

HEXCEL CORP /DE/  
Form 10-K/A  
July 10, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10 K/A**

(Amendment No. 3)

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

**For the Fiscal Year Ended December 31, 2002**

or

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

**For the transition period from to**

**Commission File Number 1-8472**

**Hexcel Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of Incorporation)

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

**281 Tresser Boulevard**  
**Stamford, Connecticut 06901**  
(Address of principal executive offices and zip code)

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

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

**Title of each class**  
**COMMON STOCK**

**Name of each exchange on which registered**

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NEW YORK STOCK EXCHANGE  
PACIFIC STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act:  
**7% CONVERTIBLE SUBORDINATED DEBENTURES DUE 2011**

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes  No

The aggregate market value as of June 30, 2002 of voting common stock held by non-affiliates of the registrant: \$102,107,859

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

| Class        | Outstanding as of July 7, 2003 |
|--------------|--------------------------------|
| COMMON STOCK | 38,632,738                     |

**EXPLANATORY NOTE**

The purpose of this Amendment No. 3 to the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 3, 2003, as amended by Amendment No. 1 and Amendment No. 2 to the Annual Report on Form 10-K filed on March 31, 2003 and April 29, 2003, respectively, is to file the consolidated financial statements of Asahi-Schwebel Co. Ltd., as required by Rule 3-09(a) of Regulation S-X, and the consolidated financial statements of Hexcel S.A. and Hexcel Holdings (UK) Limited, which are required by Rule 3-16(a) of Regulation S-X. In addition, Note 25 Supplemental Guarantor Information is now included in the consolidated financial statements of Hexcel Corporation pursuant to Rule 3-10 of Regulation S-X. This amendment consists solely of a cover page, this explanatory note, the information required by Item 15 of Form 10-K (Exhibits, Financial Statement Schedules and Reports on Form 8-K), a signature page, and the principal executive officer and principal financial officer certifications required to be included herein. In accordance with Rule 12b-15 promulgated pursuant to the Securities Exchange Act of 1934, the complete text of Item 15, as amended, is included herein. However, with respect to the financial statements and financial statement schedules, other than the inclusion of Note 25 to the consolidated financial statements of Hexcel Corporation, the consolidated financial statements of Asahi-Schwebel Co. Ltd., Hexcel S.A. and Hexcel Holdings (UK) Limited, and the Reports of Independent Accountants relating to the financial statements of NITTOBO ASCO Glass Fiber Co., Ltd. (a 50% owned equity investee of Asahi-Schwebel Co. Ltd.) and Asahi-Schwebel (Taiwan) Co., Ltd. (a wholly-owned subsidiary of, and consolidated with, Asahi-Schwebel Co. Ltd.), no changes have been made.

**PART IV**

**ITEM 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

**a. 1. Financial Statements**

i. The consolidated financial statements of Hexcel Corporation and Subsidiaries, the notes thereto, and the Report of Independent Auditors are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

ii. The financial statements of BHA Aero Composite Parts Co. Ltd., the notes thereto, and the Independent Auditors Report are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

iii. The consolidated financial statements of Asahi-Schwebel Co. Ltd. and Subsidiaries, the notes thereto, and the Independent Auditors Report are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

iv. The consolidated financial statements of Hexcel S.A. and Subsidiaries, the notes thereto, and the Report of Independent Auditors are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

v. The consolidated financial statements of Hexcel Holdings (UK) Limited and Subsidiaries, the notes thereto, and the Report of Independent Auditors are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

**2. Financial Statement Schedules**

The financial statement schedule and the Report of Independent Auditors required by Item 15(a)(2) are listed on page 16 of this Annual Report on Form 10-K/A and are incorporated herein by reference.

**b. Reports on Form 8-K**

Current Report on Form 8-K dated October 23, 2002, relating to third quarter of 2002 financial results.

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Current Report on Form 8-K dated December 20, 2002, relating to announcement of signed agreements to issue equity securities and planned refinancing of existing senior credit facility.

### c. Exhibits

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 2.1                | Asset Purchase Agreement dated March 31, 2000 between Hexcel Corporation and Britax Cabin Interiors, Inc. (incorporated herein by reference to Exhibit 2.1 to Hexcel's Current Report on Form 8-K dated May 10, 2000).  |
| 3.1                | Restated Certificate of Incorporation of Hexcel Corporation (incorporated herein by reference to Exhibit 1 to Hexcel's Registration Statement on Form 8-A dated July 9, 1996, Registration No. 1-08472).  |
| 3.2                | Certificate of Amendment of the Restated Certificate of Incorporation of Hexcel Corporation (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003). |
| 3.3                | Amended and Restated Bylaws of Hexcel Corporation (incorporated herein by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).   |
| 4.1                | Indenture dated as of January 21, 1999 between Hexcel Corporation and The Bank of New York, as trustee, relating to the issuance of the 9 <sup>3</sup> / <sub>4</sub> % Senior Subordinated Notes   |

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- due 2009 (incorporated herein by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-4 (No. 333-71601), filed on February 2, 1999).
- 4.2 Indenture dated as of August 1, 1986 between Hexcel and the Bank of California, N.A., as trustee, relating to the 7% Convertible Subordinated Notes due 2011 of the Company (incorporated herein by reference to Exhibit 4.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
- 4.2(a) Instrument of Resignation, Appointment and Acceptance, dated as of October 1, 1993 (incorporated herein by reference to Exhibit 4.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1993).
- 4.3 Indenture, dated as of March 19, 2003 among Hexcel Corporation, the Guarantors named therein and Wells Fargo Bank Minnesota, National Association, as trustee, relating to the 9.875% Senior Secured Notes due 2008 (incorporated herein by reference to Exhibit 4.4 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 4.4 Certificate of Designation of Series A Convertible Preferred Stock of Hexcel Corporation (incorporated herein by reference to Exhibit 4.5 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 4.5 Certificate of Designation of Series B Convertible Preferred Stock of Hexcel Corporation (incorporated herein by reference to Exhibit 4.6 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.1 Credit and Guaranty Agreement, dated as of March 19, 2003, by and among Hexcel Corporation, Hexcel Composites Limited, Hexcel Composites GmbH (Austria), Hexcel Composites GmbH (Germany), the Guarantors named therein, the lenders from time to time party thereto, Fleet Capital Corporation, as Administrative Agent, Fleet National Bank, London U.K. branch, trading as FleetBoston Financial, as Fronting Bank and Issuing Bank, Fleet National Bank, as Issuing Bank, and Fleet Securities Inc., as Lead Arranger (incorporated herein by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.2 Security Agreement, dated as of March 19, 2003, by and among Hexcel Corporation, Clark-Schwebel Corporation, Hexcel Pottsville Corporation, Clark-Schwebel Holding Corp., CS Tech-Fab Holding, Inc. and Fleet Capital Corporation, as Administrative Agent (incorporated herein by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.3\* Hexcel Corporation 2003 Incentive Stock Plan (incorporated herein by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.4\* Hexcel Corporation Incentive Stock Plan as amended and restated January 30, 1997 (incorporated herein by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8, Registration No. 333-36163).
- 10.4(a)\* Hexcel Corporation Incentive Stock Plan as amended and restated January 30, 1997 and further amended December 10, 1997 (incorporated herein by reference to Exhibit 10.5(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
- 10.4(b)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on January 30, 1997, and further amended on December 10, 1997 and March 25, 1999 (incorporated herein by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed on

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July 26, 1999).

- 10.4(c)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on January 30, 1997, and further amended on December 10, 1997, March 25, 1999 and December 2, 1999 (incorporated by reference to Exhibit 10.3(c) of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.4(d)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on February 3, 2000 (incorporated herein by reference to Annex A of the Company's Proxy Statement dated March 31, 2000).
- 10.4(e)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on December 19, 2000 (incorporated herein by reference to Exhibit 10.3(e) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.4(f)\* Hexcel Corporation Incentive Stock Plan, as amended and restated on December 19, 2000 and further amended on January 10, 2002 (incorporated herein by reference to Exhibit 10.3(f) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.5\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan (incorporated herein by reference to Exhibit 4.3 of the Company's Form S-8 filed on June 19, 1998, Registration No. 333-57223).
- 10.5(a)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000 (incorporated by reference to Exhibit 10.1 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 2000).
- 10.5(b)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001 (incorporated herein by reference to Exhibit 10.4(b) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.5(c)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001 and January 10, 2002 (incorporated herein by reference to Exhibit 10.4(c) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.5(d)\* Hexcel Corporation 1998 Broad Based Incentive Stock Plan, as amended on February 3, 2000, and further amended on February 1, 2001, January 10, 2002 and December 12, 2002 (incorporated herein by reference to Exhibit 10.4(d) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.6\* Hexcel Corporation Management Stock Purchase Plan (incorporated herein by reference to Exhibit 10.9 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.6(a)\* Hexcel Corporation Management Stock Purchase Plan, as amended on March 25, 1999 (incorporated herein by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed on July 26, 1999).
- 10.6(b)\* Hexcel Corporation Management Stock Purchase Plan, as amended on March 25, 1999 and December 2, 1999 (incorporated by reference to Exhibit 10.5(b) of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.6(c)\* Hexcel Corporation Management Stock Purchase Plan, as amended and restated on February 3, 2000 (incorporated herein by reference to Annex B of the Company's Proxy Statement dated March 31, 2000).

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- 10.6(d)\* Hexcel Corporation Management Stock Purchase Plan, as amended and restated on December 19, 2000 (incorporated herein by reference to Exhibit 10.5(d) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.6(e)\* Hexcel Corporation Management Stock Purchase Plan, as amended and restated on March 19, 2003 (incorporated herein by reference to Exhibit 10.6(e) to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.7\* Hexcel Corporation Management Incentive Compensation Plan, as amended and restated on December 19, 2000 and as further amended on February 27, 2002 (incorporated herein by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.8\* Hexcel Corporation Long-Term Incentive Plan (incorporated herein by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.9\* Form of Employee Option Agreement (2003) (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.10\* Form of Employee Option Agreement (2002) (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.11\* Form of Employee Option Agreement (2000) (incorporated herein by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.12\* Form of Employee Option Agreement Special Executive Grant (2000) dated December 20, 2000 (incorporated by reference to Exhibit 10.8 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.13\* Form of Employee Option Agreement Special Executive Grant (1999) dated December 2, 1999 (incorporated by reference to Exhibit 10.7 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.14\* Form of Employee Option Agreement (1999) dated December 2, 1999 (incorporated by reference to Exhibit 10.8 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.15\* Form of Employee Option Agreement (1999) (incorporated herein by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1999).
- 10.16\* Form of Employee Option Agreement (1998) (incorporated herein by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 1998).
- 10.17\* Form of Employee Option Agreement (1997) (incorporated herein by reference to Exhibit 10.4 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.18\* Form of Employee Option Agreement (1996) (incorporated herein by reference to Exhibit 10.5 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1996).



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- 10.19\* Form of Employee Option Agreement (1995) (incorporated herein by reference to Exhibit 10.6 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1996).
- 10.20\* Form of Retainer Fee Option Agreement for Non-Employee Directors (2003) (incorporated herein by reference to Exhibit 10.19 the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.21\* Form of Retainer Fee Option Agreement for Non-Employee Directors (2000) (incorporated by reference to Exhibit 10.16 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.22\* Form of Retainer Fee Option Agreement for Non-Employee Directors (1999) (incorporated by reference to Exhibit 10.14 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.23\* Form of Retainer Fee Option Agreement for Non-Employee Directors (1998) (incorporated herein by reference to Exhibit 10.11 to Hexcel's Annual Report on Form 10-K for the fiscal year ended December 31, 1998).
- 10.24\* Form of Retainer Fee Option Agreement for Non-Employee Directors (1997) (incorporated herein by reference to Exhibit 10.8 to Hexcel's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
- 10.25\* Form of Option Agreement (Directors) (incorporated herein by reference to Exhibit 10.13 to Hexcel's Annual Report on Form 10-K for the fiscal year ended December 31, 1995).
- 10.26\* Form of Supplemental Compensation Option Agreement (Directors) (incorporated herein by reference to Exhibit 10.23 to Hexcel's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.27\* Form of Performance Accelerated Restricted Stock Unit Agreement (December 20, 2000) (incorporated herein by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.28\* Form of Performance Accelerated Restricted Stock Unit Agreement (Special Executive Grant December 2, 1999) (incorporated by reference to Exhibit 10.19 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.29\* Form of Performance Accelerated Restricted Stock Unit Agreement (December 2, 1999) (incorporated by reference to Exhibit 10.20 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.30\* Form of Performance Accelerated Restricted Stock Unit Agreement (1999) (incorporated herein by reference to Exhibit 10.2 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1999).
- 10.31\* Form of Performance Accelerated Restricted Stock Unit Agreement (1998) (incorporated herein by reference to Exhibit 10.2 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1998).
- 10.32\* Form of Performance Accelerated Restricted Stock Unit Agreement (1997) (incorporated herein by reference to Exhibit 10.5 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.33\* Form of Performance Accelerated Restricted Stock Unit Agreement (1996) (incorporated herein by reference to Exhibit 10.9 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1996).

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- 10.34\* Form of Restricted Stock Unit Agreement (2003) (incorporated herein by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.35\* Form of Restricted Stock Unit Agreement (2002) (incorporated herein by reference to Exhibit 10.31 to Hexcel's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.36\* Form of Reload Option Agreement (1997) (incorporated herein by reference to Exhibit 10.8 of Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.37\* Form of Reload Option Agreement (1996) (incorporated herein by reference to Exhibit 10.10 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1996).
- 10.38\* Form of Exchange Performance Accelerated Stock Option Agreement (incorporated herein by reference to Exhibit 10.3 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended September 30, 1998).
- 10.39\* Form of Performance Accelerated Stock Option Agreement (Director) (incorporated herein by reference to Exhibit 10.6 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.40\* Form of Performance Accelerated Stock Option (Employee) (incorporated herein by reference to Exhibit 10.7 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.41\* Form of Grant of Restricted Stock Unit Agreement (incorporated herein by reference to Exhibit 10.3 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1999).
- 10.42\* Form of Grant of Restricted Stock Unit Agreement (incorporated herein by reference to Exhibit 10.10 to Hexcel's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
- 10.43\* Hexcel Corporation 1997 Employee Stock Purchase Plan, as amended and restated as of March 19, 2003 (incorporated herein by reference to Exhibit 10.43 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.44\* Employment Agreement dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37 to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.44(a)\* Amendment, dated December 12, 2002, to Employment Agreement dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated herein by reference to Exhibit 10.43(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 10.44(b)\* Employee Option Agreement dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(a) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.44(c)\* Employment Option Agreement (performance-based option) dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(b) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).

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- 10.44(d)\* Restricted Stock Agreement dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(c) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.44(e)\* Supplemental Executive Retirement Agreement dated as of July 30, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(d) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.44(f)\* Letter Agreement dated August 1, 2001 between Hexcel Corporation and David E. Berges (incorporated by reference herein to Exhibit 10.37(e) to Hexcel's Registration Statement on Form S-4 (No. 333-66582), filed on August 2, 2001).
- 10.44(g)\* Letter Agreement dated August 28, 2001 between Hexcel Corporation and David E. Berges (incorporated herein by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001).
- 10.45\* Letter dated December 2, 1999 from Hexcel Corporation to Stephen C. Forsyth, regarding the Company's Management Incentive Compensation Plan for 1999 (incorporated by reference to Exhibit 10.35 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.45(a)\* Supplemental Executive Retirement Agreement dated as of May 10, 2000 between Hexcel Corporation and Stephen C. Forsyth (incorporated herein by reference to Exhibit 10.5 of the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 2000).
- 10.45(b)\* Amendment to Agreements, dated as of October 11, 2000 by and between Hexcel Corporation and Stephen C. Forsyth (incorporated herein by reference to Exhibit 10.8 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2000).
- 10.45(c)\* Amendment to Amendments to Agreements, dated as of November 21, 2000, by and between Hexcel Corporation and Stephen C. Forsyth (incorporated herein by reference to Exhibit 10.39(c) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.45(d)\* First Amendment to Supplemental Executive Retirement Agreement dated as of July 30, 2001 between Hexcel Corporation and Stephen C. Forsyth (incorporated herein by reference to Exhibit 10.43(d) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.46\* Letter dated December 2, 1999 from Hexcel Corporation to Ira J. Krakower, regarding the Company's Management Incentive Compensation Plan for 1999 (incorporated herein by reference to Exhibit 10.40 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.46(a)\* Supplemental Executive Retirement Agreement dated as of May 10, 2000 between Hexcel and Ira J. Krakower (incorporated herein by reference to Exhibit 10.6 of the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 2000).
- 10.46(b)\* Amendment to Agreements, dated as of October 11, 2000 by and between Hexcel Corporation and Ira J. Krakower (incorporated herein by reference to Exhibit 10.7 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2000).
- 10.46(c)\* First Amendment to Supplemental Executive Retirement Agreement dated as of July 30, 2001 between Hexcel Corporation and Ira J. Krakower (incorporated herein by reference to Exhibit 10.44(c) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).

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- 10.47\* Form of Executive Severance Agreement between Hexcel and certain executive officers dated as of February 3, 1999 (incorporated herein by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1999).
- 10.48\* Form of Executive Severance Agreement between Hexcel and certain executive officers dated as of February 3, 1999 (incorporated herein by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1999).
- 10.49\* Amendment to Agreements, dated as of October 11, 2000 by and between Hexcel Corporation and William Hunt (incorporated herein by reference to Exhibit 10.14 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2000).
- 10.49(a)\* Amendment to Amendments to Agreements, dated as of November 21, 2000, by and between Hexcel Corporation and William Hunt (incorporated herein by reference to Exhibit 10.45(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.50\* Amendment to Agreements, dated as of October 11, 2000 by and between Hexcel Corporation and David Tanonis (incorporated herein by reference to Exhibit 10.12 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2000).
- 10.51\* Amendment to Agreements, dated as of October 11, 2000 by and between Hexcel Corporation and Joseph Shaulson (incorporated herein by reference to Exhibit 10.9 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2000).
- 10.51(a)\* Amendment to Amendments to Agreements, dated as of November 21, 2000, by and between Hexcel Corporation and Joseph Shaulson (incorporated herein by reference to Exhibit 10.48(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
- 10.52 Lease Agreement, dated as of September 15, 1998, by and among Clark-Schwebel Corporation (a wholly-owned subsidiary of Hexcel) as lessee, CSI Leasing Trust as lessor, and William J. Wade as co-trustee for CSI Leasing Trust (incorporated herein by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 1998).
- 10.53 Amended and Restated Governance Agreement, dated as of March 19, 2003, among LXH L.L.C., LXH II, L.L.C., GS Capital Partners 2000 L.P., GS Capital Partners 2000 Offshore, L.P., GS Capital Partners 2000 Employee Fund, L.P., GS Capital Partners 2000 GmbH & Co. Beteiligungs KG, Stone Street Fund 2000, L.P. and Hexcel Corporation (incorporated herein by reference to Exhibit 10.53 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.54 Stockholders Agreement, dated as of March 19, 2003, among Berkshire Fund V, Limited Partnership, Berkshire Fund VI, Limited Partnership, Berkshire Fund V Investment Corp., Berkshire Fund VI Investment Corp., Berkshire Investors LLC, Greenbriar Co-Investment Partners L.P, Greenbriar Equity Fund, L.P. and Hexcel Corporation (incorporated herein by reference to Exhibit 10.54 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.55 Amended and Restated Registration Rights Agreement, dated as of March 19, 2003, by and among Hexcel Corporation, LXH, L.L.C., LXH II, L.L.C., GS Capital Partners 2000 L.P., GS Capital Partners 2000 Offshore, L.P., GS Capital Partners 2000 Employee Fund, L.P., GS Capital Partners 2000 GmbH & Co. Beteiligungs KG and Stone Street Fund 2000, L.P. (incorporated herein by reference to Exhibit 10.55 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).

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- 10.56 Registration Rights Agreement, dated as of March 19, 2003, among Hexcel Corporation, Berkshire Fund V, Limited Partnership, Berkshire Fund VI, Limited Partnership, Berkshire Investors LLC, Greenbriar Co-Investment Partners L.P. and Greenbriar Equity Fund, L.P. (incorporated herein by reference to Exhibit 10.56 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.57 Agreement, dated October 11, 2000, by and among Hexcel Corporation, LXH, L.L.C. and LXH II, L.L.C. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated October 13, 2000).
- 10.58 Consent and Termination Agreement, dated as of October 11, 2000, by and between Hexcel Corporation and Ciba Specialty Chemicals Holding Inc. (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated October 13, 2000).
- 10.59 Purchase Agreement, dated as of June 15, 2001, among Hexcel Corporation and Credit Suisse First Boston Corporation, Deutsche Banc Alex. Brown Inc., Goldman, Sachs & Co. and J.P. Morgan Securities Inc (incorporated herein by reference to Exhibit 10.56 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).
- 10.60 Stock Purchase Agreement, dated as of December 18, 2002, by and among Hexcel Corporation, Berkshire Investors LLC, Berkshire Fund V, Limited Partnership, Berkshire Fund VI, Limited Partnership, Greenbriar Equity Fund, L.P. and Greenbriar Co-Investment Partners, L.P. (incorporated herein by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated December 20, 2002).
- 10.61 Stock Purchase Agreement, dated as of December 18, 2002, by and among Hexcel Corporation, GS Capital Partners 2000, L.P., GS Capital Partners 2000 Offshore, L.P., GS Capital Partners 2000 Employee Fund, L.P., GS Capital Partners 2000 GmbH & Co. Beteiligungs KG and Stone Street Fund 2000, L.P. (incorporated herein by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K dated December 20, 2002).
- 10.62 Purchase Agreement, dated as of March 7, 2003, among Goldman, Sachs & Co., Fleet Securities, Inc. and Hexcel Corporation (incorporated herein by reference to Exhibit 10.62 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.63 Exchange and Registration Rights Agreement dated as of March 19, 2003 among Hexcel Corporation, Clark-Schwebel Holding Corp., Clark-Schwebel Corporation, Hexcel Pottsville Corporation and CS Tech-Fab Holding, Inc. (incorporated herein by reference to Exhibit 10.63 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.64 Pledge and Security Agreement, dated as of March 19, 2003, between Hexcel Corporation, Clark-Schwebel Holding Corp., Clark-Schwebel Corporation, Hexcel Pottsville Corporation, CS Tech-Fab Holding, Inc. and Hexcel International, and HSBC Bank USA, as Joint Collateral Agent (incorporated herein by reference to Exhibit 10.64 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.65 Collateral Agency Agreement, dated as of March 19, 2003, by and among Hexcel Corporation, HSBC Bank USA, as Joint Collateral Agent, Well Fargo Bank Minnesota, National Association, as trustee, and the representatives of the holders of Parity Lien Debt who may become a party thereto (incorporated herein by reference to Exhibit 10.65 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 10.66 Intercreditor and Agency Agreement dated as of March 19, 2003, by and among HSBC

Bank USA, as Joint Collateral Agent, Fleet Capital Corporation, as Intercreditor Agent and Security Trustee, Fleet Capital Corporation, as Administrative Agent under the Existing Credit Facility, Well Fargo Bank Minnesota, National Association, as trustee, and each other Credit Facility Agent that may become a party thereto (incorporated herein by reference to Exhibit 10.66 to the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, filed on March 31, 2003).

- 12.1 Statement regarding the computation of ratio of earnings to fixed charges for the Company (incorporated herein by reference to Exhibit 12.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 21.1 Subsidiaries of the Company (incorporated herein by reference to Exhibit 21.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002).
- 23.1 Consent of Independent Auditors - PricewaterhouseCoopers LLP (Hexcel Corporation).
- 23.2 Consent of Independent Auditors - PricewaterhouseCoopers LLP (Hexcel S.A. and Hexcel Holdings (UK) Limited).
- 23.3 Consent of Independent Auditors - PricewaterhouseCoopers (NITTOBO ASCO Glass Fiber Co., Ltd.).
- 23.4 Consent of Independent Auditors - PricewaterhouseCoopers (Asahi-Schwebel (Taiwan) Co., Ltd.).
- 23.5 Consent of Independent Auditors - Deloitte Touche Tohmatsu (BHA Aero Composite Parts Co. Ltd.).
- 23.6 Consent of Independent Auditors - Deloitte Touche Tohmatsu (Asahi-Schwebel Co., Ltd.).
- 24.1 Powers of Attorney (included on signature page and incorporated herein by reference to Exhibit 24.1 to the Company's Annual Report on Form 10-K/A (Amendment No. 1) for the fiscal year ended December 31, 2002, filed on March 31, 2003).
- 99.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\* Indicates management contract or compensatory plan or arrangement.

**SIGNATURES**

**Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Stamford, State of Connecticut.**

**Hexcel Corporation**

July 10, 2003  
(Date)

/s/ STEPHEN C. FORSYTH  
Stephen C. Forsyth  
Chief Financial Officer

KNOWN TO ALL PERSONS BY THESE PRESENTS, that each of Sandra L. Derickson and Peter M. Sacerdote constitutes and appoints Stephen C. Forsyth his or her attorney-in-fact, with the power of substitution, for him or her in any and all capacities, to sign any amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

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

| Signature  | Title   | Date          |
|--|---|---------------|
| /s/ DAVID E. BERGES*<br>(David E. Berges)                | Chairman of the<br>Board of Directors, President and<br>Chief Executive Officer<br><b>(Principal Executive Officer)</b> | July 10, 2003 |
| /s/ STEPHEN C. FORSYTH<br>(Stephen C. Forsyth)           | Executive Vice President and<br>Chief Financial Officer<br><b>(Principal Financial Officer)</b>                         | July 10, 2003 |
| /s/ WILLIAM J. FAZIO*<br>(William J. Fazio)              | Corporate Controller<br><b>(Principal Accounting Officer)</b>   | July 10, 2003 |
| /s/ JOEL S. BECKMAN*<br>(Joel S. Beckman)                | Director  | July 10, 2003 |
| /s/ H. ARTHUR BELLOWES, JR.*<br>(H. Arthur Bellows, Jr.) | Director  | July 10, 2003 |
| /s/ SANDRA L. DERICKSON                                  | Director  | July 10, 2003 |

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(Sandra L. Derickson)

/s/ JAMES J. GAFFNEY\*  
(James J. Gaffney)

Director

July 10, 2003



|   |          |               |
|---|----------|---------------|
| /s/ SANJEEV K. MEHRA*<br>(Sanjeev K. Mehra)   | Director | July 10, 2003 |
| /s/ LEWIS RUBIN*<br>(Lewis Rubin)             | Director | July 10, 2003 |
| /s/ PETER M. SACERDOTE<br>(Peter Sacerdote)   | Director | July 10, 2003 |
| /s/ ROBERT J. SMALL*<br>(Robert J. Small)     | Director | July 10, 2003 |
| /s/ MARTIN L. SOLOMON*<br>(Martin L. Solomon) | Director | July 10, 2003 |

\*By: /s/ STEPHEN C. FORSYTH  
Stephen C. Forsyth  
Attorney-in-fact

**CERTIFICATIONS**

I, David E. Berges, certify that:

1. I have reviewed this annual report on Form 10-K/A (Amendment No. 3) of Hexcel Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

July 10, 2003  
(Date)

/s/ DAVID E. BERGES  
David E. Berges  
Chairman of the Board of Directors,  
President and Chief Executive Officer

I, Stephen C. Forsyth, certify that:

1. I have reviewed this annual report on Form 10-K/A (Amendment No. 3) of Hexcel Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

July 10, 2003  
(Date)

/s/ STEPHEN C. FORSYTH  
Stephen C. Forsyth  
Executive Vice President and  
Chief Financial Officer

## Consolidated Financial Statements

### Description

#### Management Responsibility for Consolidated Financial Statements

##### Report of Independent Auditors

Consolidated Financial Statements Hexcel Corporation and Subsidiaries:

Consolidated Balance Sheets as of December 31, 2002 and 2001

Consolidated Statements of Operations for each of the three years ended December 31, 2002

Consolidated Statements of Stockholders' Equity (Deficit) and Comprehensive Income (Loss) for each of the three years ended December 31, 2002

Consolidated Statements of Cash Flows for each of the three years ended December 31, 2002

Notes to the Consolidated Financial Statements

##### Independent Auditors' Report

Financial Statements BHA Aero Composite Parts Co. Ltd.:

Balance Sheets as of December 31, 2002 and 2001

Statements of Operations for each of the three years ended December 31, 2002

Statements of Owners' Equity for each of the three years ended December 31, 2002

Statements of Cash Flows for each of the three years ended December 31, 2002

Notes to the Financial Statements

##### Independent Auditors' Report

Consolidated Financial Statements Asahi-Schwebel Co. Ltd. and Subsidiaries:

Consolidated Balance Sheets as of March 31, 2003 and 2002

Consolidated Statements of Operations and Unappropriated Retained Earnings for each of the three years ended March 31, 2003

Consolidated Statements of Comprehensive Income (Loss) for each of the three years ended March 31, 2003

Consolidated Statements of Cash Flows for each of the three years ended March 31, 2003

Notes to the Consolidated Financial Statements

Report of Independent Accountants to the Shareholders of Asahi-Schwebel (Taiwan) Co., Ltd.

Report of Independent Accountants to the Shareholders of NITTOBO ASCO Glass Fiber Co., Ltd.

##### Report of Independent Auditors

Consolidated Financial Statements Hexcel S.A. and Subsidiaries:

Consolidated Balance Sheets as of December 31, 2002 and 2001

Consolidated Statements of Operations for the years ended December 31, 2002 and 2001

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2002 and 2001

Consolidated Statements of Cash Flows for the years ended December 31, 2002 and 2001

Notes to the Consolidated Financial Statements

##### Report of Independent Auditors

Consolidated Financial Statements Hexcel Holdings (UK) Limited and Subsidiaries:

Consolidated Balance Sheets as of December 31, 2002 and 2001

Consolidated Statements of Operations for the years ended December 31, 2002 and 2001

Consolidated Statements of Stockholders' Equity (Deficit) and Comprehensive Income for the years ended December 31, 2002 and 2001

Consolidated Statements of Cash Flows for the years ended December 31, 2002 and 2001

Notes to the Consolidated Financial Statements

##### Report of Independent Auditors on Financial Statement Schedule

Schedule of Valuation and Qualifying Accounts



### **Management Responsibility for Consolidated Financial Statements**

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

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 Company's independent accountants, PricewaterhouseCoopers LLP, in connection with the audit of the Company's consolidated financial statements. The Audit Committee, composed solely of outside directors, meets periodically, separately and jointly, with management and the independent accountants.

