

HEXCEL CORP /DE/
Form 10-Q
July 22, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended June 30, 2013

or

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

For the transition period from to

Commission File Number 1-8472

Hexcel Corporation

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

94-1109521
(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 No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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

Class
COMMON STOCK

Outstanding at July 18, 2013
99,489,439

Table of Contents

HEXCEL CORPORATION AND SUBSIDIARIES

INDEX

	Page	
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	
	• <u>Condensed Consolidated Balance Sheets June 30, 2013 and December 31, 2012</u>	3
	• <u>Condensed Consolidated Statements of Operations The Quarters and Six Months Ended June 30, 2013 and 2012</u>	4
	• <u>Condensed Consolidated Statements of Comprehensive Income The Quarters and Six Months Ended June 30, 2013 and 2012</u>	4
	• <u>Condensed Consolidated Statements of Cash Flows The Six Months Ended June 30, 2013 and 2012</u>	5
	• <u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>ITEM 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	20
<u>ITEM 4.</u>	<u>Controls and Procedures</u>	21
<u>PART II.</u>	<u>OTHER INFORMATION</u>	21
<u>ITEM 1.</u>	<u>Legal Proceedings</u>	21
<u>ITEM 1A.</u>	<u>Risk Factors</u>	21
<u>ITEM 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
<u>ITEM 6.</u>	<u>Exhibits and Reports on Form 8-K</u>	21
<u>SIGNATURE</u>		22

Table of Contents**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)	June 30,	(Unaudited)	December 31,
	2013		2012
Assets			
Current assets:			
Cash and cash equivalents	\$ 56.7	\$	32.6
Accounts receivable, net	246.1		229.0
Inventories, net	251.7		232.8
Current deferred tax assets and other current assets	71.8		81.3
Total current assets	626.3		575.7
Property, plant and equipment	1,521.0		1,459.2
Less accumulated depreciation	(560.2)		(544.8)
Property, plant and equipment, net	960.8		914.4
Goodwill and intangible assets	57.4		57.8
Investments in affiliated companies	23.3		22.6
Deferred tax assets	13.9		15.4
Other assets	13.3		17.2
Total assets	\$ 1,695.0	\$	1,603.1
Liabilities and Stockholders Equity			
Current liabilities:			
Short-term borrowings and current maturities of debt	\$ 5.0	\$	16.6
Accounts payable	114.2		115.7
Accrued liabilities	94.5		103.0
Total current liabilities	213.7		235.3
Long-term debt	309.0		240.0
Other non-current liabilities	131.1		133.7
Total liabilities	653.8		609.0
Stockholders equity:			
Common stock, \$0.01 par value, 200.0 shares authorized, 103.8 and 102.4 shares issued at June 30, 2013 and December 31, 2012, respectively	1.0		1.0
Additional paid-in capital	640.1		617.0
Retained earnings	540.3		448.2
Accumulated other comprehensive loss	(42.7)		(31.9)
	1,138.7		1,034.3
	(97.5)		(40.2)

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Less Treasury stock, at cost, 4.3 shares at June 30, 2013 and 2.5 shares at December 31, 2012				
Total stockholders' equity		1,041.2		994.1
Total liabilities and stockholders' equity		\$ 1,695.0	\$	1,603.1

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

Table of Contents**Hexcel Corporation and Subsidiaries****Condensed Consolidated Statements of Operations**

(In millions, except per share data)	Quarter Ended June 30,		(Unaudited)	
	2013	2012	Six Months Ended June 30, 2013	2012
Net sales	\$ 422.6	\$ 399.2	\$ 839.1	\$ 799.3
Cost of sales	305.8	293.7	610.3	587.4
Gross margin	116.8	105.5	228.8	211.9
Selling, general and administrative expenses	34.8	32.5	72.8	69.1
Research and technology expenses	10.1	8.6	21.1	17.8
Other operating (income)		(9.5)		(9.5)
Operating income	71.9	73.9	134.9	134.5
Interest expense, net	2.1	3.0	3.8	6.0
Non-operating expense	1.0	1.1	1.0	1.1
Income before income taxes and equity in earnings of affiliated companies	68.8	69.8	130.1	127.4
Provision for income taxes	20.6	22.1	38.5	40.5
Income before equity in earnings of affiliated companies	48.2	47.7	91.6	86.9
Equity in earnings of affiliated companies	0.3	0.3	0.5	0.7
Net income	\$ 48.5	\$ 48.0	\$ 92.1	\$ 87.6
Basic net income per common share:	\$ 0.49	\$ 0.48	\$ 0.92	\$ 0.88
Diluted net income per common share:	\$ 0.48	\$ 0.47	\$ 0.90	\$ 0.86
Weighted average common shares outstanding:				
Basic	100.0	100.2	100.2	100.0
Diluted	101.8	102.0	102.0	101.9

Hexcel Corporation and Subsidiaries**Condensed Consolidated Statements of Comprehensive Income**

(In millions, except per share data)	Quarter Ended June 30,		(Unaudited)	
	2013	2012	Six Months Ended June 30, 2013	2012
Net income	\$ 48.5	\$ 48.0	\$ 92.1	\$ 87.6
Currency translation adjustments	6.6	(18.1)	(10.4)	(7.1)
Net unrealized pension and other benefit actuarial gains (losses) and prior service costs (credits)		0.7	2.6	0.3
Net unrealized gains (losses) on financial instruments, net of tax	3.2	(5.3)	(3.0)	(1.5)

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Total other comprehensive income (loss)		9.8		(22.7)		(10.8)		(8.3)
Comprehensive income	\$	58.3	\$	25.3	\$	81.3	\$	79.3

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

Table of Contents**Hexcel Corporation and Subsidiaries****Condensed Consolidated Statements of Cash Flows**

