debt maturities are now scheduled for 2008 and beyond, when we should have returned to better times in our core markets.



automobile | Hexcel materials are utilized in bumper safety applications in certain automobiles. Other manufacturers use Hexcel materials for interior safety applications.

# Corporate Governance

Hexcel continues to maintain a high standard in its disclosure controls and procedures. The company has implemented policies and procedures to address its current obligations under the Sarbanes-Oxley Act and related SEC rules, as well as under the rules of the NYSE. As the SEC and the NYSE provide further guidance and mandates, the company will adopt policies and procedures to assure that any new standards are met.

Hexcel has a long-standing code of business conduct that is periodically reviewed so that it reflects the current laws and best practices. The code was adopted by the board of directors and is sponsored by the senior management of the company.

Each employee is annually requested to review the code and is reminded that compliance with the code is an important company policy. As well, the company has a toll-free, international, 24/7 hotline where employees can anonymously report code infractions.

Hexcel also has other policies and procedures that help assure and confirm compliance with the code.

## Board of Directors

David E. Berges  
Chairman  
President and Chief Executive Officer  
Hexcel Corporation

Joel S. Beckman  
Managing Partner  
Greenbriar Equity Group LLC

H. Arthur Bellows, Jr.  
Chairman  
Braeburn Associates and  
The Finance Network  
Audit Committee  
Finance Committee

Sandra L. Derickson  
Group Executive  
Retail Services, Refund Lending &  
Insurance Services  
Household International

James J. Gaffney  
Vice Chairman  
Viking Pacific Holdings Ltd.  
Audit Committee

Sanjeev K. Mehra  
Managing Director  
Merchant Banking Division  
Goldman, Sachs & Co.  
Compensation Committee\*  
Finance Committee\*  
Nominating Committee

Lewis Rubin  
President and Chief Executive Officer  
XTRA Corporation  
Audit Committee\*

Peter M. Sacerdote  
Advisory Director  
Goldman, Sachs & Co.

Robert J. Small  
Managing Director  
Berkshire Partners

Martin L. Solomon  
Co-Chairman  
American Country Holdings, Inc.  
Compensation Committee\*  
Finance Committee

\*Denotes Committee Chairman

## Executive Officers

David E. Berges  
Chairman  
President and Chief Executive Officer

Stephen C. Forsyth  
Executive Vice President and  
Chief Financial Officer

Ira J. Krakower  
Senior Vice President  
General Counsel and Secretary

William J. Fazio  
Corporate Controller

Michael J. MacIntyre  
Treasurer

William Hunt  
President, Composites Business Unit

Joseph H. Shaulson  
President, Reinforcements Business Unit

David R. Tanonis  
President  
Structures and Interiors Business Unit

## Corporate Information

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or go to www.hexcel.com.

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Stock Exchanges  
Hexcel common stock is listed on the New  
York Stock and Pacific Exchanges under  
the symbol "HXL."



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