FINANCIAL REVIEW

SELECTED FINANCIAL DATA

(In thousands, except per share data)

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

	1996 [(a)]	1995	1994	1993	1992
INCOME STATEMENT DATA:					
Net sales	**$ 695,251**	$ 350,238	$ 313,795	$ 310,635	$ 352,987
Cost of sales	**(553,942)**	(283,148)	(265,367)	(263,090)	(285,088)
Gross margin	**141,309**	67,090	48,428	47,545	67,899
Selling, general and administrative expenses	**(96,150)**	(49,324)	(45,785)	(52,510)	(62,053)
Business acquisition and consolidation expenses	**(42,370)**	—	—	—	—
Restructuring expenses	**—**	—	—	(46,600)	(23,000)
Other income (expenses), net	**2,994**	791	4,861	(12,780)	2,992
Operating income (loss)	**5,783**	18,557	7,504	(64,345)	(14,162)
Interest expense	**(21,537)**	(8,682)	(11,846)	(8,862)	(8,196)
Bankruptcy reorganization expenses	**—**	(3,361)	(20,152)	(641)	—
Income (loss) from continuing operations before income taxes	**(15,754)**	6,514	(24,494)	(73,848)	(22,358)
Benefit (provision) for income taxes	**(3,436)**	(3,313)	(3,586)	(6,024)	6,375
Income (loss) from continuing operations	**$ (19,190)**	$ 3,201	$ (28,080)	$ (79,872)	$ (15,983)
Income (loss) per share from continuing operations [(b)]	**$ (0.58)**	$ 0.20	$ (3.84)	$ (10.89)	$ (2.20)
BALANCE SHEET DATA:					
Current assets	**$ 316,931**	$ 128,055	$ 148,352	$ 134,710	$ 160,001
Non-current assets	**384,805**	102,547	95,105	128,532	150,659
Total assets	**$ 701,736**	$ 230,602	$ 243,457	$ 263,242	$ 310,660
Current liabilities	**$ 188,812**	$ 66,485	$ 171,307	$ 72,965	$ 79,305
Long-term liabilities	**333,595**	115,743	78,035	169,524	125,206
Stockholders' equity (deficit)	**179,329**	48,374	(5,885)	20,753	106,149
Total liabilities and stockholders' equity (deficit)	**$ 701,736**	$ 230,602	$ 243,457	$ 263,242	$ 310,660
OTHER DATA:					
Cash dividends per share	**—**	—	—	—	$ 0.44
Shares outstanding at year-end	**36,561**	18,091	7,301	7,310	7,296

(a) A discussion of the impact of business acquisitions on 1996 selected financial data is contained in Notes 1, 2 and 3 to the accompanying consolidated financial statements.

(b) Primary and fully diluted net income (loss) per share for all five years were the same because the fully diluted computation was antidilutive.

Business Acquisitions and Consolidation

Business Acquisitions

Hexcel acquired the worldwide composites division of Ciba-Geigy Limited, a Swiss corporation, and Ciba-Geigy Corporation, a New York corporation (collectively, "Ciba"), including most of Ciba's composite materials, parts and structures businesses, on February 29, 1996. The company subsequently acquired Ciba's Austrian composites business on May 30, 1996, and various remaining assets of Ciba's worldwide composites division at various dates through February 28, 1997. The composites businesses acquired from Ciba (collectively, the "Acquired Ciba Business") are engaged in the manufacture and marketing of industrial fabrics and lightweight, high-performance composite materials, parts and structures for commercial aerospace, space and defense, recreation, and general industrial markets. Product lines include industrial fabrics, pre-impregnated fabrics ("prepregs"), structural adhesives, honeycomb core, sandwich panels and fabricated components, as well as composite structures and interiors primarily for the commercial and military aerospace markets.

The acquisition of the Acquired Ciba Business was consummated pursuant to a Strategic Alliance Agreement dated as of September 29, 1995, among Ciba and Hexcel, as amended (the "Strategic Alliance Agreement"). Under the Strategic Alliance Agreement, the company acquired the assets (including the capital stock of certain non-US subsidiaries) and assumed the liabilities of the Acquired Ciba Business, other than certain excluded assets and liabilities, in exchange for: (a) 18.0 million newly issued shares of Hexcel common stock; (b) $25.0 million in cash; (c) senior subordinated notes in an aggregate principal amount of $34.9 million; and (d) senior demand notes in an aggregate principal amount of $5.3 million. The aggregate purchase price for the net assets acquired in 1996 was $206.4 million. Furthermore, in exchange for various remaining assets of Ciba's worldwide composites division acquired between January 1, 1997 and February 28, 1997, the company has subsequently undertaken to deliver additional senior subordinated notes in an aggregate principal amount of approximately $2.7 million.

Hexcel acquired the composite products division of Hercules Incorporated ("Hercules"), including Hercules' carbon fibers and prepreg businesses (the "Acquired Hercules Business"), on June 27, 1996. The Acquired Hercules Business, which manufactures carbon fibers and prepregs for commercial aerospace, space and defense, recreation, and general industrial markets, was purchased for $135.0 million in cash subject to certain post-closing adjustments. The adjusted purchase price was $139.4 million as of December 31, 1996, but additional post-closing purchase price adjustments could arise in 1997.

Further discussion of the acquisitions of the Acquired Ciba Business and the Acquired Hercules Business (collectively, the "Acquired Businesses") is contained in Note 2 to the accompanying consolidated financial statements.

Business Consolidation

In May of 1996, Hexcel announced the commencement of a plan to consolidate the company's operations over a period of three years. In December of 1996, the company announced the commencement of further consolidation activities identified during the ongoing integration of the Acquired Businesses. The total expense of the business consolidation program is estimated at approximately $58 million, including $42.4 million of expenses incurred in 1996. The company expects to incur the majority of the remaining expenses of approximately $16 million in 1997. Cash expenditures for expenses and capital necessary to complete the business consolidation program are expected to total approximately $51 million, net of estimated proceeds from asset sales.

The objective of the business consolidation program is to integrate acquired assets and operations into Hexcel, and to reorganize the company's manufacturing and research activities around strategic centers dedicated to select product technologies. The business consolidation is also intended to eliminate excess manufacturing capacity and redundant administrative functions. Specific actions contemplated by the consolidation program include the closure of the Anaheim, California facility acquired in connection with the purchase of the Acquired Ciba Business, the closure of a portion of the Welkenraedt, Belgium facility, the reorganization of the company's manufacturing operations in France, the consolidation of the company's US special process manufacturing activities, and the integration of sales, marketing and administrative resources.

Management expects that the business consolidation program will take up to three years to complete, in part because of aerospace industry requirements to "qualify" specific equipment and manufacturing facilities for the manufacture of certain products. These qualification requirements increase the complexity, cost and time of moving equipment and rationalizing manufacturing activities. Based on Hexcel's experience with previous plant consolidations, compliance with these qualification requirements necessitates an approach to the consolidation of manufacturing facilities that will require two to three years to complete.

Management estimates that the business consolidation program will result in annual cost savings of approximately $32 million when it is fully implemented in 1999. During 1997 and 1998, the cash costs associated with the consolidation program, net of estimated proceeds from asset sales, are expected to approximate the incremental savings generated by the program during the same period.

Further discussion of the business consolidation program is contained in Note 3 to the accompanying consolidated financial statements.

Results of Operations

1996 Compared to 1995

Net Sales: Net sales for 1996 were $695.3 million, compared with net sales for 1995 of $350.2 million. The results for 1996 include the results of the Acquired Ciba Business and the Acquired Hercules Business for the periods from the respective acquisition dates through December 31, 1996. Excluding the results of the Acquired Businesses, 1996 sales were approximately $385 million, a 10% increase over 1995. This increase was largely attributable to improved sales of composite materials to commercial aerospace customers, and reflects the initial impact of recently announced increases in production rates for certain aircraft as well as the increased utilization of composite materials on new generation aircraft. In particular, the company benefited from higher sales of carbon honeycomb core and carbon-based prepregs. The company also benefited from improved sales of fabricated honeycomb parts to the commercial aerospace market, and from increased sales of fabrics for use in the manufacture of printed circuit boards. Changes in foreign currency exchange rates did not have a material impact on the level of 1996 sales relative to 1995 sales.

Approximately 32% of Hexcel's 1996 sales were to The Boeing Company, Airbus Industrie and related subcontractors. Reported commercial aircraft deliveries by Boeing and Airbus improved only modestly in 1996, from a combined 330 aircraft in 1995 to 344 aircraft in 1996. However, these two manufacturers reported receiving a net total of 960 orders for new aircraft in 1996, compared with 367 orders in 1995. Depending on the product, orders placed with Hexcel are received anywhere between one and eighteen months prior to delivery of the aircraft to the customer. In January of 1997, Boeing and Airbus reported that they expect to deliver a total of 523 aircraft in 1997. Published industry analysis indicates that combined deliveries by these two manufacturers in 1998 should approximate 700 aircraft, and that the demand for new aircraft will continue to grow through the turn of the century.

Pro Forma Net Sales: Pro forma net sales for 1996, giving effect to the acquisitions of the Acquired Businesses as if those transactions had occurred at the beginning of the year, were $798.5 million. This compares with pro forma net sales for 1995 of $771.3 million. Pro forma net sales to third-party customers by product group and market segment for 1996 and 1995 were as follows:

(In millions)	Fibers and Fabrics	Composite Materials	Engineered Products	Total	
1996 Pro Forma Net Sales					
Commercial aerospace	$ 17.4	$ 317.1	$ 102.5	$ 437.0	55%
Space and defense	20.2	60.8	10.4	91.4	11
Recreation	27.4	63.3	—	90.7	11
General industrial and other	116.8	60.8	1.8	179.4	23
Total	$ 181.8	$ 502.0	$ 114.7	$ 798.5	100%
1995 Pro Forma Net Sales					
Commercial aerospace	$ 14.8	$ 294.7	$ 94.9	$ 404.4	52%
Space and defense	25.3	49.0	15.8	90.1	12
Recreation	31.3	74.3	—	105.6	14
General industrial and other	123.0	45.4	2.8	171.2	22
Total	$ 194.4	$ 463.4	$ 113.5	$ 771.3	100%

The growth in pro forma sales to the commercial aerospace market from 1995 to 1996 was largely attributable to increased sales of composite materials and engineered products. The improvement in sales of composite materials reflects the build rate and product utilization increases noted above. The improvement for engineered products primarily reflects the production of structural and interior components outsourced to Hexcel by The Boeing Company during the second half of 1996, as well as strong shipments of retrofit interiors to airline customers. As a result of the additional work from Boeing, the company expects that sales of engineered products will continue to grow in 1997.

Pro forma space and defense sales were essentially unchanged from 1995 to 1996, reflecting a decline in sales of fibers and fabrics and engineered structures, offset by improved sales of composite materials to select military programs. The current international and domestic political climate suggests that overall military spending, including aircraft procurement, is not likely to change significantly from current levels in the near future. Consequently, management does not expect a significant change in 1997 from the current level of sales to the space and defense market.

The decrease in pro forma sales to the recreation market during 1996 is primarily attributable to reduced demand for composite materials by ski and snowboard manufacturers due to excess inventories. Pro forma sales of fabrics for certain marine applications were also slightly lower. The increase in pro forma general industrial sales reflects improved sales of fabrics for printed circuit boards and composite materials for various transportation applications, partially offset by reduced sales of carbon fibers to non-aerospace customers. Hexcel does not expect a rebound in the demand for composite materials by ski and snowboard producers until the second half of 1997, but sales of fabrics and composite materials to other recreation and general industrial markets are anticipated to grow modestly throughout the year.

Gross Margin: Gross margin for 1996 was $141.3 million, or 20.3% of sales, compared with $67.1 million for 1995, or 19.2% of sales. Excluding the Acquired Businesses, 1996 gross margin was approximately 24% of sales. The improvement in 1996 gross margin relative to 1995, excluding the impact of the Acquired Businesses, is the result of both higher sales volumes and improved manufacturing productivity, especially for composite materials. Hexcel also benefited from the cost reductions associated with the completion, in mid-1995, of a previous restructuring of the company's composite materials business. Due to the highly competitive nature of most of the markets in which the company competes, product price changes were not a significant factor in the 1996 gross margin improvement.

The aggregate gross margin of the Acquired Businesses from the respective acquisition dates through December 31, 1996, was approximately 16% of sales. The integration of the Acquired Businesses into Hexcel, including the consolidation and rationalization of manufacturing facilities and processes, is a primary objective of the business consolidation program. Although the consolidation program commenced in 1996, the productivity improvements expected to result from this program will not be fully realized until 1999.