(In millions)	(Unaudited)	
	Six Months Ended June 30,	
	2013	2012
Cash flows from operating activities		
Net income	\$ 92.1	\$ 87.6
Reconciliation to net cash provided by operating activities:		
Depreciation and amortization	28.1	28.3
Amortization of deferred financing costs and call premium expense	1.5	2.1
Deferred income taxes	17.6	15.3
Equity in earnings from affiliated companies	(0.5)	(0.7)
Stock-based compensation	12.0	10.5
Gain on sale of property		(4.9)
Excess tax benefits on stock-based compensation	(4.0)	(5.4)
Changes in assets and liabilities:		
Increase in accounts receivable	(14.6)	(54.4)
Increase in inventories	(20.3)	(28.7)
(Increase) decrease in prepaid expenses and other current assets	(9.0)	1.5
Increase in accounts payable and accrued liabilities	4.7	28.0
Other-net	0.6	(5.4)
Net cash provided by operating activities	108.2	73.8
Cash flows from investing activities		
Proceeds from sale of real estate		5.3
Capital expenditures	(92.0)	(144.4)
Net cash used for investing activities	(92.0)	(139.1)
Cash flows from financing activities		
Proceeds from senior secured credit facility	309.0	121.0
Capital lease obligations and other debt, net	(1.6)	4.1
Issuance costs related to senior secured credit facility	(2.2)	(0.6)
Repayment of senior secured credit facility - term loan	(85.0)	(2.5)
Repayment of senior secured revolving credit facility	(165.0)	
Purchase of stock	(50.0)	
Activity under stock plans	3.8	2.5
Repayment of 6.75% senior subordinated notes		(73.5)
Call premium payment for 6.75% senior subordinated notes		(0.8)
Net cash provided by financing activities	9.0	50.2
Effect of exchange rate changes on cash and cash equivalents	(1.1)	(1.8)
Net increase (decrease) in cash and cash equivalents	24.1	(16.9)
Cash and cash equivalents at beginning of period	32.6	49.5
Cash and cash equivalents at end of period	\$ 56.7	\$ 32.6
Supplemental data:		
Accrual basis additions to property, plant and equipment	\$ 82.1	\$ 114.5

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

Table of Contents

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, 2012 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, 2012 was derived from the audited 2012 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 2012 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 8, 2013.

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.

Recently Adopted Accounting Pronouncements

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

In February 2013 the Financial Accounting Standards Board issued Accounting Standards Update 2013-02 Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income . The Company adopted this update in the first quarter of 2013. The amounts reclassified out of accumulated other comprehensive income during the six-month period were not material.

Note 2 Net Income per Common Share

(In millions, except per share data)	Quarter Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<i>Basic net income per common share:</i>				
Net income	\$ 48.5	\$ 48.0	\$ 92.1	\$ 87.6
Weighted average common shares outstanding	100.0	100.2	100.2	100.0
Basic net income per common share	\$ 0.49	\$ 0.48	\$ 0.92	\$ 0.88
<i>Diluted net income per common share:</i>				
Net income	\$ 48.5	\$ 48.0	\$ 92.1	\$ 87.6
Weighted average common shares outstanding				
Basic	100.0	100.2	100.2	100.0
<i>Plus incremental shares from assumed conversions:</i>				
Restricted stock units	0.7	0.6	0.7	0.7
Stock options	1.1	1.2	1.1	1.2
Weighted average common shares outstanding				
Dilutive	101.8	102.0	102.0	101.9
Diluted net income per common share	\$ 0.48	\$ 0.47	\$ 0.90	\$ 0.86

Table of Contents

Total shares underlying stock options of 0.3 million were excluded from the computation of diluted net income per share for the quarter and six months ended June 30, 2013, as they were anti-dilutive. Total shares underlying stock options of 0.5 million were excluded from the computation of diluted net income per share for the quarter and six months ended June 30, 2012, as they were anti-dilutive.

Note 3 Inventories, net

(In millions)	June 30, 2013		December 31, 2012	
Raw materials	\$	99.4	\$	95.0
Work in progress		53.6		51.2
Finished goods		98.7		86.6
Total inventories	\$	251.7	\$	232.8

Note 4 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, 2013 and 2012, were as follows:

(In millions)	Quarter Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<i>U.S. Nonqualified Defined Benefit Retirement Plans</i>				
Service cost	\$ 0.7	\$ 0.4	\$ 1.4	\$ 0.7
Interest cost	0.2	0.2	0.4	0.5
Net amortization and deferral	0.6	0.5	1.3	1.1
Net periodic benefit cost	\$ 1.5	\$ 1.1	\$ 3.1	\$ 2.3

June 30, 2013	December 31, 2012
------------------	----------------------

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Amounts recognized on the balance sheet:				
Accrued liabilities		\$	0.3	\$ 0.3
Other non-current liabilities			40.0	38.3
Total accrued benefit		\$	40.3	\$ 38.6

(In millions)	Quarter Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<i>European Defined Benefit Retirement Plans</i>				
Service cost	\$	0.1	\$ 0.2	\$ 0.3
Interest cost		1.8	1.6	3.5
Expected return on plan assets		(2.1)	(1.8)	(3.6)
Net amortization and deferral		0.3	0.2	0.6
Net periodic benefit cost	\$	0.1	\$ 0.2	\$ 0.4

		June 30,	December 31,
		2013	2012
Amounts recognized on the balance sheet:			
Accrued liabilities	\$	0.4	\$ 0.4
Other non-current liabilities		34.8	36.1
Total accrued benefit	\$	35.2	\$ 36.5

Table of Contents*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 \$0.3 million in 2013 to cover unfunded benefits. We contributed \$0.3 million to our U.S. non-qualified defined benefit retirement plans during the 2012 fiscal year.

We contributed \$1.3 million and \$1.5 million to our European defined benefit retirement plans in the second quarters of 2013 and 2012, respectively. Contributions to the defined benefit retirement plans were \$2.7 million and \$3.0 million for the six months ended June 30, 2013 and 2012. We plan to contribute approximately \$5.8 million during 2013 to these European plans. We contributed \$5.7 million to our European plans during the 2012 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, 2013 and 2012 were immaterial.

Amounts recognized on the balance sheet:

Accrued liabilities	\$	0.6	\$	0.6
Other non-current liabilities		7.4		7.5
Total accrued benefit	\$	8.0	\$	8.1

In connection with our postretirement plans, we contributed \$0.2 million and \$0.1 million during the six-month periods ended June 30, 2013 and 2012, respectively. Contributions during the second quarter of 2013 were \$0.1 million and were less than \$0.1 million in the second quarter of 2012. We periodically fund our postretirement plans to pay covered expenses as they are incurred. Based on six months of activity, we expect to contribute approximately \$0.3 million in 2013 to cover unfunded benefits. We contributed \$0.3 million to our postretirement plans during the 2012 fiscal year.