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

/s/ STEPHEN C. FORSYTH  
Stephen C. Forsyth  
*Chief Financial Officer*

/s/ WILLIAM J. FAZIO  
William J. Fazio  
*Chief Accounting Officer*



**Report of Independent Auditors**

To the Board of Directors and  
Stockholders of Hexcel Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity (deficit) and comprehensive income (loss) and of cash flows present fairly, in all material respects, the financial position of Hexcel Corporation and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 1 and 3 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP

Stamford, Connecticut

February 28, 2003, except for Notes 2 and 8 which are as of March 19, 2003 and Note 25 which is as of July 8, 2003

## Hexcel Corporation and Subsidiaries

## Consolidated Balance Sheets

As of December 31,

| (In millions, except per share data)   | Unaudited<br>Pro Forma<br>(see Note 24) |          |          |
|--|---|----------|----------|
|  | 2002                                    | 2002     | 2001     |
| <b>Assets</b>  |   |          |          |
| Current assets:  |   |          |          |
| Cash and cash equivalents  | \$ 12.6                                 | \$ 8.2   | \$ 11.6  |
| Accounts receivable, net   | 117.3                                   | 117.3    | 140.5    |
| Inventories, net   | 113.6                                   | 113.6    | 131.7    |
| Prepaid expenses and other assets  | 9.2                                     | 9.2      | 4.4      |
| Total current assets   | 252.7                                   | 248.3    | 288.2    |
| Net property, plant and equipment  | 309.4                                   | 309.4    | 329.2    |
| Goodwill, net  | 74.4                                    | 74.4     | 72.4     |
| Investments in affiliated companies  | 34.0                                    | 34.0     | 56.9     |
| Other assets   | 46.9                                    | 42.0     | 42.7     |
| Total assets   | \$ 717.4                                | \$ 708.1 | \$ 789.4 |
| <b>Liabilities and Stockholders Equity (Deficit)</b>   |   |          |          |
| Current liabilities:   |   |          |          |
| Notes payable and current maturities of capital lease obligations  | \$ 6.2                                  | \$ 621.7 | \$ 17.4  |
| Accounts payable   | 54.9                                    | 54.9     | 58.6     |
| Accrued compensation and benefits  | 37.6                                    | 37.6     | 42.6     |
| Accrued interest   | 15.9                                    | 19.1     | 18.8     |
| Business consolidation and restructuring liabilities   | 10.5                                    | 10.5     | 33.4     |
| Other accrued liabilities  | 35.3                                    | 35.3     | 33.7     |
| Total current liabilities  | 160.4                                   | 779.1    | 204.5    |
| Long-term notes payable and capital lease obligations  | 512.4                                   |          | 668.5    |
| Long-term retirement obligations   | 48.1                                    | 48.1     | 31.3     |
| Other non-current liabilities  | 8.3                                     | 8.3      | 17.7     |
| Total liabilities  | 729.2                                   | 835.5    | 922.0    |
| Commitments and contingencies (see Note 16)  |   |          |          |
| Mandatorily redeemable convertible preferred stock, 125,000 series A shares and 125,000 series B shares authorized, issued and outstanding | 96.4                                    |          |          |
| Stockholders' equity (deficit):  |   |          |          |
| Preferred stock, no par value, 20.0 shares of stock authorized, no shares issued or outstanding  |   |          |          |

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|  |                 |                 |          |
|--|-----------------|-----------------|----------|
| Common stock, \$0.01 par value, 100.0 shares of stock authorized, shares issued of 39.8 at December 31, 2002 and 39.4 at December 31, 2001 | <b>0.4</b>      | <b>0.4</b>      | 0.4      |
| Additional paid-in capital   | <b>311.6</b>    | <b>288.2</b>    | 287.7    |
| Accumulated deficit  | <b>(385.7)</b>  | <b>(381.5)</b>  | (367.9)  |
| Accumulated other comprehensive loss   | <b>(21.2)</b>   | <b>(21.2)</b>   | (39.7)   |
|  | <b>(94.9)</b>   | <b>(114.1)</b>  | (119.5)  |
| Less- Treasury stock, at cost, 1.3 shares at December 31, 2002 and 1.2 shares at December 31, 2001   | <b>(13.3)</b>   | <b>(13.3)</b>   | (13.1)   |
| Total stockholders' equity (deficit)   | <b>(108.2)</b>  | <b>(127.4)</b>  | (132.6)  |
| Total liabilities and stockholders' equity (deficit)   | \$ <b>717.4</b> | \$ <b>708.1</b> | \$ 789.4 |

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

## Hexcel Corporation and Subsidiaries

Consolidated Statements of Operations  
For the Years Ended December 31,

| (In millions, except per share data)  | 2002      | 2001       | 2000       |
|---|-----------|------------|------------|
| Net sales   | \$ 850.8  | \$ 1,009.4 | \$ 1,055.7 |
| Cost of sales   | 689.5     | 818.6      | 824.3      |
| Gross margin  | 161.3     | 190.8      | 231.4      |
| Selling, general and administrative expenses  | 85.9      | 120.9      | 123.9      |
| Research and technology expenses  | 14.7      | 18.6       | 21.2       |
| Business consolidation and restructuring expenses                                       | 0.5       | 58.4       | 10.9       |
| Impairment of goodwill and other purchased intangibles                                  |           | 309.1      |            |
| Operating income (loss)   | 60.2      | (316.2)    | 75.4       |
| Litigation gain   | 9.8       |            |            |
| Interest expense  | (62.8)    | (64.8)     | (68.7)     |
| Gain (loss) on early retirement of debt   | 0.5       | (2.7)      |            |
| Gain on sale of Bellingham aircraft interiors business                                  |           |            | 68.3       |
| Income (loss) before income taxes   | 7.7       | (383.7)    | 75.0       |
| Provision for income taxes  | 11.3      | 40.5       | 26.3       |
| Income (loss) before equity in earnings (losses)  | (3.6)     | (424.2)    | 48.7       |
| Equity in earnings (losses) of and write-downs of an investment in affiliated companies | (10.0)    | (9.5)      | 5.5        |
| Net income (loss)   | \$ (13.6) | \$ (433.7) | \$ 54.2    |
| Net income (loss) per share:  |           |            |            |
| Basic   | \$ (0.35) | \$ (11.54) | \$ 1.47    |
| Diluted   | \$ (0.35) | \$ (11.54) | \$ 1.32    |
| Weighted average shares:  |           |            |            |
| Basic   | 38.4      | 37.6       | 36.8       |
| Diluted   | 38.4      | 37.6       | 45.7       |

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



## Hexcel Corporation and Subsidiaries

**Consolidated Statements of Stockholders Equity (Deficit) and Comprehensive Income (Loss)  
For the Years Ended December 31, 2002, 2001 and 2000**

| (In millions)                                | Par    | Common Stock<br>Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Shares | Total<br>Stockholders<br>Equity (Deficit) | Comprehensive<br>Income (Loss) |
|--|--------|--|--|--|--------------------|---|--------------------------------|
| <b>Balance, January 1, 2000</b>              | \$ 0.4 | \$ 273.6   | \$ 11.6  | \$ (4.8)   | \$ (10.7)          | \$ 270.1                                  |                                |
| Net income                                   |        |  | 54.2   |  |                    | 54.2                                      | \$ 54.2                        |
| Currency translation adjustment              |        |  |  | (10.2)   |                    | (10.2)                                    | (10.2)                         |
| Minimum pension obligation                   |        |  |  | (5.0)  |                    | (5.0)                                     | (5.0)                          |
| Comprehensive income                         |        |  |  |  |                    |   | \$ 39.0                        |
| Activity under stock plans and other         |        | 7.1  |  |  | (0.5)              | 6.6                                       |                                |
| <b>Balance, December 31, 2000</b>            | \$ 0.4 | \$ 280.7   | \$ 65.8  | \$ (20.0)  | \$ (11.2)          | \$ 315.7                                  |                                |
| Net loss                                     |        |  | (433.7)  |  |                    | (433.7)                                   | \$ (433.7)                     |
| Currency translation adjustment              |        |  |  | (12.1)   |                    | (12.1)                                    | (12.1)                         |
| Net unrealized loss on financial instruments |        |  |  | (5.9)  |                    | (5.9)                                     | (5.9)                          |
| Minimum pension obligation                   |        |  |  | (1.7)  |                    | (1.7)                                     | (1.7)                          |
| Comprehensive loss                           |        |  |  |  |                    |   | \$ (453.4)                     |
| Activity under stock plans and other         |        | 7.0  |  |  | (1.9)              | 5.1                                       |                                |
| <b>Balance, December 31, 2001</b>            | \$ 0.4 | \$ 287.7   | \$ (367.9)                                       | \$ (39.7)  | \$ (13.1)          | \$ (132.6)                                |                                |
| Net loss                                     |        |  | (13.6)   |  |                    | (13.6)                                    | \$ (13.6)                      |
| Currency translation adjustment              |        |  |  | 19.6   |                    | 19.6                                      | 19.6                           |
| Net unrealized gain on financial instruments |        |  |  | 9.3  |                    | 9.3                                       | 9.3                            |
| Minimum pension obligation                   |        |  |  | (10.4)   |                    | (10.4)                                    | (10.4)                         |
| Comprehensive loss                           |        |  |  |  |                    |   | \$ (4.9)                       |
| Activity under stock plans and other         |        | 0.5  |  |  | (0.2)              | 0.3                                       |                                |
| <b>Balance, December 31, 2002</b>            | \$ 0.4 | \$ 288.2   | \$ (381.5)                                       | \$ (21.2)  | \$ (13.3)          | \$ (127.4)                                |                                |

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

## Hexcel Corporation and Subsidiaries

Consolidated Statements of Cash Flows  
For the Years Ended December 31,

| (In millions)   | 2002      | 2001       | 2000    |
|---|-----------|------------|---------|
| <b>Cash flows from operating activities</b>   |           |            |         |
| Net income (loss)   | \$ (13.6) | \$ (433.7) | \$ 54.2 |
| Reconciliation to net cash provided by operations:                                      |           |            |         |
| Depreciation  | 47.2      | 50.7       | 45.6    |
| Amortization of goodwill and other intangibles assets                                   |           | 12.5       | 13.1    |
| Deferred income taxes   | 1.7       | 27.6       | 8.6     |
| Business consolidation and restructuring expenses                                       | 0.5       | 58.4       | 10.9    |
| Business consolidation and restructuring payments                                       | (24.3)    | (12.0)     | (11.8)  |
| Impairment of goodwill and other purchased intangibles                                  |           | 309.1      |         |
| Loss (gain) on early retirement of debt   | (0.5)     | 0.7        |         |
| Gain on sale of Bellingham aircraft interiors business                                  |           |            | (68.3)  |
| Gain on curtailment of pension plan   |           |            | (5.1)   |
| Equity in (earnings) losses of and write-downs of an investment in affiliated companies | 10.0      | 9.5        | (5.5)   |
| Changes in assets and liabilities:  |           |            |         |
| Decrease (increase) in accounts receivable  | 35.6      | 4.6        | (7.7)   |
| Decrease (increase) in inventories  | 25.8      | 20.6       | (17.0)  |
| Decrease (increase) in prepaid expenses and other assets                                | (1.7)     | 1.1        | (0.4)   |
| Increase (decrease) in accounts payable and accrued liabilities                         | (15.7)    | (19.2)     | 10.7    |
| Changes in other non-current assets and long-term liabilities                           | 0.9       | 5.1        | 5.7     |
| Net cash provided by operating activities   | 65.9      | 35.0       | 33.0    |
| <b>Cash flows from investing activities</b>   |           |            |         |
| Capital expenditures  | (14.9)    | (38.8)     | (39.6)  |
| Proceeds from sale of an ownership in an affiliated company                             | 10.0      |            |         |
| Proceeds from sale of Bellingham aircraft interiors business                            |           |            | 113.3   |
| Proceeds from sale of other assets  | 1.5       |            | 3.4     |
| Dividends from (investments in) affiliated companies                                    | 1.6       | 0.8        | (8.3)   |
| Other   | (0.5)     | (0.3)      |         |
| Net cash provided by (used for) investing activities                                    | (2.3)     | (38.3)     | 68.8    |
| <b>Cash flows from financing activities</b>   |           |            |         |
| Proceeds (repayments) of credit facilities, net   | (57.4)    | 24.6       | 29.5    |
| Proceeds from issuance of long-term debt  |           | 98.5       |         |
| Repayments of long-term debt and capital lease obligations                              | (9.9)     | (110.6)    | (126.0) |
| Debt issuance costs   |           | (3.5)      | (0.9)   |
| Activity under stock plans and other  |           | (0.4)      | 2.4     |
| Net cash provided by (used for) financing activities                                    | (67.3)    | 8.6        | (95.0)  |

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|  |               |         |        |
|--|---------------|---------|--------|
| Effect of exchange rate changes on cash and cash equivalents | <b>0.3</b>    | 1.2     | (1.9)  |
| Net increase (decrease) in cash and cash equivalents         | <b>(3.4)</b>  | 6.5     | 4.9    |
| Cash and cash equivalents at beginning of year               | <b>11.6</b>   | 5.1     | 0.2    |
| Cash and cash equivalents at end of year                     | \$ <b>8.2</b> | \$ 11.6 | \$ 5.1 |

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



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 - Significant Accounting Policies**

*Nature of Operations and Basis of Consolidation*

The consolidated financial statements include the accounts of Hexcel Corporation and its subsidiaries ( Hexcel or the Company ), after elimination of intercompany transactions and accounts. Investments in affiliated companies in which the Company s interests are generally between 20% and 50%, and where the Company does not control the financial and operating decisions, are accounted for using the equity method of accounting.

Hexcel is a leading producer of advanced structural materials. The Company develops, manufactures and markets lightweight, high-performance reinforcement products, composite materials and composite structures for use in commercial aerospace, space and defense, electronics, and industrial applications. The Company s materials are used in a wide variety of end products, such as commercial and military aircraft, space launch vehicles and satellites, printed wiring boards, computers, cellular telephones, soft body armor, high-speed trains and ferries, cars and trucks, wind turbine blades, reinforcements for bridges and other structures, window blinds, skis, snowboards and other recreational equipment.

The Company serves international markets through manufacturing facilities and sales offices located in the United States and Europe, and through sales offices located in Asia, Australia and South America. The Company is also an investor in six joint ventures; three of which manufacture and market reinforcement products in Europe, Asia and the United States; one manufactures and markets composite materials in Japan; and two manufacture composite structures in Asia.

As discussed in Note 22, Hexcel sold its Bellingham aircraft interiors business on April 26, 2000. As a result of this transaction, the statements of operations, of stockholders equity (deficit) and comprehensive income (loss), and of cash flows include the financial position, results of operations and cash flows of the Bellingham aircraft interiors business as of such dates and for such periods that the business was owned.

*Use of Estimates*

The preparation of the consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Estimates are used for, but not limited to, allowances for doubtful accounts, inventory allowances, product warranty, depreciation and amortization, business consolidation and restructuring costs, impairment of long-lived assets, employee benefits, taxes, and contingencies. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. These investments consist primarily of Eurodollar time deposits and are stated at cost, which approximates fair value.

*Inventories*

Inventories are valued at the lower of cost or market, with cost determined using the first-in, first-out and average cost methods. The Company provides allowances for obsolete and unmarketable inventory. As of December 31, 2002 and 2001, inventory allowances were \$21.3 million and \$25.1 million, respectively.

*Property, Plant and Equipment*

Property, plant and equipment are recorded at cost and depreciated over estimated useful lives using accelerated and straight-line methods. The estimated useful lives range from 10 to 40 years for buildings and improvements and from 3 to 20 years for machinery and equipment. Repairs and

maintenance are expensed as incurred, while major replacements and betterments are capitalized and depreciated over the estimated life of the related asset.

#### *Goodwill and Other Purchased Intangibles*

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets of an acquired business. Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No.142, Goodwill and Other Intangible Assets, ( FAS 142 ). Prior to adopting FAS 142, goodwill was amortized on a straight-line basis over estimated economic lives, ranging from 15 to 40 years. As a result of adopting FAS 142, goodwill is no longer amortized, but instead is tested for impairment at the reporting unit level at least annually and whenever events or changes in circumstances indicate that goodwill might be impaired. A reporting unit is the lowest level of an entity that is a business and can be distinguished from other activities, operations, and assets of the entity. If, during the annual impairment review, the book value of the reporting unit exceeds the fair value, the implied fair value of the reporting unit's goodwill is compared with the carrying amount of the unit's goodwill. If the carrying amount exceeds the implied fair value, goodwill is written down to its implied value. FAS 142 requires management to estimate the fair value of each reporting unit, as well as the fair value of the assets and liabilities of each reporting unit, other than goodwill. The implied fair value of goodwill is determined as the difference between the fair value of a reporting unit, taken as a whole, and the fair value of the assets and liabilities of such reporting unit. No impact to the Company's consolidated financial statements was identified upon completion of the transitional impairment test required by FAS 142. The Company's annual impairment testing date will be during the fourth quarter of each year. In 2001, the Company recognized an impairment charge of \$309.1 million on goodwill and other purchased intangibles acquired through previous acquisitions (see Note 3).

#### *Impairment of Long-Lived Assets*

Other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the assets from the estimated undiscounted future net cash flows, before interest and taxes, of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires estimates of these cash flows and fair value. The calculation of fair value may be determined based either on discounted cash flows or third party appraised values depending on the nature of the asset.

#### *Investments*

The Company has investments in affiliated companies with equity interests ranging from 25% to 50%. Hexcel does not control the financial and operating decisions of these companies and, therefore, accounts for its share of their operating performance using the equity method of accounting. Future adverse changes in market conditions or poor operating results of the underlying investments could result in losses and the inability to recover the carrying value of the investments, thereby possibly requiring an impairment charge. The Company reviews its investments for impairment whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. The Company records an investment impairment charge when the decline in value is considered to be other than temporary. The Company recorded an impairment of \$4.0 million in 2002 and \$7.8 million in 2001, relating to its investments in Asahi-Schwebel Co. Ltd. and Interglas Technologies AG, respectively (see Note 7).

*Debt Financing Costs*

Debt financing costs are deferred and amortized to interest expense over the life of the related debt, which ranges from 7 to 10 years. At December 31, 2002 and 2001, deferred debt financing costs were \$11.7 million and \$15.5 million, net of accumulated amortization of \$14.5 million and \$10.7 million, respectively, and are included in other assets in the consolidated balance sheets.

*Stock-Based Compensation*

Stock-based compensation is accounted for under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ). Accordingly, compensation expense is not recognized when options are granted at the fair market value on the date of grant. However, the Company does recognize compensation expense for restricted stock and similar stock-based plans over the defined vesting periods. As of December 31, 2002, the Company had several on-going stock-based compensation plans, including stock options, restricted stock and various forms of restricted stock unit awards, which are described further in Note 13.

The Company has elected to continue following APB 25 to account for its stock-based compensation plans. The effects on net income (loss) and net income (loss) per share as if the Company had applied the fair value method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( FAS 123 ) for the years ended December 31, 2002, 2001 and 2000 are as follows:

| (in millions, except per share data)  | 2002      | 2001       | 2000    |
|---|-----------|------------|---------|
| <b>Net income (loss):</b>   |           |            |         |
| Net income (loss), as reported  | \$ (13.6) | \$ (433.7) | \$ 54.2 |
| <i>Add:</i> Stock-based compensation expense included in reported net income, net of tax                            | 0.8       | 2.0        | 4.5     |
| <i>Deduct:</i> Stock-based compensation expense determined under fair value based method for all awards, net of tax | (6.0)     | (5.9)      | (9.8)   |
| Pro forma net income (loss)   | \$ (18.8) | \$ (437.6) | \$ 48.9 |
| <b>Net income (loss) per share:</b>   |           |            |         |
| Basic net income (loss) per share:  |           |            |         |
| As reported   | \$ (0.35) | \$ (11.54) | \$ 1.47 |
| Pro forma   | \$ (0.49) | \$ (11.64) | \$ 1.33 |
| Diluted net income (loss) per share:  |           |            |         |
| As reported   | \$ (0.35) | \$ (11.54) | \$ 1.32 |
| Pro forma   | \$ (0.49) | \$ (11.64) | \$ 1.21 |

*Currency Translation*

The assets and liabilities of international subsidiaries are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. Cumulative currency translation adjustments are included in accumulated other comprehensive loss in the stockholders equity section of the consolidated balance sheets. Realized gains and losses from currency exchange transactions are recorded in selling, general and administrative expenses in the consolidated statements of operations and were not material to Hexcel's consolidated results of operations in 2002, 2001 or 2000.



*Revenue Recognition*

Product sales are recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured, which is generally at the time of shipment. Revenues derived from design, installation and support services are recognized when the service is provided, or alternatively, when the product to which the service relates is delivered to the customer. The Company accrues for sales returns and allowances based on its historical experience at the time of sale.

*Product Warranty*

The Company provides for an estimated amount of product warranty at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience.

### *Shipping and Handling Costs*

The Company recognizes shipping and handling costs as incurred as a component of cost of sales in the consolidated statements of operations. Shipping or handling costs billed to the customer for reimbursement purposes were not significant.

### *Research and Technology*

Research and technology costs are expensed as incurred.

### *Income Taxes*

The Company provides for income taxes using the liability approach prescribed by the Financial Accounting Standards Board ( FASB ) in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ( FAS 109 ). Under the liability approach, deferred income tax assets and liabilities reflect tax carryforwards and the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets require a valuation allowance when it is more likely than not that some portion of the deferred tax assets may not be realized. The realization of deferred tax assets is dependent upon the timing and magnitude of future taxable income prior to the expiration of the deferred tax assets attributes. When events and circumstances so dictate, the Company evaluates the realizability of its deferred tax assets and the need for a valuation allowance by forecasting future taxable income. In 2001, the Company established a full valuation allowance on its U.S. deferred tax assets. The amount of the deferred tax assets considered realizable, however, could change if estimates of future U.S. taxable income during the carry-forward period improve (see Note 12).

### *Concentration of Credit Risk*

Financial instruments that potentially subject Hexcel to significant concentrations of credit risk consist primarily of trade accounts receivable. The Company's sales to two customers and their related subcontractors accounted for approximately 37%, 39% and 33% of the Company's 2002, 2001 and 2000 net sales, respectively. The Company performs ongoing credit evaluations of its customers' financial condition but generally does not require collateral or other security to support customer receivables. The Company establishes an allowance for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends and other financial information. As of December 31, 2002 and 2001, the allowance for doubtful accounts was \$5.1 million and \$8.5 million, respectively. Bad debt expense was a net credit of \$(0.9) million in 2002, \$3.4 million in 2001 and \$0.7 million in 2000.

### *Derivative Financial Instruments*

Hexcel uses various financial instruments, including foreign currency forward exchange contracts and interest rate cap agreements, to manage its risk to market fluctuations by generating cash flows that offset, in relation to their amount and timing, the cash flows of certain foreign currency

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denominated transactions or underlying debt instruments. The Company designates its foreign currency forward exchange contracts as cash flow hedges against forecasted foreign currency denominated transactions and reports the effective portions of changes in fair value of the instruments in other comprehensive income until the underlying hedged transactions affect income. The Company designates its interest rate cap agreements as cash flow hedges against specific debt instruments and recognizes interest differentials as adjustments to interest expense as the differentials may occur. The most recent effective interest rate cap agreement expired on October 29, 2002. The Company does not use financial instruments for trading or speculative purposes.

Effective January 1, 2001, Hexcel adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( FAS 133 ), and its corresponding amendments under Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, ( FAS 138 ). FAS 133 requires an entity to recognize all derivatives as either assets or liabilities on its balance sheet and measure those instruments at fair value. Gains or losses resulting from changes in the fair values of those derivatives are accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The adoption of FAS 133 and FAS 138 did not have a material effect on the Company's consolidated financial position or results of operations (see Note 15).

*Self-insurance*

Hexcel is self-insured up to specific levels for certain liabilities. Accruals are established based on actuarial assumptions and historical claim experience, and include estimated amounts for incurred but not reported claims. Effective January 1, 2002, Hexcel expanded its self-insured medical program to cover the majority of U.S. non-union employees, in order to more effectively manage its medical costs. The program includes stop loss insurance, which caps Hexcel's risk at \$250,000 per individual per annum. By its nature, as compared to traditional insurance plans, self-insured medical coverage may increase the monthly volatility in cash flows of the Company.

*Recently Issued Accounting Standards*

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections (FAS 145). Among other matters, FAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, which required all gains and losses from extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in Accounting Principles Board Opinion 30 will now be used to classify those gains and losses. The Company adopted FAS 145 as of January 1, 2002. As a result, a \$2.7 million extraordinary loss on early retirement of debt recorded in 2001 was reclassified as a separate line item below operating income in the consolidated statements of operations (see Note 8).

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (FAS 146). FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured, initially at fair value, only when the liability is incurred; therefore, nullifying Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3) that required a liability for an exit cost to be recognized at the date of an entity's commitment to an exit plan. This change in accounting would be expected to result in a delayed recognition of certain types of costs, especially facility closure costs. The provisions of FAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. Since FAS 146 is effective only for new exit or disposal activities, adoption of this standard will not affect amounts currently reported in the Company's consolidated financial statements. However, the adoption of FAS 146 could affect the types and timing of costs included in any future business consolidation and restructuring programs. The Company adopted FAS 146 as of January 1, 2003.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, (FAS 148). FAS 148 amends FAS 123 and Accounting Principles Board Opinion No. 28, Interim Financial Reporting to present alternative methods of transition for an entity that voluntarily adopts the fair value based method of accounting for stock-based employee compensation, and provides modifications to the disclosure provisions to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation in quarterly and annual financial statements. At this time, the Company has not voluntarily adopted the fair value method of accounting under FAS 123. However, appropriate disclosures about the effects on reported net income of the Company's accounting policy with respect to stock-based employee compensation are provided above.

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In November 2002, the FASB issued Financial Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, (FIN 45). FIN 45 requires a guarantor to disclose (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor's obligations under the guarantee; and (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a

guarantee, a liability at fair value for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. As the disclosure requirements in FIN 45 are effective for financial statements with periods ending after December 15, 2002, the Company has included the new disclosures herein.

FIN 45 also addresses the disclosure requirements regarding product warranties. Instead of disclosing the maximum potential amount of future payments under the product warranty guarantee, a guarantor is required to disclose its accounting policy and methodology used in determining its liability for product warranties, as well as, a tabular reconciliation of the changes in the guarantor's product warranty liability for the reporting period (see Note 16).

#### *Reclassifications*

Certain prior year amounts in the accompanying consolidated financial statements and related notes have been reclassified to conform to the 2002 presentation.

#### **Note 2 Refinancing of Capital Structure**

On March 19, 2003, Hexcel successfully completed the refinancing of its capital structure through the simultaneous closings of three financing transactions: the completion of its previously announced sale of mandatorily redeemable convertible preferred stock for \$125.0 million, the issuance of \$125.0 million of 9-7/8% senior secured notes, due 2008, and the establishment of a new \$115.0 million senior secured credit facility, also due 2008.

The proceeds from the sale of the convertible preferred stock have been used to provide for the redemption of \$46.9 million principal amount of the Company's 7% convertible subordinated notes, due 2003, and to repay outstanding borrowings under the existing senior credit facility. Proceeds to be used to redeem the 7% convertible subordinated notes have been remitted to US Bank Trust, trustee for the notes, for the express purpose of retiring the outstanding principal balance of the notes, plus accrued interest.

The remaining advances under the existing senior credit facility, after the application of a portion of the equity proceeds, have been repaid with the proceeds from the issuance of the Company's new 9-7/8% senior secured notes and a new senior secured credit facility.

#### *Mandatorily Redeemable Convertible Preferred Stock*

On March 19, 2003, Hexcel issued 125,000 shares of a series A convertible preferred stock and 125,000 shares of a series B convertible preferred stock for \$125.0 million in cash. Upon issuance, the total number of Hexcel's outstanding common shares including potential shares issuable upon conversion of both of the new series of convertible preferred stocks increased from approximately 38.6 million shares to approximately 88.4 million shares. In addition, common shares authorized for issuance increased from 100.0 million shares to 200.0 million shares.

Hexcel issued 77,875 shares of series A convertible preferred stock and 77,875 shares of series B convertible preferred stock to affiliates of Berkshire Partners LLC and Greenbriar Equity Group LLC (the Berkshire/Greenbriar Investors) for a cash payment of approximately \$77.9 million. The series A and the series B convertible preferred stocks are mandatorily redeemable on January 22, 2010 for cash or for common stock at the Company's election. Both preferred stocks are convertible, at the option of the holder, into common stock at a conversion price of \$3.00 per share, and will automatically be converted into common stock if the closing trading price of the common stock for any period of 60 consecutive trading days ending after March 19, 2006 exceeds \$9.00 per share. The preferred stockholders are entitled to vote on an as converted basis with Hexcel's common stockholders. The series A preferred stock accrues dividends at a rate of 6% per annum following the third anniversary of the issuance. Dividends may be paid in cash or added to the accrued value of the preferred stock, at Hexcel's option. The series B preferred stock does not accrue dividends.

Hexcel has separately issued 47,125 shares of series A convertible preferred stock and 47,125 shares of series B convertible preferred stock to investment funds controlled by affiliates of The Goldman Sachs Group, Inc. (the Goldman Sachs Investors ) for a cash payment of approximately \$47.1 million.

In conjunction with the aforementioned transactions, Hexcel and the Berkshire/Greenbriar Investors entered into a stockholders agreement, which gives the Berkshire/Greenbriar Investors the right to nominate up to two directors (of a total of ten) to Hexcel's board of directors and certain other rights. The Goldman Sachs Investors will continue to have the right to nominate up to three directors under the governance agreement entered into at the time of their investment in Hexcel in 2000. The stockholders agreement and the amended Goldman Sachs Investors governance agreement require that the approval of at least six directors, including at least two directors not nominated by the Berkshire/Greenbriar Investors or the Goldman Sachs Investors, be obtained for board actions generally. The stockholders agreement also prohibits the purchase of voting securities in excess of 39.5% of Hexcel's outstanding voting securities unless approved by Hexcel's board. The Berkshire/Greenbriar Investors and the Goldman Sachs Investors have agreed to an 18-month lock up on the securities being issued, except for certain registered offerings.

*Senior Secured Notes, due 2008*



The Company also issued, through a private placement under Rule 144A, \$125.0 million of 9-7/8% senior secured notes at a price of 98.95% of face value. The senior secured notes, due October 1, 2008, are secured by a first priority security interest in substantially all of Hexcel's and its domestic subsidiaries' property, plant and equipment, intangibles, intercompany notes and other obligations receivable, and 100% of the outstanding voting stock of certain of Hexcel's domestic subsidiaries. In addition, the senior secured notes are secured by a pledge of 65% of the stock of Hexcel's French and UK first-tier holding companies. This pledge of foreign stock is on an equal basis with a substantially identical pledge of such stock given to secure the obligations under the Company's new senior secured credit facility, described below. The senior secured notes are also guaranteed by Hexcel's material domestic subsidiaries. Hexcel has the ability to incur additional debt that would be secured on an equal basis by the collateral securing the senior secured notes. The amount of additional secured debt that may be incurred is currently limited to \$10.0 million, but may increase over time based on a formula relating to the total net book value of Hexcel's domestic property, plant and equipment.