Selling, General and Administrative ("SG&A") Expenses: SG&A expenses were $96.2 million in 1996, or 13.8% of sales, including research and technology expenses of $16.7 million, or 2.4% of sales. This compares with 1995 SG&A expenses of $49.3 million, or 14.1% of sales, including $7.6 million of research and technology expenses equal to 2.2% of sales. The aggregate dollar increase in SG&A expenses from 1995 to 1996 is attributable to the acquisitions of the Acquired Businesses. The slight decrease in SG&A expenses as a percentage of sales primarily reflects higher sales levels. Management expects a modest improvement in SG&A expenses, relative to sales, in 1997.

Operating Income: Operating income was $5.8 million in 1996, or 0.8% of sales, compared with $18.6 million in 1995, or 5.3% of sales. The $74.2 million increase in gross margin from 1995 to 1996 was more than offset by $46.8 million in additional SG&A expenses and $42.4 million in business acquisition and consolidation expenses. The results for 1996 also include other income of $3.0 million, which is largely attributable to the receipt of additional cash proceeds in connection with the disposition of the Chandler, Arizona manufacturing facility and certain related assets in 1994, and to the partial settlement of a claim arising from the sale of assets in 1991. The results for 1995 included $0.8 million of other income.

Interest Expense: Interest expense totaled $21.5 million in 1996 and $8.7 million in 1995. The year-on-year increase primarily reflects the cost of financing the acquisitions of the Acquired Businesses. Hexcel financed approximately $200 million of aggregate purchase price with various debt and credit facilities, and wrote off $3.4 million of capitalized debt financing costs in connection with the acquisition-related refinancing of certain debt in 1996.

Provision for Income Taxes: Income tax provisions of $3.4 million in 1996 and $3.3 million in 1995 primarily reflect international taxes on certain European subsidiaries, state taxes, and the settlement of various tax audits. The 1996 income tax provision is net of a $2.5 million benefit from the favorable resolution of a US federal tax audit. As of December 31, 1996, Hexcel had net operating loss ("NOL") carryforwards for US federal income tax purposes of approximately $70 million and NOL carryforwards for Belgium income tax purposes of approximately $22 million. As discussed in Note 12 to the accompanying consolidated financial statements, the company has not recognized any tax benefits in 1996 or 1995 attributable to the potential future realization of these NOL carryforwards or any other deferred tax assets.

Net Earnings: The 1996 net loss was $19.2 million, or $0.58 per share, compared with net income for 1995 of $2.7 million, or $0.17 per share. The 1996 net loss includes business acquisition and consolidation expenses of $42.4 million, or $1.16 per share after income taxes. Net income for 1995 is after bankruptcy reorganization expenses of $3.4 million, or $0.21 per share.

There were 33.4 million weighted average shares and equivalent shares outstanding during 1996, versus 15.7 million during 1995. The increase in the number of weighted average shares and equivalent shares in 1996 is primarily attributable to the delivery of 18.0 million newly issued shares of Hexcel common stock to Ciba on February 29, 1996, in connection with the purchase of the Acquired Ciba Business. As of December 31, 1996, there were 36.6 million shares of Hexcel common stock issued and outstanding.

1995 Compared to 1994

Net Sales: Net sales for 1995 totaled $350.2 million, compared with 1994 net sales of $313.8 million. The 12% increase from 1994 to 1995 is attributable to increased sales of fabrics and prepregs, which were partially offset by decreased sales of honeycomb. Sales of fabrics for use in recreation and general industrial markets were higher, as were sales of prepregs to commercial aerospace and general industrial customers. In addition, results for 1995 benefited from a significant military contract for prepregs, and improved sales of honeycomb to the commercial aerospace market. The overall decrease in honeycomb sales was attributable to the divestiture of the Chandler, Arizona manufacturing facility and the related reduction in military aerospace sales. The Chandler facility and certain related assets were sold to the Northrop Grumman Corporation in December of 1994.

Changes in currency exchange rates were also a factor in the 1995 sales increase relative to 1994. During 1995, the US dollar declined against most of the major European currencies, including the Belgian and French francs. Accordingly, sales from Hexcel's European subsidiaries increased when translated into US dollars.

Net sales to third-party customers by product group and market segment for 1995 and 1994 were as follows:

(In millions)	**Fabrics**	**Composite Materials**	**Total**	
1995 Net Sales				
Commercial aerospace	$ 7.1	$ 151.9	$ 159.0	45%
Space and defense	14.3	23.0	37.3	11
Recreation	8.4	24.2	32.6	9
General industrial and other	89.3	32.0	121.3	35
Total	$ 119.1	$ 231.1	$ 350.2	100%
1994 Net Sales				
Commercial aerospace	$ 4.3	$ 143.2	$ 147.5	47%
Space and defense	14.8	20.1	34.9	11
Recreation	8.3	21.0	29.3	9
General industrial and other	67.4	34.7	102.1	33
Total	$ 94.8	$ 219.0	$ 313.8	100%

Sales of composite materials to the commercial aerospace market increased in 1995 as a result of modest improvements in the build rates for certain commercial aircraft, as well as increased sales of selected products. A significant component of the 1995 sales gains came from carbon-based prepregs and certain honeycomb products that are utilized on new generation aircraft. In addition, Hexcel benefited from an improved economic environment in Europe.

The slight increase in 1995 sales to space and defense markets is attributable to a significant military contract for prepregs, partially negated by the decline in honeycomb sales resulting from the divestiture of the Chandler facility.

Sales to recreation and general industrial markets of new products introduced within the past few years increased during 1995. In addition, Hexcel benefited from strong European demand for printed circuit boards, and continued demand for certain composite materials used in athletic shoes, golf club shafts, energy absorption products, and automotive and mass transit components.

Gross Margin: Gross margin for 1995 was $67.1 million, or 19.2% of sales, compared with $48.4 million for 1994, or 15.4% of sales. The increase in 1995 gross margin over the prior year reflects the impact of higher sales, as well as certain manufacturing cost reductions. Cost reductions resulted from a restructuring of the company's composite materials business that was initiated in 1992, expanded in 1993, and completed in the middle of 1995. Product price changes were not a significant factor in the growth of 1995 gross margin.

SG&A Expenses: SG&A expenses were $49.3 million in 1995, or 14.1% of sales, compared with $45.8 million in 1994, or 14.6% of sales. The aggregate dollar increase in SG&A expenses during 1995 is largely attributable to higher selling expenses and changes in currency exchange rates. The decrease in SG&A expenses as a percentage of sales was due to higher sales levels.

Operating Income: Operating income was $18.6 million in 1995, or 5.3% of sales, compared with $7.5 million in 1994, or 2.4% of sales. The $18.7 million increase in gross margin from 1994 to 1995 was partially offset by $3.5 million in additional SG&A expenses and a $4.1 million decrease in other income. Other income for 1994 of $4.9 million included a $15.9 million gain resulting from the divestiture of the Chandler facility and certain related assets, less an $8.0 million provision to reflect the estimated costs of restructuring a joint venture and a $2.9 provision for bankruptcy claim adjustments.

Interest Expense: Interest expense was $8.7 million in 1995 and $11.8 million in 1994. The decline in interest expense from 1994 to 1995 reflects the absence of interest on bankruptcy claims after February 9, 1995, the date that Hexcel Corporation emerged from bankruptcy reorganization proceedings, as well as the elimination of various debt obligations with proceeds from a 1995 subscription rights offering and the Chandler transaction.

Provision for Income Taxes: The 1995 and 1994 income tax provisions of $3.3 million and $3.6 million, respectively, resulted from international taxes on certain European subsidiaries, state taxes, and the settlement of various tax audits. Hexcel did not recognize any tax benefits in 1995 or 1994 attributable to the potential future realization of NOL carryforwards or other deferred tax assets.

Net Earnings: Net income for 1995 was $2.7 million, or $0.17 per share, compared with a net loss for 1994 of $30.0 million, or $4.10 per share. The 1994 net loss includes bankruptcy reorganization expenses of $20.2 million, or $2.76 per share, as well as a loss from discontinued operations of $1.9 million, or $0.26 per share.

There were 15.7 million weighted average shares and equivalent shares outstanding during 1995, versus 7.3 million during 1994. The increase in the number of weighted average shares and equivalent shares from 1994 to 1995 is primarily attributable to the issuance of an additional 10.8 million shares of Hexcel common stock pursuant to a standby purchase agreement and subscription rights offering in connection with Hexcel Corporation's reorganization under US bankruptcy laws. Further discussion of Hexcel Corporation's bankruptcy reorganization is contained in Note 19 to the accompanying consolidated financial statements.

Financial Condition and Liquidity

Financial Resources

In connection with the purchase of the Acquired Ciba Business, Hexcel obtained a three-year revolving credit facility of up to $175.0 million (the "Senior Secured Credit Facility") to: (a) fund the cash component of the purchase price; (b) refinance outstanding indebtedness under certain US and European credit facilities; and (c) provide for the ongoing working capital and other financing requirements of the company, including business consolidation activities, on a worldwide basis. The Senior Secured Credit Facility was subsequently replaced with a new revolving credit facility (the "Revolving Credit Facility") in connection with the purchase of the Acquired Hercules Business.

The Revolving Credit Facility was obtained to: (a) refinance outstanding indebtedness under the Senior Secured Credit Facility; (b) finance the purchase of the Acquired Hercules Business; and (c) provide for the ongoing working capital and other financing requirements of the company, including business consolidation activities, on a worldwide basis. The Revolving Credit Facility initially provided for up to $310.0 million of borrowing capacity. However, as a result of the company's issuance of $114.5 million in convertible subordinated notes in July of 1996, maximum availability under the Revolving Credit Facility was reduced from $310.0 million to $254.6 million, in accordance with the terms of that facility. As of December 31, 1996, outstanding borrowings and letter of credit commitments under the Revolving Credit Facility totaled $111.2 million. The Revolving Credit Facility expires in February of 1999.

Management expects that the financial resources of Hexcel, including the Revolving Credit Facility, will be sufficient to fund the company's worldwide operations. Further discussion of the company's financial resources is contained in Note 7 to the accompanying consolidated financial statements.

EBITDA and Cash Flows

1996: Earnings before business acquisition and consolidation expenses, other income, interest, bankruptcy reorganization expenses, taxes, depreciation and amortization ("Adjusted EBITDA") was $71.9 million. Pro forma Adjusted EBITDA, giving effect to the acquisitions of the Acquired Businesses as if those transactions had occurred at the beginning of the year, was approximately $86 million.

Net cash provided by operating activities was $26.5 million. Net cash used for investing activities was $206.4 million, including $164.4 million used in connection with the acquisitions of the Acquired Businesses and $43.6 million for capital expenditures. Net cash provided by financing activities, including borrowings under the Revolving Credit Facility and proceeds from the issuance of $114.5 million in convertible subordinated notes, was $181.7 million. Non-cash financing of the purchase of the Acquired Ciba Business included the issuance of debt securities valued at $37.2 million and the issuance of 18.0 million shares of Hexcel common stock valued at $144.2 million.

1995: Adjusted EBITDA was $29.4 million, and pro forma Adjusted EBITDA was approximately $62 million. Net cash used by operating activities was $2.5 million. Net cash provided by investing activities was $15.7 million, primarily reflecting $31.9 million in cash proceeds from the sale of various assets and $12.1 million of capital expenditures. Net cash used by financing activities of $9.6 million includes proceeds from short-term debt and the issuance of Hexcel common stock, as well as the repayment of allowed claims in connection with Hexcel Corporation's emergence from bankruptcy reorganization proceedings.

Adjusted EBITDA and pro forma Adjusted EBITDA have been presented to provide a measure of Hexcel's operating performance that is commonly used by investors and financial analysts to analyze and compare companies. Adjusted EBITDA and pro forma Adjusted EBITDA do not represent alternative measures of the company's cash flows or operating income, and should not be considered in isolation or as substitutes for measures of performance presented in accordance with generally accepted accounting principles.

Capital Expenditures

Capital expenditures were $43.6 million in 1996, compared with $12.1 million in 1995 and $8.4 million in 1994. The significant increase in 1996 expenditures over prior years reflects the impact of the Acquired Businesses on capital requirements, including the impact of certain business consolidation activities. The increase also reflects expenditures on manufacturing equipment necessary to improve manufacturing processes and to expand production capacity for select product lines that are in very high demand. Further increases in capital spending are expected in 1997 as a result of ongoing business consolidation activities and opportunities for additional manufacturing improvements. Such expenditures will be financed with cash generated from operations and borrowings under the Revolving Credit Facility.