Note 5 Debt

(In millions)	June 30, 2013	December 31, 2012
Working capital line of credit China	\$ 5.0	\$ 4.8
Current maturities of term loan		10.0
Current maturities of capital lease and other obligations		1.8
Notes payable and current maturities of long-term liabilities	5.0	16.6
Senior secured credit facility term loan due 2015		75.0

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Senior secured credit facility revolving loan due 2015			165.0
Senior secured credit facility revolving loan due 2018		309.0	
Long-term notes payable		309.0	240.0
Total notes payable and capital lease obligations	\$	314.0	\$ 256.6

As discussed in Note 11, in June 2013 we entered into a new \$600 million senior secured revolving credit facility which matures in June 2018. The new facility replaces the Company's previous senior secured credit facility (\$82.5 million term loan and a \$360 million revolving loan) that would have expired in July 2015. The initial interest rate for the revolver is LIBOR + 1.50% through September 30, 2013, and then can range up or down depending upon the leverage ratio. The new initial interest rate is 50 basis points lower than the prior facility, and at the current leverage ratio the new rate would be LIBOR + 1.25% beginning after covenant compliance reporting is completed for the period ending September 30, 2013. In addition to the lower interest rates and fees on undrawn balances, the new facility provides greater flexibility. The proceeds from the new facility were used to repay all amounts, and terminate all commitments outstanding under the Company's credit agreement and to pay fees and expenses in connection with the refinancing. As a result of the refinancing, the Company accelerated certain unamortized financing costs of the credit facility being replaced and the deferred expense on related interest rate swaps incurring a pretax charge of \$1.0 million in the second quarter of 2013.

The new 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. In accordance with the terms of the new facility, we are required to maintain a minimum interest coverage ratio of 3.50 (based on the ratio of EBITDA, as defined in the credit agreement, to interest expense) and may not exceed a maximum leverage ratio of 3.50 (based on the ratio of total debt to EBITDA) throughout the term of the new facility. In addition, the new facility contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default.

Table of Contents

Note 6 Derivative Financial Instruments

Interest Rate Swap Agreements

In June 2012 and in 2010, we entered into agreements to swap \$75 million and \$98 million, respectively, of floating rate obligations for fixed rate obligations at 0.6725% and 1.03% against LIBOR in U.S. dollars. Both swaps were scheduled to mature in March 2014, and were accounted for as cash flow hedges of our floating rate bank loans. With the June 2013 refinancing, the 1.03% interest rate swap totaling \$98 million associated with our term loan was redesignated and \$0.4 million of deferred expenses were released from accumulated other comprehensive income. Going forward, this swap will be marked to market through interest expense. The principal terms of the remaining \$75 million of floating rate swaps match the terms of the new revolving bank loans thereby allowing hedge accounting to continue on these swaps. The fair value of both interest rate swaps was a liability of \$0.6 million at June 30, 2013 and a liability \$1.0 million at December 31, 2012.

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 2015. The aggregate notional amount of these contracts was \$222.3 million and \$201.2 million at June 30, 2013 and December 31, 2012, respectively. The purpose of these contracts is to hedge a portion of the forecasted transactions of European subsidiaries under long-term sales contracts with certain customers. These contracts are expected to provide us with a more balanced matching of future cash receipts and expenditures by currency, thereby reducing our exposure to fluctuations in currency exchange rates. The effective portion of the hedges, gains of \$2.7 million and losses of \$5.0 million, were recorded in other comprehensive income (OCI) for the three months and six months ended June 30, 2013, respectively, and losses of \$7.8 million and \$3.1 million for the three- and six-month periods ended June 30, 2012, respectively. The carrying amount of these contracts was \$2.3 million classified in other assets and \$3.1 million in other liabilities on the Condensed Consolidated Balance Sheets at June 30, 2013 and \$3.6 million in other assets and \$1.6 million classified in other liabilities at December 31, 2012. During the three months ended June 30, 2013 and 2012, we recognized net losses of \$0.8 million and net losses of \$0.8 million, respectively, recorded in gross margin. During the six months ended June 30, 2013 and 2012, we recognized net losses of \$0.7 million and net losses of \$1.3 million, respectively, recorded in gross margin. For the quarters and six-month periods ended June 30, 2013 and 2012, hedge ineffectiveness was immaterial.

In addition, we enter into foreign exchange forward contracts which are not designated as hedges. These are used to provide an offset to transactional gains or losses arising from the remeasurement of non-functional monetary assets and liabilities such as accounts receivable. The change in the fair value of the derivatives is recorded in the statement of operations. There are no credit contingency features in these derivatives. During the quarters ended June 30, 2013 and 2012, we recognized net foreign exchange gains of \$2.1 million and foreign exchange losses of \$3.2 million, respectively, in the Condensed Consolidated Statements of Operations. During the six-month periods ended June 30, 2013 and 2012, we recognized net foreign exchange losses of \$2.5 million and net foreign exchange losses of \$0.1 million respectively, in the Consolidated Statements of Operations. The net foreign exchange impact recognized from these hedges offset the translation exposure of these transactions. The carrying amount of the contracts for asset and liability derivatives not designated as hedging instruments was \$0.4 million classified in other assets and \$0.8 million in other liabilities and \$3.1 million classified in other assets and \$0.1 million in other liabilities on the June 30, 2013 and December 31, 2012 Condensed Consolidated Balance Sheets, respectively.

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

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, 2013 and 2012 was as follows:

(In millions)	Quarter Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Unrealized (losses) gains at beginning of period, net of tax	\$ (3.8)	\$ (0.7)	\$ 2.4	\$ (4.5)
Losses reclassified to net sales	0.7	0.5	0.6	0.9
Increase (decrease) in fair value	2.2	(5.7)	(3.9)	(2.3)
Unrealized (losses) at end of period, net of tax	\$ (0.9)	\$ (5.9)	\$ (0.9)	\$ (5.9)

We expect to reclassify \$1.2 million of unrealized losses into earnings over the next twelve months as the hedged sales are recorded.

Table of Contents

Note 7 Income Taxes

The income tax provisions for the quarter and six months ended June 30, 2013 were \$20.6 million and \$38.5 million, respectively. The effective tax rate for both periods was about 30%. The first half of 2013 benefitted from the extension of the 2012 and 2013 U.S. Research & Development tax credits that was enacted in January 2013. The full retroactive benefit from 2012 was taken in the first quarter of 2013 for a benefit of \$0.6 million. The income tax provisions for the quarter and six months ended June 30, 2012 were \$22.1 million and \$40.5 million, respectively. The effective tax rate for both periods was just under 32%.