The Company will pay interest on the notes on April 1<sup>st</sup> and October 1<sup>st</sup> of each year. The first payment will be made on October 1, 2003. The Company will have the option to redeem all or a portion of the notes at any time during the one-year period beginning April 1, 2006 at 104.938% of principal plus accrued and unpaid interest. This percentage decreases to 102.469% for the one-year period beginning April 1, 2007, and to 100.0% for the period beginning April 1, 2008. In addition, the Company may use the net proceeds from one or more equity offerings at any time prior to April 1, 2006 to redeem up to 35% of the aggregate principal amount of the notes at 109.875% of the principal amount, plus accrued and unpaid interest.

The indenture governing the senior secured notes contains many other terms and conditions, including limitations with respect to asset sales, incurrence of debt, granting of liens, the making of restricted payments and entering into transactions with affiliates.

Hexcel has agreed, under a registration rights agreement, to offer to all noteholders the opportunity to exchange their notes for new notes that are substantially identical to the existing notes except that the new notes will be registered with the Securities and Exchange Commission (SEC) and will not have any restrictions on transfer. In the event that Hexcel cannot affect such an exchange, Hexcel will be required to file a shelf registration statement with the SEC to permit the noteholders to resell their notes generally without restriction.

An affiliate of Goldman Sachs Investors, a related party, performed underwriting services in connection with the Company's private placement offering of senior secured notes, and received \$2.3 million for such services rendered.

*Senior Secured Credit Facility*

Also on March 19, 2003, Hexcel entered into a \$115.0 million asset-backed senior secured credit facility with a new syndicate of lenders led by Fleet Capital Corporation as agent. The credit facility matures on March 31, 2008. Borrowers under the credit facility include, in addition to Hexcel Corporation, Hexcel's operating subsidiaries in the UK, Austria and Germany. The credit facility provides for borrowings of U.S. dollars, Pound Sterling and Euro currencies, including the issuance of letters of credit, with the amount available to each borrower dependent on the borrowing base of that borrower and its subsidiaries. For Hexcel Corporation and the UK borrower, the borrowing base is determined by an agreed percentage of eligible accounts receivable and eligible inventory, subject to certain reserves. The borrowing base of each of the Austrian and German borrowers is based on an agreed percentage of eligible accounts receivable, subject to certain reserves. In addition, the UK, Austrian and German borrowers have facility sublimits of \$12.5 million, \$7.5 million and \$5.0 million, respectively. Borrowings under the new facility bear interest at a floating rate based on either the agent's defined prime rate plus a margin that can vary from 0.75% to 3.25% or LIBOR plus a margin that can vary from 2.25% to 3.25%. The margin in effect for a borrowing at any given time depends on the Company's fixed charge ratio and the currency denomination of such borrowing. The credit facility also provides for the payment of customary fees and expenses.

All obligations under the credit facility are secured by a first priority security interest in accounts receivable, inventory and cash and cash equivalents of Hexcel Corporation and its material domestic subsidiaries. In addition, all obligations under the credit facility are secured by a pledge of 65% of the stock of Hexcel's French and UK first-tier holding companies. This pledge of foreign stock is on an equal basis with a substantially identical pledge of such stock given to secure the obligations under the senior secured notes. The obligations of the UK borrower are secured by the accounts receivable, inventory, and cash and cash equivalents of the UK borrower. The obligations of the Austrian and German borrowers are secured by the accounts receivable of the Austrian and German borrowers, respectively.

Hexcel is required to maintain various financial ratios throughout the term of the credit facility. These financial covenants set maximum values for the Company's leverage (the ratios of total and senior debt to EBITDA), fixed charge coverage (the ratio of EBITDA, less capital expenditures and cash taxes, plus cash dividends, to the sum of cash interest and scheduled debt amortization), and capital expenditures (not to exceed specified annual expenditures). The credit facility also contains limitations on, among other things, incurring debt, granting liens, making investments, making restricted payments, entering into transactions with affiliates and prepaying subordinated debt. The credit facility also contains other customary terms relating to, among other things, representations and warranties, additional covenants and events of default.

On March 19, 2003, the Company borrowed \$13.0 million and issued letters of credit totaling approximately \$25.8 million under the new senior secured credit facility.

#### *Classification of Debt and Capital Lease Obligations as of December 31, 2002*

As of December 31, 2002, the Company had a scheduled debt obligation due August 1, 2003, which, if made, would cause the Company to violate one or more financial covenants in the Company's existing debt agreements. The Company also required an amendment of its existing senior credit facility before the end of the first quarter of 2003 to maintain compliance with the financial covenants under that facility. As the anticipated refinancing of the Company's capital structure was not completed as of February 28, 2003 (the 2002 financial statement issuance date) and the Company had not obtained an amendment of the aforementioned financial covenants, all debt and capital lease obligations had been classified as current at December 31, 2002.

As a result of the March 19, 2003 refinancing transactions, the uncertainties surrounding the Company's ability to meet its scheduled 2003 debt maturities and comply with its debt covenants have been mitigated. Management believes the Company will comply with the new debt covenants and has adequate liquidity available to finance operations beyond December 31, 2003. Also as a result of the refinancing transactions, substantially all of the Company's debt will be reclassified to long-term at March 31, 2003 reflecting the new scheduled debt maturities. Refer to Note 24, Subsequent Event Pro Forma Consolidated Balance Sheet (Unaudited).



**Note 3 - Goodwill and Other Purchased Intangibles**

Upon the Company's adoption of FAS 142 as of January 1, 2002, amortization of goodwill ceased. Although no amortization expense was recognized in 2002, the consolidated statements of operations include amortization expense of \$12.5 million in 2001 and \$13.1 million in 2000.

Net income (loss) and net income (loss) per share for the years ended December 31, 2002, 2001 and 2000, adjusted to exclude amortization expense, net of tax, are as follows:

| (in millions)                                | 2002      | 2001       | 2000    |
|--|-----------|------------|---------|
| <b>Net income (loss):</b>                    |           |            |         |
| Net income (loss)                            | \$ (13.6) | \$ (433.7) | \$ 54.2 |
| Goodwill amortization, net of tax            |           | 11.2       | 8.5     |
| Adjusted net income (loss)                   | \$ (13.6) | \$ (422.5) | \$ 62.7 |
| <b>Basic net income (loss) per share:</b>    |           |            |         |
| Net income (loss)                            | \$ (0.35) | \$ (11.54) | \$ 1.47 |
| Goodwill amortization, net of tax            |           | 0.30       | 0.23    |
| Adjusted basic net income (loss) per share   | \$ (0.35) | \$ (11.24) | \$ 1.70 |
| <b>Diluted net income (loss) per share:</b>  |           |            |         |
| Net income (loss)                            | \$ (0.35) | \$ (11.54) | \$ 1.32 |
| Goodwill amortization, net of tax            |           | 0.30       | 0.19    |
| Adjusted diluted net income (loss) per share | \$ (0.35) | \$ (11.24) | \$ 1.51 |

The gross carrying amount and accumulated amortization of goodwill, by the Company's reportable segments, as of December 31, 2002 and 2001, are as follows:

| (in millions)  | December 31, 2002           |                             |         | December 31, 2001           |                             |         |
|----------------|-----------------------------|-----------------------------|---------|-----------------------------|-----------------------------|---------|
|                | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net     | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net     |
| Reinforcements | \$ 69.9                     | \$ 29.8                     | \$ 40.1 | \$ 69.6                     | \$ 29.7                     | \$ 39.9 |
| Composites     | 31.1                        | 13.4                        | 17.7    | 27.9                        | 12.0                        | 15.9    |
| Structures     | 23.5                        | 6.9                         | 16.6    | 23.5                        | 6.9                         | 16.6    |
| Goodwill       | \$ 124.5                    | \$ 50.1                     | \$ 74.4 | \$ 121.0                    | \$ 48.6                     | \$ 72.4 |

Changes in the net carrying amount of goodwill for the years ended December 31, 2002, 2001 and 2000, by reportable segment, are as follows:

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| (in millions)  | Reinforcements | Composites     | Structures     | Total          |
|--|----------------|----------------|----------------|----------------|
| <b>Balance as of January 1, 2000</b>                     | \$ 350.3       | \$ 36.9        | \$ 24.0        | \$ 411.2       |
| Amortization of goodwill and other purchased intangibles | (9.1)          | (2.7)          | (1.3)          | (13.1)         |
| Sale of Bellingham aircraft interiors business           |                |                | (4.9)          | (4.9)          |
| Currency translation adjustment and other                |                | (1.5)          |                | (1.5)          |
| <b>Balance as of December 31, 2000</b>                   | \$ 341.2       | \$ 32.7        | \$ 17.8        | \$ 391.7       |
| Amortization of goodwill and other purchased intangibles | (9.1)          | (2.2)          | (1.2)          | (12.5)         |
| Impairment of goodwill and other purchased intangibles   | (292.1)        | (17.0)         |                | (309.1)        |
| Acquired goodwill  |                | 2.9            |                | 2.9            |
| Currency translation adjustment                          | (0.1)          | (0.5)          |                | (0.6)          |
| <b>Balance as of December 31, 2001</b>                   | \$ 39.9        | \$ 15.9        | \$ 16.6        | \$ 72.4        |
| Currency translation adjustment                          | <b>0.2</b>     | <b>1.8</b>     |                | <b>2.0</b>     |
| <b>Balance as of December 31, 2002</b>                   | \$ <b>40.1</b> | \$ <b>17.7</b> | \$ <b>16.6</b> | \$ <b>74.4</b> |

As of December 31, 2002 and 2001, other purchased intangibles had no carrying value.

*Impairment of Goodwill and Other Purchased Intangibles*

During the fourth quarter of 2001, the Company reviewed its long-lived assets under FASB Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, particularly goodwill and other

purchased intangibles acquired in recent years, for impairment. The review was undertaken in response to changes in market conditions and the Company's revised business outlook resulting from a sharp decline in demand for the Company's woven glass fabrics, primarily in the electronics market, and the announced reductions in commercial airline production following the tragic events of September 11, 2001. The Company also revised its forecasts of revenue growth for its acquired satellite business due to the continuing slow down in commercial satellite launches following the financial failure of a number of satellite based telecommunication projects and the postponement of others. These adverse changes in market conditions led to the lowering of revenue forecasts associated with certain businesses in the Reinforcements and Composites segments.

Based on this review, the Company determined that the long-lived assets, including goodwill, of the fabrics business acquired from Clark-Schwebel in 1998 and the satellite business acquired from Fiberite in 1997 were not fully recoverable. The Company recorded non-cash impairment charges of \$292.1 million and \$17.0 million related to the goodwill and other purchased intangibles associated with the Clark-Schwebel and Fiberite acquisitions, respectively. The amounts of the impairment charges were calculated as the excess of the carrying value of the assets over their fair values. Fair values were determined using discounted future cash flow models, market valuations and third party appraisals, where appropriate. There were no tax benefits recognized on the impairments because of limitations on the Company's ability to realize the tax benefits.

#### Note 4 - Business Consolidation and Restructuring Programs

The aggregate business consolidation and restructuring activities for the three years ended December 31, 2002, consisted of the following:

| (in millions)   | Employee<br>Severance | Facility &<br>Equipment | Total   |
|---|-----------------------|-------------------------|---------|
| <b>Balance as of January 1, 2000</b>                  | \$ 3.5                | \$ 0.6                  | \$ 4.1  |
| Business consolidation expenses:                      |                       |                         |         |
| Current period expenses                               | 3.7                   | 10.6                    | 14.3    |
| Reversal of 1999 business consolidation expenses      | (0.3)                 | (3.1)                   | (3.4)   |
| Net business consolidation expenses                   | 3.4                   | 7.5                     | 10.9    |
| Cash expenditures                                     | (3.9)                 | (7.9)                   | (11.8)  |
| Non-cash items:                                       |                       |                         |         |
| Reversal of 1999 business consolidation expenses      |                       | 3.1                     | 3.1     |
| Non-cash usage, including asset write-downs           | (0.6)                 | (3.0)                   | (3.6)   |
| Total non-cash items                                  | (0.6)                 | 0.1                     | (0.5)   |
| <b>Balance as of December 31, 2000</b>                | \$ 2.4                | \$ 0.3                  | \$ 2.7  |
| Business consolidation and restructuring expenses     | 34.5                  | 23.9                    | 58.4    |
| Cash expenditures                                     | (6.4)                 | (5.6)                   | (12.0)  |
| Non-cash usage, including asset write-downs           |                       | (15.7)                  | (15.7)  |
| <b>Balance as of December 31, 2001</b>                | \$ 30.5               | \$ 2.9                  | \$ 33.4 |
| Business consolidation and restructuring expenses     |                       |                         |         |
| Current period expenses                               |                       | 2.8                     | 2.8     |
| Reversal of 1999 business consolidation expenses      |                       | (0.5)                   | (0.5)   |
| Change in estimated expenses                          | (2.9)                 | 1.1                     | (1.8)   |
| Net business consolidation and restructuring expenses | (2.9)                 | 3.4                     | 0.5     |
| Cash expenditures                                     | (20.5)                | (3.8)                   | (24.3)  |
| Currency translation adjustment                       | 0.9                   |                         | 0.9     |



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|  |           |            |           |              |                |
|--|-----------|------------|-----------|--------------|----------------|
| Non-cash items:                                  |           |            |           |              |                |
| Reversal of 1999 business consolidation expenses |           |            |           | <b>0.5</b>   | <b>0.5</b>     |
| Non-cash usage, including asset write-downs      |           |            |           | <b>(0.5)</b> | <b>(0.5)</b>   |
| Total non-cash items                             |           |            |           |              |                |
| <b>Balance as of December 31, 2002</b>           | <b>\$</b> | <b>8.0</b> | <b>\$</b> | <b>2.5</b>   | <b>\$ 10.5</b> |

*November 2001 Program*

In November 2001, the Company announced a program to restructure its business operations in accordance with a revised business outlook for build rate reductions in commercial aircraft production, the continued depressed business conditions in the electronics market and the weakness in the general economy. The program targeted a 20% reduction in cash fixed costs, or \$60.0 million, compared to previous spending rates and included company-wide reductions in managerial,

professional, indirect manufacturing and administrative employees along with organizational rationalization. In connection with the program, the Company recognized charges of \$47.9 million in the fourth quarter of 2001. During 2002, the Company continued the implementation of this program in 2002, reducing its workforce, since announcement, by approximately 25% to 4,245 employees.

In 2002, the Company recognized a net change in estimated business consolidation and restructuring expenses related to this program of \$0.7 million. This resulted from a \$1.8 million reduction of previously accrued liabilities as employee severance and other benefit costs were lower than previously expected, offset in part, by a \$1.1 million increase in restructuring liabilities for facility lease termination costs. An additional \$1.2 million was expensed as incurred in 2002.

Business consolidation and restructuring activities for this program consisted of the following:

| (in millions)   | Employee<br>Severance | Facility &<br>Equipment | Total   |
|---|-----------------------|-------------------------|---------|
| <b>Balance as of December 31, 2000</b>                | \$                    | \$                      | \$      |
| Business consolidation and restructuring expenses     | 30.8                  | 17.1                    | 47.9    |
| Cash expenditures                                     | (3.2)                 |                         | (3.2)   |
| Non-cash usage, including asset write-downs           |                       | (14.3)                  | (14.3)  |
| <b>Balance as of December 31, 2001</b>                | \$ 27.6               | \$ 2.8                  | \$ 30.4 |
| Business consolidation and restructuring expenses     |                       |                         |         |
| Current period expenses                               |                       | 1.2                     | 1.2     |
| Change in estimated expenses                          | (1.8)                 | 1.1                     | (0.7)   |
| Net business consolidation and restructuring expenses | (1.8)                 | 2.3                     | 0.5     |
| Cash expenditures                                     | (18.9)                | (2.1)                   | (21.0)  |
| Non-cash usage, including asset write-downs           |                       | (0.5)                   | (0.5)   |
| Currency translation adjustment                       | 0.9                   |                         | 0.9     |
| <b>Balance as of December 31, 2002</b>                | \$ 7.8                | \$ 2.5                  | \$ 10.3 |

*July 2001 Program*

As a result of the weakness in the electronics market, the Company initiated cost reduction actions in July 2001. These actions incorporated steps to furlough employees, idle manufacturing facilities and cut non-essential expenditures, by effecting a reduction in the work force of approximately 275 employees primarily in the Reinforcements and Composites business segments. In connection with the program, the Company recognized a charge of \$3.9 million in 2001. During 2002, the Company reviewed its remaining liability under the program and recognized a change in estimated business consolidation and restructuring expenses of \$0.6 million, as employee severance and other benefit costs were lower than previously expected.

Business consolidation and restructuring activities for this program consisted of the following:

| (in millions)                                     | Employee<br>Severance | Facility &<br>Equipment | Total        |
|---|-----------------------|-------------------------|--------------|
| <b>Balance as of December 31, 2000</b>            | \$                    | \$                      | \$           |
| Business consolidation and restructuring expenses |                       | 3.6                     | 0.3          |
| Cash expenditures                                 |                       | (2.1)                   | (0.2)        |
| <b>Balance as of December 31, 2001</b>            | \$                    | 1.5                     | \$ 0.1       |
| Change in estimated expenses                      |                       | <b>(0.6)</b>            | <b>(0.6)</b> |
| Cash expenditures                                 |                       | <b>(0.9)</b>            | <b>(0.1)</b> |
| <b>Balance as of December 31, 2002</b>            | \$                    | \$                      | \$           |

*December 1998 and September 1999 Programs*

As a result of several substantial business acquisitions, the Company initiated business consolidation programs in December 1998 and September 1999. The primary purpose of these programs was to integrate acquired assets and operations into the Company, and to close or restructure insufficiently profitable facilities and activities. Due to aerospace industry requirements to qualify specific equipment and manufacturing processes for certain products, some business consolidation actions have taken up to three years to complete. These qualification requirements increase the complexity, cost and time of moving equipment and rationalizing manufacturing activities. In connection with these business consolidation programs, the Company closed three

manufacturing facilities, vacated approximately 560 thousand square feet of manufacturing space, and eliminated more than 700 manufacturing, marketing and administrative positions.

In 2000, the Company added two further actions to the September 1999 business consolidation program. The Company decided to close the two smaller of its four U.S. prepreg manufacturing facilities one in Lancaster, Ohio and another in Gilbert, Arizona. The Gilbert, Arizona facility was closed in 2001 and the closure of the Lancaster, Ohio facility was completed in 2002. The manufacturing output from these two plants is now being produced by the two remaining U.S. prepreg facilities in Livermore, California and Salt Lake City, Utah. In connection with the program, including the program revisions, the Company recognized a charge of \$14.3 million in 2000.

In addition, during 2000, Hexcel amended its September 1999 business consolidation program in response to the manufacturing constraints caused by a stronger than expected increase in sales and production for its electronic woven glass fabrics and its ballistic protection products. Based on these improved market conditions and a manufacturing capacity review, the Company decided to expand its capacity by purchasing additional looms and revising the previous decision to consolidate a number of weaving activities at two of the Company's facilities. As a result of the decision not to proceed to consolidate production, the Company reversed a total of \$3.4 million of business consolidation expenses that were previously recognized in 1999, including \$3.1 million in non-cash write-downs of machinery and equipment that was to have been sold or scrapped as a result of the consolidation.

In 2002, the Company recognized a change in estimated business consolidation expenses related to this program of \$0.5 million, as actual employee severance was lower than previously expected. Business consolidation expenses for equipment relocation and re-qualification costs, expensed as incurred, were \$1.6 million and \$6.5 million in 2002 and 2001, respectively. Equipment relocation and re-qualification costs primarily related to the planned closure of the Lancaster, Ohio and Gilbert, Arizona prepreg manufacturing facilities. In addition, the Company recognized a benefit on the sale of a previously idled Cleveland, Georgia facility of \$0.5 million by reversing expenses previously accrued in 1999.

Business consolidation activities for the December 1998 and September 1999 programs consisted of the following:

| (in millions)                                    | Employee<br>Severance | Facility &<br>Equipment | Total         |
|--|-----------------------|-------------------------|---------------|
| <b>Balance as of January 1, 2000 (a)</b>         | \$ 3.5                | \$ 0.6                  | \$ 4.1        |
| Business consolidation expenses:                 |                       |                         |               |
| Current period expenses                          | 3.7                   | 10.6                    | 14.3          |
| Reversal of 1999 business consolidation expenses | (0.3)                 | (3.1)                   | (3.4)         |
| Net business consolidation expenses              | 3.4                   | 7.5                     | 10.9          |
| Cash expenditures                                | (3.9)                 | (7.9)                   | (11.8)        |
| Non-cash items:                                  |                       |                         |               |
| Reversal of 1999 business consolidation expenses |                       | 3.1                     | 3.1           |
| Non-cash usage, including asset write-downs      | (0.6)                 | (3.0)                   | (3.6)         |
| Total non-cash items                             | (0.6)                 | 0.1                     | (0.5)         |
| <b>Balance as of December 31, 2000</b>           | <b>\$ 2.4</b>         | <b>\$ 0.3</b>           | <b>\$ 2.7</b> |
| Business consolidation expenses                  | 0.1                   | 6.5                     | 6.6           |
| Cash expenditures                                | (1.1)                 | (5.4)                   | (6.5)         |
| Non-cash usage, including asset write-downs      |                       | (1.4)                   | (1.4)         |

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|   |    |              |    |              |              |
|---|----|--------------|----|--------------|--------------|
| <b>Balance as of December 31, 2001</b>                    | \$ | 1.4          | \$ | \$           | 1.4          |
| Business consolidation expenses                           |    |              |    |              |              |
| Current period expenses                                   |    |              |    | <b>1.6</b>   | <b>1.6</b>   |
| Reversal of 1999 business consolidation expenses          |    |              |    | <b>(0.5)</b> | <b>(0.5)</b> |
| Change in estimated expenses                              |    | <b>(0.5)</b> |    |              | <b>(0.5)</b> |
| Net business consolidation expenses                       |    | <b>(0.5)</b> |    | <b>1.1</b>   | <b>0.6</b>   |
| Cash expenditures   |    | <b>(0.7)</b> |    | <b>(1.6)</b> | <b>(2.3)</b> |
| Non-cash reversal of 1999 business consolidation expenses |    |              |    | <b>0.5</b>   | <b>0.5</b>   |
| <b>Balance as of December 31, 2002</b>                    | \$ | <b>0.2</b>   | \$ | \$           | <b>0.2</b>   |

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(a) The December 1998 program had an accrued liability balance of \$1.0 million for employee severance at January 1, 2000, which was utilized during 2000.

As of December 31, 2002, the December 1998, September 1999 and July 2001 programs have been essentially completed, while the November 2001 program will be substantially completed in 2003. Management will continue to closely monitor spending under the November 2001 program and evaluate opportunities that may exist for future actions, as the Company continues to right-size the business in response to existing conditions in the markets it serves.

#### Note 5 - Inventories

| (in millions)    | December 31, |          |
|------------------|--------------|----------|
|                  | 2002         | 2001     |
| Raw materials    | \$ 40.7      | \$ 59.1  |
| Work in progress | 37.6         | 35.2     |
| Finished goods   | 35.3         | 37.4     |
| Inventories      | \$ 113.6     | \$ 131.7 |

#### Note 6 Net Property, Plant and Equipment

| (in millions)                     | December 31, |          |
|-----------------------------------|--------------|----------|
|                                   | 2002         | 2001     |
| Land                              | \$ 21.1      | \$ 23.5  |
| Buildings                         | 140.2        | 132.7    |
| Equipment                         | 470.7        | 443.8    |
| Construction in Progress          | 10.8         | 17.0     |
| Property, plant and equipment     | 642.8        | 617.0    |
| Less accumulated depreciation     | (333.4)      | (287.8)  |
| Net property, plant and equipment | \$ 309.4     | \$ 329.2 |

#### Note 7 Investments in Affiliated Companies

In 1999, Hexcel, Boeing International Holdings, Ltd. and Aviation Industries of China (now known as China Aviation Industry Corporation I) formed a joint venture, BHA Aero Composite Parts Co., Ltd. ( BHA Aero ), to manufacture composite parts for secondary structures and interior applications for commercial aircraft. Hexcel has a 33.3% equity ownership interest in this joint venture, which is located in Tianjin, China. In addition, in 1999, Hexcel formed another joint venture, Asian Composites Manufacturing Sdn. Bhd. ( Asian Composites ), with Boeing Worldwide Operations Limited, Sime Link Sdn. Bhd., and Malaysia Helicopter Services Bhd. (now known as Naluri Berhadto), to manufacture composite parts for secondary structures for commercial aircraft. Hexcel has a 25% equity ownership interest in this joint venture, which is located in Alor Setar, Malaysia. Asian Composites began shipping composite structures to customers during the second half of 2001, while BHA Aero began deliveries in the first half of 2002. During 2000, Hexcel made cash equity investments totaling \$8.3 million in these two joint ventures. No additional cash equity investments were made during 2002 and 2001. As of December 31, 2002 and 2001, the Company had an outstanding letter of credit of \$11.1 million in support of a loan to BHA Aero (see Note 16).

The Company also has equity ownership interests in three joint ventures which manufacture reinforcement products: a 43.6% share in Interglas Technologies AG ( Interglas ), headquartered in Germany; a 33.3% share in Asahi-Schwebel Co., Ltd. ( Asahi-Schwebel ), headquartered in Japan, which in turn owns interests in two joint ventures in Taiwan a 50% interest in NITTOBO Asahi Glass and a 51% interest in Asahi-Schwebel Taiwan; and a 50% share in Clark-Schwebel Tech-Fab Company ( CS Tech-Fab ), headquartered in the United States. Interglas and Asahi-Schwebel are fiberglass fabric producers serving the European and Asian manufacturers of printed circuit board laminates and other reinforcement product applications. CS Tech-Fab manufactures non-woven reinforcement materials for roofing, construction, sail cloth and other specialty applications.

In 2002, the Company agreed with its Asian Electronics venture partner to restructure its minority interest in Asahi-Schwebel. Under the terms of the agreement, the Company reduced its ownership interest in the joint venture from 43.3% to 33.3% and received cash proceeds of \$10.0 million. The



agreement also included, among other matters, a put option in favor of the Company to sell and a call option in favor of the Company's joint venture partner to purchase the Company's remaining ownership interest in the joint venture for \$23.0 million. The options are simultaneously effective for a six-month period beginning July 1, 2003. Reflecting these terms, the Company wrote-down the carrying value of its remaining equity investment in this joint venture to its estimated fair market value of \$23.0 million, recording a non-cash impairment charge of \$4.0 million. There was no tax benefit recognized on the write-down.

In 2001, the Company wrote-down its investment in Interglas by \$7.8 million. The write-down was the result of an assessment that an other-than-temporary decline in value of the investment had occurred due to a severe industry downturn and the resulting impact on the financial condition of this company. The amount of the write-down was determined based on available market information and appropriate valuation methodologies. The Company did not record deferred tax benefits on the write-down because of limitations imposed by foreign tax laws and the Company's ability to realize the tax benefits.

Lastly, Hexcel owns a 45% equity interest in DIC-Hexcel Limited ( DHL ), a joint venture with Dainippon Ink and Chemicals, Inc. ( DIC ). This joint venture is located in Komatsu, Japan, and produces and sells prepregs, honeycomb and decorative laminates using technology licensed from Hexcel and DIC. Hexcel is contingently liable to pay DIC up to \$1.5 million with respect to DHL's debt under certain defined circumstances through January 31, 2004, unless renewed. This contingent liability will cease upon DHL's repayment of the underlying loan.

Summarized condensed combined financial information for these joint ventures as of December 31, 2002 and 2001 and for the three years ended December 31, 2002 is as follows:

| (in millions)                                       | December 31, |          |
|---|--------------|----------|
|   | 2002         | 2001     |
| <b>Summarized Condensed Combined Balance Sheets</b> |              |          |
| Current assets                                      | \$ 106.0     | \$ 132.0 |
| Noncurrent assets                                   | 209.7        | 213.3    |
| Total assets  | \$ 315.7     | \$ 345.3 |
| Current liabilities                                 | \$ 66.8      | \$ 52.0  |
| Noncurrent liabilities                              | 99.2         | 87.0     |
| Total liabilities                                   | 166.0        | 139.0    |
| Minority Interest                                   | 20.3         | 21.3     |
| Partners' equity                                    | 129.4        | 185.0    |
| Total liabilities and partners' equity              | \$ 315.7     | \$ 345.3 |

|   | For the Year Ended December 31, |          |          |
|---|---------------------------------|----------|----------|
|   | 2002                            | 2001     | 2000     |
| <b>Summarized Condensed Combined Statements of Operations</b> |                                 |          |          |
| Net sales   | \$ 232.7                        | \$ 276.5 | \$ 337.3 |
| Cost of sales   | 207.5                           | 204.5    | 250.2    |
| Gross profit  | 25.2                            | 72.0     | 87.1     |

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|                          |  |                  |  |                 |  |               |
|--------------------------|--|------------------|--|-----------------|--|---------------|
| Other costs and expenses |  | <b>78.6</b>      |  | 76.0            |  | 79.8          |
| Net income (loss)        |  | <b>\$ (53.4)</b> |  | <b>\$ (4.0)</b> |  | <b>\$ 7.3</b> |

**Note 8 - Notes Payable**

| (in millions)   | December 31, |          |
|---|--------------|----------|
|   | 2002         | 2001     |
| Senior Credit Facility  | \$ 179.7     | \$ 233.9 |
| European credit and overdraft facilities  | 0.2          | 3.5      |
| Senior subordinated notes, due 2009 (net of unamortized discount of \$1.2 and \$1.4 as of December 31, 2002 and 2001) | 338.8        | 338.6    |
| Convertible subordinated notes, due 2003  | 46.9         | 46.9     |
| Convertible subordinated debentures, due 2011   | 22.7         | 24.5     |
| Various notes payable   |              | 0.1      |
| Total notes payable   | 588.3        | 647.5    |
| Capital lease obligations   | 33.4         | 38.4     |
| Total notes payable and capital lease obligations   | \$ 621.7     | \$ 685.9 |
| Notes payable and current maturities of capital lease obligations   | \$ 621.7     | \$ 17.4  |
| Long-term notes payable and capital lease obligations, less current maturities  |              | 668.5    |
| Total notes payable and capital lease obligations   | \$ 621.7     | \$ 685.9 |

*Senior Credit Facility*

Hexcel had a global credit facility (the Senior Credit Facility) with a syndicate of banks to provide for ongoing working capital and other financing requirements. The Senior Credit Facility, which consisted of revolving credit, overdraft and term loan facilities, provided Hexcel with committed lines of approximately \$297.6 million as of December 31, 2002, subject to certain limitations. These commitments consisted of funded term loans of \$106.8 million, revolving credit and overdraft facilities of \$160.8 million, and letter of credit facilities of \$30.0 million. As of December 31, 2002, drawings under the revolving credit facility were \$72.9 million, leaving undrawn commitments under the facilities of \$87.9 million. As of December 31, 2002, letters of credit issued under the facility approximated \$24.2 million, of which \$11.1 million supports a loan to the Company's BHA Aero joint venture. The Company was subject to various financial covenants and restrictions under the Senior Credit Facility, including limitations on incurring debt, granting liens, selling assets, repaying subordinated indebtedness, redeeming capital stock and paying dividends. The Senior Credit Facility was scheduled to expire in 2004, except for approximately \$55.8 million of term loans that are due for repayment in 2005. The Senior Credit Facility was paid in full on March 19, 2003 (see Note 2).