Risks, Uncertainties and Other Factors With Respect to "Forward-Looking Statements"

Certain statements contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations," the notes to the accompanying consolidated financial statements, and elsewhere constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of Hexcel, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: General economic and business conditions; changes in political, social and economic conditions and local regulations, particularly in Europe and Asia; changes in, or failure to comply with government regulations; demographic changes; changes in customer preferences; the loss of any significant customers; changes in methods of distribution and technology; industry capacity; competition; the assimilation of the Acquired Ciba Business; the assimilation of the Acquired Hercules Business; changes in business strategy or development plans; indebtedness of the company; the availability, terms and deployment of capital; quality of management, business abilities and judgment of the company's personnel; availability of qualified personnel; and various other factors referenced in "Management's Discussion and Analysis of Financial Condition and Results of Operations," the notes to the accompanying consolidated financial statements, and elsewhere. The company assumes no obligation to update the forward-looking information to reflect actual results or changes in the factors affecting such forward-looking information.

The forward-looking information referred to above includes, but is not limited to: (a) estimates of commercial aircraft orders and deliveries; (b) expectations regarding sales growth, manufacturing productivity, and selling, general and administrative expenses; (c) the availability and utilization of NOL carryforwards for income tax purposes; (d) expectations regarding Hexcel's financial condition and liquidity, as well as future cash flows; and (e) the estimated total cost of the company's business consolidation program, the estimated amount of cash expenditures to complete the program and the estimated annual cost savings resulting from the consolidation program.

In addition to the risks, uncertainties and other factors referred to above which may cause the actual costs, cash expenditures and estimated annual cost savings of the business consolidation program to differ materially from estimated amounts, such estimated amounts are based on various factors and were derived utilizing numerous important assumptions, including: (a) achieving estimated reductions in the number of total employees within anticipated time frames and at currently projected severance costs levels, while maintaining work flow in the business areas affected; (b) the ability to maintain manufacturing know-how with respect to production processes conducted at facilities that will be closed or at which the number of employees will be reduced, including cooperation by employees who will be terminated; (c) the assimilation and integration of the Acquired Ciba Business and the Acquired Hercules Business with the company's operations without disruption to manufacturing, marketing and distribution activities; (d) the assimilation of the production processes at closed facilities with production at other company facilities without undue disruption to the manufacturing, marketing and distribution functions, including the cooperation of customers in connection with requalifying the subject products for various customer and government programs; (e) selling vacated facilities within anticipated time frames at anticipated selling prices; and (f) the absence of changes in business conditions that would require significant modifications to the current program. The failure of these assumptions to be realized may cause the actual total cost of the consolidation program, the actual amount of cash expenditures to complete the program and the actual annual cost savings resulting from the program to differ materially from the estimates.

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

Hexcel maintains accounting and other control systems which management believes provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are safeguarded and accounted for properly. Underlying this concept of reasonable assurance is the premise that the cost of control should not exceed benefits derived from control.

The Audit Committee of the Board of Directors reviews and monitors the financial reports and accounting practices of Hexcel. These reports and practices are reviewed regularly by management and by the independent auditors, Deloitte & Touche LLP, in connection with the audit of the company's financial statements. The Audit Committee, composed solely of outside directors, meets periodically, separately and jointly, with management and the independent auditors.

JOHN J. LEE
Chief Executive Officer

STEPHEN C. FORSYTH
Chief Financial Officer

WAYNE C. PENSKY
Chief Accounting Officer

To the Board of Directors and Stockholders of Hexcel Corporation:

We have audited the accompanying consolidated balance sheets of Hexcel Corporation and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of Hexcel's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Hexcel Corporation and subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP
Oakland, California
February 28, 1997

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	December 31, 1996	December 31, 1995
ASSETS		
Current assets:		
Cash and equivalents	**$ 7,975**	$ 3,829
Accounts receivable	**151,263**	65,888
Inventories	**145,884**	55,475
Prepaid expenses	**11,809**	2,863
Total current assets	**316,931**	128,055
Property, plant and equipment	**468,173**	203,580
Less accumulated depreciation	**(141,390)**	(117,625)
Net property, plant and equipment	**326,783**	85,955
Intangibles and other assets	**58,022**	16,592
Total assets	**$ 701,736**	$ 230,602
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and current maturities of long-term liabilities	**$ 23,835**	$ 1,802
Accounts payable	**73,117**	22,904
Accrued liabilities	**91,860**	41,779
Total current liabilities	**188,812**	66,485
Long-term notes payable and capital lease obligations	**254,919**	88,342
Indebtedness to related parties	**32,262**	—
Deferred liabilities	**46,414**	27,401
Stockholders' equity:		
Common stock, $0.01 par value, authorized 100,000 shares, shares issued and outstanding of 36,561 in 1996 and 18,091 in 1995	**366**	181
Additional paid-in capital	**259,592**	111,259
Accumulated deficit	**(89,171)**	(69,981)
Minimum pension obligation adjustment	—	(535)
Cumulative currency translation adjustment	**8,542**	7,450
Total stockholders' equity	**179,329**	48,374
Total liabilities and stockholders' equity	**$ 701,736**	$ 230,602

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	1996	1995	1994
Net sales	**$ 695,251**	$ 350,238	$ 313,795
Cost of sales	**(553,942)**	(283,148)	(265,367)
Gross margin	**141,309**	67,090	48,428
Selling, general and administrative expenses	**(96,150)**	(49,324)	(45,785)
Business acquisition and consolidation expenses	**(42,370)**	—	—
Other income, net	**2,994**	791	4,861
Operating income	**5,783**	18,557	7,504
Interest expense	**(21,537)**	(8,682)	(11,846)
Bankruptcy reorganization expenses	**—**	(3,361)	(20,152)
Income (loss) from continuing operations before income taxes	**(15,754)**	6,514	(24,494)
Provision for income taxes	**(3,436)**	(3,313)	(3,586)
Income (loss) from continuing operations	**(19,190)**	3,201	(28,080)
Discontinued operations:			
Income from operations, net of provision for income taxes of $441 in 1994	**—**	—	989
Losses during phase-out period, net of provision for income taxes of $136 in 1994	**—**	(468)	(2,879)
Net income (loss)	**$ (19,190)**	$ 2,733	$ (29,970)
Net income (loss) per share and equivalent share:			
Primary and fully diluted:			
Continuing operations	**$ (0.58)**	$ 0.20	$ (3.84)
Discontinued operations	**—**	(0.03)	(0.26)
Net income (loss)	**$ (0.58)**	$ 0.17	$ (4.10)
Weighted average shares and equivalent shares	**33,351**	15,742	7,310

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except per share data)

	Common Stock Outstanding Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Minimum Pension Obligation Adjustment	Cumulative Currency Translation Adjustment	Total Stockholders' Equity
Balance, January 1, 1994	7,310	$ 73	$ 62,562	$ (42,744)	$ (646)	$ 1,508	$ 20,753
Net loss				(29,970)			(29,970)
Activity under stock plans	(9)		64				64
Pension obligation adjustment					509		509
Currency translation adjustment						2,759	2,759
Balance, December 31, 1994	7,301	73	62,626	(72,714)	(137)	4,267	(5,885)
Net income				2,733			2,733
Sale of new common stock under standby purchase commitment and subscription rights offering	10,800	108	48,631				48,739
Activity under stock plans	(10)		2				2
Pension obligation adjustment					(398)		(398)
Currency translation adjustment						3,183	3,183
Balance, December 31, 1995	18,091	181	111,259	(69,981)	(535)	7,450	48,374
Net loss				**(19,190)**			**(19,190)**
Issuance of shares to Ciba at $8 per share, net of issuance costs of $2,993	**18,022**	**180**	**141,001**				**141,181**
Activity under stock plans	**408**	**4**	**7,133**				**7,137**
Other issuance of shares	**40**	**1**	**199**				**200**
Pension obligation adjustment					**535**		**535**
Currency translation adjustment						**1,092**	**1,092**
Balance, December 31, 1996	**36,561**	**$366**	**$259,592**	**$(89,171)**	**$ —**	**$8,542**	**$179,329**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	1996	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES			
Income (loss) from continuing operations	**$ (19,190)**	$ 3,201	$ (28,080)
Reconciliation to net cash provided (used) by continuing operations:			
Depreciation and amortization	**26,730**	11,623	14,230
Accrued business acquisition and consolidation expenses	**42,370**	—	—
Business acquisition and consolidation expenditures	**(11,579)**	—	—
Other income relating to sale of the Chandler, Arizona manufacturing facility and certain related assets	**(1,560)**	(600)	(15,900)
Provision for DIC-Hexcel Limited	**—**	—	8,000
Deferred provision (benefit) for income taxes	**(520)**	(329)	3,609
Changes in assets and liabilities:			
Increase in accounts receivable	**(14,695)**	(1,752)	(1,168)
Increase in inventories	**(5,072)**	(8,111)	(6,228)
(Increase) decrease in prepaid expenses	**(1,430)**	718	(454)
Increase (decrease) in accounts payable and accrued liabilities	**15,549**	(10,090)	30,966
Changes in other non-current assets and long-term liabilities	**(4,096)**	2,346	(3,876)
Net cash provided (used) by continuing operations	**26,507**	(2,994)	1,099
Net cash provided (used) by discontinued operations	**—**	486	(2,206)
Net cash provided (used) by operating activities	**26,507**	(2,508)	(1,107)
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	**(43,569)**	(12,144)	(8,362)
Proceeds from equipment sold	**—**	17	229
Cash paid for the Acquired Ciba Business	**(25,000)**	—	—
Deferred business acquisition costs, incurred in connection with the purchase of the Acquired Ciba Business	**—**	(4,150)	—
Cash paid for the Acquired Hercules Business	**(139,400)**	—	—
Proceeds from sale of the Chandler, Arizona manufacturing facility and certain related assets	**1,560**	27,294	2,294
Proceeds from sale of discontinued resins business	—	4,648	6,125
Net cash provided (used) by investing activities	**(206,409)**	15,665	286
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt	**286,974**	4,317	171
Payments of long-term debt	**(124,288)**	(5,402)	(11,413)
Proceeds of short-term debt, net	**15,319**	20,923	1,687
Proceeds from issuance of common stock	**3,702**	48,741	—
Payments of allowed claims pursuant to the Reorganization Plan	—	(78,144)	—
Net cash provided (used) by financing activities	**181,707**	(9,565)	(9,555)
Effect of exchange rate changes on cash and equivalents	**2,341**	(694)	(41)
Net increase (decrease) in cash and equivalents	**4,146**	2,898	(10,417)
Cash and equivalents at beginning of year	**3,829**	931	11,348
Cash and equivalents at end of year	**$ 7,975**	$ 3,829	$ 931

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

1. Significant Accounting Policies

Nature of Operations and Basis of Accounting

The accompanying consolidated financial statements include the accounts of Hexcel Corporation and subsidiaries ("Hexcel" or the company), after elimination of intercompany transactions and accounts. Hexcel is a leading international developer and manufacturer of carbon fibers, industrial fabrics, and lightweight, high-performance composite materials, parts and structures for use in the commercial aerospace, space and defense, recreation, and general industrial markets. The company serves international markets through manufacturing and marketing facilities located in the United States and Europe, as well as sales offices in Asia, Australia, and South America. The company is also a partner in one joint venture that markets composite materials in the US, and in another joint venture that manufactures and markets composite materials in Asia.

As discussed in Note 2, Hexcel acquired the worldwide composites division of Ciba-Geigy Limited, a Swiss corporation, and Ciba-Geigy Corporation, a New York corporation (collectively, "Ciba"), including most of Ciba's composite materials, parts and structures businesses, on February 29, 1996. The company subsequently acquired Ciba's Austrian composites business on May 30, 1996, and various remaining assets of Ciba's worldwide composites division at various dates through February 28, 1997. Accordingly, the accompanying consolidated balance sheet as of December 31, 1996, includes the financial position of the businesses acquired from Ciba on or before that date. The accompanying consolidated statements of operations, stockholders' equity and cash flows for 1996 include the results of operations and cash flows, respectively, of the businesses acquired from Ciba for the periods from the respective acquisition dates through December 31, 1996.

In addition, as discussed in Note 2, Hexcel acquired the composite products division of Hercules Incorporated ("Hercules"), including Hercules' carbon fibers and prepreg businesses, on June 27, 1996. Accordingly, the accompanying consolidated balance sheet as of December 31, 1996, includes the financial position of the businesses acquired from Hercules as of that date. The accompanying consolidated statements of operations, stockholders' equity and cash flows for 1996 include the results of operations and cash flows, respectively, of the businesses acquired from Hercules for the period from the acquisition date through December 31, 1996.

Cash and Equivalents

Hexcel invests excess cash in investments with original maturities of less than three months. The investments consist of Eurodollar time deposits and are stated at cost, which approximates fair value. The company considers such investments to be cash equivalents for purposes of the statements of cash flows.