Note 8 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.
- 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 incorporate non-performance risk (the credit standing of the counterparty when the derivative is in a net asset position, and the credit standing of Hexcel when the derivative is in a net liability position). The fair value of these assets and liabilities was approximately \$2.7 million and \$4.5 million, respectively at June 30, 2013. Below is a summary of valuation techniques for all Level 2 financial assets and liabilities:

- Interest rate swap valued using LIBOR yield curves at the reporting date. Fair value was a liability of \$0.6 million at June 30, 2013.

- 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, 2013 was \$2.7 million and \$3.9 million, respectively.

Counterparties to the above contracts are highly rated financial institutions, none of which experienced any significant downgrades in the three months ended June 30, 2013 that would reduce the receivable amount owed, if any, to the Company.

Note 9 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 operating segments for the quarters and six months ended June 30, 2013 and 2012 is as follows:

Table of Contents

(In millions)	(Unaudited)			Total
	Composite Materials (b)	Engineered Products	Corporate & Other (a)	
<u>Second Quarter 2013</u>				
Net sales to external customers:				
Commercial aerospace	\$ 200.7	\$ 69.3	\$	\$ 270.0
Space and defense	70.3	26.4		96.7
Industrial	53.7	2.2		55.9
Net sales to external customers	324.7	97.9		422.6
Intersegment sales	18.0	0.5	(18.5)	
Total sales	342.7	98.4	(18.5)	422.6
Operating income (a)	71.2	15.1	(14.4)	71.9
Depreciation and amortization	12.6	1.1	0.1	13.8
Stock-based compensation expense	1.3	0.2	1.8	3.3
Accrual basis additions to capital expenditures	38.0	2.7		40.7
<u>Second Quarter 2012</u>				
Net sales to external customers:				
Commercial aerospace	\$ 172.4	\$ 61.1	\$	\$ 233.5
Space and defense	67.2	20.9		88.1
Industrial	77.1	0.5		77.6
Net sales to external customers	316.7	82.5		399.2
Intersegment sales	14.9	0.2	(15.1)	
Total sales	331.6	82.7	(15.1)	399.2
Operating income (a), (b)	80.9	11.7	(18.7)	73.9
Depreciation and amortization	13.3	1.0		14.3
Stock-based compensation expense	0.9	0.1	2.0	3.0
Other operating (income) expense (b)	(14.5)		5.0	(9.5)
Accrual basis additions to capital expenditures	67.0	2.6	0.2	69.8
<u>Six Months Ended June 30, 2013</u>				
Net sales to external customers:				
Commercial aerospace	\$ 402.4	\$ 136.5	\$	\$ 538.9
Space and defense	143.1	49.6		192.7
Industrial	104.0	3.5		107.5
Net sales to external customers	649.5	189.6		839.1
Intersegment sales	34.7	1.1	(35.8)	
Total sales	684.2	190.7	(35.8)	839.1
Operating income (a)	139.1	28.5	(32.7)	134.9
Depreciation and amortization	25.7	2.3	0.1	28.1
Stock-based compensation expense	3.3	0.7	8.0	12.0
Accrual basis additions to capital expenditures	76.4	5.7		82.1
<u>Six Months Ended June 30, 2012</u>				
Net sales to external customers:				
Commercial aerospace	\$ 351.9	\$ 123.9	\$	\$ 475.8
Space and defense	131.1	41.9		173.0
Industrial	149.9	0.6		150.5
Net sales to external customers	632.9	166.4		799.3
Intersegment sales	30.8	0.3	(31.1)	
Total sales	663.7	166.7	(31.1)	799.3
Operating income (a), (b)	146.7	23.5	(35.7)	134.5
Depreciation and amortization	26.2	2.1		28.3

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Stock-based compensation expense	3.0	0.5	7.0	10.5
Other operating (income) expense (b)	(14.5)		5.0	(9.5)
Accrual basis additions to capital expenditures	110.6	3.7	0.2	114.5

(a) We do not allocate corporate expenses to the operating segments.

(b) In the quarter and six months ended June 30, 2012, operating income for Composite Materials includes \$9.6 million of insurance proceeds from a 2011 business interruption claim and a \$4.9 million gain on the sale of land from a previously closed manufacturing facility. In addition, Corporate and other includes a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986 (see note 10).

Goodwill and Intangible Assets

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

Table of Contents

(In millions)	June 30, 2013		December 31, 2012	
Composite Materials	\$	41.4	\$	41.7
Engineered Products		16.0		16.1
Goodwill and intangible assets	\$	57.4	\$	57.8

No impairments have been recorded against these amounts.

Note 10 Other Operating (Income) Expense

In June 2012, the company settled a business interruption insurance claim resulting from tornado damage in 2011 and recorded operating income of \$9.6 million. Also in June 2012, the Company recorded a pre-tax gain of \$4.9 million on the sale of land from a previously closed manufacturing facility. In addition, in June 2012, the Company recorded \$5.0 million of charges primarily for additional remediation of a manufacturing facility sold in 1986 (see Note 12).

Note 11 Other Non-Operating Expense

In June 2013, the Company entered into new \$600 million senior secured revolving credit facility that will mature in five years. The new facility replaces the Company's previous senior secured credit facility (\$82.5 million term loan and a \$360 million revolving loan) that would have expired in July 2015. As a result of the refinancing, we accelerated certain unamortized financing costs of the credit facility being replaced and the deferred expense on related interest rate swaps incurring a pretax charge of \$1.0 million in the second quarter of 2013.

Note 12 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, and similar state and international laws and regulations that impose responsibility for the control, remediation and abatement of air, water and soil pollutants and the manufacturing, storage, handling and disposal of hazardous substances and waste.

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

Lodi, New Jersey Site

Pursuant to the New Jersey Industrial Site Recovery Act, Hexcel entered into an Administrative Consent Order for the environmental remediation of a manufacturing facility we own and formerly operated in Lodi, New Jersey. We have not operated this site since 1986. We have been remediating this site in accordance with a State approved plan and continue to do so under the New Jersey Licensed Site Remediation Professional program. The primary remediation activities have been completed and we now believe that the remediation has removed most of the contamination. However, there are still select contaminated areas that we will have to continue remediating using alternative methods. The accrual is \$3.2 million at June 30, 2013.