Effective January 25, 2002, Hexcel entered into an amendment of the Senior Credit Facility. The amendment provided for revised financial covenants through 2002; a 100 basis point increase in the interest spread payable over LIBOR for advances under the facility; and an immediate decrease in the commitment of revolving credit and overdraft facilities from a cumulative amount of \$205.0 million to \$190.0 million, with a further reduction to \$182.0 million on or before September 30, 2002. The amendment also provided for a 25 basis point increase on January 1, 2003 if the Company did not reduce the commitment by a further \$25.0 million, prior to that date. The Senior Credit Facility financial covenants set certain maximum values for the Company's leverage (the ratios of total and senior debt to an Adjusted EBITDA), and certain minimum values for its interest coverage (the ratio of an Adjusted EBITDA to cash interest expense) and fixed charge coverage (the ratio of an Adjusted EBITDA less capital expenditures to the sum of certain fixed expenses). In addition, during the term of the amendment, all net proceeds generated through asset sales, and most other liquidity events, in each case to the extent in excess of \$2.5 million, and 100% of all net proceeds generated from litigation settlements and judgments, must be used to prepay loans under the Senior Credit Facility. Hexcel also agreed to limit capital expenditures to \$25.0 million during 2002, with a \$10.0 million limit during any quarter in 2002. At December 31, 2002, the Company was in compliance with the covenants, as amended, under its Senior Credit Facility.

In connection with the credit agreement amendment, Hexcel also agreed to grant additional collateral. The Company had previously granted a security interest in most of its U.S. accounts receivable, inventory, property, plant, equipment and real estate. It had also pledged some or all of the shares of certain subsidiaries. Under the terms of the amendment, Hexcel granted to the banks a security interest in additional U.S. accounts receivable, inventory, property, plant, equipment and real

estate, as well as its intellectual property. In addition, each of a group of Hexcel's European subsidiaries granted a security interest in its accounts receivable that secured certain local borrowings advanced to that subsidiary.

The Senior Credit Facility had been subject to several previous amendments to accommodate, among other things, the planned sale of assets, the planned investments in additional manufacturing capacity for selected products, the impact of the decline of the Company's operating results on certain financial covenants, the purchase by an investor group of approximately 14.5 million shares of Hexcel common stock held by a significant shareholder of the Company, a restructuring of the ownership of certain of the Company's European subsidiaries, the issuance of additional senior subordinated debt and the early redemption of certain term debt. In connection with the 2002 and previous amendments, included in interest expense in 2002 and 2001 are fees and expenses incurred of approximately \$1.8 million and \$1.0 million, respectively.

The January 25, 2002 amendment relaxed the 2002 quarterly financial covenants to accommodate the impact of the downturn in the commercial aerospace and electronics markets. Under the terms of the amendment, the financial covenants effective beginning with the quarter ending March 31, 2003 were to be those that applied before the amendment. As these market conditions experienced in 2002 are expected to continue during 2003, the Company needed to obtain a further amendment of the facility before the end of the first quarter of 2003 to accommodate its projected financial performance for that quarter and to be in compliance with the financial covenants as provided in the Senior Credit Facility agreement, or refinance the facility. The Company executed a refinancing of the facility on March 19, 2003 (see Note 2).

The weighted average interest rate on the Senior Credit Facility was 7.71%, 8.50% and 11.55% for the years ended December 31, 2002, 2001 and 2000, respectively. During the three years ended December 31, 2002, interest rates have been in the following ranges:

|                               | <b>In excess of the applicable<br/>London interbank rate</b> | <b>In excess of the base rate<br/>of the administrative<br/>agent for the lenders</b> |
|-------------------------------|--|---|
| January 2002 to December 2002 | 2.00% - 4.25%  | 1.25% - 3.25%   |
| May 2001 to January 2002      | 1.00% - 3.25%  | 0.25% - 2.25%   |
| March 2000 to May 2001        | 0.75% - 3.00%  | 0.00% - 2.00%   |
| Prior to March 2000           | 0.75% - 2.50%  | 0.00% - 1.50%   |

The Senior Credit Facility was subject to a commitment fee varying from approximately 0.20% to 0.50% per annum of the total facility.

At December 31, 2001, Hexcel had an interest rate cap agreement outstanding which covered a notional amount of \$50.0 million of the Senior Credit Facility, providing a maximum fixed rate of 5.50% on the applicable London interbank rate. The agreement expired on October 29, 2002 (see Note 15).

#### *European Credit and Overdraft Facilities*

In addition to the Senior Credit Facility, certain of Hexcel's European subsidiaries have access to limited credit and overdraft facilities provided by various local banks. These credit and overdraft facilities are primarily uncommitted facilities that are terminable at the discretion of the lenders. The interest rates on these credit and overdraft facilities for the three years ended December 31, 2002, ranged from 1.5% to 6.6%.



*Senior Subordinated Notes, due 2009*

On January 21, 1999, the Company issued \$240.0 million of 9.75% senior subordinated notes, due 2009. On June 29, 2001, the Company offered an additional \$100.0 million under the same indenture at a price of 98.5% of face value. The senior subordinated notes are general unsecured obligations of Hexcel.



Net proceeds from the subsequent offering were used to redeem \$67.5 million aggregate principal amount of the Company's outstanding 7% convertible subordinated notes, due 2003, and to pay the entire principal amount of \$25.0 million of the increasing rate senior subordinated note, due 2003. As a result of the redemption, the Company recognized a \$2.7 million loss on the early retirement debt. With the adoption of FAS 145 on January 1, 2002, the \$2.7 million extraordinary loss on early retirement of debt recorded in 2001 was reclassified as a separate line item below operating income in the consolidated statements of operations. There was no tax benefit recognized on the loss because of limitations on the Company's ability to realize the tax benefits.

*Convertible Subordinated Notes, due 2003*

The convertible subordinated notes carry an annual interest rate of 7.00% and are convertible into Hexcel common stock at any time on or before August 1, 2003, unless previously redeemed, at a conversion price of \$15.81 per share, subject to adjustment under certain conditions. The convertible subordinated notes are redeemable, in whole or in part, at the Company's option at any time, at various redemption prices set forth in the convertible notes indenture, plus accrued interest. On June 29, 2001, \$67.5 million aggregate principal amount of the convertible subordinated notes was redeemed.

*Convertible Subordinated Debentures, due 2011*

The convertible subordinated debentures carry an annual interest rate of 7.00% and are convertible into shares of Hexcel common stock prior to maturity, unless previously redeemed, at a conversion price of \$30.72 per share. Mandatory redemption of the convertible debentures was scheduled to begin in 2002 through annual sinking fund requirements of \$1.1 million in 2002 and \$1.8 million in each year thereafter. The Company satisfied the 2002 annual sinking fund requirement in 2001. In 2002, the Company recognized a \$0.5 million gain on the early retirement of debt, relating to the repurchase of \$1.8 million in satisfaction of the 2003 sinking fund requirement. The debt was repurchased at market prices, which resulted in a gain. In accordance with the requirements of FAS 145, the gain has been reported as a separate line item below operating income in the consolidated statements of operations.

*Increasing Rate Senior Subordinated Note, due 2003*

The increasing rate senior subordinated note, due 2003 was a general unsecured obligation payable to certain subsidiaries of Ciba Specialty Chemicals Holding, Inc. Effective February 1999, the interest rate on the note was 10.50% per annum, a rate which increased by 0.50% per annum each February thereafter until the repayment of principal. The average interest rate on the note was 11.42% in 2001 and 10.96% in 2000. The note was redeemed in full on June 29, 2001 with the proceeds of the \$100.0 million issuance of 9.75% senior subordinated notes, due 2009.

*Aggregate Maturities of Notes Payable*

The table below reflects aggregate scheduled maturities of notes payable, excluding capital lease obligations (see Note 9):

| <b>Payable during the years ending December 31:</b> | <b>(in millions)</b> |              |
|---|----------------------|--------------|
| 2003  | \$                   | 55.7         |
| 2004  |                      | 117.1        |
| 2005  |                      | 57.6         |
| 2006  |                      | 1.8          |
| 2007  |                      | 1.8          |
| Thereafter  |                      | 355.5        |
| <b>Total notes payable</b>                          | <b>\$</b>            | <b>589.5</b> |



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The aggregate maturities of notes payable in 2003 include European credit and overdraft facilities of \$0.2 million, which are repayable on demand. At December 31, 2002, the unamortized discount on the additional \$100.0 million senior subordinated notes, due 2009, issued on June 29, 2001, was \$1.2 million.

*Debt Classification as of December 31, 2002*

As described in Note 2, as the anticipated refinancing of the capital structure was not completed as of February 28, 2003 (the 2002 financial statement issuance date) and the Company had not obtained an amendment of the aforementioned financial covenants, all debt had been classified as current at December 31, 2002.

*Estimated Fair Values of Notes Payable*

The Senior Credit Facility and the various European credit facilities outstanding as of December 31, 2002 and 2001 are variable-rate debt obligations. Accordingly, the estimated fair values of each of these debt obligations approximate their respective book values. The approximate, aggregate fair values of the Company's other notes payable as of December 31, 2002 and 2001 were as follows:

| <b>(in millions)</b>                          | <b>2002</b> | <b>2001</b> |
|---|-------------|-------------|
| Senior subordinated notes, due 2009           | \$ 295.8    | \$ 190.4    |
| Convertible subordinated notes, due 2003      | 46.2        | 27.0        |
| Convertible subordinated debentures, due 2011 | 13.6        | 15.5        |

The aggregate fair values of the above notes payable were estimated on the basis of quoted market prices; however, trading in these securities is limited and may not reflect actual fair value.

**Note 9 - Leasing Arrangements**

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Assets, accumulated depreciation, and related liability balances under capital leasing arrangements, as of December 31, 2002 and 2001, were:

| (in millions)                            | 2002    | 2001    |
|--|---------|---------|
| Property, plant and equipment            | \$ 55.3 | \$ 61.1 |
| Less accumulated depreciation            | (31.4)  | (26.3)  |
| Net property, plant and equipment        | \$ 23.9 | \$ 34.8 |
| Capital lease obligations                | \$ 33.4 | \$ 38.4 |
| Less current maturities                  | (6.2)   | (5.6)   |
| Long-term capital lease obligations, net | \$ 27.2 | \$ 32.8 |

Certain sales and administrative offices, data processing equipment and manufacturing facilities are leased under operating leases. Rental expense under operating leases was \$3.8 million in 2002, \$5.4 million in 2001, and \$7.0 million in 2000.

Scheduled future minimum lease payments as of December 31, 2002 were:

| (in millions)  | Type of Lease |           |
|--|---------------|-----------|
|  | Capital       | Operating |
| Payable during years ending December 31:               |               |           |
| 2003   | \$ 8.7        | \$ 2.9    |
| 2004   | 8.7           | 2.5       |
| 2005   | 8.5           | 2.6       |
| 2006   | 11.4          | 1.7       |
| 2007   | 0.5           | 0.7       |
| Thereafter   | 3.4           | 2.0       |
| Total minimum lease payments                           | \$ 41.2       | \$ 12.4   |
| Less amounts representing interest                     | 7.8           |           |
| Present value of future minimum capital lease payments | 33.4          |           |
| Less current obligations under capital leases          | 6.2           |           |
| Long-term obligations under capital lease              | \$ 27.2       |           |

*Classification as of December 31, 2002*

As described in Note 2, the anticipated refinancing of the capital structure was not completed as of February 28, 2003 (the 2002 financial statement issuance date) and the Company has not obtained an amendment of the aforementioned financial covenants; therefore, all capital lease obligations have been classified as current at December 31, 2002.

**Note 10 - Related Parties**

*Change in Control*

On December 19, 2000, the Goldman Sachs Investors completed a purchase of approximately 14.5 million of the approximately 18 million shares of Hexcel common stock owned by subsidiaries of Ciba Specialty Chemicals Holding, Inc. The shares acquired by the Goldman Sachs Investors represented approximately 39% of the Hexcel's outstanding common stock. In addition, the Company and the Goldman Sachs Investors entered into a governance agreement that became effective on December 19, 2000. Under this governance agreement, the Goldman Sachs Investors have the right to, among other things, designate up to three directors to sit on the Company's board of directors.

Hexcel incurred \$2.2 million of costs in connection with this transaction, all of which were included in selling, general, and administrative expenses in 2000. These costs and expenses included legal, consulting, and regulatory compliance expenses, as well as a non-cash charge attributable to the accelerated vesting of certain stock-based compensation and to certain amendments to an executive retirement plan. Under the terms of the Company's various stock option and management incentive plans, the transaction constituted a change in control event, resulting in all outstanding stock options becoming vested and exercisable. The former Chief Executive Officer waived the vesting of his stock options by such event. In addition, nine of the most senior executive officers other than the former Chief Executive Officer agreed to defer the vesting of their stock options such that any of their stock options that would have otherwise vested immediately (or would have otherwise vested by their terms) vested one year after the closing with respect to half of such options, and two years after the closing with respect to the remaining half of such options, subject to earlier vesting in certain circumstances. As a result, approximately 1.3 million stock options, with exercise prices ranging from \$2.41 to \$29.63 per share, and a weighted average exercise price of \$8.99 per share, vested and became exercisable on December 19, 2000 (see Note 13).

In addition, due to the change in control event, shares of the Hexcel's common stock underlying a total of approximately 0.8 million restricted stock units and performance accelerated restricted stock units (collectively, stock units) were distributed. However, the former Chief Executive Officer waived the vesting of his stock units, and nine of the most senior executive officers other than the former Chief Executive Officer agreed to defer the distribution of shares underlying their stock units (although not the vesting of such stock units), such that any shares of common stock that would have otherwise been distributed immediately would be distributed one year after the closing with respect to half of such stock units, and two years after the closing with respect to the remaining half of such stock units, subject to earlier distribution under certain circumstances (see Note 13).

**Note 11 Retirement and Other Postretirement Benefit Plans**



Hexcel maintains qualified and nonqualified defined benefit retirement plans covering certain U.S. and European employees, as well as retirement savings plans covering eligible U.S. employees. The defined benefit retirement plans are generally based on years of service and employee compensation under either a career average or final pay benefits method, except as described below. The Company also participates in a union sponsored multi-employer pension plan covering certain U.S. employees with union affiliations.

In addition to defined benefit and retirement savings plan benefits, Hexcel also provides certain postretirement health care and life insurance benefits to eligible U.S. retirees. Depending upon the plan, benefits are available to eligible employees who retire on or after age 58 or 65 after rendering a minimum of 15 years or 25 years of service to Hexcel.

Under the retirement savings plans, eligible U.S. employees can contribute up to 16% of their compensation to an individual retirement savings account. Hexcel makes matching contributions equal to 50% of employee contributions, not to exceed 3% of employee compensation. The Company also makes profit sharing contributions when it meets or exceeds certain performance targets, which are set annually.

Effective December 31, 2000, the Company made certain changes to its U.S. retirement benefit plans that were intended to improve the flexibility and visibility of future retirement benefits for employees. These changes included an increase in the amount that the Company will contribute to individual 401(k) retirement savings accounts and an offsetting curtailment of the Company's U.S. qualified defined benefit retirement plan. Beginning January 1, 2001, the Company started to contribute an additional 2% to 3% of each eligible employee's salary to an individual 401(k) retirement savings account, depending on the employee's age. This increases the maximum contribution to individual employee savings accounts to between 5% and 6% per year, before any profit sharing contributions. Offsetting the estimated incremental cost of this additional benefit, participants in the Company's U.S. qualified defined benefit retirement plan no longer accrued benefits under this plan after December 31, 2000, and no new employees will become participants. However, employees retained all benefits earned under this plan as of that date. The Company recognized a non-cash curtailment gain of \$5.1 million (an after-tax gain of approximately \$3.3 million) in 2000 as a result of the amendment to its defined benefit retirement plan.

The net periodic expense for all of these defined benefit and retirement savings plans, for the three years ended December 31, 2002, was:

| (in millions)   | 2002    | 2001    | 2000     |
|---|---------|---------|----------|
| Defined benefit retirement plans                                    | \$ 6.8  | \$ 4.1  | \$ (1.2) |
| Union sponsored multi-employer pension plan                         | 0.2     | 0.3     | 0.3      |
| Retirement savings plans-matching contributions                     | 4.5     | 5.0     | 2.9      |
| Retirement savings plans-profit sharing and incentive contributions | 6.5     | 7.0     | 5.0      |
| Net periodic expense  | \$ 18.0 | \$ 16.4 | \$ 7.0   |

The net periodic cost of Hexcel's defined benefit retirement and U.S. postretirement plans for the three years ended December 31, 2002, were:

| (in millions)<br>Defined Benefit Retirement Plans | U.S. Plans |        |          | European Plans |        |        |
|---|------------|--------|----------|----------------|--------|--------|
|   | 2002       | 2001   | 2000     | 2002           | 2001   | 2000   |
| Service cost                                      | \$ 0.7     | \$ 0.6 | \$ 3.0   | \$ 4.3         | \$ 2.4 | \$ 2.4 |
| Interest cost                                     | 1.6        | 1.8    | 1.8      | 3.0            | 2.9    | 2.5    |
| Expected return on plan assets                    | (1.4)      | (1.4)  | (1.3)    | (4.1)          | (4.1)  | (4.5)  |
| Net amortization and deferral                     | 0.5        | 0.5    | 0.4      | 1.7            |        | (0.2)  |
| Sub-total   | 1.4        | 1.5    | 3.9      | 4.9            | 1.2    | 0.2    |
| Curtailment and settlement (gain) loss            | 0.5        | 1.0    | (5.3)    |                | 0.4    |        |
| Net periodic pension cost (benefit)               | \$ 1.9     | \$ 2.5 | \$ (1.4) | \$ 4.9         | \$ 1.6 | \$ 0.2 |

| Postretirement Plans - U.S. Plans | 2002   | 2001   | 2000   |
|-----------------------------------|--------|--------|--------|
| Service cost                      | \$ 0.1 | \$ 0.2 | \$ 0.2 |
| Interest cost                     | 0.8    | 1.0    | 1.0    |

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|  |    |              |    |       |    |       |
|--|----|--------------|----|-------|----|-------|
| Net amortization and deferral            |    | <b>(0.5)</b> |    | (0.4) |    | (0.4) |
| Net periodic postretirement benefit cost | \$ | <b>0.4</b>   | \$ | 0.8   | \$ | 0.8   |

The benefit obligation, fair value of plan assets, funded status, and amounts recognized in the consolidated financial statements for Hexcel's defined benefit retirement plans and U.S. postretirement plans, as of and for the years ended December 31, 2002 and 2001, were:

| (in millions)  | Defined Benefit Retirement Plans |           |                |          |                      |           |
|--|----------------------------------|-----------|----------------|----------|----------------------|-----------|
|  | U.S. Plans                       |           | European Plans |          | Postretirement Plans |           |
|  | 2002                             | 2001      | 2002           | 2001     | 2002                 | 2001      |
| <b>Change in benefit obligation:</b>                                   |                                  |           |                |          |                      |           |
| Benefit obligation - beginning of year                                 | \$ 27.7                          | \$ 24.1   | \$ 56.3        | \$ 49.8  | \$ 14.2              | \$ 14.2   |
| Service cost   | 0.7                              | 0.6       | 4.3            | 2.4      | 0.1                  | 0.2       |
| Interest cost  | 1.6                              | 1.8       | 3.0            | 2.9      | 0.8                  | 1.0       |
| Plan participants' contributions                                       |                                  |           | 0.5            | 0.7      | 0.4                  | 0.1       |
| Amendments   | 0.6                              | 1.8       |                |          | (1.7)                |           |
| Actuarial loss (gain)  | 1.0                              | 3.6       | (3.1)          | 2.4      | 0.7                  | 0.2       |
| Benefits paid  | (4.7)                            | (1.9)     | (1.0)          | (0.8)    | (1.5)                | (1.0)     |
| Curtailement and settlement (gain) loss                                | (1.0)                            | (2.3)     |                | 0.4      |                      | (0.5)     |
| Foreign exchange translation   |                                  |           | 6.5            | (1.5)    |                      |           |
| Benefit obligation - end of year                                       | \$ 25.9                          | \$ 27.7   | \$ 66.5        | \$ 56.3  | \$ 13.0              | \$ 14.2   |
| <b>Change in plan assets:</b>  |                                  |           |                |          |                      |           |
| Fair value of plan assets - beginning of year                          | \$ 14.5                          | \$ 14.7   | \$ 51.9        | \$ 60.4  | \$                   | \$        |
| Actual return on plan assets   | (0.9)                            | (0.5)     | (10.3)         | (8.3)    |                      |           |
| Employer contributions   | 4.4                              | 2.2       | 1.4            | 1.2      | 1.1                  | 0.9       |
| Plan participants' contributions                                       |                                  |           | 0.5            | 0.7      | 0.4                  | 0.1       |
| Benefits paid  | (4.7)                            | (1.9)     | (1.0)          | (0.8)    | (1.5)                | (1.0)     |
| Currency translation adjustments                                       |                                  |           | 5.0            | (1.7)    |                      |           |
| Settlements  | (1.5)                            |           |                | 0.4      |                      |           |
| Fair value of plan assets - end of year                                | \$ 11.8                          | \$ 14.5   | \$ 47.5        | \$ 51.9  | \$                   | \$        |
| <b>Reconciliation of funded status to net amount recognized:</b>       |                                  |           |                |          |                      |           |
| Unfunded status  | \$ (14.1)                        | \$ (13.2) | \$ (19.0)      | \$ (4.4) | \$ (13.0)            | \$ (14.2) |
| Unrecognized actuarial loss (gain)                                     | 8.9                              | 6.1       | 25.9           | 13.0     | (2.9)                | 0.9       |
| Unrecognized prior service cost  | 2.3                              | 1.9       |                |          | (1.9)                | (5.2)     |
| Net amount recognized  | \$ (2.9)                         | \$ (5.2)  | \$ 6.9         | \$ 8.6   | \$ (17.8)            | \$ (18.5) |
| <b>Amounts recognized in Consolidated Balance Sheets:</b>              |                                  |           |                |          |                      |           |
| Prepaid benefit costs  | \$                               | \$        | \$ 6.9         | \$ 8.6   | \$                   | \$        |
| Intangible asset   | 1.7                              | 1.5       |                |          |                      |           |
| Accrued benefit liability  | (13.6)                           | (13.4)    | (11.3)         |          | (17.8)               | (18.5)    |
| Accumulated other comprehensive income (before tax for European Plans) | 9.0                              | 6.7       | 11.3           |          |                      |           |
| Net amount recognized  | \$ (2.9)                         | \$ (5.2)  | \$ 6.9         | \$ 8.6   | \$ (17.8)            | \$ (18.5) |

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The total accumulated benefit obligation for pension plans with accumulated benefit obligations in excess of plan assets was \$66.3 million and \$23.1 million as of December 31, 2002 and 2001, respectively. A minimum pension obligation was recorded to the extent such excesses exceed the liability recognized under Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions. Offsetting amounts were recorded in intangible assets to the extent of unrecognized prior service costs, with the remainder recorded in accumulated other comprehensive income. Amortization of loss and other prior service costs is calculated on a straight-line basis over the expected future years of service of the plans active participants. Assets for the defined benefit pension plans generally consist of publicly traded equity securities, bonds and cash investments.

As of December 31, 2002 and 2001, the prepaid benefit cost was included in other assets in the accompanying consolidated balance sheets. For the same periods, the accrued benefit costs for the U.S. defined retirement plans and postretirement benefit plans were included in accrued compensation and benefits and other non-current liabilities, respectively, in the accompanying consolidated balance sheets.

Assumptions used to estimate the actuarial present value of benefit obligations at December 31, 2002, 2001, and 2000 were as follows:

| (in millions)                                     | 2002              | 2001       | 2000       |
|---|-------------------|------------|------------|
| <b>U.S. defined benefit retirement plans:</b>     |                   |            |            |
| Discount rates                                    | <b>6.8%</b>       | 7.3%       | 7.5%       |
| Rate of increase in compensation                  | <b>4.5%</b>       | 4.5%       | 4.5%       |
| Expected long-term rate of return on plan assets  | <b>9.0%</b>       | 9.0%       | 9.0%       |
| <b>European defined benefit retirement plans:</b> |                   |            |            |
| Discount rates                                    | <b>5.3 - 6.0%</b> | 5.8 - 6.0% | 5.8 - 6.0% |
| Rates of increase in compensation                 | <b>2.5 - 3.8%</b> | 2.5 - 4.0% | 2.5 - 4.0% |
| Expected long-term rates of return on plan assets | <b>5.0 - 7.8%</b> | 5.8 - 7.0% | 6.5 - 7.0% |
| <b>Postretirement benefit plans:</b>              |                   |            |            |
| Discount rates                                    | <b>6.8%</b>       | 7.0 - 7.3% | 7.0 - 7.5% |

The per capita cost of covered health care benefits increased by 22.0% in 2002. The annual rate of increase in the per capita cost of covered health care benefits is assumed to be approximately 6.6% for medical and 5.0% for dental and vision for 2003. The medical rates are assumed to gradually decline to 5.3% by 2012, whereas dental and vision rates are assumed to remain constant at 5.0%.

The table below presents the impact of a one-percentage-point increase and a one-percentage-point decrease in the assumed health care cost trend on the total of service and interest cost components, and on the postretirement benefit obligation.

| (in millions)  | 2002            | 2001     |
|--|-----------------|----------|
| <b>One-percentage-point increase:</b>                |                 |          |
| Effect on total service and interest cost components | \$ <b>0.1</b>   | \$ 0.1   |
| Effect on postretirement benefit obligation          | \$ <b>0.8</b>   | \$ 1.1   |
| <b>One-percentage-point decrease:</b>                |                 |          |
| Effect on total service and interest cost components | \$ <b>(0.1)</b> | \$ (0.1) |
| Effect on postretirement benefit obligation          | \$ <b>(0.7)</b> | \$ (0.9) |

#### Note 12 - Income Taxes

Income (loss) before income taxes and the provision for income taxes, for the three years ended December 31, 2002, were as follows:

| (in millions)                      | 2002 | 2001 | 2000 |
|------------------------------------|------|------|------|
| Income (loss) before income taxes: |      |      |      |

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|   |    |             |    |         |    |       |
|---|----|-------------|----|---------|----|-------|
| U.S.                                    | \$ | (22.5)      | \$ | (411.9) | \$ | 22.4  |
| International                           |    | <b>30.2</b> |    | 28.2    |    | 52.6  |
| Total income (loss) before income taxes | \$ | <b>7.7</b>  | \$ | (383.7) | \$ | 75.0  |
| Provision for income taxes:             |    |             |    |         |    |       |
| Current:                                |    |             |    |         |    |       |
| U.S.                                    | \$ |             | \$ |         | \$ |       |
| International                           |    | <b>9.6</b>  |    | 12.9    |    | 17.7  |
| Current provision for income taxes      |    | <b>9.6</b>  |    | 12.9    |    | 17.7  |
| Deferred:                               |    |             |    |         |    |       |
| U.S.                                    |    | <b>0.5</b>  |    | 30.7    |    | 9.0   |
| International                           |    | <b>1.2</b>  |    | (3.1)   |    | (0.4) |
| Deferred provision for income taxes     |    | <b>1.7</b>  |    | 27.6    |    | 8.6   |
| Total provision for income taxes        | \$ | <b>11.3</b> | \$ | 40.5    | \$ | 26.3  |

A reconciliation of the provision for income taxes at the U.S. federal statutory income tax rate of 35% to the effective income tax rate, for the three years ended December 31, 2002, is as follows:

| (in millions)  | 2002    | 2001       | 2000    |
|--|---------|------------|---------|
| Provision for taxes at U.S. federal statutory rate                           | \$ 2.7  | \$ (134.3) | \$ 26.3 |
| U.S. state taxes, less federal tax benefit                                   |         |            | 0.3     |
| Impact of different international tax rates, permanent differences and other | 0.1     | (3.1)      | (0.2)   |
| Valuation allowance  | 8.5     | 177.9      | (0.1)   |
| Total provision for income taxes   | \$ 11.3 | \$ 40.5    | \$ 26.3 |

In 2002, the Company received a dividend of \$74.0 million from one of its foreign subsidiaries, which is taxable for U.S. income tax purposes. The taxable income resulting from the dividend is fully offset by net operating losses. The utilization of net operating losses results in a corresponding reduction in the valuation allowance.

The Company has made no U.S. income tax provision for approximately \$80.4 million of undistributed earnings of international subsidiaries as of December 31, 2002. Such earnings are considered to be permanently reinvested.

*Deferred Income Taxes*



Deferred income taxes result from net operating loss carryforwards and temporary differences between the recognition of items for income tax purposes and financial reporting purposes. Principal components of deferred income taxes as of December 31, 2002 and 2001, were:

| (in millions)                    | 2002    | 2001    |
|----------------------------------|---------|---------|
| Net operating loss carryforwards | \$ 55.4 | \$ 70.0 |
| Reserves and other, net          | 43.6    | 48.3    |
| Accelerated depreciation         | (27.0)  | (23.5)  |
| Accelerated amortization         | 94.9    | 92.3    |
| Unfunded pension liability       | 6.7     | 2.4     |
| Valuation allowance              | (167.4) | (185.0) |
| Net deferred tax asset           | \$ 6.2  | \$ 4.5  |

Since 1999, the Company has generated taxable income in Europe offset by net operating loss ( NOL ) carryforwards in the United States. The Company's U.S. operations have generated such losses, in part, because most of the Company's interest expense and goodwill amortization are serviced in the United States. Through the first quarter of 2001, the Company recognized the benefit of these NOL carryforwards by increasing the deferred tax asset carried on its balance sheet.

During the second quarter of 2001, the Company began to experience a sharp decline in revenues from its electronics market. As a result, the Company reevaluated its ability to continue to recognize a benefit for U.S. net operating losses generated, and determined to increase its tax provision rate through the establishment of a non-cash valuation allowance attributable to the currently generated U.S. net operating losses until such time as the U.S. operations return to consistent profitability. Due to the effect of significant events that have occurred since such time, including the delay in anticipated recovery in the electronics market, anticipated reductions in commercial aircraft production, and a general weakening of the economy, along with the sizable impairments on certain long-lived assets recognized in the fourth quarter of 2001, the Company reduced its estimates for future U.S. taxable income during the carryforward period. As such, the Company established a full valuation allowance on its U.S. deferred tax assets, which resulted in a tax provision of \$32.6 million in the fourth quarter of 2001 to record a valuation allowance on previously reported tax assets.