Accounts Receivable

Accounts receivable were net of reserves for doubtful accounts of $6,625 and $2,603 as of December 31, 1996 and 1995, respectively.

Inventories

Inventories are valued at the lower of cost or market, with cost determined using the first-in, first-out and average cost methods.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Repairs and maintenance are charged to expense as incurred; replacements and betterments are capitalized.

The company depreciates property, plant and equipment over estimated useful lives. Accelerated and straight-line methods are used for financial statement purposes. The estimated useful lives range from 10 to 40 years for buildings and improvements and from 3 to 20 years for machinery and equipment.

Intangibles and Other Assets

Goodwill and other purchased intangibles acquired in connection with the acquisition of businesses from Ciba are included in "intangibles and other assets" at cost, less accumulated amortization (see Note 6). Amortization is provided on a straight-line basis over an estimated economic life of 20 years from the date of acquisition.

The carrying value of all long-term assets, including property, plant and equipment, goodwill, and other purchased intangibles, is evaluated annually in relation to the operating performance and estimated future cash flows of the underlying businesses, in order to determine if the carrying value exceeds the estimated recoverable value of the assets and a corresponding impairment loss should be recognized. As of December 31, 1996, the carrying value did not exceed the estimated recoverable value of these assets, and no impairment losses have been recognized.

Currency Translation

The assets and liabilities of European subsidiaries are translated into US dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. Cumulative currency translation adjustments are included in stockholders' equity. Realized gains and losses from currency exchange transactions were not material to the company's consolidated results of operations in 1996, 1995 or 1994.

Revenue Recognition

Product sales are recognized on the date of shipment.

Research and Technology Costs

Research and technology costs of $16,742 in 1996, $7,618 in 1995 and $8,201 in 1994 were expensed as incurred, and are included in "selling, general and administrative expenses" in the accompanying consolidated statements of operations.

Earnings per Share

Net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares and dilutive common share equivalents (stock options) outstanding during each year. The computation on the fully diluted basis, which considers the exercise of stock options and the conversion of convertible subordinated notes and debentures, was antidilutive in 1996, 1995 and 1994.

Stock-Based Compensation

In 1996, Hexcel adopted the disclosure requirements of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), which provide for the disclosure of pro forma net earnings and earnings per share as if the fair value method were used to account for stock-based employee compensation plans (see Note 14). Pursuant to SFAS 123, the company has elected to continue to use the intrinsic value method to account for such plans in the accompanying consolidated financial statements, in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APBO 25").

Reclassifications

Certain prior year amounts in the accompanying consolidated financial statements and related notes have been reclassified to conform to the 1996 presentation.

Estimates and Assumptions

The accompanying consolidated financial statements and related notes reflect numerous estimates and assumptions made by the management of Hexcel. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosures with respect to contingent assets and liabilities, and the reported amounts of revenues and expenses. Although management believes that the estimates and assumptions used in preparing the accompanying consolidated financial statements and related notes are reasonable in light of known facts and circumstances, actual results could differ from the estimates used.

2. Business Acquisitions

Acquired Ciba Business

Hexcel acquired most of Ciba's composite materials, parts and structures businesses on February 29, 1996, Ciba's Austrian composites business on May 30, 1996, and various remaining assets of Ciba's worldwide composites division (collectively, the "Acquired Ciba Business") at various dates through February 28, 1997. The Acquired Ciba Business is engaged in the manufacture and marketing of industrial fabrics and lightweight, high-performance composite materials, parts and structures for commercial aerospace, space and defense, recreation, and general industrial markets. Product lines include industrial fabrics, pre-impregnated fabrics ("prepregs"), structural adhesives, honeycomb core, sandwich panels and fabricated components, as well as composite structures and interiors primarily for the commercial and military aerospace markets.

The acquisition of the Acquired Ciba Business was consummated pursuant to a Strategic Alliance Agreement dated as of September 29, 1995, among Ciba and Hexcel, as amended (the "Strategic Alliance Agreement"). Under the Strategic Alliance Agreement, the company acquired the assets (including the capital stock of certain non-US subsidiaries) and assumed the liabilities of the Acquired Ciba Business, other than certain excluded assets and liabilities, in exchange for: (a) 18,022 newly issued shares of Hexcel common stock; (b) $25,000 in cash; (c) senior subordinated notes in an aggregate principal amount of $34,928, subject to certain adjustments (the "Senior Subordinated Notes"); and (d) senior demand notes in an aggregate principal amount equal to the cash on hand at certain of the non-US subsidiaries included in the Acquired Ciba Business (the "Senior Demand Notes").

As of December 31, 1996, Hexcel had delivered Senior Subordinated Notes to Ciba in an aggregate principal amount of $34,928, and with an aggregate fair value at date of issue of $31,902. Furthermore, in exchange for certain assets acquired between January 1, 1997 and February 28, 1997, from Ciba affiliates that continued to act as distributors for the Acquired Ciba Business throughout 1996 (the "Ciba Distributors"), the company has subsequently undertaken to deliver additional Senior Subordinated Notes in an aggregate principal amount of approximately $2,700. During 1996, the company also delivered Senior Demand Notes to Ciba in an aggregate principal amount of $5,329. The Senior Demand Notes were presented for payment and paid in full prior to December 31, 1996.

In connection with the purchase of the Acquired Ciba Business, Hexcel obtained a three-year revolving credit facility of up to $175,000 (the "Senior Secured Credit Facility") to: (a) fund the cash component of the purchase price; (b) refinance outstanding indebtedness under certain US and European credit facilities; and (c) provide for the ongoing working capital and other financing requirements of the company, including business consolidation activities, on a worldwide basis. The Senior Secured Credit Facility was subsequently replaced with a new revolving credit facility in connection with the purchase of the Acquired Hercules Business.

On February 21, 1997, Hexcel consented to an assignment by Ciba of Ciba's rights and obligations under the Strategic Alliance Agreement and related employment, governance and other agreements (collectively, the "Alliance Agreements"). Under the terms of this consent, Ciba was authorized to assign its rights and obligations under the Alliance Agreements to Ciba Specialty Chemicals Holding Inc., a Swiss corporation, and Ciba Specialty Chemicals Corporation, a Delaware corporation (collectively, "CSC"). In connection with the assignment of these rights and obligations, all of the Hexcel common stock and Senior Subordinated Notes previously held by Ciba will be held by CSC.

(In thousands, except per share data)

Acquired Hercules Business

Hexcel acquired the assets of the composite products division of Hercules (the "Acquired Hercules Business") on June 27, 1996. The Acquired Hercules Business, which manufactures carbon fibers and prepregs for commercial aerospace, space and defense, recreation, and general industrial markets, was purchased for $135,000 in cash subject to certain post-closing adjustments. The adjusted purchase price was $139,400 as of December 31, 1996, but additional post-closing purchase price adjustments could arise in 1997.

In connection with the purchase of the Acquired Hercules Business, Hexcel replaced the Senior Secured Credit Facility with a new revolving credit facility (the "Revolving Credit Facility"). As discussed in Note 7, the Revolving Credit Facility was obtained to: (a) refinance outstanding indebtedness under the Senior Secured Credit Facility; (b) finance the purchase of the Acquired Hercules Business; and (c) provide for the ongoing working capital and other financing requirements of the company, including business consolidation activities, on a worldwide basis (see Note 3).

Assets Acquired and Liabilities Assumed or Incurred

The acquisitions of the Acquired Ciba Business and the Acquired Hercules Business (collectively, the "Acquired Businesses"), have been accounted for using the purchase method, in accordance with Accounting Principles Board Opinion No. 16, "Business Combinations" ("APBO 16"). The assets acquired and the liabilities assumed or incurred in 1996 were:

	Acquired Ciba Business	Acquired Hercules Business	Total Acquired Businesses
Estimated fair values of assets acquired:			
Accounts receivable	$ 53,861	$ 16,819	$ 70,680
Inventories	63,048	22,289	85,337
Property, plant and equipment	119,446	110,611	230,057
Goodwill and other purchased intangibles	48,539	—	48,539
Other assets	3,069	642	3,711
Total assets acquired	287,963	150,361	438,324
Estimated fair values of liabilities assumed or incurred:			
Accounts payable and accrued liabilities	62,582	7,688	70,270
Notes payable and capital lease obligations	4,743	2,774	7,517
Deferred liabilities	14,233	499	14,732
Total liabilities assumed or incurred	81,558	10,961	92,519
Estimated fair values of net assets acquired	$ 206,405	$ 139,400	$ 345,805
Purchase price:			
Cash	$ 25,000	$ 139,400	$ 164,400
Senior Subordinated Notes issued to Ciba, at aggregate fair value	31,902	—	31,902
Senior Demand Notes issued to Ciba	5,329	—	5,329
Hexcel common stock issued to Ciba, valued at $8 per share	144,174	—	144,174
Aggregate purchase price	$ 206,405	$ 139,400	$ 345,805

The acquisitions of the Acquired Businesses are subject to certain post-closing adjustments, including, among others, adjustments resulting from the acquisition of certain assets of the Ciba Distributors at various dates through February 28, 1997. In addition, the allocations of purchase price to the assets acquired and liabilities assumed or incurred in connection with the purchase of the Acquired Hercules Business are based on current estimates of fair values, and are subject to change until June 27, 1997.

(In thousands, except per share data)

Pro Forma Financial Information (Unaudited)

The pro forma net sales, net loss and net loss per share of Hexcel for the years ended December 31, 1996 and 1995, giving effect to the acquisitions of the Acquired Businesses and the related issuance of convertible subordinated notes (see Note 7) as if those transactions had occurred at the beginning of the periods presented, were:

	1996	1995
Pro forma net sales	**$ 798,515**	$ 771,325
Pro forma net loss	**(21,191)**	(10,189)
Pro forma net loss per share	**(0.58)**	(0.30)
Weighted average shares and equivalent shares used in computing pro forma net loss per share	**36,303**	33,764

3. Business Consolidation

In May of 1996, Hexcel announced the commencement of a plan to consolidate the company's operations over a period of three years. In December of 1996, the company announced the commencement of further consolidation activities identified during the ongoing integration of the Acquired Businesses. The total expense of the business consolidation program is estimated to be approximately $58,000, including $42,370 of expenses incurred in 1996. The company expects to incur the majority of the remaining expenses of approximately $16,000 in 1997. Cash expenditures for expenses and capital necessary to complete the business consolidation program are expected to total approximately $51,000, net of estimated proceeds from asset sales.

The objective of the business consolidation program is to integrate acquired assets and operations into Hexcel, and to reorganize the company's manufacturing and research activities around strategic centers dedicated to select product technologies. The business consolidation is also intended to eliminate excess manufacturing capacity and redundant administrative functions. Specific actions contemplated by the consolidation program include the closure of the Anaheim, California facility acquired in connection with the purchase of the Acquired Ciba Business, the closure of a portion of the Welkenraedt, Belgium facility, the reorganization of the company's manufacturing operations in France, the consolidation of the company's US special process manufacturing activities, and the integration of sales, marketing and administrative resources.

Management expects that the business consolidation program will take up to three years to complete, in part because of aerospace industry requirements to "qualify" specific equipment and manufacturing facilities for the manufacture of certain products. These qualification requirements increase the complexity, cost and time of moving equipment and rationalizing manufacturing activities. Based on Hexcel's experience with previous plant consolidations, compliance with these qualification requirements necessitates an approach to the consolidation of manufacturing facilities that will require two to three years to complete.

Accrued business acquisition and consolidation costs for the year ended December 31, 1996, were as follows:

	Employee Severance and Relocation	**Facility Closure & Equipment Relocation**	**Other**	**Total**
Balance as of January 1, 1996	—	—	—	—
Business acquisition and consolidation expenses	$ 17,285	$ 10,488	$ 14,597	$ 42,370
Liabilities assumed or incurred in business acquisitions	7,104	2,497	—	9,601
Cash expenditures	(5,306)	(1,109)	(5,164)	(11,579)
Non-cash usage, including asset write-downs	—	(6,678)	(8,357)	(15,035)
Balance as of December 31, 1996	$ 19,083	$ 5,198	$ 1,076	$ 25,357

(In thousands, except per share data)

Accrued business consolidation costs of $21,780 and $3,577 were included in "accrued liabilities" and "deferred liabilities," respectively, in the accompanying consolidated balance sheet as of December 31, 1996. These liabilities reflect a portion of the cash expenditures expected to be made in 1997 and 1998.

Hexcel accrues the estimated costs of employee severance resulting from business consolidation activities on the date that each such activity is commenced and communicated to affected employees. The accrual of severance costs for employees of the Acquired Businesses are reflected as adjustments to the liabilities assumed or incurred in connection with the related acquisition. The accrual of all other severance costs are expensed. The costs of relocating employees in connection with business consolidation activities are either reflected as adjustments to the net assets acquired, in the case of the Acquired Businesses, or expensed as incurred.