Table of Contents

Lower Passaic River Study Area

In October 2003, we received, along with 66 other entities, a directive from the New Jersey Department of Environmental Protection (NJDEP) that requires the entities to assess whether operations at various New Jersey sites, including our former manufacturing site in Lodi, New Jersey, caused damage to natural resources in the Lower Passaic River watershed. The NJDEP later dismissed us from the Directive. In February 2004, 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 voluntarily 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. In June 2012, without admitting liability, we along with 69 other PRPs entered into a further agreement with EPA to remove and cap contaminated sediments near River Mile 10.9 of the Lower Passaic River at an approximate cost of \$20 million. We accrued \$0.5 million in the second quarter of 2012 for our expected allocation of these costs. Furthermore, the Federal Trustee for natural resources have indicated their intent to perform a natural resources damage assessment on the river and invited the PRPs to participate in the development and performance of this assessment. The PRP Group, including Hexcel, has not agreed to participate in the assessment at this time.

On February 4, 2009, Tierra Solutions (Tierra) and Maxus Energy Corporation (Maxus) filed a third party complaint in New Jersey Superior Court against us and over 300 other entities in an action brought against Tierra and Maxus (and other entities) by the State of New Jersey. New Jersey's suit against Tierra and Maxus relates to alleged discharges of contaminants by Tierra and Maxus to the Passaic River and seeks payment of all past and future costs the State has and will incur regarding cleanup and removal of contaminants, investigation of the Passaic River and related water bodies, assessment of natural resource injuries and other specified injuries. The third party complaint seeks contribution from us for all or part of the damages that Tierra and Maxus may owe to the State. We filed our answer to the complaint and served our initial disclosures, and have produced initial documents to Tierra and Maxus, pursuant to an order of the court. The court's trial plan and subsequent orders contemplated multiple trial tracks involving third-party defendants (including Hexcel) culminating with trials commencing as early as April 2013. However, at a case management conference held in March 2013, the Court announced that most third-party defendants had reached a tentative settlement with the State of New Jersey which, if approved by the Court, would end the state court litigation as to participating third-party defendants. We committed to join the settlement and if the settlement is approved by the Court, we would pay New Jersey \$0.3 million. This amount was accrued in the first quarter of 2013. It is anticipated that the settlement will be brought to the Court for approval in the second half of 2013. The litigation presently has been stayed as to parties participating in the settlement. The scope of Hexcel's continued involvement in the litigation depends on whether the Court approves the settlement and dismisses Hexcel from the case, which is uncertain at this time. 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. The previous owner, who also continues to own an adjacent site, has installed certain remediation and isolation technologies and is operating those in accordance with an order agreed with the State of Washington. This isolation is expected to prevent further migration of contaminants to our site and enable us to perform

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

a cleanup of our site. We and the Washington Department of Ecology have reached an agreed order to perform certain cleanup activities on our site by certain deadlines, and we are in full compliance with the order as modified. The total accrued liability related to this matter was \$1.0 million at June 30, 2013.

Omega Chemical Corporation Superfund Site, Whittier, CA

We are a potentially responsible party at a former chemical waste site in Whittier, CA. The PRPs at Omega have established a PRP Group, the Omega PRP Group, and are currently investigating and remediating soil and groundwater at the site pursuant to a Consent Decree with the EPA. The Omega PRP Group has attributed approximately 1.07% of the waste tonnage sent to the site to

Table of Contents

Hexcel. In addition to the Omega site specifically, the EPA is investigating the scope of regional groundwater contamination in the vicinity of the Omega site and recently issued a Record of Decision; the Omega PRP Group members have been noticed by the EPA as PRP's who will be required to be involved in the remediation of the regional groundwater contamination in that vicinity as well. As a member of the Omega PRP group, Hexcel will incur costs associated with the investigation and remediation of the Omega site and the regional groundwater remedy, although our ultimate liability, if any, in connection with this matter cannot be determined at this time, we have accrued \$0.6 million relating to potential liability for both the Omega site and regional groundwater remedies.

Summary of Environmental Reserves

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, 2013, our aggregate environmental related accruals were \$5.7 million, of which \$3.6 million was included in accrued liabilities with the remainder included in non-current liabilities. As related to certain environmental matters, except for the Lodi site, the accrual was estimated at the low end of a range of possible outcomes since no amount within the range is a better estimate than any other amount. If we had accrued for these matters at the high end of the range of possible outcomes, our accrual would have been \$1.5 million higher. 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 to our reserve balance for the quarter ended June 30, 2013 and 2012 was \$1.0 million and \$0.8 million, respectively, and \$1.8 million and \$2.4 million for the six months ended June 30, 2013 and 2012. In addition, our operating costs relating to environmental compliance charged to expense were \$3.3 million and \$3.7 million for the quarters ended June 30, 2013 and 2012, respectively and \$6.5 million and \$6.5 million for the six-month periods ended June 30, 2013 and 2012, respectively. Capital expenditures for environmental matters were \$0.8 million and \$0.4 million for the quarters ended June 30, 2013 and 2012, respectively and \$1.5 million and \$0.8 million for the six-month periods ended June 30, 2013 and 2012, respectively.

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 quarter ended June 30, 2013, and accrued warranty cost, included in accrued liabilities in the condensed consolidated balance sheets at June 30, 2013 and December 31, 2012, was as follows:

(In millions)		Product Warranties
Balance as of December 31, 2012	\$	5.1
Warranty expense		0.6
Deductions and other		(1.7)
Balance as of March 31, 2013		4.0
Warranty expense		1.3
Deductions and other		(0.4)
Balance as of June 30, 2013	\$	4.9

Note 13 Stock Repurchase Plan

In December 2012, our Board authorized us to repurchase up to \$50 million of our outstanding common stock (Repurchase Plan). During the six-month period ended June 30, 2013, the Company repurchased a total of 1,573,588 shares at a cost of \$50 million and has completed the December 2012 Repurchase Plan.

Table of Contents

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

Business Overview

We develop, manufacture, and market lightweight, high-performance composites, including carbon fibers, specialty reinforcements, prepregs and other fiber-reinforced matrix materials, adhesives, honeycomb, engineered honeycomb and composite structures, for use in Commercial Aerospace, Space & Defense and Industrial Applications. Our products are used in a wide variety of end applications, such as commercial and military aircraft, space launch vehicles and satellites, wind turbine blades, automotive, recreational products and a variety of other industrial applications.