Deferred tax assets require a valuation allowance when it is more likely than not that some portion of the deferred tax assets may not be realized. The realization of the deferred tax assets is dependent upon the timing and magnitude of future taxable income prior to the expiration of the deferred tax attributes. The amount of the deferred tax assets considered realizable, however, could change if estimates of future taxable U.S. income during the carry-forward period improve.

*Net Operating Loss Carryforwards*

As of December 31, 2002, Hexcel had net operating loss carryforwards for U.S. federal and Belgium income tax purposes of approximately \$156.9 million and \$7.2 million, respectively. If the Company issues the new preferred stock described in Note 2, the Company will likely experience an ownership change pursuant to IRC Section 382, which will limit the Company's ability to utilize net operating losses against future U.S. taxable income.

**Note 13 - Stockholders' Equity (Deficit)**

*Common Stock Outstanding*

| (Number of shares in millions) | 2002        | 2001 | 2000 |
|--------------------------------|-------------|------|------|
| <b>Common stock:</b>           |             |      |      |
| Balance, beginning of year     | <b>39.4</b> | 38.0 | 37.4 |
| Activity under stock plans     | <b>0.4</b>  | 1.4  | 0.6  |
| Balance, end of year           | <b>39.8</b> | 39.4 | 38.0 |
| <b>Treasury stock:</b>         |             |      |      |
| Balance, beginning of year     | <b>1.2</b>  | 0.9  | 0.8  |
| Repurchased                    | <b>0.1</b>  | 0.3  | 0.1  |
| Balance, end of year           | <b>1.3</b>  | 1.2  | 0.9  |
| Common stock outstanding       | <b>38.5</b> | 38.2 | 37.1 |

#### *Stock-Based Incentive Plans*

Hexcel has various stock option and management incentive plans for eligible employees, officers, and directors. These plans provide for awards in the form of stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. Options to purchase common stock are generally granted at the fair market value on the date of grant. Substantially all of these options have a ten-year term and generally vest over a three-year period, except that the vesting period may be accelerated under certain circumstances. At December 31, 2002, the aggregate number of shares of stock issuable under these plans was 9.9 million shares.

As of December 31, 2002, 2001, and 2000, Hexcel had outstanding a total of 0.1 million, 0.2 million and 0.7 million of performance accelerated restricted stock units ( PARS ), respectively. PARS are convertible to an equal number of shares of Hexcel common stock and generally vest at the end of a seven-year period, subject to certain terms of employment and other circumstances that may accelerate the vesting period. Approximately 0.1 million, 0.6 million and 0.2 million PARS were converted into Hexcel common stock in 2002, 2001 and 2000, respectively. In 2001 and 2000, 0.1 million and 0.5 million PARS were granted and 0.1 million and 0.7 million PARS vested, respectively. No PARS were granted in 2002.

In 2002, Hexcel granted 0.3 million restricted stock units to eligible officers. Restricted stock units are convertible to an equal number of shares of Hexcel common stock and generally vest ratably over a three-year period. One-third of the restricted stock units were converted to stock in the first quarter of 2003. In addition, the Company's Chief Executive Officer received approximately 0.1 million shares of common stock in connection with his hiring in July 2001, restricted during a twenty-month vesting period.

Compensation expense of \$0.8 million, \$2.0 million and \$4.5 million was recognized in 2002, 2001 and 2000, respectively, in regards to the PARS, restricted stock units and the Chief Executive Officer's restricted stock. In 2000, \$2.4 million of compensation expense was recognized due to accelerated vesting of PARS as a result of the attainment of certain financial and other performance target, as well as the change in control event. Compensation expense is recognized based on the quoted market price of Hexcel common stock on the date of grant.

Stock option data for the years ended December 31, 2002, 2001 and 2000, was:

| (in millions, except per share data)        | Number of<br>Options | Weighted Average<br>Exercise Price |
|---|----------------------|------------------------------------|
| Options outstanding as of January 1, 2000   | 5.9                  | \$ 11.18                           |
| Options granted                             | 1.6                  | \$ 9.23                            |
| Options exercised                           | (0.3)                | \$ 6.52                            |
| Options expired or canceled                 | (0.5)                | \$ 11.85                           |
| Options outstanding as of December 31, 2000 | 6.7                  | \$ 10.56                           |
| Options granted                             | 1.3                  | \$ 10.17                           |
| Options exercised                           | (0.2)                | \$ 6.02                            |
| Options expired or canceled                 | (0.4)                | \$ 10.72                           |
| Options outstanding as of December 31, 2001 | 7.4                  | \$ 10.62                           |
| Options granted                             | <b>1.3</b>           | <b>\$ 2.66</b>                     |
| Options exercised                           | <b>\$</b>            |                                    |
| Options expired or canceled                 | <b>(0.8)</b>         | <b>\$ 10.61</b>                    |
| Options outstanding as of December 31, 2002 | <b>7.9</b>           | <b>\$ 8.81</b>                     |

As previously discussed in Note 10, approximately 1.3 million of stock options, with exercise prices ranging from \$2.41 to \$29.63 per share, and having a weighted average exercise price of \$8.99 per share, became vested as a result of the change in control event in 2000. The total number of options exercisable as of December 31, 2002, 2001 and 2000 were 5.7 million, 5.4 million and 3.9 million, respectively, at a weighted average exercise price per share of \$10.45, \$10.70 and \$10.80, respectively.

The following table summarizes information about stock options outstanding as of December 31, 2002 (in millions, except per share data):

| Range of<br>Exercise Prices | Options Outstanding                 |   |  | Options Exercisable                 |  |  |
|-----------------------------|-------------------------------------|---|--|-------------------------------------|--|--|
|                             | Number of<br>Options<br>Outstanding | Weighted<br>Average<br>Remaining<br>Life (in Years) | Weighted<br>Average<br>Exercise<br>Price | Number of<br>Options<br>Exercisable | Weighted<br>Average<br>Exercise<br>Price |  |
| \$ 1.37 2.74                | 1.2                                 | 9.02  | \$ 2.62                                  | 0.1                                 | \$ 1.41                                  |  |
| \$ 2.87 6.36                | 1.2                                 | 4.37  | \$ 5.55                                  | 1.1                                 | \$ 5.56                                  |  |
| \$ 6.37 9.94                | 1.1                                 | 4.38  | \$ 9.19                                  | 1.0                                 | \$ 9.14                                  |  |
| \$ 9.95 10.50               | 1.1                                 | 8.53  | \$ 10.45                                 | 0.3                                 | \$ 10.43                                 |  |
| \$ 10.51 11.88              | 0.8                                 | 4.51  | \$ 11.14                                 | 0.7                                 | \$ 11.17                                 |  |
| \$ 11.89 12.11              | 1.5                                 | 3.98  | \$ 12.00                                 | 1.5                                 | \$ 12.00                                 |  |
| \$ 12.12 29.63              | 1.0                                 | 3.34  | \$ 15.35                                 | 1.0                                 | \$ 15.36                                 |  |
| \$ 1.37 29.63               | 7.9                                 | 5.70  | \$ 8.81                                  | 5.7                                 | \$ 10.45                                 |  |

The weighted average fair value of stock options granted during 2002, 2001 and 2000 was \$1.96, \$4.87 and \$4.48, respectively, and estimated using the Black-Scholes model with the following weighted-average assumptions:

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|                          | 2002  | 2001  | 2000  |
|--------------------------|-------|-------|-------|
| Expected life (in years) | 5     | 4     | 4     |
| Interest rate            | 2.78% | 4.35% | 6.50% |
| Volatility               | 88.6% | 68.9% | 40.1% |
| Dividend yield           |       |       |       |

*Employee Stock Purchase Plan ( ESPP )*

Hexcel maintains an ESPP, under which eligible employees may contribute up to 10% of their base earnings toward the quarterly purchase of the Company's common stock at a purchase price equal to 85% of the fair market value of the common stock on the purchase date. The maximum number of shares of common stock reserved for issuance under the ESPP is 0.5 million. During 2002, 2001 and 2000, an aggregate total of approximately 0.2 million shares of common stock were issued under the ESPP.

**Note 14 - Net Income (Loss) Per Share**

Computations of basic and diluted net income (loss) per share for the years ended December 31, 2002, 2001 and 2000, are as follows:

| (in millions, except per share data)               | 2002      | 2001       | 2000    |
|--|-----------|------------|---------|
| <b>Net income (loss):</b>                          |           |            |         |
| Net income (loss)                                  | \$ (13.6) | \$ (433.7) | \$ 54.2 |
| Effect of dilutive securities:                     |           |            |         |
| Convertible subordinated notes, due 2003           |           |            | 5.1     |
| Convertible subordinated debentures, due 2011      |           |            | 1.1     |
| Adjusted net income (loss) for diluted purposes    | \$ (13.6) | \$ (433.7) | \$ 60.4 |
| <b>Basic net income (loss) per share:</b>          |           |            |         |
| Weighted average common shares outstanding         | 38.4      | 37.6       | 36.8    |
| Basic net income (loss) per share                  | \$ (0.35) | \$ (11.54) | \$ 1.47 |
| <b>Diluted net income (loss) per share:</b>        |           |            |         |
| Weighted average common shares outstanding         | 38.4      | 37.6       | 36.8    |
| Effect of dilutive securities:                     |           |            |         |
| Stock options                                      |           |            | 0.8     |
| Convertible subordinated notes, due 2003           |           |            | 7.2     |
| Convertible subordinated debentures, due 2011      |           |            | 0.9     |
| Diluted weighted average common shares outstanding | 38.4      | 37.6       | 45.7    |
| Diluted net income (loss) per share                | \$ (0.35) | \$ (11.54) | \$ 1.32 |

The convertible subordinated notes, due 2003, the convertible subordinated debentures, due 2011, and all of the stock options were excluded from the 2002 and 2001 computations of diluted net loss per share, as they were antidilutive. Approximately 4.5 million stock options were excluded from the 2000 calculation of diluted net income per share as their exercise price was higher than the Company's average stock price. The exercise price for these stock options ranged from approximately \$9.19 to \$29.63 per share, with the weighted average price being approximately \$12.55 per share.

**Note 15 Derivative Financial Instruments***Interest Rate Cap Agreement*

The Company's financial results are affected by interest rate changes on its variable rate debt. In order to partially mitigate this interest rate risk, the Company entered into a five-year interest rate cap agreement in 1998. The agreement provided for a maximum fixed rate of 5.5% on the

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applicable London interbank rate used to determine the interest on a notional amount of \$50.0 million of variable rate debt under the Senior Credit Facility. The fair value and carrying amount of this contract at December 31, 2001, along with hedge ineffectiveness for the period ended October 29, 2002 and the year ended December 31, 2001, were not material. The interest rate cap agreement expired on October 29, 2002.

### *Foreign Currency Forward Exchange Contracts*

A number of the Company's European subsidiaries are exposed to the impact of exchange rate volatility between the U.S. dollar and the subsidiaries' functional currencies, being either the Euro or the British Pound Sterling. During 2001, Hexcel entered into a number of foreign currency forward exchange contracts to exchange U.S. dollars for Euros at fixed rates on specified dates through March 2005. The aggregate notional amount of these contracts was \$58.0 million and \$83.9 million at December 31, 2002 and 2001, respectively. The purpose of these contracts is to hedge a portion of the forecasted transactions of European subsidiaries under long-term sales contracts with certain customers. These contracts are expected to provide the Company with a more balanced matching of future cash receipts and expenditures by currency, thereby reducing the Company's exposure to fluctuations in currency exchange rates. For the years ended December 31, 2002 and 2001, hedge



ineffectiveness was immaterial and the fair value of the foreign currency cash flow hedges recognized in comprehensive income (loss) was a net gain of \$9.3 million and a net loss of \$5.9 million, respectively. Approximately \$2.0 million of the amounts recorded in other comprehensive income is expected to be reclassified into earnings in fiscal 2003 as the hedged sales are recorded.

**Note 16 Commitments and Contingencies**

Hexcel is involved in litigation, investigations and claims arising out of the normal conduct of its business, including those relating to commercial transactions, as well as to environmental, employment and health and safety matters. The Company estimates and accrues 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 exclude counterclaims against other third parties and 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.

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

#### *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 U.S. Environmental Protection Agency or on equivalent lists of various state governments. Because CERCLA provides for joint and several liability, the Company could be responsible for all remediation costs at such sites, even if it is one of many potentially responsible parties ( PRPs ). The Company believes, based on the amount and the nature of its waste, and the number of other financially viable PRPs, that its liability in connection with such matters will not be material.

Pursuant to the New Jersey Industrial Sites Recovery Act, Hexcel signed an administrative consent order and a later Remediation Agreement to pay for the environmental remediation of a manufacturing facility it owns and formerly operated in Lodi, New Jersey. The ultimate cost of remediating the Lodi site will depend on developing circumstances.

Hexcel was 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 Company's Kent, Washington site by the U.S. Environmental Protection Agency. Under the terms of the cost-sharing agreement, the Company was obligated to reimburse the previous owner for a portion of the cost of the required remediation activities. Management has determined that the cost-sharing agreement terminated in December 1998; however, the other party disputes this determination.

At its Livermore, California facility, Hexcel has received a series of notices of violation of air quality standards from the Bay Area Air Quality Management District. Hexcel has investigated and corrected the issues and has cooperated with the District.

The Company's estimate of its liability as a PRP, of the remaining costs associated with its responsibility to remediate the Lodi, New Jersey, and Kent, Washington sites and for any fines and penalties that may be assessed relating to the Livermore, California notices of violation is accrued in the accompanying consolidated balance sheets.



*Other Proceedings*

Hexcel is aware of a grand jury investigation being conducted by the Antitrust Division of the United States Department of Justice with respect to the carbon fiber and carbon fiber prepreg industries. The Department of Justice appears to be reviewing the pricing of all manufacturers of carbon fiber and carbon fiber prepreg since 1993. The Company, along with other manufacturers of these products, has received a grand jury subpoena requiring production of documents to the Department of Justice. Toho Tenax Co. Ltd., one of their subsidiaries and one of their employees have been indicted for obstruction of justice; Toho and its subsidiary pleaded guilty to obstruction of justice and received a combined fine of \$500,000. No other indictments have been issued in the case to date. The Company is not in a position to predict the direction or outcome of the investigation; however, it is cooperating with the Department of Justice.

In 1999, Hexcel was joined in a class action lawsuit alleging antitrust violations in the sale of carbon fiber, carbon fiber industrial fabrics and carbon fiber prepreg (Thomas & Thomas Rodmakers, Inc. et. al. v. Newport Adhesives and Composites, Inc., et. al., Amended and Consolidated Class Action Complaint filed October 4, 1999, United States District Court, Central District of California, Western Division, CV-99-07796-GHK (CTx)). The Company was one of many manufacturers joined in the lawsuit, which was spawned from the Department of Justice investigation. The Court has granted the Plaintiff's motion to certify the class. Discovery is continuing. The Company is not in a position to predict the outcome of the lawsuit, but believes that the lawsuit is without merit as to the Company.

Of the eleven companies that have opted out of the class in the Thomas & Thomas Rodmakers, Inc. case, one, Horizon Sports Technologies, Inc., has filed a case on its own behalf, with similar allegations (Horizon Sports Technologies, Inc., v. Newport Adhesives and Composites, Inc., et. al., First Amended Complaint filed October 15, 2002, United States District Court, Central District of California, Southern Division, SACV 02-911 DOC (MLGX)). The Company is not in a position to predict the outcome of the lawsuit, but believes that the lawsuit is without merit as to the Company.

The Company has also been joined as a party in numerous class action lawsuits in California and in Massachusetts spawned by the Thomas & Thomas Rodmakers, Inc. class action. These actions also allege antitrust violations and are brought on behalf of purchasers located in California and in Massachusetts, respectively, who indirectly purchased carbon fiber products. The California cases have been ordered to be coordinated in the Superior Court for the County of San Francisco and are currently referred to as Carbon Fibers Cases I, II and III, Judicial Council Coordinator Proceeding Numbers 4212, 4216 and 4222. The California cases are Lazio v. Amoco Polymers Inc., et.al., filed August 21, 2000; Proiette v. Newport Adhesives and Composite, Inc. et. al., filed September 12, 2001; Simon v. Newport Adhesives and Composite, Inc. et. al., filed September 21, 2001; Badal v. Newport Adhesives and Composite, Inc. et.al., filed September 26, 2001; Yolles v. Newport Adhesives and Composite, Inc. et.al., filed September 26, 2001; Regier v. Newport Adhesives and Composite, Inc. et.al., filed October 2, 2001; and Connolly v. Newport Adhesives and Composite, Inc. et.al., filed October 4, 2001; Elisa Langsam v Newport Adhesives and Composites, Inc, et al., filed October 4, 2001; Jubal Delong et al. v Amoco Polymers, Inc. et al., filed October 26, 2001; and Louis V. Ambrosio v Amoco Polymers, Inc. et. al., filed October 25, 2001. The Massachusetts case is Ostroff v. Newport Adhesives and Composites, Inc. et. al., filed June 7, 2002 in the Superior Court Department of the Trial Court of Middlesex, Massachusetts, Civil Action No. 02-2385. The Company is not in a position to predict the outcome of these lawsuits, but believes that the lawsuits are without merit as to the Company.

In 1999, a *qui tam* case was filed under seal by executives of Horizon Sports Technologies, Inc. alleging that Boeing and other prime contractors to the United States Government and certain carbon fiber and carbon fiber prepreg manufacturers, including the Company, submitted claims for payment to the U.S. Government which were false or fraudulent because the defendants knew of the alleged conspiracy to fix prices of carbon fiber and carbon prepreg described in the above cases (Beck, on behalf of the United States of America, v. Boeing Defense and Space Group, Inc., et. al., filed July 27, 1999, in the United States District Court for the Southern District of California, Civil Action No. 99 CV 1557 JM JAH). The case was unsealed in 2002 when the U.S. advised that it was unable to decide whether to intervene in the case based on the information available to it at that time and the Relators served the Company and other defendants. The Company is not in a position to predict the outcome of the lawsuit, but believes that the lawsuit is without merit as to the Company.



*Letters of Credit*

Letters of credit are purchased guarantees that ensure the performance or payment to third parties in accordance with specified terms and conditions. The Company had \$25.9 million and \$19.4 million letters of credit outstanding at December 31, 2002 and 2001, respectively, of which \$11.1 million was issued in support of a loan to the Company's BHA Aero joint venture in 2001.

*Loan Guarantees*



The Company has a contingent liability to pay DIC up to \$1.5 million with respect to DHL's debt (see Note 7).

*Product Warranty*

The Company provides for an estimated amount of product warranty at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience. Warranty expense for the years ended December 31, 2002, 2001 and 2000, and accrued warranty cost, included in other accrued liabilities in the consolidated balance sheets at December 31, 2002 and 2001, was as follows:

| (in millions)                          |    | <b>Product<br/>Warranties</b> |
|--|----|-------------------------------|
| <b>Balance as of January 1, 2000</b>   | \$ | 6.6                           |
| Warranty expense                       |    | 3.2                           |
| Deductions and other                   |    | (4.5)                         |
| <b>Balance as of December 31, 2000</b> | \$ | 5.3                           |
| Warranty expense                       |    | 6.0                           |
| Deductions and other                   |    | (6.3)                         |
| <b>Balance as of December 31, 2001</b> | \$ | 5.0                           |
| Warranty expense                       |    | 2.9                           |
| Deductions and other                   |    | (3.9)                         |
| <b>Balance as of December 31, 2002</b> | \$ | 4.0                           |

**Note 17 Supplemental Cash Flow Information**

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Supplemental cash flow information, including non-cash financing and investing activities, for the years ended December 31, 2002, 2001 and 2000, consist of the following:

| (in millions)                             | 2002    |    | 2001 |    | 2000 |
|---|---------|----|------|----|------|
| <b>Cash paid for:</b>                     |         |    |      |    |      |
| Interest                                  | \$ 59.3 | \$ | 62.0 | \$ | 63.3 |
| Taxes                                     | \$ 8.4  | \$ | 20.4 | \$ | 11.5 |
| <b>Non-cash items:</b>                    |         |    |      |    |      |
| Common stock issued under incentive plans | \$ 2.0  | \$ | 6.6  | \$ | 4.2  |

**Note 18 Comprehensive Income (Loss)**

Comprehensive income (loss) represents net income (loss) and other gains and losses affecting shareholders' equity (deficit) that are not reflected in the consolidated statements of operations. The components of accumulated other comprehensive loss as of December 31, 2002 and 2001 were as follows:

| (in millions)  | 2002      | 2001      |
|--|-----------|-----------|
| Currency translation adjustments                       | \$ (7.5)  | \$ (27.1) |
| Minimum pension obligations                            | (17.1)    | (6.7)     |
| Net unrealized gains (losses) on financial instruments | 3.4       | (5.9)     |
| Accumulated other comprehensive loss                   | \$ (21.2) | \$ (39.7) |

**Note 19 - Segment Information**

The financial results for Hexcel's business segments have been prepared using a management approach, which is consistent with the basis and manner in which Hexcel management internally segregates financial information for the purposes of assisting in making internal operating decisions. Hexcel evaluates performance based on operating income and generally accounts for intersegment sales based on arm's-length prices. Corporate and other expenses are not allocated to the business segments, except to the extent that the expenses can be directly attributable to the business segments. Accounting principles used in the segment information are generally the same as those used for the consolidated financial statements.

As part of the Company's November 2001 restructuring program, effective January 1, 2002, management responsibility for the Company's carbon fiber product line was transferred to the Composites business segment. As a result of this change in management responsibilities, the Company changed its business segment reporting to reflect the reclassification of this product line from the Reinforcements segment to the Composites segment. The Company also changed the names of its business segments to Reinforcements, Composites and Structures. The Company's three business segments were previously known as Reinforcement Products, Composite Materials and Engineered Products. Results for the years ended December 31, 2001 and 2000 have been reclassified for comparative purposes. Hexcel's business segments and related products are as follows:

*Reinforcements:* This segment manufactures and sells carbon, glass and aramid fiber fabrics. These reinforcement products comprise the foundation of most composite materials, parts and structures. The segment weaves electronic fiberglass fabrics that are a substrate for printed circuit boards. All of the Company's electronics sales come from reinforcement fabric sales. This segment also sells products for industrial applications such as decorative blinds and soft body armor. In addition, this segment sells to the Company's Composites business segment, and to other third-party customers in the commercial aerospace and space and defense markets.

*Composites:* This segment manufactures and sells carbon fibers and composite materials, including prepregs, honeycomb, structural adhesives, sandwich panels and specially machined honeycomb parts, primarily to the

commercial aerospace and space and defense markets, as well as to industrial markets. This segment also sells to the Company's Structures business segment.

*Structures:* This segment manufactures and sells a range of lightweight, high-strength composite structures primarily to the commercial aerospace and space and defense markets. As discussed in Note 22, the Structures business segment includes the results of the Bellingham aircraft interiors business, up to the date of its disposal on April 26, 2000. The Bellingham business manufactured and sold composite interiors to the aircraft refurbishment market.

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The following table presents financial information on the Company's business segments as of December 31, 2002, 2001 and 2000, and for the years then ended:

| (in millions)   | Reinforcements | Composites | Structures | Corporate/<br>Eliminations | Total     |
|---|----------------|------------|------------|----------------------------|-----------|
| <b>Third-Party Sales</b>  |                |            |            |                            |           |
| 2002  | \$ 217.9       | \$ 532.4   | \$ 100.5   | \$                         | \$ 850.8  |
| 2001  | 245.7          | 638.8      | 124.9      |                            | 1,009.4   |
| 2000  | 331.7          | 594.5      | 129.5      |                            | 1,055.7   |
| <b>Intersegment sales</b>   |                |            |            |                            |           |
| 2002  | \$ 70.3        | \$ 17.2    | \$         | \$ (87.5)                  | \$        |
| 2001  | 90.2           | 22.7       |            | (112.9)                    |           |
| 2000  | 84.1           | 21.3       |            | (105.4)                    |           |
| <b>Operating income (loss)</b>  |                |            |            |                            |           |
| 2002  | \$ 19.6        | \$ 65.8    | \$ 0.4     | \$ (25.6)                  | \$ 60.2   |
| 2001  | (304.6)        | 37.0       | (4.5)      | (44.1)                     | (316.2)   |
| 2000  | 42.7           | 62.2       | 4.1        | (33.6)                     | 75.4      |
| <b>Depreciation and amortization</b>  |                |            |            |                            |           |
| 2002  | \$ 15.4        | \$ 29.3    | \$ 2.4     | \$ 0.1                     | \$ 47.2   |
| 2001  | 26.1           | 32.1       | 4.1        | 0.9                        | 63.2      |
| 2000  | 23.9           | 28.7       | 4.7        | 1.4                        | 58.7      |
| <b>Equity in earnings (losses) of and write-down of an investment in affiliated companies</b> |                |            |            |                            |           |
| 2002  | \$ (5.2)       | \$         | \$ (4.8)   | \$                         | \$ (10.0) |
| 2001  | (6.5)          |            | (3.0)      |                            | (9.5)     |
| 2000  | 5.9            |            | (0.4)      |                            | 5.5       |
| <b>Business consolidation and restructuring expenses (net credits)</b>                        |                |            |            |                            |           |
| 2002  | \$ (0.5)       | \$ 1.9     | \$ 0.2     | \$ (1.1)                   | \$ 0.5    |
| 2001  | 18.8           | 24.5       | 5.7        | 9.4                        | 58.4      |
| 2000  | (1.4)          | 11.1       | 1.3        | (0.1)                      | 10.9      |
| <b>Business consolidation and restructuring payments</b>                                      |                |            |            |                            |           |
| 2002  | \$ 7.9         | \$ 11.2    | \$ 1.6     | \$ 3.6                     | \$ 24.3   |
| 2001  | 2.7            | 7.6        | 0.1        | 1.6                        | 12.0      |
| 2000  | 2.2            | 7.1        | 1.9        | 0.6                        | 11.8      |
| <b>Segment assets</b>   |                |            |            |                            |           |
| 2002  | \$ 245.4       | \$ 435.5   | \$ 80.8    | \$ (53.6)                  | \$ 708.1  |
| 2001  | 272.3          | 433.4      | 101.6      | (17.9)                     | 789.4     |
| 2000  | 605.7          | 482.4      | 102.0      | 21.3                       | 1,211.4   |
| <b>Investments in affiliated companies</b>  |                |            |            |                            |           |
| 2002  | \$ 29.2        | \$         | \$ 4.8     | \$                         | \$ 34.0   |
| 2001  | 47.3           |            | 9.6        |                            | 56.9      |

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|                      |    |            |    |             |      |            |    |            |
|----------------------|----|------------|----|-------------|------|------------|----|------------|
| 2000                 |    | 59.6       |    |             | 12.5 |            |    | 72.1       |
| Capital expenditures |    |            |    |             |      |            |    |            |
| 2002                 | \$ | <b>4.0</b> | \$ | <b>10.4</b> | \$   | <b>0.4</b> | \$ | <b>0.1</b> |
| 2001                 |    | 18.0       |    | 19.3        |      | 0.6        |    | 0.9        |
| 2000                 |    | 13.5       |    | 23.3        |      | 1.1        |    | 1.7        |

*Geographic Data*

Net sales and long-lived assets, by geographic area, consisted of the following for the three years ended December 31, 2002, 2001 and 2000:

| (in millions)                           | 2002     | 2001       | 2000       |
|---|----------|------------|------------|
| <b>Net sales to external customers:</b> |          |            |            |
| United States                           | \$ 479.5 | \$ 595.1   | \$ 650.7   |
| International                           |          |            |            |
| France                                  | 160.6    | 166.8      | 164.6      |
| United Kingdom                          | 60.5     | 71.5       | 75.0       |
| Other                                   | 150.2    | 176.0      | 165.4      |
| Total international                     | 371.3    | 414.3      | 405.0      |
| Total consolidated net sales            | \$ 850.8 | \$ 1,009.4 | \$ 1,055.7 |
| <b>Long-lived assets:</b>               |          |            |            |
| United States                           | \$ 225.3 | \$ 254.2   | \$ 281.4   |
| International                           |          |            |            |
| France                                  | 34.3     | 30.4       | 33.4       |
| United Kingdom                          | 35.3     | 30.7       | 33.6       |
| Other                                   | 31.7     | 29.2       | 26.7       |
| Total international                     | 101.3    | 90.3       | 93.7       |
| Total consolidated long-lived assets    | \$ 326.6 | \$ 344.5   | \$ 375.1   |

Net sales are attributed to geographic areas based on the location in which the sale originated. U.S. net sales include U.S. exports to non-affiliates of \$54.2 million, \$72.6 million and \$47.7 million, for the years ended December 31, 2002, 2001 and 2000, respectively, of which, \$12.1 million for the year ended December 31, 2000 were sales attributable to the Bellingham aircraft interiors business. Long-lived assets primarily consist of property, plant and equipment and other tangible assets.

Net sales are attributed to geographic areas based on the location in which the sale originated. U.S. net sales include

*Significant Customers*



To the extent that the end application of net sales can be identified, The Boeing Company and its subcontractors accounted for approximately 22%, 23% and 20% of 2002, 2001 and 2000 net sales, respectively. Similarly, EADS, including Airbus and its subcontractors accounted for approximately 15%, 16% and 13% of 2002, 2001 and 2000 net sales, respectively.

**Note 20   Litigation Gain**

In 2002, the Company recognized a litigation gain of \$9.8 million (net of related fees and expenses) in connection with a contract dispute with Hercules, Inc. that arose out of the acquisition of Hercules Composites Products Division in 1996. The net cash proceeds received from Hercules Inc. of \$11.1 million were in satisfaction of the judgment entered in favor of the Company after Hercules had exhausted all appeals from a lower court decision in the New York courts.

**Note 21   Non-Recurring Expenses**

In connection with the retirement of the former Chief Executive Officer, the Company recorded compensation expenses of \$4.7 million in 2001 as a result of the early vesting of certain deferred compensation and equity compensation awards together with a contractual termination payment. These expenses are included in selling, general and administrative expenses in the consolidated statement of operations.

**Note 22   Gain on Sale of Bellingham Aircraft Interiors Business**

On April 26, 2000, Hexcel sold its Bellingham aircraft interiors business to Britax Cabin Interiors, Inc., a wholly owned subsidiary of Britax International plc, for cash proceeds of \$113.3 million. The sale resulted in a pre-tax gain of \$68.3 million and an after-tax gain of approximately \$44.3 million (or \$0.97 per diluted share). Net proceeds from the sale were used to repay \$111.6 million of

outstanding term debt under the Company's Senior Credit Facility. The consolidated financial statements and accompanying notes reflect Bellingham's operating results as a continuing operation in the Structures business segment up to the date of disposal. Net sales and operating income for the Bellingham business were \$18.9 million and \$0.6 million, respectively, in 2000.