The consolidation program calls for the elimination of approximately 345 manufacturing, marketing and administrative positions at certain locations, partially offset by the addition of new positions at other locations. Approximately 75 positions were eliminated during 1996.

The cash costs of closing facilities, relocating equipment and requalifying certain production processes used to manufacture aerospace products are generally expensed as incurred. The costs of writing down excess equipment and facilities to estimated disposal values are either reflected as adjustments to the net assets acquired, in the case of the Acquired Businesses, or expensed upon adoption of a disposal plan. The costs of certain environmental remediation and other activities required to dispose of excess land and buildings are accounted for in the same manner.

Other business acquisition and consolidation costs consist of various compensation and benefit costs incurred in connection with the acquisition and consolidation of the Acquired Businesses, including $5,211 of costs incurred in the first quarter of 1996, as well as a provision to write down certain intangible assets, and various other costs attributable to the integration of research, sales, marketing and administrative functions.

During 1996, business consolidation activities were financed with operating cash flows and borrowings under the Revolving Credit Facility. Management expects that the cash expenditures to be incurred in connection with the consolidation program during 1997 and 1998 will approximate the savings generated by the program.

4. Inventories

Inventories as of December 31, 1996 and 1995, were:

	1996	1995
Raw materials	**$ 66,055**	$ 24,009
Work in progress	**45,469**	13,688
Finished goods	**34,360**	17,778
Inventories	**$ 145,884**	$ 55,475

5. Property, Plant and Equipment

Property, plant and equipment as of December 31, 1996 and 1995, were:

	1996	1995
Land	**$ 19,253**	$ 2,349
Buildings	**127,863**	46,560
Equipment	**321,057**	154,671
Property, plant and equipment	**468,173**	203,580
Less accumulated depreciation	**(141,390)**	(117,625)
Net property, plant and equipment	**$ 326,783**	$ 85,955

(In thousands, except per share data)

6. Intangibles and Other Assets

Intangibles and other assets as of December 31, 1996 and 1995, were:

	1996	1995
Goodwill and other purchased intangibles, net of accumulated amortization of $2,074 as of December 31, 1996	**$ 47,692**	—
Debt financing costs, net of accumulated amortization of $877 and $529 as of December 31, 1996 and 1995, respectively	**5,915**	$ 1,658
Investments in joint ventures	**1,450**	6,615
Deferred business acquisition costs	**—**	4,150
Other assets	**2,965**	4,169
Intangibles and other assets	**$ 58,022**	$ 16,592

Goodwill and Other Purchased Intangibles

Goodwill and other purchased intangibles, including certain intellectual property, were acquired in connection with the purchase of the Acquired Ciba Business (see Note 2).

Debt Financing Costs

Debt financing costs are deferred and amortized over the life of the related debt. Unamortized debt financing costs as of December 31, 1996, relate to the Revolving Credit Facility obtained in June of 1996, and to the convertible subordinated notes issued in July of 1996 (see Notes 2 and 7). Unamortized debt financing costs as of December 31, 1995, relate to debt obligations that were extinguished on February 29, 1996, in connection with the purchase of the Acquired Ciba Business (see Note 2). Accordingly, the unamortized balance of such costs was written off by a charge to "interest expense" during the first quarter of 1996.

Investments in Joint Ventures

As of December 31, 1996, Hexcel owned a 40% equity interest in Hexcel-Fyfe, L.L.C. ("Hexcel-Fyfe"), a joint venture with Fyfe Associates Corporation, and a 43% equity interest in DIC-Hexcel Limited ("DHL"), a joint venture with Dainippon Ink and Chemicals, Inc. ("DIC"). On December 31, 1996, the company sold its 50% equity interest in Knytex company, L.L.C. to the joint venture partner, Owens Corning Corporation, for net cash proceeds that approximated the company's investment.

Investments in joint ventures are accounted for by the equity method. Equity in the earnings of joint ventures were not material to Hexcel's consolidated results of operations for 1996, 1995 or 1994.

The DHL joint venture, which owns and operates a manufacturing facility in Komatsu, Japan, was formed in 1990 for the production and sale of Nomex honeycomb, prepregs and decorative laminates for the Japanese market. During 1994, the economic viability of this joint venture became questionable, due to a significant decline in the demand for commercial aircraft components, including components manufactured in Japan, as well as uncertainties about obtaining necessary product qualifications from aerospace customers in a difficult economic environment. Consequently, Hexcel and DIC began to evaluate various proposals to liquidate or restructure DHL, and the company recorded an $8,000 provision in the third quarter of 1994 to reflect its obligation to reimburse DIC for 50% of DIC's repayment of the venture's bank debt in the event of liquidation.

In February of 1995, Hexcel and DIC entered into an amendment to the original joint venture agreements to provide additional funding to DHL in return for a limitation of the company's potential liability to DIC with respect to the repayment of the venture's bank debt. The company's potential liability was limited to a maximum of $9,000, which amount was to be reduced pro rata by any cash contributions the company made to the joint venture in 1995 and 1996. Under the terms of this amendment, the company and DIC each agreed to contribute $4,500 in cash to DHL, payable in installments in 1995 and 1996, and the company agreed to reduce its 50% interest in the venture in favor of DIC. As a result of these cash contributions, the company's potential liability to DIC was reduced to $4,500 as of December 31, 1996, and the company's interest in DHL was reduced to approximately 43%.

(In thousands, except per share data)

During the third quarter of 1996, Hexcel and DIC met to discuss the future potential and funding of the DHL joint venture. During 1995 and 1996, the joint venture had succeeded in obtaining a broad complement of product qualifications from its customers and the demand for its products in Japan had begun to increase. In December of 1996, Hexcel and DIC reached an agreement in principle to continue the DHL joint venture and expand its operations. The company and DIC have agreed to fund the joint venture's operations in 1997 and 1998 by each contributing an additional $3,250 in cash, payable in installments through 1998. In addition, the company and DIC will contribute certain additional technology and product manufacturing rights to DHL. Under the terms of the agreement in principle, the company remains potentially obligated to repay DIC up to $4,500 with respect to DHL's bank debt, but the probability that such repayment will be required has diminished as a result of the improvement in the venture's business prospects. Recognizing that the turnaround of DHL is not yet complete, the company's $3,500 share of the estimated cost to fund the venture's operations and eliminate its accumulated deficit is accrued in the accompanying consolidated balance sheet as of December 31, 1996.

Deferred Business Acquisition Costs

Deferred business acquisition costs as of December 31, 1995, consisted of certain transaction-related costs incurred in connection with the purchase of the Acquired Ciba Business. These costs were allocated to the net assets acquired as of the acquisition date, in accordance with the provisions of APBO 16.

7. Notes Payable

Notes payable, capital lease obligations and indebtedness to related parties as of December 31, 1996 and 1995, were:

	1996	1995
Revolving Credit Facility	$ 98,656	—
US credit facility	—	$ 30,091
European Credit and Overdraft Facilities	23,405	17,806
Convertible Subordinated Notes, due 2003	114,500	—
Convertible Subordinated Debentures, due 2011	25,625	25,625
Obligations Under IDRB Variable Rate Demand Notes	8,450	11,990
Various notes payable	1,212	1,415
Total notes payable	271,848	86,927
Capital lease obligations (see Note 8)	6,906	3,217
Senior Subordinated Notes Payable to CSC, net of unamortized discount of $2,666 as of December 31, 1996	32,262	—
Total notes payable, capital lease obligations and indebtedness to related parties	$ 311,016	$ 90,144
Notes payable and current maturities of long-term liabilities	$ 23,835	$ 1,802
Long-term notes payable and capital lease obligations, less current maturities	254,919	88,342
Indebtedness to related parties	32,262	—
Total notes payable, capital lease obligations and indebtedness to related parties	$ 311,016	$ 90,144

Revolving Credit Facility

In connection with the acquisition of the Acquired Hercules Business on June 27, 1996, Hexcel obtained the Revolving Credit Facility to: (a) refinance outstanding indebtedness under the Senior Secured Credit Facility; (b) finance the purchase of the Acquired Hercules Business; and (c) provide for the ongoing working capital and other financing requirements of the company, including business consolidation activities, on a worldwide basis. The Revolving Credit Facility initially provided for up to $310,000 of borrowing capacity. However, as a result of the company's issuance of convertible subordinated notes in July of 1996, maximum availability under the Revolving Credit Facility was reduced from $310,000 to $254,600, in accordance with the terms of that facility.

Interest on outstanding borrowings under the Revolving Credit Facility is computed at an annual rate of 0.4% in excess of the applicable London interbank rate or, at the option of Hexcel, at the base rate of the administrative agent for the lenders. In addition, the Revolving Credit Facility is subject to a commitment fee of approximately 0.2% per annum on the unused portion of the facility and a letter of credit fee of up to 0.4% per annum on the outstanding face amount of letters of credit. As of December 31, 1996, letters of credit with an aggregate face amount of $12,555 were outstanding under the Revolving Credit Facility.

The Revolving Credit Facility is secured by a pledge of stock of certain of Hexcel's subsidiaries. In addition, the company is subject to various financial covenants and restrictions under the Revolving Credit Facility, and is generally prohibited from paying dividends or redeeming capital stock. The Revolving Credit Facility expires in February of 1999.

The Revolving Credit Facility replaced the Senior Secured Credit Facility, which had previously replaced certain US and European credit facilities that were available to the company and in use as of December 31, 1995. As a result of the extinguishment of the Senior Secured Credit Facility, Hexcel wrote off $1,800 of capitalized debt financing costs in the second quarter of 1996. The company wrote off $1,600 of capitalized debt financing costs in the first quarter of 1996 in connection with the extinguishment of certain US and European credit facilities. Both write offs are included in "interest expense" in the accompanying consolidated statement of operations for 1996.

European Credit and Overdraft Facilities

In addition to the Revolving Credit Facility, certain of Hexcel's European subsidiaries have access to limited credit and overdraft facilities provided by various local lenders. These credit and overdraft facilities, which are only available to finance certain activities by specific subsidiaries, are primarily uncommitted facilities that are terminable at the discretion of the lenders. The credit and overdraft facilities in use by the company's European subsidiaries as of December 31, 1996, other than the Revolving Credit Facility, bear interest at rates between 3.5% and 9.1% per year.

Convertible Subordinated Notes, due 2003

In July of 1996, Hexcel completed an offering of $114,500 in convertible subordinated notes due 2003 (the "Convertible Subordinated Notes"). The Convertible Subordinated Notes carry an annual interest rate of 7% and are convertible into Hexcel common stock at a conversion price of $15.81 per share, subject to adjustment under certain conditions. Net proceeds of $111,351 from this offering were used to repay outstanding borrowings under the Revolving Credit Facility.

The Convertible Subordinated Notes are redeemable beginning in August of 1999, in whole or in part, at the option of Hexcel. The redemption prices range from 103.5% to 100.0% of the outstanding principal amount, depending on the period in which redemption occurs.

Convertible Subordinated Debentures, due 2011

The 7% convertible subordinated debentures, due 2011, are redeemable by Hexcel under certain provisions, although any such redemption is restricted by the terms of the Revolving Credit Facility. Mandatory redemption is scheduled to begin in 2002 through annual sinking fund requirements. The debentures are convertible prior to maturity into common stock of the company at $30.72 per share, subject to adjustment under certain conditions.

Obligations Under IDRB Variable Rate Demand Notes

Hexcel has various industrial development revenue bonds ("IDRBs") outstanding, all of which mature at various dates after 2001. The IDRBs are guaranteed by bank letters of credit issued under the Revolving Credit Facility. The interest rates on the IDRBs are variable and averaged 4.2% in 1996, 6.2% in 1995 and 3.9% in 1994.

(In thousands, except per share data)

Senior Subordinated Notes Payable to CSC

In connection with the purchase of the Acquired Ciba Business, Hexcel has delivered Senior Subordinated Notes to Ciba in an aggregate principal amount of $34,928. As discussed in Note 2, Hexcel has consented to an assignment by Ciba of Ciba's rights and obligations under the Alliance Agreements to CSC. In connection with the assignment of these rights and obligations, the Senior Subordinated Notes that were previously payable to Ciba will be payable to CSC.

At the date of issue, the aggregate fair value of the Senior Subordinated Notes was $31,902, or $3,026 less than the aggregate principal amount. The original discount of $3,026 reflects the absence of certain call protection provisions from the terms of the Senior Subordinated Notes and the difference between the stated interest rate on the Senior Subordinated Notes and the estimated market rate for debt obligations of comparable quality and maturity. This discount, which is amortized over the life of the Senior Subordinated Notes, had an unamortized balance of $2,666 as of December 31, 1996.