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

Hexcel has two segments, Composite Materials and Engineered Products. The Composite Materials segment is comprised of our carbon fiber, specialty reinforcements, resins, prepregs and other fiber-reinforced matrix materials, and honeycomb core product lines. The Engineered Products segment is comprised of lightweight high strength composite structures, molded components and specialty machined honeycomb product lines.

Net sales for the quarter were \$422.6 million, 5.9% higher (5.2% in constant currency) than the \$399.2 million reported for the second quarter of 2012. Year to date net sales were 4.6% higher in constant currency. The growth was led by the commercial aerospace market, which accounts for 64% of our year to date sales.

Commercial aerospace sales of \$270.0 million increased 15.6% for the quarter (15.1% in constant currency) as compared to the second quarter of 2012 and increased 13.3% (12.9% in constant currency) for the six-month period as compared to 2012. Combined revenues attributed to new aircraft programs (A380, A350, B787, B747-8) increased over 20% versus the same period last year and comprise over 30% of Commercial Aerospace sales. Sales for Airbus and Boeing legacy aircraft were up over 10% compared to the second quarter of 2012 and just less than the first quarter of 2013.

Sales to other commercial aerospace, which includes regional and business aircraft customers, were down slightly compared to the same period last year.

Space and Defense sales of \$96.7 million were 9.8% higher (9.3% in constant currency) than the second quarter of 2012 and year to date sales were 11.4% higher (11.0% higher in constant currency) than last year's comparable period. Growth was again led by rotorcraft, which accounted for nearly 60% of Space & Defense sales for the quarter.

Total Industrial sales of \$55.9 million for the second quarter of 2013 were 28.0% lower (28.8% in constant currency) than the second quarter of 2012, but up sequentially 8.4% versus the first quarter of 2013. As expected, wind sales were down over 35% from the record level in the second quarter of 2012.

Gross margin was 27.6% of net sales for the quarter as compared to 26.4% in the same period last year on higher sales volume. The impact from exchange rates on gross margin percentage is slightly favorable compared to the second quarter of last year. SG&A expenses were 7.1% higher than the comparable period in 2012, due to additional investment and staffing to support the current and future growth. As expected, R&T expenses were \$1.5 million higher than the second quarter of 2012 reflecting the increased focus on new product and process development costs (R&T costs were \$0.9 million lower than the first quarter of 2013). Adjusted operating income increased from 16.1% in the second quarter of 2012 to 17.0% in the second quarter of 2013, with foreign exchange rates accounting for less than 10 basis points of the increase.

Free cash flow (defined as cash provided by operating activities less capital expenditures) generated in the first half of 2013 was \$16.2 million as compared to a use of \$70.6 million for the first six months of 2012 reflecting lower capital expenditures and lower working capital usage. Cash spent on capital expenditures in the first six months of 2013 was \$92.0 million compared to \$144.4 million in 2012. Accrual basis additions to capital expenditures were \$82.1 million in the first half of 2013 as compared to \$114.5 million during the first half of 2012. We expect accrual basis capital expenditures to be \$180 million to \$200 million in 2013, as we continue to expand capacity to meet the planned needs of our customers.

Table of Contents**Financial Overview****Results of Operations**

(In millions, except per share data)	Quarter Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Net sales	\$ 422.6	\$ 399.2	5.9%	\$ 839.1	\$ 799.3	5.0%
Net sales change in constant currency			5.2%			4.6%
Operating income	71.9	73.9	(2.7)%	134.9	134.5	0.3%
Net income	48.5	48.0	1.0%	92.1	87.6	5.1%
Diluted net income per common share	\$ 0.48	\$ 0.47		\$ 0.90	\$ 0.86	
<i>Non-GAAP measures:</i>						
Adjusted operating income	\$ 71.9	\$ 64.4	11.6%	\$ 134.9	\$ 125.0	7.9%
<i>As a percentage of net sales</i>	<i>17.0%</i>	<i>16.1%</i>		<i>16.1%</i>	<i>15.6%</i>	
Adjusted net income	\$ 49.1	\$ 42.7	15.0%	\$ 92.7	\$ 82.3	12.6%
Adjusted diluted earnings per share	\$ 0.48	\$ 0.42		\$ 0.91	\$ 0.81	

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.

(In millions, except per share data)	Quarter Ended June 30,			Six Months Ended June 30,		
	2013	2012		2013	2012	
Operating income	\$ 71.9	\$ 73.9		\$ 134.9	\$ 134.5	
Other operating (income) (a)			(9.5)			(9.5)
Adjusted operating income	\$ 71.9	\$ 64.4		\$ 134.9	\$ 125.0	
Net income	\$ 48.5	\$ 48.0		\$ 92.1	\$ 87.6	
Other operating (income), net of tax (a)			(6.0)			(6.0)
Non-operating expense, net of tax (b)	0.6	0.7		0.6	0.7	
Adjusted net income	\$ 49.1	\$ 42.7		\$ 92.7	\$ 82.3	

(a) Other operating income for the three and six months ended June 30, 2012 includes income from a \$9.6 million business interruption insurance settlement related to a prior year claim, a \$4.9 million gain on the sale of land from a previously closed manufacturing facility and a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986.

(b) Non-operating expense in 2013 is the accelerated amortization of deferred financing costs related to our previous senior secured credit facility and the recognition of the deferred expense on related interest rate swaps. Non-operating expense in 2012 is the accelerated amortization of deferred financing costs and expensing of the call premium from redeeming \$73.5 million in June 2012 of the Company's 6.75% senior subordinated notes.