### Note 23 - Quarterly Financial Data (Unaudited)

Quarterly financial data for the years ended December 31, 2002 and 2001, were:

| (in millions)   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|---|------------------|-------------------|------------------|-------------------|
| <b>2002</b>   |                  |                   |                  |                   |
| Net sales   | \$ 222.1         | \$ 221.2          | \$ 201.0         | \$ 206.5          |
| Gross margin  | 39.6             | 44.8              | 37.3             | 39.6              |
| Business consolidation and restructuring expenses (net credits) | 0.7              | 0.1               | (0.1)            | (0.2)             |
| Operating income  | 13.3             | 19.5              | 15.1             | 12.3              |
| Litigation gain   |                  | 9.8               |                  |                   |
| Loss (gain) on early retirement of debt                         |                  |                   | (0.5)            |                   |
| Net income (loss)   | (9.2)            | 5.3               | (3.6)            | (6.1)             |
| Net income (loss) per share:                                    |                  |                   |                  |                   |
| Basic   | \$ (0.24)        | \$ 0.14           | \$ (0.09)        | \$ (0.16)         |
| Diluted   | \$ (0.24)        | \$ 0.14           | \$ (0.09)        | \$ (0.16)         |
| Market price:   |                  |                   |                  |                   |
| High  | \$ 4.99          | \$ 5.40           | \$ 4.35          | \$ 3.15           |
| Low   | \$ 2.14          | \$ 3.50           | \$ 2.36          | \$ 1.25           |
| <b>2001</b>   |                  |                   |                  |                   |
| Net sales   | \$ 276.2         | \$ 253.5          | \$ 240.6         | \$ 239.1          |
| Gross margin  | 60.1             | 51.7              | 43.8             | 35.2              |
| Business consolidation and restructuring expenses               | 1.1              | 1.8               | 4.4              | 51.1              |
| Impairment of goodwill and other purchased intangibles          |                  |                   |                  | 309.1             |
| Operating income (loss) (a)                                     | 22.6             | 11.4              | 7.2              | (357.4)           |
| Loss (gain) on early retirement of debt                         |                  | 3.1               |                  | (0.4)             |
| Net income (loss) (a)   | 5.5              | (12.6)            | (12.8)           | (413.8)           |
| Net income (loss) per share:                                    |                  |                   |                  |                   |
| Basic   | \$ 0.15          | \$ (0.34)         | \$ (0.34)        | \$ (10.88)        |
| Diluted   | \$ 0.15          | \$ (0.34)         | \$ (0.34)        | \$ (10.88)        |
| Market price:   |                  |                   |                  |                   |
| High  | \$ 12.40         | \$ 12.99          | \$ 12.69         | \$ 4.06           |
| Low   | \$ 8.76          | \$ 8.90           | \$ 3.96          | \$ 1.98           |

(a) Operating and net loss for the second quarter of 2001 include compensation expenses of \$4.7 million in connection with the retirement of the former Chief Executive Officer (see Note 21).

Hexcel has not declared or paid cash dividends per common stock during the periods presented.

**Note 24 Subsequent Event - Pro Forma Consolidated Balance Sheet (Unaudited)**

The unaudited pro forma consolidated balance sheet as of December 31, 2002 has been prepared to illustrate the effect of (i) the issuance of \$125.0 million mandatorily redeemable convertible preferred stock, (ii) the private placement under Rule 144A of \$125.0 million 9-7/8% senior secured notes, due 2008, and (iii) the establishment of a new \$115.0 million senior secured credit facility, as if the transactions had occurred as of December 31, 2002. The proceeds from the sale of mandatorily redeemable convertible preferred stock have been used to provide for the redemption of the

Company's 7% convertible subordinated notes, due 2003, and to repay outstanding borrowings under the existing senior credit facility. The remaining advances under the existing senior credit facility, after the application of a portion of the equity proceeds, have been repaid with the proceeds from the issuance of the Company's new 9-7/8% senior secured notes and a new senior credit facility. The transactions closed on March 19, 2003 (see Note 2).

### Unaudited Pro Forma Consolidated Balance Sheet

As of December 31, 2002

| (In millions, except per share data)   | Historical | Adjustments   | Pro Forma |
|--|------------|---------------|-----------|
| <b>Assets</b>  |            |               |           |
| Current assets:  |            |               |           |
| Cash and cash equivalents  | \$ 8.2     | \$ 4.4(a)     | \$ 12.6   |
| Accounts receivable, net   | 117.3      |               | 117.3     |
| Inventories, net   | 113.6      |               | 113.6     |
| Prepaid expenses and other assets  | 9.2        |               | 9.2       |
| Total current assets   | 248.3      | 4.4           | 252.7     |
| Net property, plant and equipment  | 309.4      |               | 309.4     |
| Goodwill, net  | 74.4       |               | 74.4      |
| Investments in affiliated companies  | 34.0       |               | 34.0      |
| Other assets   | 42.0       | 4.9           | 46.9      |
| Total assets   | \$ 708.1   | \$ 9.3        | \$ 717.4  |
| <b>Liabilities and Stockholders' Equity (Deficit)</b>  |            |               |           |
| Current liabilities:   |            |               |           |
| Notes payable and current maturities of capital lease obligations  | \$ 621.7   | \$ (615.5)(a) | \$ 6.2    |
| Accounts payable   | 54.9       |               | 54.9      |
| Accrued compensation and benefits  | 37.6       |               | 37.6      |
| Accrued interest   | 19.1       | (3.2)(a)      | 15.9      |
| Business consolidation and restructuring liabilities   | 10.5       |               | 10.5      |
| Other accrued liabilities  | 35.3       |               | 35.3      |
| Total current liabilities  | 779.1      | (618.7)       | 160.4     |
| Long-term notes payable and capital lease obligations  |            | 512.4(a)      | 512.4     |
| Long-term retirement obligations   | 48.1       |               | 48.1      |
| Other non-current liabilities  | 8.3        |               | 8.3       |
| Total liabilities  | 835.5      | (106.3)       | 729.2     |
| Mandatorily redeemable convertible preferred stock, 125,000 series A shares and 125,000 series B shares authorized, issued and outstanding |            | 96.4(b)       | 96.4      |
| Stockholders' equity (deficit):  |            |               |           |
| Preferred stock, no par value, 20.0 shares of stock authorized, no shares issued or outstanding  |            |               |           |

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|  |          |          |          |
|--|----------|----------|----------|
| Common stock, \$0.01 par value, 100.0 shares of stock authorized, shares issued of 39.8 at December 31, 2002 | 0.4      |          | 0.4      |
| Additional paid-in capital   | 288.2    | 23.4(b)  | 311.6    |
| Accumulated deficit  | (381.5)  | (4.2)(c) | (385.7)  |
| Accumulated other comprehensive loss   | (21.2)   |          | (21.2)   |
|  | (114.1)  | 19.2     | (94.9)   |
| Less- Treasury stock, at cost, 1.3 shares at December 31, 2002   | (13.3)   |          | (13.3)   |
| Total stockholders' equity (deficit)   | (127.4)  | 19.2     | (108.2)  |
| Total liabilities and stockholders' equity (deficit)   | \$ 708.1 | \$ 9.3   | \$ 717.4 |

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(a) The Company received gross proceeds of \$123.7 million from the issuance of 9-7/8% senior secured notes, due 2008, after discount of \$1.3 million, along with \$125.0 million of gross proceeds from the issuance of mandatorily redeemable convertible preferred stock. The proceeds from the issuance of the senior secured notes, together with a portion of the proceeds from the issuance of mandatorily redeemable convertible preferred stock, were used to repay \$179.9 million of the Company's existing Senior Credit Facility, accrued interest of \$1.8 million on the existing Senior Credit Facility as of December 31, 2002 and a portion of total estimated transaction fees and expenses of \$14.3 million (which includes the preferred stock issuance expenses of \$5.2 million). The remaining portion of the proceeds from the issuance of the mandatorily redeemable

convertible preferred stock was used remitted to US Bank Trust, trustee for the Company's 7% convertible subordinated notes, due August 1, 2003, for the express purpose of retiring the remaining \$46.9 million of such notes and paying the accrued interest of \$1.4 million thereon as of December 31, 2002. Estimated excess cash proceeds of approximately \$4.4 million will be used for general corporate purposes. A substantial portion of the Company's indebtedness has been reclassified as long-term to reflect scheduled debt payments after the refinancing transactions.

(b) The Company received net proceeds of \$119.8 million, after issuance expenses of \$5.2 million, from the issuance of 125,000 shares of series A preferred stock and 125,000 shares of series B preferred stock. In addition, a beneficial conversion feature of \$23.4 million was recognized. The beneficial conversion feature is the implicit discount on the preferred stock computed based upon the conversion to the underlying common stock at the conversion price of \$3.00 per share and the average market price of Hexcel common stock on March 19, 2003 of \$2.93 per share.

(c) As the result of the repayment of the existing Senior Credit Facility and the 7% convertible subordinated notes, due 2003, the Company wrote-off \$4.2 million unamortized discount and capitalized debt issuance costs.

**Note 25 - Supplemental Guarantor Information**

Certain subsidiaries of Hexcel have jointly, severally, fully and unconditionally guaranteed the Senior Secured Notes due 2008. Presented below is consolidating information for Hexcel (parent, issuer and primary obligor of the debt), Clark-Schwebel Holding Corp., Clark-Schwebel Corporation, CS Tech-Fab Holding, Inc. and Hexcel Pottsville Corporation (guarantor subsidiaries), and the non-guarantor subsidiaries of Hexcel. Hexcel wholly owns all of the subsidiary guarantors.

**Hexcel Corporation and Subsidiaries****Consolidating Balance Sheet**

As of December 31, 2002

| (In millions)   | Parent   | Guarantors | Non-Guarantors | Eliminations | Total    |
|---|----------|------------|----------------|--------------|----------|
| <b>Assets</b>   |          |            |                |              |          |
| Current assets:   |          |            |                |              |          |
| Cash and cash equivalents   | \$ (0.2) | \$ 1.3     | \$ 7.1         | \$           | \$ 8.2   |
| Accounts receivable, net  | 34.1     | 12.4       | 70.8           |              | 117.3    |
| Inter-company accounts receivable                                 | 79.4     | 147.0      | 4.4            | (230.8)      |          |
| Inventories, net  | 40.6     | 28.6       | 44.4           |              | 113.6    |
| Inter-company short-term notes receivable                         | 160.9    |            |                | (160.9)      |          |
| Prepaid expenses and other assets                                 | 3.5      | 0.4        | 5.3            |              | 9.2      |
| Total current assets  | 318.3    | 189.7      | 132.0          | (391.7)      | 248.3    |
| Net property, plant and equipment                                 | 153.6    | 65.7       | 90.1           |              | 309.4    |
| Goodwill, net   | 22.1     | 39.0       | 13.3           |              | 74.4     |
| Investments in subsidiaries                                       | (366.5)  |            |                | 366.5        |          |
| Investments in affiliated companies                               |          | 29.2       | 4.8            |              | 34.0     |
| Inter-company long-term notes receivable                          | 531.2    |            | 0.7            | (531.9)      |          |
| Other assets  | 25.1     | 0.5        | 45.1           | (28.7)       | 42.0     |
| Total assets  | \$ 683.8 | \$ 324.1   | \$ 286.0       | \$ (585.8)   | \$ 708.1 |
| <b>Liabilities and Stockholders Equity</b>                        |          |            |                |              |          |
| Current liabilities:  |          |            |                |              |          |
| Notes payable and current maturities of capital lease obligations | \$ 516.5 | \$ 29.4    | \$ 75.8        | \$           | \$ 621.7 |
| Accounts payable  | 13.3     | 11.8       | 29.8           |              | 54.9     |
| Inter-company accounts payable                                    | 165.6    | 39.0       | 26.2           | (230.8)      |          |
| Accrued compensation and benefits                                 | 19.2     | 5.0        | 13.4           |              | 37.6     |
| Accrued interest  | 18.4     |            | 0.7            |              | 19.1     |
| Business consolidation and restructuring liabilities              | 4.2      | 0.6        | 5.7            |              | 10.5     |

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|   |                 |                 |                 |                |                 |
|---|-----------------|-----------------|-----------------|----------------|-----------------|
| Inter-company short-term notes payable                      |                 | 160.9           |                 | (160.9)        |                 |
| Other accrued liabilities                                   | 18.3            | 4.5             | 12.5            |                | <b>35.3</b>     |
| <b>Total current liabilities</b>                            | <b>755.5</b>    | <b>251.2</b>    | <b>164.1</b>    | <b>(391.7)</b> | <b>779.1</b>    |
| Inter-company long-term notes payable                       | 0.7             | 468.1           | 63.1            | (531.9)        |                 |
| Long-term retirement obligations                            | 22.9            | 7.9             | 17.3            |                | <b>48.1</b>     |
| Other non-current liabilities                               | 3.3             |                 | 5.0             |                | <b>8.3</b>      |
| <b>Total liabilities</b>                                    | <b>782.4</b>    | <b>727.2</b>    | <b>249.5</b>    | <b>(923.6)</b> | <b>835.5</b>    |
| Stockholders' equity (deficit)                              | (98.6)          | (403.1)         | 36.5            | 337.8          | <b>(127.4)</b>  |
| <b>Total liabilities and stockholders' equity (deficit)</b> | <b>\$ 683.8</b> | <b>\$ 324.1</b> | <b>\$ 286.0</b> | <b>(585.8)</b> | <b>\$ 708.1</b> |



## Hexcel Corporation and Subsidiaries

## Consolidating Balance Sheet

As of December 31, 2001

| (In millions)   | Parent   | Guarantors | Non-Guarantors | Eliminations | Total    |
|---|----------|------------|----------------|--------------|----------|
| <b>Assets</b>   |          |            |                |              |          |
| Current assets:   |          |            |                |              |          |
| Cash and cash equivalents   | \$ 2.2   | \$ 7.1     | 2.3            | \$           | \$ 11.6  |
| Accounts receivable, net  | 53.0     | 16.3       | 71.2           |              | 140.5    |
| Inter-company accounts receivable                                 | 60.7     | 107.6      | 4.5            | (172.8)      |          |
| Inventories, net  | 51.4     | 40.3       | 40.0           |              | 131.7    |
| Inter-company short-term notes receivable                         | 123.4    |            |                | (123.4)      |          |
| Prepaid expenses and other assets                                 | 2.5      | 0.1        | 1.8            |              | 4.4      |
| Total current assets  | 293.2    | 171.4      | 119.8          | (296.2)      | 288.2    |
| Net property, plant and equipment                                 | 171.9    | 77.1       | 80.2           |              | 329.2    |
| Goodwill, net   | 22.1     | 39.0       | 11.3           |              | 72.4     |
| Investments in subsidiaries                                       | (308.9)  |            |                | 308.9        |          |
| Investments in affiliated companies                               |          | 47.3       | 9.6            |              | 56.9     |
| Inter-company long-term notes receivable                          | 468.1    |            | 0.3            | (468.4)      |          |
| Other assets  | 28.5     | 0.7        | 39.1           | (25.6)       | 42.7     |
| Total assets  | \$ 674.9 | \$ 335.5   | \$ 260.3       | \$ (481.3)   | \$ 789.4 |
| <b>Liabilities and Stockholders Equity</b>                        |          |            |                |              |          |
| Current liabilities:  |          |            |                |              |          |
| Notes payable and current maturities of capital lease obligations | \$ 8.3   | \$ 5.5     | \$ 3.6         | \$           | \$ 17.4  |
| Accounts payable  | 18.2     | 15.5       | 24.9           |              | 58.6     |
| Inter-company accounts payable                                    | 104.2    | 44.7       | 23.9           | (172.8)      |          |
| Accrued compensation and benefits                                 | 25.2     | 7.9        | 9.5            |              | 42.6     |
| Accrued interest  | 18.6     |            | 0.2            |              | 18.8     |
| Business consolidation and restructuring liabilities              | 17.5     | 5.8        | 10.1           |              | 33.4     |
| Inter-company short-term notes payable                            |          | 123.4      |                | (123.4)      |          |
| Other accrued liabilities   | 13.4     | 2.3        | 18.0           |              | 33.7     |
| Total current liabilities   | 205.4    | 205.1      | 90.2           | (296.2)      | 204.5    |
| Long-term notes payable and capitalized lease obligations         | 548.7    | 29.3       | 90.5           |              | 668.5    |
| Inter-company long-term notes payable                             | 0.3      | 468.1      |                | (468.4)      |          |
| Long-term retirement obligations                                  | 20.0     | 7.6        | 3.7            |              | 31.3     |
| Other non-current liabilities                                     | 7.5      |            | 10.2           |              | 17.7     |
| Total liabilities   | 781.9    | 710.1      | 194.6          | (764.6)      | 922.0    |

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|  |          |          |          |            |          |
|--|----------|----------|----------|------------|----------|
| Stockholders' equity (deficit)                       | (107.0)  | (374.6)  | 65.7     | 283.3      | (132.6)  |
| Total liabilities and stockholders' equity (deficit) | \$ 674.9 | \$ 335.5 | \$ 260.3 | \$ (481.3) | \$ 789.4 |

**Hexcel Corporation and Subsidiaries**  
**Consolidating Statement of Operations**  
**For the Year Ended December 31, 2002**

| (In millions)   | Parent    | Guarantors | Non-Guarantors | Eliminations | Total     |
|---|-----------|------------|----------------|--------------|-----------|
| Net sales   | \$ 347.9  | \$ 200.1   | \$ 376.2       | \$ (73.4)    | \$ 850.8  |
| Cost of sales   | 293.7     | 176.0      | 293.2          | (73.4)       | 689.5     |
| Gross margin  | 54.2      | 24.1       | 83.0           |              | 161.3     |
| Selling, general and administrative expenses                    | 37.1      | 12.7       | 37.5           | (1.4)        | 85.9      |
| Research and technology expenses                                | 7.1       | 1.1        | 6.5            |              | 14.7      |
| Business consolidation and restructuring expenses               | (1.7)     | (0.9)      | 3.1            |              | 0.5       |
| Operating income  | 11.7      | 11.2       | 35.9           | 1.4          | 60.2      |
| Litigation gain   | 9.8       |            |                |              | 9.8       |
| Interest expense  | (16.9)    | (40.2)     | (5.7)          |              | (62.8)    |
| Gain on early retirement of debt                                | 0.5       |            |                |              | 0.5       |
| Income (loss) before income taxes                               | 5.1       | (29.0)     | 30.2           | 1.4          | 7.7       |
| Provision for income taxes                                      | 0.5       |            | 10.8           |              | 11.3      |
| Income (loss) before equity in earnings                         | 4.6       | (29.0)     | 19.4           | 1.4          | (3.6)     |
| Equity in losses of subsidiaries                                | (19.6)    |            |                | 19.6         |           |
| Equity in losses and write-downs of an investment in affiliates |           | (5.2)      | (4.8)          |              | (10.0)    |
| Net income (loss)   | \$ (15.0) | \$ (34.2)  | \$ 14.6        | \$ 21.0      | \$ (13.6) |

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**Hexcel Corporation and Subsidiaries**  
**Consolidating Statement of Operations**  
**For the Year Ended December 31, 2001**

| (In millions) | Parent | Guarantors | Non-Guarantors | Eliminations | Total |
|---------------|--------|------------|----------------|--------------|-------|
|---------------|--------|------------|----------------|--------------|-------|

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|   |    |         |    |         |    |       |    |        |    |                |
|---|----|---------|----|---------|----|-------|----|--------|----|----------------|
| Net sales   | \$ | 438.0   | \$ | 242.8   | \$ | 427.5 | \$ | (98.9) | \$ | <b>1,009.4</b> |
| Cost of sales   |    | 370.6   |    | 219.9   |    | 327.0 |    | (98.9) |    | <b>818.6</b>   |
| Gross margin  |    | 67.4    |    | 22.9    |    | 100.5 |    |        |    | <b>190.8</b>   |
| Selling, general and administrative expenses                    |    | 47.0    |    | 29.9    |    | 44.5  |    | (0.5)  |    | <b>120.9</b>   |
| Research and technology expenses                                |    | 9.2     |    | 1.7     |    | 7.7   |    |        |    | <b>18.6</b>    |
| Business consolidation and restructuring expenses               |    | 28.4    |    | 16.0    |    | 14.0  |    |        |    | <b>58.4</b>    |
| Impairment of goodwill and other purchased intangibles          |    | 17.0    |    | 292.1   |    |       |    |        |    | <b>309.1</b>   |
| Operating income (loss)   |    | (34.2)  |    | (316.8) |    | 34.3  |    | 0.5    |    | <b>(316.2)</b> |
| Interest expense  |    | (17.8)  |    | (40.3)  |    | (6.7) |    |        |    | <b>(64.8)</b>  |
| Loss on early retirement of debt                                |    | (2.7)   |    |         |    |       |    |        |    | <b>(2.7)</b>   |
| Gain on asset sale  |    | 25.0    |    |         |    |       |    | (25.0) |    |                |
| Income (loss) before income taxes                               |    | (29.7)  |    | (357.1) |    | 27.6  |    | (24.5) |    | <b>(383.7)</b> |
| Provision for income taxes                                      |    | 30.8    |    |         |    | 9.7   |    |        |    | <b>40.5</b>    |
| Income (loss) before equity in earnings                         |    | (60.5)  |    | (357.1) |    | 17.9  |    | (24.5) |    | <b>(424.2)</b> |
| Equity in losses of subsidiaries                                |    | (348.7) |    |         |    |       |    | 348.7  |    |                |
| Equity in losses and write-downs of an investment in affiliates |    |         |    | (6.5)   |    | (3.0) |    |        |    | <b>(9.5)</b>   |
| Net income (loss)   | \$ | (409.2) | \$ | (363.6) | \$ | 14.9  | \$ | 324.2  | \$ | <b>(433.7)</b> |

**Hexcel Corporation and Subsidiaries**  
**Consolidating Statement of Operations**  
**For the Year Ended December 31, 2000**

| (In millions)  | Parent   | Guarantors | Non-Guarantors | Eliminations | Total      |
|--|----------|------------|----------------|--------------|------------|
| Net sales  | \$ 420.6 | \$ 314.3   | \$ 412.3       | \$ (91.5)    | \$ 1,055.7 |
| Cost of sales  | 352.5    | 257.0      | 306.3          | (91.5)       | 824.3      |
| Gross margin   | 68.1     | 57.3       | 106.0          |              | 231.4      |
| Selling, general and administrative expenses           | 47.2     | 30.8       | 45.9           |              | 123.9      |
| Research and technology expenses                       | 12.2     | 2.4        | 6.6            |              | 21.2       |
| Business consolidation and restructuring expenses      | 10.0     | (2.6)      | 3.5            |              | 10.9       |
| Operating income (loss)                                | (1.3)    | 26.7       | 50.0           |              | 75.4       |
| Interest expense                                       | (24.8)   | (41.3)     | (2.6)          |              | (68.7)     |
| Gain on sale of Bellingham aircraft interiors business | 68.3     |            |                |              | 68.3       |
| Income (loss) before income taxes                      | 42.2     | (14.6)     | 47.4           |              | 75.0       |
| Provision for income taxes                             | 9.0      |            | 17.3           |              | 26.3       |
| Income (loss) before equity in earnings                | 33.2     | (14.6)     | 30.1           |              | 48.7       |
| Equity in earnings of subsidiaries                     | 21.0     |            |                | (21.0)       |            |
| Equity in earnings (losses) of affiliates              |          | 5.9        | (0.4)          |              | 5.5        |
| Net income (loss)                                      | \$ 54.2  | \$ (8.7)   | \$ 29.7        | \$ (21.0)    | \$ 54.2    |

**Hexcel Corporation and Subsidiaries**  
**Consolidating Statement of Cash Flows**  
**For the Year Ended December 31, 2002**

| (In millions)  | Parent    | Guarantors | Non-Guarantors | Eliminations | Total     |
|--|-----------|------------|----------------|--------------|-----------|
| <b>Cash flows from operating activities</b>                        |           |            |                |              |           |
| Net income (loss)  | \$ (15.0) | \$ (34.2)  | \$ 14.6        | \$ 21.0      | \$ (13.6) |
| Reconciliation to net cash provided by operations:                 |           |            |                |              |           |
| Depreciation   | 22.8      | 12.6       | 11.8           |              | 47.2      |
| Amortization   |           |            | 1.4            | (1.4)        |           |
| Deferred income taxes  | 0.5       |            | 1.2            |              | 1.7       |
| Business consolidation and restructuring expenses                  | (1.7)     | (0.9)      | 3.1            |              | 0.5       |
| Business consolidation and restructuring payments                  | (10.7)    | (5.3)      | (8.3)          |              | (24.3)    |
| Gain on early retirement of debt                                   | (0.5)     |            |                |              | (0.5)     |
| Equity in losses of subsidiaries                                   | 19.6      |            |                | (19.6)       |           |
| Equity in losses of and write-downs of an investment in affiliates |           | 5.2        | 4.8            |              | 10.0      |
| Changes in assets and liabilities:                                 |           |            |                |              |           |
| Decrease (increase) in accounts receivable                         | 18.8      | 3.9        | 12.9           |              | 35.6      |
| Decrease (increase) in inventories                                 | 10.9      | 11.6       | 3.3            |              | 25.8      |
| Decrease (increase) in prepaid expenses and other assets           | (0.9)     | (0.3)      | (0.5)          |              | (1.7)     |
| Increase (decrease) in accounts payable and accrued liabilities    | (5.5)     | (4.0)      | (6.2)          |              | (15.7)    |
| Net change in inter-company receivable and payable                 | 43.0      | (45.0)     | 2.0            |              |           |
| Changes in other non-current assets and long-term liabilities      | (10.9)    | 6.3        | 5.5            |              | 0.9       |
| Net cash provided by (used for) operating activities               | 70.4      | (50.1)     | 45.6           |              | 65.9      |
| <b>Cash flows from investing activities</b>                        |           |            |                |              |           |
| Capital expenditures   | (5.3)     | (1.6)      | (8.0)          |              | (14.9)    |
| Proceeds from sale of an ownership interest in an affiliate        |           | 10.0       |                |              | 10.0      |
| Proceeds from sale of other assets                                 | 0.3       | 0.9        | 0.3            |              | 1.5       |
| Dividends from affiliates  |           | 1.6        |                |              | 1.6       |
| Other  | (0.5)     |            |                |              | (0.5)     |
| Net cash provided by (used for) investing activities               | (5.5)     | 10.9       | (7.7)          |              | (2.3)     |
| <b>Cash flows from financing activities</b>                        |           |            |                |              |           |
|  | (38.9)    |            | (18.5)         |              | (57.4)    |

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|  |          |        |        |               |
|--|----------|--------|--------|---------------|
| Proceeds (repayments) of credit facilities, net              |          |        |        |               |
| Proceeds (repayments) of long-term debt, net                 | (1.0)    | (5.4)  | (3.5)  | <b>(9.9)</b>  |
| Proceeds (repayments) of long-term inter-company debt, net   | (100.5)  | 37.4   | 63.1   |               |
| Intercompany distributions received (paid)                   | 73.1     |        | (73.1) |               |
| Net cash provided by (used for) financing activities         | (67.3)   | 32.0   | (32.0) | <b>(67.3)</b> |
| Effect of exchange rate changes on cash and cash equivalents |          | 1.4    | (1.1)  | <b>0.3</b>    |
| Net increase (decrease) in cash and cash equivalents         | (2.4)    | (5.8)  | 4.8    | <b>(3.4)</b>  |
| Cash and cash equivalents at beginning of year               | 2.2      | 7.1    | 2.3    | <b>11.6</b>   |
| Cash and cash equivalents at end of year                     | \$ (0.2) | \$ 1.3 | \$ 7.1 | \$ <b>8.2</b> |

**Hexcel Corporation and Subsidiaries**  
**Consolidating Statement of Cash Flows**  
**For the Year Ended December 31, 2001**

| (In millions)  | Parent     | Guarantors | Non-Guarantors | Eliminations | Total      |
|--|------------|------------|----------------|--------------|------------|
| <b>Cash flows from operating activities</b>                        |            |            |                |              |            |
| Net income (loss)  | \$ (409.2) | \$ (363.6) | \$ 14.9        | \$ 324.2     | \$ (433.7) |
| Reconciliation to net cash provided by operations:                 |            |            |                |              |            |
| Depreciation   | 24.9       | 13.4       | 12.4           |              | 50.7       |
| Amortization   | 2.7        | 9.0        | 1.5            | (0.7)        | 12.5       |
| Deferred income taxes  | 30.7       |            | (3.1)          |              | 27.6       |
| Business consolidation and restructuring expenses                  | 28.4       | 16.0       | 14.0           |              | 58.4       |
| Business consolidation and restructuring payments                  | (7.2)      | (2.0)      | (2.8)          |              | (12.0)     |
| Loss on early retirement of debt                                   | 0.7        |            |                |              | 0.7        |
| Equity in losses of subsidiaries                                   | 348.7      |            |                | (348.7)      |            |
| Equity in losses of and write-downs of an investment in affiliates |            | 6.5        | 3.0            |              | 9.5        |
| Impairment of goodwill and other purchased intangibles             | 17.0       | 292.1      |                |              | 309.1      |
| Gain on asset sale   | (25.0)     |            |                | 25.0         |            |
| Changes in assets and liabilities:                                 |            |            |                |              |            |
| Decrease (increase) in accounts receivable                         | (1.8)      | 6.7        | (0.3)          |              | 4.6        |
| Decrease (increase) in inventories                                 | (0.3)      | 6.2        | 14.7           |              | 20.6       |
| Decrease (increase) in prepaid expenses and other assets           | 0.9        |            | 0.2            |              | 1.1        |
| Increase (decrease) in accounts payable/accrued liabilities        | 0.9        | (12.6)     | (7.5)          |              | (19.2)     |
| Net change in inter-company receivable and payable                 | (0.3)      | 6.9        | (6.6)          |              |            |
| Changes in other non-current assets/long-term liabilities          | (3.1)      | 3.3        | 4.7            | 0.2          | 5.1        |
| Net cash provided by (used for) operating activities               | 8.0        | (18.1)     | 45.1           |              | 35.0       |
| <b>Cash flows from investing activities</b>                        |            |            |                |              |            |
| Capital expenditures   | (8.5)      | (14.0)     | (16.3)         |              | (38.8)     |
| Dividends from affiliates  |            | 0.8        |                |              | 0.8        |
| Other  | (0.3)      |            |                |              | (0.3)      |
| Net cash used for investing activities                             | (8.8)      | (13.2)     | (16.3)         |              | (38.3)     |
| <b>Cash flows from financing activities</b>                        |            |            |                |              |            |
| Proceeds (repayments) of credit facilities, net                    | 20.1       |            | 4.5            |              | 24.6       |
| Proceeds from issuance of long-term debt                           | 98.5       |            |                |              | 98.5       |