The Senior Subordinated Notes are general unsecured obligations of Hexcel that bear interest for three years at a rate of 7.5% per annum, payable semiannually from February 29, 1996. The interest rate will increase to 10.5% per annum on the third anniversary of the purchase of the Acquired Ciba Business, and by an additional 0.5% per year thereafter until the Senior Subordinated Notes mature in the year 2003.

As discussed in Note 9, Hexcel has various financial and other relationships with CSC. Accordingly, the company's net indebtedness to CSC under the Senior Subordinated Notes has been classified as "indebtedness to related parties" in the accompanying consolidated balance sheet as of December 31, 1996.

In accordance with the terms of the amended Strategic Alliance Agreement, Hexcel acquired certain assets of the Ciba Distributors between January 1, 1997 and February 28, 1997, in exchange for an undertaking to deliver additional Senior Subordinated Notes in an aggregate principal amount of approximately $2,700 (see Note 2). Upon delivery of these additional Senior Subordinated Notes, the total aggregate principal amount of Senior Subordinated Notes payable to CSC will be approximately $37,600.

Aggregate Maturities of Notes Payable

Aggregate maturities of notes payable as of December 31, 1996, were:

Payable during years ending December 31:	
1997 (principally European credit and overdraft facilities)	$ 23,067
1998	487
1999	99,290
2000	147
2001	154
2002 and thereafter	148,703
Total notes payable	$ 271,848

Estimated Fair Values of Notes Payable

The Revolving Credit Facility, the Obligations Under IDRB Variable Rate Demand Notes, and substantially all of the various European credit facilities and other notes payable outstanding as of December 31, 1996, are variable-rate debt obligations. Accordingly, management believes that the estimated fair value of each of these debt obligations approximates the respective book value.

The aggregate fair values of the Convertible Subordinated Notes, due 2003, and the Convertible Subordinated Debentures, due 2011, are estimated on the basis of quoted market prices, although trading in these debt securities is limited and may not reflect fair value. The aggregate fair value of the Convertible Subordinated Notes, due 2003, was approximately $141,700 as of December 31, 1996. The aggregate fair value of the Convertible Subordinated Debentures, due 2011, was approximately $24,000 and $21,800 as of December 31, 1996 and 1995, respectively.

(In thousands, except per share data)

Interest Payments

Interest payments were $14,061 in 1996, $8,345 in 1995 and $3,909 in 1994. No interest was capitalized in 1996, 1995 or 1994.

8. Leasing Arrangements

Assets, accumulated depreciation and related liability balances under capital leasing arrangements as of December 31, 1996 and 1995, were:

	1996	1995
Property, plant and equipment	**$ 11,572**	$ 7,205
Less accumulated depreciation	**(2,927)**	(2,611)
Net property, plant and equipment	**$ 8,645**	$ 4,594
Capital lease obligations	**$ 6,906**	$ 3,217
Less current maturities	**(768)**	(313)
Long-term capital lease obligations, net	**$ 6,138**	$ 2,904

Certain sales and administrative offices, data processing equipment, and manufacturing facilities are leased under operating leases. Rental expenses under operating leases were $4,623 in 1996, $2,871 in 1995 and $3,675 in 1994.

Future minimum lease payments as of December 31, 1996, were:

	Type of Lease	
Payable during years ending December 31:	Capital	Operating
1997	$ 1,322	$ 4,297
1998	959	2,811
1999	959	2,312
2000	872	1,569
2001	557	533
2002 and thereafter	7,164	1,450
Total minimum lease payments	$ 11,833	$ 12,972

Total minimum capital lease payments include $4,927 of imputed interest.

9. Related Parties

In connection with the purchase of the Acquired Ciba Business, Hexcel delivered 18,022 newly issued shares of Hexcel common stock to Ciba, representing 49.9% of the Hexcel common stock issued and outstanding at that date. In addition, the company and Ciba entered into the Alliance Agreements which currently provide for, among other things, the designation by Ciba of four of the company's ten directors, and the approval of a majority of these four designated directors for the taking of certain significant actions by the company. On February 21, 1997, the company consented to an assignment by Ciba of Ciba's rights and obligations under the Alliance Agreements to CSC. In connection with the assignment of these rights and obligations, all of the Hexcel common stock previously held by Ciba will be held by CSC.

As discussed in Notes 2 and 7, Hexcel has delivered Senior Subordinated Notes in an aggregate principal amount of $34,928 to Ciba in connection with the purchase of the Acquired Ciba Business, and has undertaken to deliver additional Senior Subordinated Notes in an aggregate principal amount of approximately $2,700 in connection with the acquisition of certain assets of the Ciba Distributors. In connection with the assignment of Ciba's rights and obligations under the Alliance Agreements, the Senior Subordinated Notes that were previously payable to Ciba will be payable to CSC. During 1996, the company also delivered Senior Demand Notes to Ciba in an aggregate principal amount of $5,329. The Senior Demand Notes were presented for payment and paid in full prior to December 31, 1996. Aggregate interest expense on the Senior Subordinated Notes and the Senior Demand Notes was $2,715 in 1996.

Hexcel purchases certain raw materials from various Ciba subsidiaries. In addition, the company sells certain finished products to various Ciba subsidiaries, including the Ciba Distributors. The company's aggregate purchases from Ciba subsidiaries for the period from March 1, 1996 through December 31, 1996, were $15,116. The company's aggregate sales to Ciba subsidiaries for the same period were $32,408. These sales were primarily to the Ciba Distributors pursuant to a distribution agreement which expired February 28, 1997. In addition, the company incurred $214 of expenses related to the Acquired Ciba Business that are subject to reimbursement by Ciba under the terms of the Strategic Alliance Agreement. As of December 31, 1996, aggregate receivables from Ciba or Ciba subsidiaries included in "accounts receivable" in the accompanying consolidated balance sheet were $5,951. Aggregate payables to Ciba or Ciba subsidiaries included in "accounts payable" and "accrued liabilities" as of the same date were $1,812.

10. Retirement Plans

Hexcel maintains a retirement savings and contribution plan and a defined benefit pension plan covering most US employees, except for certain employees with union affiliations. In addition, the company maintains a separate retirement savings plan available to certain US employees with union affiliations, and contributes to a union sponsored multi-employer pension plan covering these same employees. The company also maintains various retirement plans covering certain European employees, as well as defined benefit retirement plans for eligible senior executives and directors. The net expense to the company of all of these retirement plans was $9,107 in 1996, $2,768 in 1995 and $2,443 in 1994.

Under the US retirement savings and contribution plan, eligible employees may contribute up to 16% of their compensation to an individual retirement savings account. Hexcel makes matching contributions to individual retirement savings accounts equal to 50% of employee contributions, not to exceed 3% of employee compensation. Furthermore, the company makes profit sharing contributions of up to an additional 4% of employee compensation when the company meets or exceeds certain performance targets established by the Board of Directors. Matching contributions to the US retirement savings and contribution plan were $2,160 for 1996, $1,290 for 1995 and $1,039 for 1994. The profit sharing contribution for 1996 was $3,236. There were no profit sharing contributions for 1995 or 1994.

The US defined benefit pension plan is a career average pension plan covering both hourly and salaried employees. Benefits are based on years of service and the annual compensation of the employee. Hexcel's funding policy is to contribute the minimum amount required by applicable regulations.

Hexcel maintains a separate retirement savings plan available to certain US employees of the composite structures business acquired from Ciba on February 29, 1996. Under this plan, employees may contribute up to 14% of their compensation to an individual retirement savings account. There are no matching or profit sharing contributions. In addition, the company participates in a union sponsored multi-employer pension plan covering these same employees. The company's contribution to this plan for 1996 was $731.

On May 30, 1996, Hexcel assumed responsibility for various defined benefit retirement plans covering the employees of an Austrian subsidiary acquired from Ciba on that date. On January 1, 1997, the company established a defined benefit retirement plan covering the employees of a United Kingdom subsidiary acquired from Ciba on February 29, 1996. Prior to 1997, the employees of this subsidiary participated in a defined benefit retirement plan provided by Ciba. The company's other European subsidiaries participate in government retirement programs which cover substantially all of the employees of those subsidiaries.

(In thousands, except per share data)

The net periodic cost of Hexcel's defined benefit pension and retirement plans for the years ended December 31, 1996, 1995 and 1994, were:

	1996	1995	1994
Service cost - benefits earned during the year	**$ 2,515**	$ 661	$ 753
Interest cost on projected benefit obligation	**778**	660	706
Return on assets – actual	**(586)**	(1,103)	33
Net amortization and deferral	**273**	1,260	(88)
Net periodic cost	**$ 2,980**	$ 1,478	$ 1,404

The actuarial present value of benefit obligations and the funded status of Hexcel's defined benefit pension and retirement plans as of December 31, 1996 and 1995, were:

	1996	1995
Actuarial present value of benefit obligation:		
Vested benefit obligation	**$ 11,842**	$ 8,047
Non-vested benefit obligation	**473**	1,281
Accumulated benefit obligation	**$ 12,315**	$ 9,328
Projected benefit obligation for service rendered to date	**$ 14,564**	$ 10,985
Less plan assets at fair value (primarily listed stocks, insurance contracts and government bonds)	**(8,379)**	(5,117)
Projected benefit obligation in excess of plan assets	**6,185**	5,868
Unrecognized net loss	**(157)**	(2,176)
Unrecognized prior service costs	**(1,215)**	(240)
Unrecognized net transition obligation being recognized over 15 years	**(212)**	(255)
Adjustment required to recognize minimum pension liability	**—**	1,014
Defined benefit pension and retirement liability	**4,601**	4,211
Less current portion of pension and retirement liability	**(2,395)**	(1,780)
Deferred pension and retirement liability (see Note 13)	**$ 2,206**	$ 2,431

Assumptions used to estimate the actuarial present value of benefit obligations as of December 31, 1996, 1995 and 1994, were:

	1996	1995	1994
US defined benefit pension and retirement plans:			
Discount rate	7.5%	7.0%	8.0%
Rate of increase in compensation	4.5%	4.0%	4.0%
Expected long-term rate of return on plan assets	9.0%	9.5%	9.5%

	1996
European defined benefit retirement plans:	
Discount rates	6.5%–7.5%
Rates of increase in compensation	2.0%–4.5%
Expected long-term rates of return on plan assets	6.5%–9.0%

11. Postretirement Health Care and Life Insurance Benefits

Hexcel provides certain postretirement health care and life insurance benefits to eligible retirees. Substantially all US employees hired on or before December 31, 1995, are eligible for benefits, as well as certain US employees hired on February 29, 1996, in connection with the purchase of the Acquired Ciba Business, and on June 27, 1996, in connection with the purchase of the Acquired Hercules Business. Effective January 1, 1996, the company amended its postretirement benefit program to eliminate any benefits for employees hired after December 31, 1995, other than senior executives and certain employees hired in connection with business acquisitions.

Benefits are available to eligible employees who retire on or after age 58 after rendering at least 15 years of service to Hexcel, including years of service rendered to the Acquired Ciba Business or the Acquired Hercules Business prior to the dates of acquisition. Benefits consist of coverage of up to 50% of the annual cost of certain health insurance plans, as well as annual life insurance coverage equal to 65% of the final base pay of the retiree until the age of 70. Upon reaching 70 years of age, life insurance coverage is reduced. Effective January 1, 1996, Hexcel amended its postretirement benefit program to limit health care benefit coverage to selected health insurance plans for the majority of active employees.

(In thousands, except per share data)

Hexcel funds postretirement health care and life insurance benefit costs on a pay-as-you-go basis and, for 1996, 1995 and 1994, made benefit payments of approximately $400, $600 and $400, respectively. Net defined postretirement benefit costs for the years ended December 31, 1996, 1995 and 1994, were:

	1996	1995	1994
Service cost - benefits earned during the year	**$ 80**	$ 279	$ 389
Interest cost on accumulated postretirement benefit obligation	**701**	780	915
Net amortization and deferral	**(222)**	(201)	—
Net periodic postretirement benefit cost	**$ 559**	$ 858	$ 1,304

Defined postretirement benefit liabilities as of December 31, 1996 and 1995, were:

	1996	1995
Accumulated postretirement benefit obligation:		
Retirees	**$ 7,302**	$ 6,766
Fully eligible active plan participants	**1,658**	1,264
Other active plan participants	**1,031**	3,726
	9,991	11,756
Unrecognized prior service credit	**890**	—
Unrecognized net gain	**3,567**	2,778
Defined postretirement benefit liability	**14,448**	14,534
Less current portion of postretirement benefit liability	**(722)**	(583)
Deferred postretirement benefit liability (see Note 13)	**$ 13,726**	$ 13,951

Two health care cost trend rates were used in measuring the accumulated postretirement benefit obligation. For indemnity health care costs, the assumed cost trend in 1997 was 10.0% for participants less than 65 years of age and 6.0% for participants 65 years of age and older, gradually declining to 5.0% for both age groups in the year 2002. For HMO health care costs, the assumed cost trend in 1997 was 7.0% for participants less than 65 years of age and 4.0% for participants 65 years of age and older, gradually declining to 5.0% and 4.0%, respectively, in the year 1999.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.5% in 1996 and 7.0% in 1995. The rate of increase in compensation used in determining the obligation was 4.5% in 1996 and 4.0% in 1995.