Table of ContentsNet Sales

The following table summarizes net sales to third-party customers by segment and end market for the quarters and six months ended June 30, 2013 and 2012:

Consolidated Net Sales	\$	422.6	\$	399.2	5.9%	\$	839.1	\$	799.3	5.0%
Commercial Aerospace		270.0		233.5	15.6%		538.9		475.8	13.3%
Space & Defense		96.7		88.1	9.8%		192.7		173.0	11.4%
Industrial		55.9		77.6	(28.0)%		107.5		150.5	(28.6)%
Composite Materials	\$	324.7	\$	316.7	2.5%	\$	649.5	\$	632.9	2.6%
Commercial Aerospace		200.7		172.4	16.4%		402.4		351.9	14.4%
Space & Defense		70.3		67.2	4.6%		143.1		131.1	9.2%
Industrial		53.7		77.1	(30.4)%		104.0		149.9	(30.6)%
Engineered Products	\$	97.9	\$	82.5	18.7%	\$	189.6	\$	166.4	13.9%
Commercial Aerospace		69.3		61.1	13.4%		136.5		123.9	10.2%
Space & Defense		26.4		20.9	26.3%		49.6		41.9	18.4%
Industrial		2.2		0.5	340.0%		3.5		0.6	483.3%

Commercial Aerospace: Net sales increased \$36.5 million, or 15.6% (15.1% on a constant currency basis), to \$270.0 million for the second quarter of 2013. Net sales for the six months ended June 30, 2013 increased \$63.1 million or 13.3% (12.9% on a constant currency basis) to \$538.9 million. For the quarter, new aircraft programs (A380, A350, B787, B747-8) increased over 20% versus the same period last year and comprise over 30% of Commercial Aerospace sales. Airbus and Boeing legacy aircraft related sales for the quarter were up over 10% compared to the second quarter of 2012 but were just lower than the first quarter of 2013. Sales to other commercial aerospace, which includes regional and business aircraft customers, were down slightly compared to the same period last year.

Space & Defense: Net sales increased \$8.6 million, or 9.8% (9.3% on a constant currency basis), to \$96.7 million for the second quarter of 2013. Net sales of \$192.7 million for the six months ended June 30, 2013 increased \$19.7 million or 11.4% (11.0% on a constant currency basis), above the prior year level as we continued to benefit from rotorcraft growth.

Industrial: Net sales for the second quarter of 2013 decreased \$21.7 million, or 28.0% (28.8% on a constant currency basis) as compared to the second quarter of 2012. Net sales for the six months ended June 30, 2013 decreased \$43.0 million or 28.6% (29.1% on constant currency basis) to \$107.5 million. Wind sales were down over 35% compared to the record level of the second quarter of 2012.

Gross Margin

Quarter Ended June 30,

Six Months Ended June 30,

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

(In millions)	2013		2012		% Change	2013		2012		% Change
Gross margin	\$	116.8	\$	105.5	10.7%	\$	228.8	\$	211.9	8.0%
Percentage of sales		27.6%		26.4%			27.3%		26.5%	

We achieved a gross margin percentage of 27.6% in the second quarter and 27.3% in the first six months of 2013. The benefit of higher volume combined with good cost control and favorable mix led to the margin growth. Foreign exchange rates had a slightly favorable impact on margins for the quarter and six-month period.

Operating Expenses

(In millions)	Quarter Ended June 30,			Six Months Ended June 30,						
	2013	2012	% Change	2013	2012	% Change				
SG&A expense	\$	34.8	\$	32.5	7.1%	\$	72.8	\$	69.1	5.4%
Percentage of sales		8.2%		8.1%			8.7%		8.6%	
R&T expense	\$	10.1	\$	8.6	17.4%	\$	21.1	\$	17.8	18.5%
Percentage of sales		2.4%		2.2%			2.5%		2.2%	

Table of Contents

Selling, general and administrative (SG&A) and research and technology (R&T) expenses in the second quarter and first six months of 2013 were 9.2% and 8.1%, respectively, higher than the comparable 2012 periods due to additional investment and staffing to support the current and future growth. Higher R&T expenses also reflect the increased spending on new product and process development costs.

Operating Income

(In millions)	Quarter Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Consolidated operating income	\$ 71.9	\$ 73.9	(2.7)%	\$ 134.9	\$ 134.5	0.3%
<i>Operating margin</i>	17.0%	18.5%		16.1%	16.8%	
Composite Materials	71.2	80.9	(12.0)%	139.1	146.7	(5.2)%
<i>Operating margin</i>	20.8%	24.4%		20.3%	22.1%	
Engineered Products	15.1	11.7	29.1%	28.5	23.5	21.3%
<i>Operating margin</i>	15.3%	14.1%		14.9%	14.1%	
Corporate & Other	(14.4)	(18.7)	23.0%	(32.7)	(35.7)	8.4%

Operating income of \$71.9 million or 17.0% of sales for second quarter 2013 increased \$7.5 million over the adjusted operating income of \$64.4 million or 16.1% of sales in the second quarter of 2012, as gross margin improvement was partially offset by higher operating expenses. Operating income before adjustments in the second quarter and six months ended June 30, 2012 included \$9.6 million of insurance proceeds from a 2011 business interruption claim and a \$4.9 million gain on the sale of land from a previously closed manufacturing facility that were attributed to the Composites Materials segment. Excluding these items, operating margins for the Composite Materials segment would have been 20.0% of sales for the second quarter of 2012 and 19.9% for the six month period. Operating income for this same period attributed to Corporate & Other included a \$5.0 million charge for additional environmental reserves primarily for remediation of a manufacturing facility sold in 1986.

Interest Expense, Net

(In millions)	Quarter Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Interest expense, net	\$ 2.1	\$ 3.0	(30.0)%	\$ 3.8	\$ 6.0	(36.7)%

The decrease in interest expense for the quarter and six months ended 2013 was primarily due to lower average borrowing rates as a result of the June 2012 prepayment of \$73.5 million of the 6.75% senior subordinated notes and higher capitalized interest in 2013.

Provision for Income Taxes

(In millions)	Quarter Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

Income tax expense	\$	20.6	\$	22.1	\$	38.5	\$	40.5
Effective tax rate		29.9%		31.7%		29.6%		31.8%

The 29.6% effective tax rate for the six months ended June 30, 2013 is slightly favorable to our expected rate for the year of 30.3%, reflecting a \$0.6 million benefit primarily from the extension of the 2012 and 2013 U.S. Research & Development tax credits that was enacted in January 2013. The full retroactive benefit from 2012 was taken in the first quarter and reduced the tax rate by one percentage point. Implementation of tax planning strategies and the mix of income by country accounted for the remaining improvement in the tax rate. We expect our effective tax rate for the rest of the year to be about 30.5%.