Significant Customers

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|  |        |        |        |                |
|--|--------|--------|--------|----------------|
| Repayments of long-term debt and capital lease obligations   | (98.0) | (4.6)  | (8.0)  | <b>(110.6)</b> |
| Proceeds (repayments) of long-term inter- company debt, net  | (38.7) | 37.4   | 1.3    |                |
| Intercompany distributions received (paid)                   | 25.0   |        | (25.0) |                |
| Debt issuance costs  | (3.5)  |        |        | <b>(3.5)</b>   |
| Other  | (0.4)  |        |        | <b>(0.4)</b>   |
| Net cash provided by (used for) financing activities         | 3.0    | 32.8   | (27.2) | <b>8.6</b>     |
| Effect of exchange rate changes on cash and cash equivalents |        | 4.9    | (3.7)  | <b>1.2</b>     |
| Net increase (decrease) in cash and cash equivalents         | 2.2    | 6.4    | (2.1)  | <b>6.5</b>     |
| Cash and cash equivalents at beginning of year               |        | 0.7    | 4.4    | <b>5.1</b>     |
| Cash and cash equivalents at end of year                     | \$ 2.2 | \$ 7.1 | \$ 2.3 | \$ <b>11.6</b> |

## Hexcel Corporation and Subsidiaries

## Consolidating Statement of Cash Flows

For the Year Ended December 31, 2000

| (In millions)   | Parent  | Guarantors | Non-Guarantors | Eliminations | Total   |
|---|---------|------------|----------------|--------------|---------|
| <b>Cash flows from operating activities</b>                     |         |            |                |              |         |
| Net income (loss)   | \$ 54.2 | \$ (8.7)   | \$ 29.7        | \$ (21.0)    | \$ 54.2 |
| Reconciliation to net cash provided by operations:              |         |            |                |              |         |
| Depreciation  | 23.7    | 11.9       | 10.0           |              | 45.6    |
| Amortization  | 3.4     | 9.0        | 0.7            |              | 13.1    |
| Deferred income taxes   | 9.0     |            | (0.4)          |              | 8.6     |
| Business consolidation and restructuring expenses               | 10.1    | (2.6)      | 3.4            |              | 10.9    |
| Business consolidation and restructuring payments               | (8.0)   | (1.1)      | (2.7)          |              | (11.8)  |
| Gain on sale of Bellingham interiors business                   | (68.3)  |            |                |              | (68.3)  |
| Gain on curtailment of pension plan                             | (5.1)   |            |                |              | (5.1)   |
| Equity in (earnings) losses of subsidiaries                     | (21.0)  |            |                | 21.0         |         |
| Equity in (earnings) losses of affiliates                       |         | (5.9)      | 0.4            |              | (5.5)   |
| Changes in assets and liabilities:                              |         |            |                |              |         |
| Decrease (increase) in accounts receivable                      | (4.8)   | 3.0        | (5.9)          |              | (7.7)   |
| Decrease (increase) in inventories                              | (4.6)   | (3.2)      | (9.2)          |              | (17.0)  |
| Decrease (increase) in prepaid expenses and other assets        | (0.6)   |            | 0.2            |              | (0.4)   |
| Increase (decrease) in accounts payable and accrued liabilities | (2.8)   | 2.3        | 11.2           |              | 10.7    |
| Net change in inter-company receivable and payable              | 8.3     | (20.5)     | 12.2           |              |         |
| Changes in other non-current assets and long-term liabilities   | (5.9)   | 8.5        | 3.1            |              | 5.7     |
| Net cash provided by (used for) operating activities            | (12.4)  | (7.3)      | 52.7           |              | 33.0    |
| <b>Cash flows from investing activities</b>                     |         |            |                |              |         |
| Capital expenditures  | (13.7)  | (9.0)      | (16.9)         |              | (39.6)  |
| Proceeds from sale of Bellingham aircraft interiors business    | 113.3   |            |                |              | 113.3   |
| Proceeds from sale of other assets                              | 83.4    |            |                | (80.0)       | 3.4     |
| Acquisition   |         |            | (80.0)         | 80.0         |         |
| Investments in affiliates                                       |         |            | (8.3)          |              | (8.3)   |
|   | 183.0   | (9.0)      | (105.2)        |              | 68.8    |

Net cash provided by (used for) investing activities

**Cash flows from financing activities**

|  |         |       |        |    |                |    |            |
|--|---------|-------|--------|----|----------------|----|------------|
| Proceeds (repayments) of credit facilities, net              | (40.9)  |       | 70.4   |    | <b>29.5</b>    |    |            |
| Proceeds (repayments) of long-term debt, net                 | (119.1) | (4.7) | (2.2)  |    | <b>(126.0)</b> |    |            |
| Proceeds (repayments) of long-term inter-company debt, net   | (11.2)  | 21.5  | (10.3) |    |                |    |            |
| Debt issuance costs  | (0.9)   |       |        |    | <b>(0.9)</b>   |    |            |
| Activity under stock plan and other                          | 2.4     |       |        |    | <b>2.4</b>     |    |            |
| Net cash provided by (used for) financing activities         | (169.7) | 16.8  | 57.9   |    | <b>(95.0)</b>  |    |            |
| Effect of exchange rate changes on cash and cash equivalents |         | (0.5) | (1.4)  |    | <b>(1.9)</b>   |    |            |
| Net increase (decrease) in cash and cash equivalents         | 0.9     |       | 4.0    |    | <b>4.9</b>     |    |            |
| Cash and cash equivalents at beginning of year               | (0.9)   | 0.7   | 0.4    |    | <b>0.2</b>     |    |            |
| Cash and cash equivalents at end of year                     | \$      | \$    | 0.7    | \$ | 4.4            | \$ | <b>5.1</b> |

INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS OF BHA AERO COMPOSITE PARTS CO., LTD.

(A Sino-foreign equity joint venture established in the People's Republic of China)

We have audited the accompanying balance sheets of BHA Aero Composite Parts Co., Ltd. (the Company) as of December 31, 2002 and 2001, and the related statements of operations, owners' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 financial statements present fairly, in all material respects, the financial position of the BHA Aero Composite Parts Co., Ltd. at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company's recurring losses from operations and accumulated deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Deloitte Touche Tohmatsu

Deloitte Touche Tohmatsu  
Certified Public Accountants Ltd.  
Beijing, China  
March 2, 2003

BHA AERO COMPOSITE PARTS CO., LTD.  
BALANCE SHEETS

| <b>December 31,</b> |             | <b>December 31,</b> |             |
|---------------------|-------------|---------------------|-------------|
| <b>2001</b>         | <b>2002</b> | <b>2002</b>         | <b>2002</b> |
| <b>RMB</b>          | <b>RMB</b>  |                     | <b>US\$</b> |

**ASSETS**

## Current assets:

|                                    |                 |             |            |           |
|------------------------------------|-----------------|-------------|------------|-----------|
| Cash                               |                 | 104,374,290 | 3,516,469  | 424,833   |
| Account receivable - related party |                 |             | 5,423,054  | 655,172   |
| Other receivables                  | - others        | 3,150,437   | 1,154,352  | 139,460   |
|                                    | - related party |             | 364,013    | 43,977    |
| Value-added tax receivable         |                 | 696,125     | 3,512,760  | 424,385   |
| Prepaid expenses                   |                 | 59,087      | 139,595    | 16,865    |
| Advance to suppliers               |                 | 34,196      | 2,271,093  | 274,376   |
| Inventories                        |                 | 12,291,162  | 18,354,749 | 2,217,480 |
| Total current assets               |                 | 120,605,297 | 34,736,085 | 4,196,548 |

|                                    |  |             |             |            |
|------------------------------------|--|-------------|-------------|------------|
| Property, plant and equipment, net |  | 260,526,689 | 250,780,914 | 30,297,430 |
|------------------------------------|--|-------------|-------------|------------|

|                     |  |                    |                    |                   |
|---------------------|--|--------------------|--------------------|-------------------|
| <b>Total assets</b> |  | <b>381,131,986</b> | <b>285,516,999</b> | <b>34,493,978</b> |
|---------------------|--|--------------------|--------------------|-------------------|

**LIABILITIES AND OWNERS EQUITY**

## Current Liabilities:

|                           |                   |            |            |           |
|---------------------------|-------------------|------------|------------|-----------|
| Accounts payable          | - trade           | 625,138    | 4,002,034  | 483,495   |
|                           | - related party   |            | 41,221     | 4,980     |
| Other payables            | - others          | 32,071,673 | 5,233,684  | 632,294   |
|                           | - related parties | 1,494,514  | 9,646,676  | 1,165,438 |
| Accrued expenses          |                   | 16,745,053 | 11,105,218 | 1,341,647 |
| Total current liabilities |                   | 50,936,378 | 30,028,833 | 3,627,854 |

## Long-term Liabilities:

|                             |  |             |             |            |
|-----------------------------|--|-------------|-------------|------------|
| Deferred tax liability      |  | 406,000     | 406,000     | 49,050     |
| Long-term bank loans        |  | 216,022,240 | 233,416,680 | 28,199,616 |
| Total long-term liabilities |  | 216,428,240 | 233,822,680 | 28,248,666 |

|                   |  |             |             |            |
|-------------------|--|-------------|-------------|------------|
| Total liabilities |  | 267,364,618 | 263,851,513 | 31,876,520 |
|-------------------|--|-------------|-------------|------------|

## Commitments (Note 12)

## Owners Equity:

|                    |  |              |               |              |
|--------------------|--|--------------|---------------|--------------|
| Paid in capital    |  | 165,562,762  | 165,562,762   | 20,002,025   |
| Accumulated losses |  | (51,795,394) | (143,897,276) | (17,384,567) |
|                    |  | 113,767,368  | 21,665,486    | 2,617,458    |

|  |  |                    |                    |                   |
|--|--|--------------------|--------------------|-------------------|
| <b>Total Liabilities and Owners Equity</b> |  | <b>381,131,986</b> | <b>285,516,999</b> | <b>34,493,978</b> |
|--|--|--------------------|--------------------|-------------------|

See accompanying notes to financial statements.

BHA AERO COMPOSITE PARTS CO., LTD.  
STATEMENTS OF OPERATIONS

|                                      | Year ended<br>December 31,<br>2000<br>RMB<br>(unaudited) | Year ended<br>December 31,<br>2001<br>RMB | Year ended December 31,<br>2002<br>RMB |  | 2002<br>US\$ |
|--------------------------------------|--|---|--|--|--------------|
| Sales                                |  |   | 14,878,101                             |  | 1,797,458    |
| Cost of sales                        |  |   | (52,441,976)                           |  | (6,335,638)  |
| Gross loss                           |  |   | (37,563,875)                           |  | (4,538,180)  |
| Operating expenses:                  |  |   |  |  |              |
| Selling, general and administrative  | (3,288,193)  | (49,399,753)                              | (46,880,099)                           |  | (5,663,694)  |
| Loss from operations                 | (3,288,193)  | (49,399,753)                              | (84,443,974)                           |  | (10,201,874) |
| Other income (expense):              |  |   |  |  |              |
| Interest income                      |  | 2,405,474                                 | 669,453                                |  | 80,878       |
| Interest expense                     |  | (541,730)                                 | (7,640,625)                            |  | (923,082)    |
| Foreign exchange loss                |  | (79,896)                                  | (197,930)                              |  | (23,912)     |
| Other                                |  | (485,296)                                 | (488,806)                              |  | (59,054)     |
|                                      |  | 1,298,552                                 | (7,657,908)                            |  | (925,170)    |
| Net loss before income tax provision | 3,288,193  | 48,101,201                                | 92,101,882                             |  | 11,127,044   |
| Income tax provision    deferred     |  | 406,000                                   |  |  |              |
| Net loss                             | 3,288,193  | 48,507,201                                | 92,101,882                             |  | 11,127,044   |

See accompanying notes to financial statements.

BHA AERO COMPOSITE PARTS CO., LTD.  
STATEMENTS OF OWNERS' EQUITY

|                                      | <b>Paid-in capital</b> | <b>Accumulated</b> | <b>Total owners</b> |
|--------------------------------------|------------------------|--------------------|---------------------|
|                                      | <b>RMB</b>             | <b>losses</b>      | <b>equity</b>       |
|                                      | <b>RMB</b>             | <b>RMB</b>         | <b>RMB</b>          |
| Balance, January 1, 2000 (unaudited) | 66,516,090             |                    | 66,516,090          |
| Capital contribution (unaudited)     | 99,046,672             |                    | 99,046,672          |
| Net loss (unaudited)                 |                        | (3,288,193)        | (3,288,193)         |
| Balance, January 1, 2001             | 165,562,762            | (3,288,193)        | 162,274,569         |
| Net loss                             |                        | (48,507,201)       | (48,507,201)        |
| Balance, December 31, 2001           | 165,562,762            | (51,795,394)       | 113,767,368         |
| Net loss                             |                        | (92,101,882)       | (92,101,882)        |
| Balance, December 31, 2002           | 165,562,762            | (143,897,276)      | 21,665,486          |
| In US\$                              | 20,002,025             | (17,384,567)       | 2,617,458           |

See accompanying notes to financial statements.



BHA AERO COMPOSITE PARTS CO., LTD.  
STATEMENTS OF CASH FLOWS

|  | December 31,<br>2000<br>RMB<br>(unaudited) | December 31,<br>2001<br>RMB | December 31,<br>2002<br>RMB | December 31,<br>2002<br>US\$ |
|--|--|-----------------------------|-----------------------------|------------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |  |                             |                             |                              |
| Net loss   | (3,288,193)                                | (48,507,201)                | (92,101,882)                | (11,127,044)                 |
| Adjustments to reconcile net loss to net cash provided<br>by operating activities: |  |                             |                             |                              |
| Depreciation and amortization  | 265,193                                    | 2,416,887                   | 18,641,555                  | 2,252,130                    |
| Gain on disposal of fixed assets   |  |                             | 101,990                     | 12,322                       |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES</b>                                 |  |                             |                             |                              |
| Account receivable - related party   |  |                             | (5,423,054)                 | (655,172)                    |
| Other receivables - others   | (632,997)                                  | (2,517,440)                 | 1,996,085                   | 241,151                      |
| - related parties  |  |                             | (364,013)                   | (43,977)                     |
| Value-added tax receivable   |  | (696,125)                   | (2,816,635)                 | (340,284)                    |
| Prepaid expenses   | (59,523)                                   | 436                         | (80,508)                    | (9,726)                      |
| Advance to suppliers   |  | (34,196)                    | (2,236,897)                 | (270,245)                    |
| Inventories  |  | (12,291,162)                | (6,063,587)                 | (732,556)                    |
| Accounts payable - trade   |  | 625,138                     | 3,376,896                   | 407,971                      |
| - related party  |  |                             | 41,221                      | 4,980                        |
| Other payables - others  | 7,078,763                                  | 906,489                     | (1,257,055)                 | (151,868)                    |
| - related parties  |  |                             | 8,152,162                   | 984,882                      |
| Accrued expenses   | 1,290,756                                  | 15,454,297                  | (5,639,835)                 | (681,362)                    |
| Deferred tax liability   |  | 406,000                     |                             |                              |
| Net cash used in operating activities  | 4,653,999                                  | (44,236,877)                | (83,673,557)                | (10,108,798)                 |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |  |                             |                             |                              |
| Capital contribution   | 99,046,672                                 |                             |                             |                              |
| Purchase of property, plant and equipment  | (27,643,083)                               | (209,984,751)               | (34,697,037)                | (4,191,830)                  |
| Proceeds received from disposal of fixed assets                                    |  |                             | 118,333                     | 14,296                       |
| Net cash used in investing activities  | 71,403,589                                 | (209,984,751)               | (34,578,704)                | (4,177,534)                  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |  |                             |                             |                              |
| Bank borrowings  |  | 216,022,240                 | 17,394,440                  | 2,101,463                    |
| Net cash provided by financing activities  |  | 216,022,240                 | 17,394,440                  | 2,101,463                    |
| Net increase (decrease) in cash  | 76,057,588                                 | (38,199,388)                | (100,857,821)               | (12,184,870)                 |
| Cash at beginning of year  | 66,516,090                                 | 142,573,678                 | 104,374,290                 | 12,609,703                   |
| Cash at end of year  | 142,573,678                                | 104,374,290                 | 3,516,469                   | 424,833                      |

Supplemental Cash Flow Information Cash paid during the  
year:

|          |           |           |         |
|----------|-----------|-----------|---------|
| Interest | 1,922,079 | 7,250,911 | 876,000 |
|----------|-----------|-----------|---------|

See accompanying notes to financial statements.

BHA AERO COMPOSITE PARTS CO., LTD.

NOTES TO THE FINANCIAL STATEMENTS

## 1. ORGANIZATION AND PRINCIPAL ACTIVITIES

BHA Aero Composite Parts Co., Ltd. (the Company) was incorporated in Tianjin, the People's Republic of China (PRC) as a Sino-foreign equity joint venture with an operation period of 22 years commencing July 8, 1999. The Company is invested by Hexcel China Holdings Corporation (Hexcel China), Boeing International Holdings, Ltd. (Boeing) and China Aviation Industry Corporation (China Aviation). Total registered capital of the Company is US\$20,000,001, which is equivalent to RMB165,562,762, and each investor has equal share in the Company.

The Company is primarily engaged in the manufacturing of aero composite parts. Major raw materials were purchased from Hexcel Corporation and all sales have been made to Hexcel Corporation, in year 2002 and 2001. Hexcel Corporation is the holding company of Hexcel China.

## 2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). This basis of accounting differs from that used in the statutory financial statements of the Company, which are required to be prepared in accordance with the accounting principles and the relevant financial regulations as established by the Ministry of Finance of the PRC (PRC GAAP). There was no material difference except for capitalization of borrowing cost and recognition of deferred tax.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Going Concern* - The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements for the year ended December 31, 2002, the Company incurred a net loss of RMB92,101,882 (US\$11,127,044) and cash flows used in operating activities totaled RMB83,673,557 (US\$10,108,798). These factors indicate that the Company may potentially be unable to continue as a going concern.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis, to obtain additional financing and ultimately to attain successful operations. Management believes the Company can meet its obligations and sustain operations from a combination of additional equity and/or debt financing, which it is currently seeking, and the release of new products.



*Inventories* - Inventories are stated at the lower of cost (weighted average) or market.

*Property, plant and equipment, net* - Property, plant and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed over its estimate useful life using the straight-line method as follows:

|  |  |
|--|--|
| Land use rights                                  | Over the shorter of lease term or operation period |
| Buildings  | 20 years   |
| Machinery and production equipment               | 10 years   |
| System software and related electronic equipment | 5 years  |
| Motor vehicles                                   | 5 years  |

The Company constructs certain of its production equipment. In addition to costs under the construction contracts, internal costs directly related to the construction of such equipment including interest and salaries of certain employees, are capitalized. No depreciation is charged on construction in progress until the assets are operational.

*Impairment of Long-lived assets* - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets the Company would recognize an impairment loss. There was no impairment in the carrying value of long-lived assets at December 31, 2002 and 2001.

*Fair Value of Financial Instruments* The Company's financial instruments consist of cash, accounts receivable, accounts payable and bank borrowings. At December 31, 2002 and 2001, the fair value of such instruments approximated their financial statements carrying amounts.

*Revenue recognition* Revenue from products sold directly to the customer is recognized upon delivery. The Company does not record a provision for estimated returns and warranty costs at the time revenue is recognized. Estimated returns and warranty costs have not been material in any period presented.

*Foreign currencies* - Transactions in currencies other than RMB are translated at the approximate rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in currencies other than RMB are translated at the rates ruling on the balance sheet date. Exchange gains and losses are taken to the statement of operations.



*Convenience translation into United States Dollars* - The financial statements are presented in Renminbi. The translation of Renminbi amounts into United States dollars has been made for the convenience of the reader and has been made at the rate of exchange quoted by the People's Bank of China on December 31, 2002 of RMB8.2773 to US\$1.00. Such translation amounts should not be construed as representations that the Renminbi amounts could be readily converted into United States dollars at that rate or any other rate.

*Comprehensive loss* - SFAS No. 130, Reporting Comprehensive Income requires that an enterprise report by major components and as a single total, the change in its net assets from non-owner sources. Comprehensive loss equals net loss for both years ended December 31, 2002 and 2001.

*Capitalization of interest* - The Company capitalized interest costs based upon the cost of capital projects in progress during 2001. Capitalized interest of RMB2,708,650 (US\$327,238) in 2001, has been added to the cost of the underlying assets during the period and is amortized over the respective useful lives of the assets. Amortization expenses relating to capitalized interest for the year was RMB135,432 (US\$16,362), RMB11,286 and nil (unaudited) for 2002, 2001 and 2000, respectively.

*Income taxes* - Deferred income taxes are provided using the asset and liability method. Under this method, deferred income taxes are recognized for all significant temporary differences between the tax and financial statement bases of assets and liabilities and for net operating loss and tax credit carry forwards. The tax consequences of those differences are classified as current or non-current based upon the classification of the related asset or liability in the financial statements. A valuation allowance is provided to reduce the amount of deferred tax asset if it is considered more likely than not that some portion of, or all of, the deferred tax asset will not be realized.

*Use of estimates* - The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Segment information* - The company reports segment data pursuant to SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. The Company operates in one reportable segments (Note 13).

*Recently issued accounting standards* - In June 2001, the Financial Accounting Standards Board issued ( FASB ) issued SFAS No.141, Business Combinations, and SFAS No.142, Goodwill and Other Intangible Assets. SFAS No.141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method and addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No.142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No.142 provides that intangible assets with indefinite useful lives will not be amortized, but will be tested at least annually for impairment. The Company did not have goodwill or other intangible assets at December 31, 2002. Consequently, the adoption of SFAS No.142, effective January 1, 2002, did not have an impact on its financial statements.

In August 2001, FASB issued SFAS No.144, Accounting for Impairment of Disposal of Long-Lived Assets . SFAS No.144 supersedes SFAS No.121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The adoption of SFAS No.144, effective January 1, 2002, did not have an impact on its financial statements.

In June 2002, the FASB issued SFAS No.146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses accounting for restructuring and similar costs. SFAS No.146 supersedes previous accounting guidance, principally Emerging Issue Task Force Issue ( EITF ) No.94-3. The Company will adopt the provisions of SFAS No.146 for restructuring activities initiated after December 31, 2002. SFAS No.146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No.94-3, a liability for an exit cost was recognized at the date of commitment to an exit plan. SFAS No.146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No.146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized. The Company does not believe the adoption of such interpretation will have a material impact on its results of operations or financial position.

In November 2002, the FASB issued Interpretation Number 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ( FIN 45 ). This interpretation requires certain disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN 45 are effective for interim and annual periods after December 15, 2002 and the Company has adopted those requirements for these financial statements. The initial recognition and initial measurement requirements of FIN 45 are effective prospectively for guarantees issued or modified after December 31, 2002. The Company does not believe the adoption of such interpretation will have a material impact on its results of operations or financial position.



In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities. This interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. It explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. This interpretation applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company does not believe the adoption of such interpretation will have a material impact on its results of operations or financial position.

#### 4. INVENTORIES

|                  | December 31,<br>2001<br>RMB | December 31,<br>2002<br>RMB | December 31,<br>2002<br>US\$ |
|------------------|-----------------------------|-----------------------------|------------------------------|
| Raw materials    | 12,291,162                  | 13,201,120                  | 1,594,858                    |
| Work in progress |                             | 3,963,747                   | 478,870                      |
| Finished goods   |                             | 1,189,882                   | 143,752                      |
| Inventories      | 12,291,162                  | 18,354,749                  | 2,217,480                    |

#### 5. PROPERTY, PLANT AND EQUIPMENT, NET

|  | December 31,<br>2001<br>RMB | December 31,<br>2002<br>RMB | December 31,<br>2002<br>US\$ |
|--|-----------------------------|-----------------------------|------------------------------|
| Land use rights                                  | 5,092,160                   | 5,092,237                   | 615,205                      |
| Buildings  | 156,098,987                 | 161,513,897                 | 19,512,872                   |
| Machinery and production equipment               | 88,363,675                  | 84,550,008                  | 10,214,686                   |
| System software and related electronic equipment | 7,897,039                   | 19,515,807                  | 2,357,750                    |
| Motor vehicles                                   | 2,025,789                   | 1,534,589                   | 185,397                      |
|  | 259,459,650                 | 272,206,538                 | 32,885,910                   |
| Less: Accumulated depreciation and amortization  | (2,682,079)                 | (21,425,624)                | (2,588,480)                  |
|  | 256,777,571                 | 250,780,914                 | 30,297,430                   |
| Projects under construction                      | 3,749,118                   |                             |                              |
| Property, plant and equipment, net               | 260,526,689                 | 250,780,914                 | 30,297,430                   |

The depreciation and amortization expense for 2002, 2001 and 2000 was RMB18,641,555 (US\$2,252,130), RMB2,416,887 and RMB265,193 (unaudited), respectively.

## 6. ACCRUED EXPENSES

|                  | December 31,<br>2001<br>RMB | December 31,<br>2002<br>RMB | December 31,<br>2002<br>US\$ |
|------------------|-----------------------------|-----------------------------|------------------------------|
| Interest accrual | 1,328,300                   | 1,718,015                   | 207,557                      |
| Payroll accrual  | 12,842,780                  | 3,661,610                   | 442,368                      |
| Other accruals   | 2,573,973                   | 5,725,593                   | 691,722                      |
| Accrued expenses | 16,745,053                  | 11,105,218                  | 1,341,647                    |

## 7. LONG TERM BANK LOANS

As of December 31, 2002, the Company had total long term credit facilities, composed of US dollar loan and RMB loan facilities, for working capital purposes totaling US\$21,333,334 and RMB88,320,000 (equivalent to US\$10,670,146) expiring in May 2004 and July 2004 respectively. The US dollar loan facilities are guaranteed by Hexcel China and Boeing and the RMB loan facilities are guaranteed by China Aviation. Unused facilities was US\$2,533,334 and RMB10,516,560 (equivalent to US\$1,270,530) as of December 31, 2002.

|   | December 31,<br>2001<br>RMB | December 31,<br>2002<br>RMB | December 31,<br>2002<br>US\$ |
|---|-----------------------------|-----------------------------|------------------------------|
| Loans drawn down from US dollar facilities bear interest at rate of LIBOR plus 0.5% per annum (2.417% weighted average in 2002) and due in May 2004 | 144,012,840                 | 155,613,240                 | 18,800,000                   |
| Loans drawn down from RMB facilities bear interest at a rate of 4.437% per annum and due in July 2004.  | 72,009,400                  | 77,803,440                  | 9,399,616                    |
|   | 216,022,240                 | 233,416,680                 | 28,199,616                   |

## 8. TAXATION

*Income tax*

The Company is governed by the Income Tax Law of the PRC (the "Income Tax Laws"). Under the Income Tax Laws, companies generally are subject to income tax at an effective rate of 33% (30% state income taxes plus 3% local income taxes) on income as reported in their statutory financial statements after appropriate tax adjustments unless the enterprise is located in specially designated regions or cities for which more favorable effective rates apply.



Pursuant to the Income Tax Laws, companies approved as manufacturing enterprises with operation period more than 10 years are eligible for a two-year exemption from income tax followed by a 50% reduction of income tax for the next three years. Since the Company is located in Tianjin new technology development zone, it also enjoys a reduced income tax rate at 15% with approval.

No current year tax provision has been made as the Company does not has any taxable income in 2002 and 2001.

*Deferred tax*

Significant components of the Company's deferred income tax liabilities are as follows:

|                                  | <b>December 31,</b> |             | <b>December 31,</b> |
|----------------------------------|---------------------|-------------|---------------------|
|                                  | <b>2001</b>         | <b>2002</b> | <b>2002</b>         |
|                                  | <b>RMB</b>          | <b>RMB</b>  | <b>US\$</b>         |
| <b>Deferred tax liabilities:</b> |                     |             |                     |
| Interest capitalization          | (406,000)           | (406,000)   | (49,050)            |
| Total deferred tax liabilities   | (406,000)           | (406,000)   | (49,050)            |

Significant components of deferred income tax assets are as follows:

|                                   | <b>December 31,</b> |              | <b>December 31,</b> |
|-----------------------------------|---------------------|--------------|---------------------|
|                                   | <b>2001</b>         | <b>2002</b>  | <b>2002</b>         |
|                                   | <b>RMB</b>          | <b>RMB</b>   | <b>US\$</b>         |
| <b>Deferred tax assets:</b>       |                     |              |                     |
| Net operating loss carry forwards |                     | 12,556,000   | 1,516,920           |
| Inventory valuation               |                     | 1,395,000    | 168,533             |
| Depreciation and amortization     | 8,114,000           | 8,968,000    | 1,083,445           |
| Total deferred tax assets         | 8,114,000           | 22,919,000   | 2,768,898           |
| Valuation allowance               | (8,114,000)         | (22,919,000) | (2,768,898)         |
| Total net deferred tax assets     |                     |              |                     |

At December 31, 2002, the Company had tax loss carry-forwards of approximately RMB83.71 million (US\$10.11 million), which expire in 2007. The utilization of the carry forwards is dependant upon the future profitability of the Company. A full valuation allowance was taken by the Company due to the uncertainties of their eventual realization.



9. VALUE ADDED TAX

The Company is subject to value added tax at a rate of 17% on product sales. Value added tax payable on sales is computed net of value added tax paid on purchases for all domestic sales. For all good produced for overseas sales purpose, the Company is entitled to an exemption on value added taxes on the sales amount and conversely the input value added tax levied on the raw materials purchased is allowed to be settled with any domestic sales incurred in the future. The Company did not generate any domestic sales in 2002, 2001 and 2000 therefore the Company has not recorded any value added tax payable.

10. DISTRIBUTION OF PROFITS

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprises, the Company is required to make appropriations from net income as determined under accounting principles generally accepted in the PRC ( PRC GAAP ) to non-distributable reserves which include a general reserve, an enterprise expansion reserve and a employee welfare and bonus reserve.

The general reserve is used to offset future extraordinary losses as defined under PRC GAAP. The Company may, upon a resolution passed by the owners, convert the general reserve into capital. The employee welfare and bonus reserve is used for the collective welfare of the employees of the Company. The enterprise expansion reserve is used for the expansion of the Company and can be converted to capital subject to approval by the relevant authorities. The Company did not record any reserves in 2002, 2001 and 2000 as the Company incurred loss under PRC GAAP. Therefore was not required to record such reserves.

11. RELATED PARTY TRANSACTIONS

All sales generated in 2002 were made to Hexcel Corporation. The balance related to such sales is included in account receivable - related party balance.

The Company purchases raw materials from Hexcel Corporation. Total raw materials purchased from Hexcel Corporation in 2002, 2001 and 2000 was RMB1.68 million (US\$0.20 million), Nil and Nil (unaudited), respectively. The balance related to such purchases are included in accounts payable - related party balance.

Other receivables from related party represented reimbursements paid on behalf of Hexcel Corporation, which are non-interest bearing, unsecured and repayable on demand.