If the health care cost trend rate assumptions were increased by 1.0%, the accumulated postretirement benefit obligation as of December 31, 1996 would be increased by 5.5%. The effect of this change on the sum of the service cost and interest cost would be an increase of 4.7%.

12. Income Taxes

Net Operating Loss Carryforwards

As of December 31, 1996, Hexcel had net operating loss ("NOL") carryforwards for US federal income tax purposes of approximately $70,000 and net operating loss carryforwards for Belgium income tax purposes of approximately $22,000. The US NOL carryforwards, which are available to offset future taxable income, expire at various dates through the year 2011.

As a result of the ownership change which occurred in connection with the purchase of the Acquired Ciba Business, a limitation on the utilization of NOL carryforwards in the US was created. This utilization limitation, which applies to loss carryforwards generated prior to February 29, 1996, is estimated to be approximately $12,000 per year.

(In thousands, except per share data)

Provision for Income Taxes

As a result of the losses from continuing operations before income taxes incurred in recent years, including 1996, as well as the limitation on the utilization of net operating loss carryforwards for US federal income tax purposes, there is uncertainty as to the realization of Hexcel's deferred income tax assets. Accordingly, the company has not recognized any tax benefits attributable to the potential future realization of these assets in the accompanying consolidated statements of operations for 1996, 1995 or 1994.

Income tax provisions of $3,436 in 1996, $3,313 in 1995 and $3,586 in 1994, primarily reflect international taxes on certain European subsidiaries, state taxes, and the settlement of various tax audits. The 1996 income tax provision is net of a $2,452 benefit from the favorable resolution of a US federal tax audit.

Income (loss) before income taxes and the tax provision for income taxes from continuing operations for the years ended December 31, 1996, 1995 and 1994, were:

	1996	1995	1994
Income (loss) before income taxes:			
US	**$ (11,956)**	$ (1,027)	$ (24,745)
International	**(3,798)**	7,541	251
Total income (loss) before income taxes	**$ (15,754)**	$ 6,514	$ (24,494)
Benefit (provision) for income taxes:			
Current:			
US	**$ 1,600**	$ (197)	$ (85)
International	**(5,556)**	(3,445)	108
Current benefit (provision) for income taxes	**(3,956)**	(3,642)	23
Deferred:			
US	**—**	—	(2,226)
International	**520**	329	(1,383)
Deferred benefit (provision) for income taxes	**520**	329	(3,609)
Total provision for income taxes	**$ (3,436)**	$ (3,313)	$ (3,586)

A reconciliation of the tax provision to the US federal statutory income tax rate of 34% for the years ended December 31, 1996, 1995 and 1994, was:

	1996	1995	1994
Benefit (provision) at US federal statutory rate	**$ 5,356**	$ (2,215)	$ 8,328
US state taxes, less federal tax benefit	**(21)**	254	(244)
Impact of different international tax rates, adjustments to income tax accruals and other	**9,656**	(492)	(3,837)
Valuation allowance	**(18,427)**	(860)	(7,833)
Total provision for income taxes	**$ (3,436)**	$ (3,313)	$ (3,586)

The company paid income taxes of $8,911 in 1996, $3,864 in 1995 and $253 in 1994. The company has made no US income tax provision for approximately $30,200 of undistributed earnings of international subsidiaries as of December 31, 1996. Such earnings are considered to be permanently reinvested. The additional US income tax on these earnings, if repatriated, would be offset in part by foreign tax credits.

(In thousands, except per share data)

Deferred Income Taxes

Deferred income taxes result from temporary differences between the recognition of items for income tax purposes and financial reporting purposes. Principal temporary differences as of December 31, 1996 and 1995, were:

	1996	1995
Accelerated depreciation and amortization	**$ 13,646**	$ 10,473
Accrued business acquisition and consolidation expenses	**(5,759)**	—
Net operating loss carryforwards	**(33,922)**	(27,562)
Reserves and other, net	**(40,965)**	(30,964)
Valuation allowance	**68,433**	50,006
Deferred tax liability (see Note 13)	**$ 1,433**	$ 1,953

13. Deferred Liabilities

Deferred liabilities as of December 31, 1996 and 1995, were:

	1996	1995
Deferred liability for business consolidation activities (see Note 3)	**$ 3,577**	—
Deferred liability for DIC-Hexcel Limited (see Note 6)	**3,500**	$ 3,500
Deferred pension and retirement liability (see Note 10)	**2,206**	2,431
Deferred postretirement benefit liability (see Note 11)	**13,726**	13,951
Deferred tax liability (see Note 12)	**1,433**	1,953
Deferred liability for environmental remediation activities (see Note 15)	**7,070**	2,300
Other	**14,902**	3,266
Deferred liabilities	**$ 46,414**	$ 27,401

14. Stockholders' Equity and Stock-Based Incentive Plans

Stockholders' Equity

In February of 1996, Hexcel's stockholders approved an amendment to the company's Certificate of Incorporation increasing the number of authorized shares of Hexcel common stock from 40,000 to 100,000. There were 36,561 and 18,091 shares of Hexcel common stock issued and outstanding as of December 31, 1996 and 1995, respectively. The increase in the number of issued and outstanding shares during 1996 is primarily attributable to the delivery of 18,022 newly issued shares of Hexcel common stock to Ciba on February 29, 1996, in connection with the purchase of the Acquired Ciba Business (see Note 2).

In May of 1996, Hexcel's stockholders approved an amendment to the company's Certificate of Incorporation increasing the number of authorized shares of Hexcel preferred stock from 1,500 to 20,000, but no such shares have been issued.

Hexcel did not declare or pay any dividends in 1996, 1995 or 1994. The Board of Directors suspended dividend payments beginning in 1993, and such payments are generally prohibited by the Revolving Credit Facility (see Note 7).

Stock-Based Incentive Plans

In February of 1996, Hexcel's stockholders approved an incentive stock plan (the "Incentive Stock Plan"), which amended and restated certain prior stock plans into a combined plan. The Incentive Stock Plan authorizes the use of Hexcel common stock for providing a variety of stock-based incentive awards to eligible employees, officers, directors and consultants. The Incentive Stock Plan provides for grants of stock options, stock appreciation rights, restricted stock and restricted stock units, and other stock-based awards. On January 30, 1997, the Board of Directors amended and restated the Incentive Stock Plan and increased by 3,850 the aggregate number of shares of Hexcel common stock available for use under the Incentive Stock Plan, subject to stockholder approval. Accordingly, the aggregate number of shares of Hexcel common stock available for future stock-based incentive awards under the Incentive Stock Plan, subject to stockholder approval, was increased to 4,013 at that date.

(In thousands, except per share data)

In December of 1996, the Board of Directors authorized the adoption of a management stock purchase plan (the "Management Stock Purchase Plan"), subject to stockholder approval. The Management Stock Purchase Plan would authorize an aggregate of 150 shares of Hexcel common stock for use by the company in providing stock-based incentive awards to senior executives and certain key management employees.

Stock option data for the three years ended December 31, 1996, 1995 and 1994, were:

	Number of Shares	Weighted Average Exercise Price
Options outstanding at January 1, 1994	534	$ 12.43
Options granted	—	—
Options exercised	—	—
Options expired or canceled	(66)	$ 12.96
Options outstanding at December 31, 1994	468	$ 12.37
Options granted	787	$ 5.63
Options exercised	(1)	$ 7.56
Options expired or canceled	(240)	$ 11.80
Options outstanding at December 31, 1995	1,014	$ 7.27
Options granted	1,577	$ 12.69
Options exercised	(447)	$ 9.40
Options expired or canceled	(85)	$ 11.45
Options outstanding at December 31, 1996	2,059	$ 10.36
Options exercisable at December 31, 1994	468	$ 12.37
Options exercisable at December 31, 1995	251	$ 12.32
Options exercisable at December 31, 1996	841	$ 8.64

The following table summarizes information about stock options outstanding at December 31, 1996:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Life (in Years)	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
$4.75–5.00	240	5.6	$ 4.75	240	$ 4.75
$5.01–10.00	450	8.6	$ 6.06	247	$ 6.21
$10.01–15.00	1,263	8.9	$ 12.40	310	$ 12.43
$15.01–20.00	103	7.1	$ 16.74	41	$ 16.25
$20.01–25.00	—	—	—	—	—
$25.01–30.00	2	1.0	$ 27.48	2	$ 27.48
$30.01–32.06	1	2.1	$ 32.06	1	$ 32.06
$4.75–32.06	2,059	8.4	$ 10.36	841	$ 8.64

In January of 1997, an additional 213 options were granted at exercise prices of $16.00 per share. These options vest and become exercisable in increments through 2000. In February of 1997, another 2,474 options were granted at exercise prices of $18.50 per share, subject to stockholder approval of the Incentive Stock Plan as amended and restated by the Board of Directors on January 30, 1997. These options vest and become exercisable in increments through 2006, subject to accelerated vesting under certain circumstances.

In January of 1997, 61 short-term options were granted which expire 90 days after the date of grant. The holders of the short-term options are entitled to receive two additional "reload" options for each short-term option exercised. Consequently, as many as 122 additional options could be granted during the 90 day period ending April 30, 1997, in connection with the exercise of short-term options.

(In thousands, except per share data)

As of December 31, 1996 and 1995, Hexcel had outstanding a total of 7 and 10 shares of restricted stock, respectively, which vest in increments through 1997. The holders of these shares are entitled to vote. In addition, as of December 31, 1996, the company had outstanding a total of 286 performance accelerated restricted stock units ("PARS"). The PARS vest in increments through 2003, subject to accelerated vesting under certain circumstances. In January 1997, an additional 66 PARS were granted.

Pro Forma Disclosures

In 1996, Hexcel adopted the disclosure requirements of SFAS 123, which provide for the disclosure of pro forma net earnings and net earnings per share as if the fair value method were used to account for stock-based employee compensation plans. Pursuant to SFAS 123, the company has elected to continue to use the intrinsic value method to account for the Incentive Stock Plan in the accompanying consolidated financial statements, in accordance with APBO 25.

During 1996, the company recognized $3,635 of compensation expense under the intrinsic value method resulting from stock options which vested in connection with the purchase of the Acquired Ciba Business. This compensation expense was based on the difference between the exercise price of the stock options granted and the market price of Hexcel common stock on the date that the company's stockholders approved the Incentive Stock Plan under which these options were granted. The recognition of compensation expense in connection with these stock options resulted in a corresponding $3,635 increase in the additional paid-in capital of the company.

If compensation expense had been determined for stock options granted in 1996 and 1995 using the fair value method at the date of grant, consistent with the provisions of SFAS 123, Hexcel's pro forma net earnings and earnings per share would have been as follows:

	1996	1995
Net income (loss), as reported	**$ (19,190)**	$ 2,733
Pro forma compensation adjustment	**(43)**	(1,029)
Pro forma net income (loss)	**$ (19,233)**	$ 1,704
Net income (loss) per share, as reported	**$ (0.58)**	$ 0.17
Pro forma compensation adjustment	**0.02**	(0.06)
Pro forma net income (loss) per share	**$ (0.56)**	$ 0.11

The weighted average fair value of options granted during 1996 and 1995 were $12.75 and $5.63, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 1996 and 1995:

Dividend yield	0.0%
Expected volatility	40.0%
Risk-free interest rate	6.2%
Expected term	4.7 Years

15. Contingencies

Hexcel is involved in litigation, investigations and claims arising out of the conduct of its business, including those relating to government contracts, commercial transactions, and environmental, health and safety matters. The company estimates its liabilities resulting from such matters based on a variety of factors, including outstanding legal claims and proposed settlements, assessments by internal and external counsel of pending or threatened litigation, and assessments by environmental engineers and consultants of potential environmental liabilities and remediation costs. Such estimates incorporate insignificant amounts for probable recoveries under applicable insurance policies but exclude counterclaims against other third parties. 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. Although it is impossible to determine the level of future expenditures for legal, environmental and related matters with any degree of certainty, it is management's opinion, based on available information, that it is unlikely that these matters, individually or in the aggregate, will have a material adverse effect on the consolidated financial position or results of operations of the company.