Financial Condition

Liquidity: As of June 30, 2013, we had cash and cash equivalents of \$56.7 million. In June 2013, the Company entered into a new \$600 million senior secured revolving credit facility that will mature in five years. The new facility replaces the Company's previous senior secured credit facility (\$82.5 million term loan and a \$360 million revolving loan) that would have expired in July 2015. The Facility permits us to issue letters of credit up to an aggregate amount of \$40.0 million. The initial interest rate for the revolver is LIBOR + 1.50% through September 30, 2013, and then can range up or down depending upon the leverage ratio. The new initial interest rate is 50 basis points lower than the prior facility, and at the current leverage ratio the new rate would be LIBOR + 1.25% beginning after covenant compliance reporting is completed for the period ending September 30, 2013. Interest costs are expected to

Table of Contents

decrease in the first twelve months by nearly \$2.5 million, with the payback from the refinancing estimated to be under a year. Outstanding letters of credit reduce the amount available for borrowing under our revolving loan. As of June 30, 2013, we had issued letters of credit under the Facility totaling \$2.6 million, resulting in undrawn availability under the Facility as of June 30, 2013 of \$288.4 million. In addition, we borrowed \$5.0 million from the credit line established in China associated with our operations there. Our total debt, net of cash, as of June 30, 2013 was \$257.3 million. This represents an increase of \$33.3 million from December 31, 2012. The increase in debt in the first half of 2013 primarily reflects the free cash flow generated of \$16.2 million less the \$50 million repurchase of stock.

The new 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. In accordance with the terms of the new facility, we are required to maintain a minimum interest coverage ratio of 3.50 (based on the ratio of EBITDA, as defined in the credit agreement, to interest expense) and may not exceed a maximum leverage ratio of 3.50 (based on the ratio of total debt to EBITDA) throughout the term of the new facility. In addition, the new facility contains other terms and conditions such as customary representations and warranties, additional covenants and customary events of default. The new facility is less restrictive than the prior agreement. As of June 30, 2013, 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, 2013, long-term liquidity requirements consist primarily of obligations under our long-term debt obligations. We do not have any significant required debt repayments until June 2018 when our revolving credit facility expires.

Operating Activities: Net cash provided by operating activities was \$108.2 million in the first six months of 2013, as compared to net cash provided by operating activities of \$73.8 million in the first six months of 2012. Higher income combined with lower working capital needs were the primary drivers of the higher cash from operating activities. Working capital was a use of \$39.2 million in the first half of 2013 and a use of \$53.6 million in the first half of 2012.

Investing Activities: Net cash used for investing activities of \$92.0 million in the first half of 2013 was for capital expenditures as we continue to expand capacity to meet the planned needs of our customers. In 2012, capital expenditures of \$144.4 million were partly offset by proceeds of \$5.3 million from the sale of land.

Financing Activities: Financing activities provided \$9.0 million of net cash in the first half of 2013 compared with \$50.2 million in the same period of 2012. In 2012, we borrowed \$121.0 million from our revolving credit facility which was partly used to redeem the remaining \$73.5 million of our 6.75% senior subordinated notes at a call premium of 1.125%.

In June 2013, the Company entered into a new \$600 million senior secured revolving credit facility that will mature in five years. The Company borrowed \$252.2 million under the new facility to pay off the amounts outstanding under the previous senior secured credit facility and to pay the related issuance costs. As a result of the refinancing, we accelerated certain unamortized financing costs of the credit facility being replaced and the deferred expense on related interest rate swaps incurring a pretax charge of \$1.0 million (after tax less than \$0.01 per diluted share) in the second quarter of 2013. As a result of the redemption in 2012, we accelerated the unamortized financing costs of the senior subordinated notes being redeemed and expensed the call premium incurring a pretax charge of \$1.1 million (after tax of \$0.01 per diluted share) in June 2012.

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

In December 2012, our Board authorized us to repurchase up to \$50 million of our outstanding common stock (Repurchase Plan). During the six-month period the Company repurchased a total of 1,573,588 shares at a cost of \$50 million. On July 22, 2013, the Company's Board of Directors authorized the repurchase of an additional \$150 million of the Company's common stock. Under the program, the Company may purchase its common stock from time to time in the open market or in privately negotiated transactions. The repurchases will be funded from cash from operating activities and, if needed, the existing credit facilities. The amount and timing of the purchases will depend on a number of factors including the price and availability of shares of common stock, trading volume and general market conditions.

Financial Obligations and Commitments: As of June 30, 2013, current debt maturities reflect our foreign credit line of \$5.0 million. We do not have any other current maturities of debt due in 2013 and we do not have any capital lease obligations. Certain sales and administrative offices, data processing equipment and manufacturing facilities are leased under operating leases.

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.

Table of Contents

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, 2012. There were no significant changes in our accounting policies and estimates since the end of fiscal 2012.

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 terms and 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 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 2013 financial results. In addition, actual results may differ materially from the results anticipated in the forward looking statements due to a variety of factors, including but not limited to changing market conditions, increased competition, product mix, inability to achieve planned manufacturing improvements 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; 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 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 2012 Annual Report on Form 10-K.

Table of Contents

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, 2013 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 12 on pages 12 through 14 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, 2012, 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)

Edgar Filing: HEXCEL CORP /DE/ - Form 10-Q

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, 2013	918,333	\$ 33.56	1,449,063(1)	\$ 4,179,275
May 1 May 31, 2013	0	N/A	1,449,063	4,179,275
June 1 June 30, 2013	124,953(2)	33.57	1,573,588	0
Total	1,043,286	\$ 33.56	1,573,588	\$ 0

(1) On December 12, 2012 the Company announced that the Board of Directors approved the repurchase by the Company of up to \$50 million of its common stock. An aggregate of 530,730 shares of common stock were repurchased during the first quarter of 2013 under its authorized Repurchase Plan and 1,042,858 shares were purchased in the second quarter of 2013. The \$50 million share repurchase has now been completed.

(2) In June of 2013, 428 shares were delivered by one employee in payment of the exercise price of non-qualified stock options.

ITEM 5. Other Information

Not applicable

ITEM 6. Exhibits

Exhibit No.	Description
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

Table of Contents

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99 Form of Restricted Stock Unit Agreement (2013)

101 The following materials from the Hexcel Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Comprehensive Income, (iv) Condensed Consolidated Statements of Cash Flows, and (v) related notes.

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 22, 2013
(Date)

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

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
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.
99	Form of Restricted Stock Unit Agreement (2013)
101	The following materials from the Hexcel Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Comprehensive Income, (iv) Condensed Consolidated Statements of Cash Flows, and (v) related notes.