US Government Claims

Hexcel, as a defense subcontractor, is subject to US government audits and reviews of negotiations, performance, cost classifications, accounting and general practices relating to government contracts. Under the direction of the Corporate Administrative Contracting Officer ("CACO"), the Defense Contract Audit Agency ("DCAA") reviews cost accounting and business practices of government contractors and subcontractors, including the company. The company has been engaged in discussions with the CACO and the DCAA regarding a number of cost accounting issues identified during the course of various audits performed by the DCAA. During the fourth quarter of 1996, the company reached an agreement with the CACO and the DCAA that resolves the primary issues identified during the course of these audits. Under the terms of the agreement, the company agreed to pay the US federal government $1,314 in exchange for the irrevocable discharge of any claims with respect to the issues that were resolved.

Legal and Environmental Claims and Proceedings

Hexcel has been named as a potentially responsible party with respect to several hazardous waste disposal sites that it does not own or possess which are included on the Superfund National Priority List of the US Environmental Protection Agency or on equivalent lists of various state governments. The company estimates that its liability with respect to these sites is de minimis.

Pursuant to the New Jersey Environmental Responsibility and Clean-Up Act, Hexcel signed an administrative consent order to pay for the environmental remediation of a manufacturing facility it formerly owned and operated in Lodi, New Jersey. The company's $2,600 estimate of the remaining cost to satisfy this consent order is accrued in the accompanying consolidated balance sheet as of December 31, 1996. While the company believes that the actual remaining cost to remediate the Lodi facility should not exceed the amount that has been accrued, the current owner of the site has asserted that the remaining cost will be significantly in excess of that amount. The ultimate cost of remediating the Lodi site will depend on developing circumstances.

In connection with the purchase of the Acquired Ciba Business, Hexcel assumed various liabilities including a liability with respect to certain environmental remediation activities at an acquired facility in Kent, Washington. The company is a 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 the Kent site by the US Environmental Protection Agency. Under the terms of the cost sharing agreement, the company is obligated to reimburse the previous owner for a portion of the cost of the required remediation activities. The company's $5,550 estimate of its share of the cost is accrued in the accompanying consolidated balance sheet as of December 31, 1996.

Product Claims

In 1993, Hexcel became aware of an aluminum honeycomb sandwich panel delamination problem with panels produced by its wholly-owned Belgium subsidiary, Hexcel Composites S.A., and installed in rail cars in France and Spain. Certain customers have alleged that Hexcel Composites S.A. is responsible for the problem. The company and its insurer continue to investigate these claims. The company is also working with the customers to repair or replace panels when necessary, with certain costs to be allocated upon determination of responsibility for the delamination. Two customers in France requested that a court appoint experts to investigate the claims; to date, the experts have not reported any conclusions. The company's primary insurer for this matter has agreed to fund legal representation and to provide coverage of the claim to the extent of the policy limit for one year. The company is investigating additional insurance coverage. Even if additional insurance coverage is not available, management believes that, based on available information, it is unlikely that these claims will have a material adverse effect on the consolidated financial position or results of operations of the company.

(In thousands, except per share data)

16. Raw Materials, Significant Customers, and Markets

Hexcel purchases most of the raw materials used in production. Several key materials are available from relatively few sources, and in many cases the cost of product qualification makes it impractical to develop multiple sources of supply. The unavailability of these materials, which the company does not anticipate, could have a material adverse effect on sales and earnings.

The Boeing Company and Boeing subcontractors accounted for approximately 22% of 1996 sales, 21% of 1995 sales and 22% of 1994 sales. The Airbus Industrie consortium and Airbus subcontractors accounted for approximately 10% of 1996 sales, and less than 10% of 1995 and 1994 sales. The loss of all or a significant portion of the business with Boeing or Airbus, which Hexcel does not anticipate, could have a material adverse effect on sales and earnings.

Net sales by market for the years ended December 31, 1996, 1995 and 1994, were:

	1996	1995	1994
Commercial aerospace	**56%**	45%	47%
Space and defense	**11**	11	11
Recreation	**10**	9	9
General industrial and other	**23**	35	33
Net sales	**100%**	100%	100%

17. Business Segment Data

Hexcel operates within a single business segment: Advanced Structural Materials. The following table summarizes certain financial data for continuing operations by geographic area as of December 31, 1996, 1995, and 1994, and for the years then ended:

	1996	1995	1994
Net sales:			
US	**$ 394,524**	$ 197,665	$ 185,544
International	**300,727**	152,573	128,251
Consolidated	**$ 695,251**	$ 350,238	$ 313,795
Income (loss) before income taxes:			
US	**$ (2,934)**	$ 2,912	$ (21,462)
International	**(12,820)**	3,602	(3,032)
Consolidated	**$ (15,754)**	$ 6,514	$ (24,494)
Total assets:			
US	**$ 429,025**	$ 134,972	$ 149,890
International	**272,711**	95,630	90,567
Consolidated	**$ 701,736**	$ 230,602	$ 240,457
Capital expenditures:			
US	**$ 27,217**	$ 7,729	$ 6,022
International	**16,352**	4,415	2,340
Consolidated	**$ 43,569**	$ 12,144	$ 8,362
Depreciation and amortization:			
US	**$ 15,239**	$ 6,528	$ 8,455
International	**11,491**	5,095	5,775
Consolidated	**$ 26,730**	$ 11,623	$ 14,230

US net sales include US exports of $53,333 in 1996, $18,092 in 1995 and $14,008 in 1994.

The international segment is comprised primarily of operations in Western Europe conducted by various European subsidiaries. International net sales consist of the net sales of these European subsidiaries, sold primarily in Europe.

To compute income (loss) before income taxes, Hexcel allocated administrative expenses to the international segment of $9,022 in 1996, $3,939 in 1995 and $3,283 in 1994.

18. Other Income, Net

Other income of $2,994 recognized in 1996 is largely attributable to the receipt of an additional $1,560 of cash in connection with the disposition of the Chandler, Arizona manufacturing facility and certain related assets in 1994, and to the receipt of $1,054 in partial settlement of a claim arising from the sale of certain assets in 1991.

Other income of $791 recognized in 1995 is largely attributable to the receipt of an additional $600 of cash in connection with the disposition of the Chandler, Arizona manufacturing facility and certain related assets in 1994.

Other income of $4,861 recognized in 1994 includes $15,900 of income arising from the disposition of the Chandler, Arizona manufacturing facility and certain related assets, partially offset by an $8,000 provision for the estimated cost of restructuring or liquidating DIC-Hexcel Limited (see Note 6) and a $2,900 provision for bankruptcy claim adjustments (see Note 19). Hexcel sold its Chandler, Arizona manufacturing facility and certain related assets, including technology, to Northrop Grumman Corporation ("Northrop") in the fourth quarter of 1994. Initial net cash proceeds of $2,294 and $26,694 were received in 1994 and the first quarter of 1995, respectively.

Under the terms of the Chandler transaction, Hexcel retained a royalty-free, non-exclusive license to use the technology sold to Northrop in non-military applications. In addition, the company will receive royalties from Northrop on certain applications of the technology by Northrop. The company received additional cash proceeds of $600 in the third quarter of 1995 and $1,560 in the first quarter of 1996 due to the satisfaction of certain conditions of the transaction.

19. Bankruptcy Reorganization

On January 12, 1995, the US Bankruptcy Court for the Northern District of California entered an order dated January 10, 1995, confirming the First Amended Plan of Reorganization (the "Reorganization Plan") proposed by Hexcel and the Official Committee of Equity Security Holders (the "Equity Committee"). On February 9, 1995, the Reorganization Plan became effective and Hexcel Corporation (a Delaware corporation) emerged from the bankruptcy reorganization proceedings which had begun on December 6, 1993, when Hexcel filed a voluntary petition for relief under the provisions of Chapter 11 of the federal bankruptcy laws.

The Reorganization Plan which became effective on February 9, 1995 provided for, among other things: (a) the completion of the first closing under a standby purchase commitment whereby Mutual Series Fund Inc. ("Mutual Series") purchased 1,946 shares of newly issued Hexcel common stock for $9,000 and loaned the company $41,000 as an advance against the proceeds of a subscription rights offering for additional shares of Hexcel common stock; and (b) the reinstatement or payment in full, with interest, of all allowed claims, including prepetition accounts payable and notes payable. The subscription rights offering concluded on March 27, 1995, with the issuance of an additional 7,156 shares of Hexcel common stock. The resulting cash proceeds of $33,098 were used to reduce the outstanding balance of the loan from Mutual Series. The second closing under the standby purchase agreement was completed on April 6, 1995, with the issuance of an additional 1,590 shares of Hexcel common stock to Mutual Series, the issuance of an additional 108 shares of Hexcel common stock to John J. Lee, the company's Chief Executive Officer, and the retirement of the remaining balance of the Mutual Series loan.

The Reorganization Plan provided for the reinstatement or payment in full, with interest, of all allowed claims, including prepetition accounts payable and notes payable. On February 9, 1995, Hexcel paid $78,144 in prepetition claims and interest, and reinstated another $60,575 in prepetition liabilities. The payment of claims and interest on February 9, 1995 was financed with: (a) cash proceeds of $26,694 received in the first quarter of 1995 from the sale of the company's Chandler, Arizona manufacturing facility and certain related assets (see Note 18); (b) the $50,000 in cash received from Mutual Series in connection with the standby purchase agreement; and (c) borrowings under a $45,000 US credit facility obtained on February 9, 1995. This $45,000 US credit facility was subsequently replaced by the Senior Secured Credit Facility on February 29, 1996, which in turn was replaced by the Revolving Credit Facility on June 27, 1996 (see Notes 2 and 7).

Professional fees and other costs directly related to bankruptcy proceedings were expensed as incurred, and have been reflected in the accompanying consolidated statements of operations as "bankruptcy reorganization expenses." Bankruptcy reorganization expenses consisted primarily of professional fees paid to legal and financial advisors of Hexcel, the Equity Committee and the Official Committee of Unsecured Creditors. In addition, these expenses included incentives for employees to remain with the company for the duration of bankruptcy proceedings and the write-off of previously capitalized costs related to the issuance of prepetition debt.

20. Discontinued Operations

In December of 1994, Hexcel sold its European resins operations for net cash proceeds of approximately $8,727. In October of 1995, the company sold its US resins operations for net cash proceeds that approximated the net book value of the assets sold.

The sale of Hexcel's US resins operations in 1995 completed the divestiture of the company's resins business, which has been accounted for as a discontinued operation in the accompanying consolidated statements of operations and cash flows for 1995 and 1994. The net sales of the discontinued resins business were $6,944 and $30,691 in 1995 and 1994, respectively.

(In thousands, except per share data)

21. Quarterly Financial Data (Unaudited)

Quarterly financial data for the years ended December 31, 1996 and 1995, were:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1996				
Net sales	$ 126,418	$ 166,770	$ 189,542	$ 212,521
Gross margin	26,783	35,188	35,813	43,525
Operating income (loss)	6,787	(17,612)	8,931	7,677
Net income (loss)	1,848	(23,667)	346	2,283
Primary and fully diluted net income (loss) per share and equivalent share	$ 0.07	$ (0.65)	$ 0.01	$ 0.06
Dividends per share	—	—	—	—
Market price:				
High	$ 13.13	$ 16.00	$ 20.00	$ 19.88
Low	10.63	11.50	12.75	15.75
1995				
Net sales	$ 85,155	$ 91,023	$ 81,366	$ 92,694
Gross margin	14,795	18,055	15,888	18,352
Operating income	2,629	5,949	5,130	4,849
Income (loss) from continuing operations	(2,369)	1,950	1,561	2,059
Loss from discontinued operations	(112)	(185)	(171)	—
Net income (loss)	(2,481)	1,765	1,390	2,059
Primary and fully diluted income (loss) per share and equivalent share:				
Continuing operations	$ (0.27)	$ 0.11	$ 0.09	$0.11
Discontinued operations	(0.01)	(0.01)	(0.01)	—
Net income (loss)	(0.28)	0.10	0.08	0.11
Dividends per share	—	—	—	—
Market price:				
High	$ 6.63	$ 7.25	$ 12.25	$ 11.25
Low	4.25	4.50	7.25	8.25

Results for 1996 include business acquisition and consolidation expenses of $5,211 in the first quarter, $29,209 in the second quarter, $1,382 in the third quarter and $6,568 in the fourth quarter (see Note 3). In addition, first quarter results include other income of $2,697 (see Note 18).

Results for 1995 include bankruptcy reorganization expenses of $2,125 in the first quarter, $826 in the second quarter and $410 in the third quarter (see Note 19).