Other payables to investors are as follows:

|                              | December 31,<br>2001<br>RMB | 2002<br>RMB | December 31,<br>2002<br>US\$ |
|------------------------------|-----------------------------|-------------|------------------------------|
| <b>Royalty fee payables:</b> |                             |             |                              |
| Hexcel Corporation           |                             | 80,559      | 9,733                        |
| Boeing                       |                             | 40,279      | 4,866                        |
| China Aviation               |                             | 60,419      | 7,299                        |
|                              |                             | 181,257     | 21,898                       |
| <b>Temporary advance:</b>    |                             |             |                              |
| Hexcel Corporation           | 275,991                     | 275,991     | 33,344                       |
| <b>Reimbursements:</b>       |                             |             |                              |
| Hexcel Corporation           | 1,218,523                   | 7,139,157   | 862,498                      |
| Boeing                       |                             | 2,050,271   | 247,698                      |
|                              | 1,218,523                   | 9,189,428   | 1,110,196                    |
|                              | 1,494,514                   | 9,646,676   | 1,165,438                    |

The reimbursements represents salaries and related benefits paid by the investors on behalf of the Company.

Pursuant to the royalty agreements signed between the Company and the investors. Royalty fee is calculated based on a fixed percentage of the cash collection of the Company's annual sales and is payable on a semi-annual basis. Accordingly, the Company has recorded RMB181,257 (US\$21,898) in 2002 and Nil in 2001, and 2000 in royalty expenses.

At December 31, 2002 and 2001, the investors have guaranteed the Company's bank credit facilities and bank borrowings.

## 12. COMMITMENTS

Operating lease - As of December 31, 2002, the Company was committed under certain operating leases, requiring annual rental expense as follows:

RMB                      US\$

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|      |           |         |
|------|-----------|---------|
| 2003 | 2,727,000 | 329,455 |
| 2004 | 365,000   | 44,097  |
|      | 3,092,000 | 373,552 |



The rent expense in 2002, 2001 and 2000 was RMB3,889,533 (US\$469,904), RMB3,250,379 and RMB274,443 (unaudited), respectively.

Commitments - at December 31, 2002, the Company had purchase commitments to purchase machinery and equipment for approximately RMB200,000 (US\$24,000) from a third party by April 30, 2003.

### 13. SEGMENT REPORTING

SFAS No. 131 requires disclosures regarding products and services, geographic areas, and major customers. The Company operates in one reportable segment. For the year ended December 31, 2002, the Company recorded revenue from a customer from the United States.

The Company generates revenue from one segment, products for aero composite parts. The Company's business activities and accounts receivable are with a sole customer, Hexcel Corporation. The Company will maintain allowances for estimated potential bad debt losses and will revise its estimates of collectibility on a periodic basis. There is no history of bad debt experience with Hexcel Corporation and collection of receivable is reasonably assured.

The Company's business growth is dependent on demand from Hexcel corporation. The slow down of airline industry globally will have a material adverse effect on the Company's business. The Company's customer base is concentrated and the loss of Hexcel Corporation could cause the Company's business to suffer.

### 14. EMPLOYEE RETIREMENT BENEFITS AND POST- RETIREMENT BENEFITS

The Company's employees in the PRC are entitled to retirement benefits calculated with reference to their basic salaries on retirement and their length of service in accordance with a government managed benefit plan. The government is responsible for the benefit liability to these retired employees. The Company has to contribute to the fund based on 25.7% of the employees' basic monthly salaries. The expense of such arrangements to the Company was approximately RMB1,187,111 (US\$143,418), RMB764,406 and RMB50,158 (unaudited) for the years ended December 31, 2002, 2001 and 2000, respectively. The Company is not obligated under any other post-retirement plans and does not provide any post-employment benefits.

**INDEPENDENT AUDITORS REPORT**

Asahi-Schwebel Co., Ltd.:

We have audited the accompanying consolidated balance sheet of Asahi-Schwebel Co., Ltd. (a majority-owned subsidiary of Asahi Kasei Corporation) and subsidiaries as of March 31, 2003, and the related consolidated statements of operations and unappropriated retained earnings, comprehensive income (loss), and cash flows for the year then ended (all expressed in Japanese yen). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of Asahi-Schwebel (Taiwan) Co., Ltd. ( A-S (Taiwan) ), a consolidated subsidiary, which statements reflect total assets constituting 30% of consolidated total assets as of March 31, 2003, and total revenues constituting 42% of consolidated total revenues for the year ended March 31, 2003. We also did not audit the financial statements of NITTOBO ASCO Glass Fiber Co., Ltd. ( NAG ), a 50% owned equity investee of the Company, the Company's investment in which is accounted for by use of the equity method. The Company's equity of ¥1,993,999 thousand in NAG's net assets at December 31, 2002, and of ¥91,136 thousand, in that company's net income for the year ended December 31, 2002, are included in the accompanying consolidated financial statements. The financial statements of A-S (Taiwan) and NAG were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for A-S (Taiwan) and NAG, are based solely on the reports of such other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Asahi-Schwebel Co., Ltd. and subsidiaries as of March 31, 2003, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte Touche Tohmatsu

May 29, 2003  
Osaka, Japan

## Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

Consolidated Balance Sheets  
March 31

(Amounts in Thousands of Japanese Yen, Except Share Amounts)

|  | Notes | 2003             | 2002<br>(Unaudited) |
|--|-------|------------------|---------------------|
| <b>ASSETS</b>                                      |       |                  |                     |
| <b>CURRENT ASSETS:</b>                             |       |                  |                     |
| Cash and cash equivalents                          |       | ¥ 357,426        | ¥ 80,163            |
| Notes and accounts receivable - principally trade: |       |                  |                     |
| Customers  |       | 2,055,998        | 1,947,195           |
| Shareholders and affiliated companies              | 9     | 24,458           | 17,976              |
| Allowance for doubtful receivables                 |       | (11,581)         | (12,832)            |
| Inventories:                                       | 1     |                  |                     |
| Finished products                                  |       | 1,005,352        | 1,074,568           |
| Work in process                                    |       | 884,786          | 1,017,703           |
| Raw materials and supplies                         |       | 406,281          | 445,058             |
| Refundable consumption tax                         |       | 70,307           | 37,766              |
| Deferred income taxes                              | 1,7   | 203,563          |                     |
| Other current assets                               |       | 110,760          | 249,044             |
| <b>Total current assets</b>                        |       | <b>5,107,350</b> | <b>4,856,641</b>    |
| <b>PROPERTY, PLANT, AND EQUIPMENT - At cost:</b>   |       |                  |                     |
| Land and improvements                              |       | 1,423,874        | 1,435,549           |
| Buildings and improvements                         |       | 5,385,438        | 5,490,982           |
| Machinery and equipment                            |       | 17,067,123       | 17,619,356          |
| Construction in progress                           |       | 649,094          | 168,271             |
| Total  |       | 24,525,529       | 24,714,158          |
| Less accumulated depreciation                      | 1     | 16,521,151       | 15,723,885          |
| <b>Net property, plant, and equipment</b>          |       | <b>8,004,378</b> | <b>8,990,273</b>    |
| <b>OTHER ASSETS:</b>                               |       |                  |                     |
| Investments in affiliated companies                | 2     | 3,960,677        | 4,260,444           |
| Goodwill   | 1     | 807,410          | 807,410             |
| Deferred income taxes non-current                  | 1,7   | 110,499          |                     |
| Income tax receivable                              |       | 70,416           |                     |
| Other  | 1     | 356,750          | 149,269             |

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|                    |   |            |   |            |
|--------------------|---|------------|---|------------|
| Total other assets |   | 5,305,752  |   | 5,217,123  |
| TOTAL              | ¥ | 18,417,480 | ¥ | 19,064,037 |

See the accompanying notes to consolidated financial statements.

## Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

## Consolidated Balance Sheets (continued)

March 31

(Amounts in Thousands of Japanese Yen, Except Share Amounts)

|   | Notes | 2003             | 2002<br>(Unaudited) |
|---|-------|------------------|---------------------|
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |       |                  |                     |
| <b>CURRENT LIABILITIES:</b>   |       |                  |                     |
| Short-term bank loans   | 3     | ¥ 4,139          | ¥ 105,831           |
| Short-term loans from Asahi Finance Co., Ltd., affiliated company;<br>interest at 0.31% in 2003 and 0.40% in 2002 |       | 1,482,497        | 642,231             |
| Current maturities of long-term debt  | 3     | 587,547          | 523,700             |
| Notes and accounts payable:   |       |                  |                     |
| Shareholders and affiliated companies   | 9     | 1,410,218        | 409,093             |
| Other   |       | 238,493          | 1,088,735           |
| Payable for purchases of equipment  |       | 67,743           | 66,966              |
| Accrued income taxes  | 7     | 16,338           | 15,794              |
| Deferred income taxes   | 1,7   |                  | 48,667              |
| Other accrued expenses - principally salaries, wages, and bonuses   |       | 536,919          | 559,465             |
| <b>Total current liabilities</b>  |       | <b>4,343,894</b> | <b>3,460,482</b>    |
| <b>LONG-TERM LIABILITIES:</b>   |       |                  |                     |
| Long-term debt, less current maturities   | 3     | 1,561,415        | 1,833,775           |
| Deferred income taxes   | 1,7   |                  | 22,247              |
| Accrued pension liabilities   | 1,6   | 7,935            | 3,553               |
| <b>Total long-term liabilities</b>  |       | <b>1,569,350</b> | <b>1,859,575</b>    |
| <b>MINORITY INTEREST</b>  |       | <b>2,467,435</b> | <b>2,457,094</b>    |
| <b>SHAREHOLDERS EQUITY:</b>   |       |                  |                     |
| Common stock - authorized, 2,400,000 shares; issued and outstanding,<br>1,296,000 shares                          | 4     | 648,000          | 648,000             |
| Capital surplus   |       | 217,800          | 217,800             |
| Retained earnings:  |       |                  |                     |
| Appropriated for legal reserve  | 5     | 162,000          | 162,000             |
| Unappropriated  | 1     | 9,458,981        | 10,282,538          |
| Accumulated other comprehensive loss  | 8     | (449,980)        | (23,452)            |

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|                            |   |            |   |            |
|----------------------------|---|------------|---|------------|
| Total shareholders' equity |   | 10,036,801 |   | 11,286,886 |
| TOTAL                      | ¥ | 18,417,480 | ¥ | 19,064,037 |

See the accompanying notes to consolidated financial statements.

## Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

Consolidated Statements of Operations and Unappropriated Retained Earnings  
Years Ended March 31

(Amounts in Thousands of Japanese Yen)

|  | Notes    | 2003        | 2002<br>(Unaudited) | 2001<br>(Unaudited) |
|--|----------|-------------|---------------------|---------------------|
| <b>REVENUES:</b>   |          |             |                     |                     |
|  | 9        |             |                     |                     |
| Net sales  |          | ¥ 9,958,898 | ¥ 9,234,508         | ¥ 19,678,420        |
| Interest and other   |          | 46,394      | 202,679             | 93,136              |
| Total revenues   |          | 10,005,292  | 9,437,187           | 19,771,556          |
| <b>COST AND EXPENSES:</b>  |          |             |                     |                     |
|  | 1,6,9,10 |             |                     |                     |
| Cost of goods sold   |          | 10,052,206  | 10,218,931          | 15,451,712          |
| Selling, general, and administrative expenses  |          | 1,073,388   | 1,123,521           | 1,361,069           |
| Interest and other   |          | 73,226      | 122,655             | 178,692             |
| Research and development   |          | 66,406      | 156,253             | 148,401             |
| Total cost and expenses  |          | 11,265,226  | 11,621,360          | 17,139,874          |
| <b>INCOME (LOSS) BEFORE INCOME TAXES,<br/>MINORITY INTEREST AND EQUITY IN NET<br/>INCOME OF AFFILIATED COMPANY</b> |          |             |                     |                     |
|  |          | (1,259,934) | (2,184,173)         | 2,631,682           |
| <b>INCOME TAXES:</b>   |          |             |                     |                     |
|  | 1,7      |             |                     |                     |
| Current  |          | (14,525)    | 7,263               | 1,230,862           |
| Deferred   |          | (400,635)   | (603,312)           | (351,304)           |
| Total income taxes   |          | (415,160)   | (596,049)           | 879,558             |
| <b>INCOME (LOSS) BEFORE MINORITY<br/>INTEREST AND EQUITY IN NET INCOME OF<br/>AFFILIATED COMPANY</b>               |          |             |                     |                     |
|  |          | (844,774)   | (1,588,124)         | 1,752,124           |
| <b>MINORITY INTEREST</b>   |          |             |                     |                     |
|  |          | 69,919      | (158,531)           | 421,673             |
| <b>EQUITY IN NET INCOME OF AFFILIATED<br/>COMPANY</b>  |          |             |                     |                     |
|  |          | 91,136      | 281,176             | 357,560             |
| <b>NET INCOME (LOSS)</b>   |          |             |                     |                     |
|  | 1        | (823,557)   | (1,148,417)         | 1,688,011           |
| <b>UNAPPROPRIATED RETAINED EARNINGS,<br/>BEGINNING OF YEAR</b>   |          |             |                     |                     |
|  |          | 10,282,538  | 11,675,899          | 10,063,056          |
| <b>Total</b>   |          |             |                     |                     |
|  |          | 9,458,981   | 10,527,482          | 11,751,067          |

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|  |   |   |           |         |            |        |            |
|--|---|---|-----------|---------|------------|--------|------------|
| DEDUCT - Cash dividend                           |   |   |           | 244,944 |            | 75,168 |            |
| UNAPPROPRIATED RETAINED EARNINGS,<br>END OF YEAR | 5 | ¥ | 9,458,981 | ¥       | 10,282,538 | ¥      | 11,675,899 |

See the accompanying notes to consolidated financial statements.



## Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)  
Years Ended March 31

(Amounts in Thousands)

|  | 2003          | 2002          | 2001        |
|--|---------------|---------------|-------------|
|  |               | (Unaudited)   | (Unaudited) |
| Net Income (Loss)  | ¥ (823,557)   | ¥ (1,148,417) | ¥ 1,688,011 |
| Other Comprehensive Income (Loss):   |               |               |             |
| Unrealized holding gains (losses) on investment securities - (Net of income taxes of ¥2,164, ¥5,601, and ¥2,208 for 2003, 2002, and 2001)      | 3,020         | (7,818)       | (3,083)     |
| Reclassification adjustments for write-down and sales of investment securities - (Net of income taxes of ¥3,366 and ¥19,724 for 2003 and 2002) | (4,699)       | 27,530        |             |
| Foreign currency translation adjustment  | (424,849)     | 36,392        | 374,347     |
| Total other comprehensive income (loss)  | (426,528)     | 56,104        | 371,264     |
| Comprehensive Income (Loss)  | ¥ (1,250,085) | ¥ (1,092,313) | ¥ 2,059,275 |

See the accompanying notes to consolidated financial statements.

## Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

Consolidated Statements of Cash Flows  
Years Ended March 31

(Amounts in Thousands)

|  | 2003        | 2002          | 2001        |
|--|-------------|---------------|-------------|
|  |             | (Unaudited)   | (Unaudited) |
| <b>OPERATING ACTIVITIES:</b>   |             |               |             |
| Net income (loss)  | ¥ (823,557) | ¥ (1,148,417) | ¥ 1,688,011 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |             |               |             |
| Depreciation and amortization  | 1,249,060   | 1,147,791     | 1,771,912   |
| Provision for allowance for doubtful receivables   | (1,251)     | (16,000)      | 4,209       |
| Loss on disposal of property, plant, and equipment   | 25,818      | 27,106        | 34,885      |
| Loss on sales of investment securities   | 8,545       |               |             |
| Write-down of investment securities  |             | 51,307        |             |
| Deferred income taxes  | (400,635)   | (603,312)     | (351,304)   |
| Minority interest  | 69,919      | (158,531)     | 421,673     |
| Equity in net income of affiliated company   | (91,136)    | (281,176)     | (357,560)   |
| Decrease (increase) in receivables-principally trade   | (115,285)   | 1,592,146     | (773,674)   |
| Decrease (increase) in inventories   | 240,910     | 872,554       | (946,916)   |
| Decrease (increase) in refundable consumption tax  | (32,541)    | 10,629        | (3,605)     |
| Decrease (increase) in other current assets  | 138,285     | (290,689)     | 32,581      |
| Increase (decrease) in accrued income taxes  | 544         | (1,066,481)   | 903,213     |
| Increase (decrease) in payables - principally trade  | 150,883     | (2,161,982)   | 937,573     |
| Increase in other accrued expenses   | (50,047)    | 23,018        | 559         |
| Net cash provided by (used in) operating activities  | 369,512     | (2,002,037)   | 3,361,557   |
| <b>INVESTING ACTIVITIES:</b>   |             |               |             |
| Purchases of property, plant, and equipment  | (750,316)   | (832,364)     | (1,022,010) |
| Increase (decrease) in payable for purchase of equipment   | 7,070       | (182,664)     | 16,360      |
| Proceeds from sales of property, plant, & equipment  | 2,562       | 567           | 157         |
| Proceeds from sales of investment securities   | 28,857      |               |             |
| Decrease (increase) in other assets  | (291,160)   | 15,621        | (8,931)     |
| Decrease (increase) in short-term loans to an affiliated company                                   |             | 2,515,000     | (1,590,000) |
| Net cash provided by (used in) investing activities  | (1,002,987) | 1,516,160     | (2,604,424) |
| <b>FINANCING ACTIVITIES:</b>   |             |               |             |
| Increase (decrease) in short-term bank loans   | (93,579)    | 105,831       |             |
| Increase in short-term loans from an affiliated company  | 840,266     | 642,231       |             |
| Increase in long term loans  | 176,028     |               |             |
| Payments of long-term debt   | (333,200)   | (486,739)     | (919,921)   |

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|   |   |           |           |           |
|---|---|-----------|-----------|-----------|
| Payments of lease obligations                                       |   | (10,033)  |           | (16,783)  |
| Dividend paid   |   | (244,944) |           | (75,168)  |
| Dividend paid to minority interest                                  |   | (59,579)  |           |           |
| Dividend from NAG   |   | 390,903   | 342,149   | 328,283   |
| Net cash provided by (used in) financing activities                 |   | 920,839   | 348,495   | (683,589) |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b> |   |           |           |           |
|   |   | (10,101)  | (3,162)   | 12,886    |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>         |   |           |           |           |
|   |   | 277,263   | (140,544) | 86,430    |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>                 |   |           |           |           |
|   |   | 80,163    | 220,707   | 134,277   |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>                       |   |           |           |           |
|   | ¥ | 357,426   | ¥         | 80,163    |
|   |   |           | ¥         | 220,707   |
| <b>ADDITIONAL CASH FLOW INFORMATION:</b>                            |   |           |           |           |
| Cash paid during the year for:                                      |   |           |           |           |
| Interest  | ¥ | 66,856    | ¥         | 75,883    |
| Income taxes  |   | 966       | 1,140,276 | 312,247   |

See the accompanying notes to consolidated financial statements.

Asahi-Schwebel Co., Ltd. (A Majority-owned Subsidiary of Asahi Kasei Corporation) and Subsidiaries

Notes to Consolidated Financial Statements

Years Ended March 31, 2003, 2002 (Unaudited), and 2001 (Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Description of Business* - The Company and its subsidiaries operate in a single industry, the manufacture and sale of industrial and decorative fabrics containing fiberglass. Most of the Companies' products are sold to customers in the electronics industry and are used as materials for printed circuit boards.

Significant accounting policies applied in the preparation of the accompanying consolidated financial statements are summarized as follows:

*Consolidation* - The consolidated financial statements include the accounts of Asahi-Schwebel Co., Ltd. ( the Company ), its 51% owned subsidiary, Asahi-Schwebel (Taiwan) Co., Ltd. ( A-S (Taiwan) ) and its wholly owned subsidiary, ASCO Taiwan Co., Ltd. ( ASCOT ), (together the Companies ). The Company established ASCOT (authorized capital New Taiwan Dollar 1,000,000) on June 19, 2000 under the laws of the Republic of China to engage in wholesaling of other chemical products (glass yarn, glass cloth and glass fiber) and international trade. Significant intercompany items have been eliminated upon consolidation.

The Company's 50% investment in NITTOBO ASCO Glass Fiber Co., Ltd. ( NAG ) is accounted for using the equity method.

The accompanying consolidated financial statements are stated in Japanese Yen, the currency of the country in which the Company is incorporated and operates, and have been prepared on the basis of accounting principles generally accepted in the United States of America.

*Use of Estimates* - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Significant Customer* - Sales to one customer accounted for approximately 19.1%, 16.0%, and 13.4% of net sales for the years ended March 31, 2003, 2002, and 2001. One additional customer accounted for approximately 13.2 % of net sales for the year ended March 31, 2001. No other customers singly accounted for 10% or more of net sales.

*Cash and Cash Equivalents* - Cash and cash equivalents include cash on hand, demand deposits, and time deposits with an original maturity of three months or less.

*Inventories* are stated at the lower of cost or market. Cost is determined principally using the average-cost method for inventories held by the Company and by the first-in, first-out method for inventories held by A-S (Taiwan).

**Investment Securities** - Investment securities consist of marketable equity securities and are included in other assets - other . In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 115, all of the Company s investment securities are classified as available for sale and, accordingly, are carried at fair value. Net unrealized gains or losses, net of applicable income taxes, are included in other comprehensive income. At March 31, 2003 and 2002, the investment securities aggregate fair value, gross unrealized holding gains, and gross unrealized holding losses were as follows:

|                                 | 2003           | 2002     |
|---------------------------------|----------------|----------|
|                                 | (in thousands) |          |
| Aggregate fair value            | ¥ 404          | ¥ 33,074 |
| Gross unrealized holding gains  | 43             | 7,946    |
| Gross unrealized holding losses | 112            | 13,198   |

**Depreciation of Property, Plant, and Equipment** is computed over the estimated useful lives of the assets using the straight-line method. The ranges of estimated useful lives used in the computation of depreciation are generally as follows:

|                            |              |
|----------------------------|--------------|
| Buildings and improvements | 7 - 50 years |
| Machinery and equipment    | 4 - 60 years |

**Impairment of Long-Lived Assets** - Effective April 1, 2002, the Companies adopted Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . This statement provides one accounting model for the impairment or disposal of long-lived assets. This statement also changes the criteria for classifying an asset as held for sale and broadens the scope of business to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The effect of the adoption of this statement was not material.

Management reviews long-lived assets for impairment of value whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. In such an event, the estimated future undiscounted cash flows associated with the asset is compared with the carrying value of the asset to determine if a write-down is required. If this evaluation indicates that the carrying value exceeds the fair value of the long-lived asset, the Companies recognize an impairment loss based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using anticipated cash flows discounted at a rate commensurate with the risk involved.

**Goodwill** - Prior to April 1, 2002, the excess of the purchase cost of A-S (Taiwan) and NAG over the Company s equity in the fair value of the underlying net assets at the date of acquisition (goodwill) was amortized on a straight-line basis over a period of 30 years and 10 years, respectively.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 142, Goodwill and Other Intangible Assets, which was adopted by the Company effective April 1, 2002. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets.

Effective April 1, 2002, in accordance with SFAS No. 142, the Company ceased amortizing goodwill, which decreased net loss by ¥281,368 thousand, and changed to an impairment - only approach. Accordingly, goodwill is no longer amortized and is tested for impairment at least annually. Management has concluded that there was no impairment of goodwill at March 31, 2003.

**Liability for Severance Payments and Pension Costs** - The Company has a contract with Asahi Kasei Corporation (Asahi Kasei), which provides that the Company's liability for severance-payment and non-contributory pension plans is to be settled by semi-annual lump-sum cash payments to Asahi Kasei (see Note 7). As provided in the contract, the Company's obligations under severance-payment and non-contributory pension plans are limited to amounts incurred during the year and shall be settled by making semi-annual lump-sum cash payments to Asahi Kasei. Payments are equal to one-half of the amount which would be paid by the Company if all eligible employees involuntarily terminated their employment as of the balance sheet date.

A-S (Taiwan) has a non-contributory pension plan covering all its regular employees. At March 31, 2003 and 2002, the accrued pension liability under the plan was ¥7,936 thousand and ¥3,553 thousand, respectively.

**Fair Value of Financial Instruments** - The fair values of financial instruments were approximately equal to the book values, except for marketable equity securities included in other assets - other and forward exchange contracts (see Note 12). Fair values were estimated using quoted market prices and other appropriate valuation techniques based on information available at March 31, 2003 and 2002.

**Deferred Income Taxes** - Under SFAS No. 109, deferred tax assets or liabilities are computed based on the differences between the financial statement and income tax bases of assets and liabilities using the enacted tax rate. Deferred income tax expenses or credits are based on the change in the assets and liabilities from period to period, subject to an ongoing assessment for realization.

**Revenue Recognition** - The Companies generally recognize revenue when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred resulting in transfer of title and risk of loss, (3) the sales price is fixed or determinable, and (4) collectibility is reasonably assured.

**Foreign Currency Translation** - The Company translates the financial statements of its foreign subsidiary in accordance with SFAS No. 52, Foreign Currency Translation. All assets and liabilities of the subsidiary are translated at year-end exchange rates, while revenue and expenses are translated at average exchange rates prevailing during the year. Adjustments for foreign currency translation fluctuations are excluded from net income and are included as a separate component of consolidated shareholders' equity.

**Guarantor's Accounting and Disclosure Requirements for Guarantees** - In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45), which addresses the disclosure to be made by a guarantor in its financial statements about its obligations under guarantees. The disclosure requirements are effective for financial statements ending after December 15, 2002. FIN 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees. FIN 45 requires the guarantor to recognize at the inception of the guarantee, a liability for the fair value of



the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions are effective for all guarantees within the scope of FIN 45 issued or modified after December 31, 2002. The Companies have adopted the disclosure requirements of FIN 45 (see Note 12) and the recognition and measurement provisions for all guarantees entered into or modified after December 31, 2002. The recognition and initial measurement provisions did not have a significant impact on the consolidated financial statements.

**Recently issued accounting pronouncements** -In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires that the fair value of a liability for asset retirement obligations be realized in the period that it is incurred if a reasonable estimate of fair value can be made. Companies are required to adopt SFAS No. 143 for fiscal years beginning after June 15, 2002, but early adoption is encouraged. The Company adopted SFAS No. 143 effective April 1, 2003. The adoption of SFAS No. 143 did not have a material effect on its results of operations and financial position.

In June 2002, the FASB issued SFAS No. 146, Accounting for Exit or Disposal Activities. SFAS No. 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under EITF No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) . The scope of SFAS No. 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS No. 146 will be effective for exit of disposal activities that are initiated after December 31, 2002 but early application is encouraged. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of EITF No. 94-3 prior to the adoption of SFAS No. 146. Adopting the provisions of SFAS No. 146 will change, on a prospective basis, the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred. The Company does not believe that adoption of this statement will have a material impact on its results of operations or financial position.

## 2. INVESTMENTS IN AFFILIATED COMPANIES

On December 20, 1999, the Company acquired 50% of the total outstanding shares of NAG, for ¥4,033,900 thousand in cash. NAG was established on January 15, 1988 under the laws of the Republic of China for manufacturing E-type continuous filament glass fiber yarns and started operations in December 1989. The excess of the cost over the fair market value of the net assets acquired was ¥2,477,259 thousand. Accumulated amortization was ¥1,669,849 thousand as of March 31, 2003.

The Company recognized its share of the net income of NAG based on NAG's fiscal year ended of December 31. Certain financial information of NAG for the years ended December 31, 2002, 2001, and 2000 is presented below:

|                                    | 2002           | 2001        | 2000 |
|------------------------------------|----------------|-------------|------|
|                                    | (in thousands) |             |      |
| Current assets                     | ¥ 1,668,341    | ¥ 2,008,871 |      |
| Property, plant, and equipment-net | 5,059,165      | 6,013,637   |      |
| Other assets                       | 304,188        | 357,673     |      |
| Total assets                       | ¥ 7,031,694    | ¥ 8,380,181 |      |
| Current liabilities                | ¥ 1,995,830    | ¥ 2,463,838 |      |
| Non-current liabilities            | 1,047,866      | 3,469,845   |      |
| Total liabilities                  | ¥ 3,043,696    | ¥ 5,933,682 |      |

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|            |   |           |   |           |   |           |
|------------|---|-----------|---|-----------|---|-----------|
| Net sales  | ¥ | 4,087,613 | ¥ | 4,043,852 | ¥ | 5,441,707 |
| Net income | ¥ | 153,478   | ¥ | 1,041,718 | ¥ | 1,501,754 |

Dividends received from NAG for the years ended March 31, 2003, 2002, and 2001 were ¥391 million, ¥342 million, and ¥328 million, respectively.

### 3. SHORT-TERM DEBT AND LONG-TERM DEBT

The annual interest rate applicable to the short-term bank loans were 3.5% and 2.8% at March 31, 2003 and 2002, respectively.

Long-term debt at March 31, 2003 and 2002 consisted of the following:

|   | 2003           |           | 2002        |
|---|----------------|-----------|-------------|
|   | (in thousands) |           |             |
| Loans from Sumitomo Mitsui Banking Corporation due through 2007 at 1.89%    | ¥              | 450,000   | ¥ 550,000   |
| Loans from Mizuho Corporate Bank due through 2007 at 1.863%                 |                | 450,000   | 550,000     |
| Loans from Nippon Life Insurance Company due through 2007 at 1.79%          |                | 600,400   | 733,600     |
| Loans from Land Bank due through 2004 at 2.985% (*)                         |                | 302,662   | 523,875     |
| Loans from China Development Industrial Bank due through 2007 at 2.985% (*) |                | 345,900   |             |
| Total   |                | 2,148,962 | 2,357,475   |
| Less current maturities   |                | 587,547   | 523,700     |
| Long-term loans, less current maturities                                    | ¥              | 1,561,415 | ¥ 1,833,775 |

(\*) Land, building, machinery and equipment with a cost of approximately ¥1,455,228 thousand and ¥1,674,809 thousand were pledged as guarantee for these bank loans at March 31, 2003 and 2002, respectively.

At March 31, 2003, the aggregate annual maturities of long-term debt are as follows:

|                       | (in thousands) |           |
|-----------------------|----------------|-----------|
| Year ending March 31: |                |           |
| 2004                  | ¥              | 587,547   |
| 2005                  |                | 544,310   |
| 2006                  |                | 414,597   |
| 2007                  |                | 414,597   |
| 2008                  |                | 187,911   |
| Total                 | ¥              | 2,148,962 |

### 4. COMMON STOCK

As of March 31, 2003, the Company is 66.7% owned by Asahi Kasei, a Japanese corporation, and 33.3% owned by Clark-Schwebel Holding Corporation ( Clark-Schwebel ), a United States corporation. On July 16, 2002, Clark-Schwebel sold 10% of its shares of the Company to Asahi Kasei in accordance with the Articles of Incorporation of the Company and the Joint-Venture Agreement.

The transfer of shares of the Company s common stock, as well as the transfer of any rights to such shares, is subject to restrictions under the Articles of Incorporation of the Company and the Joint-Venture Agreement, as amended as of November 10, 1970 and October 31, 1983, among the above-mentioned shareholders.

## 5. RETAINED EARNINGS AND DIVIDENDS

Japanese companies are subject to the Japanese Commercial Code (the Code) to which certain amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital.

The revised Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve until such reserve and additional paid-in capital equals 25% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

The amount of retained earnings available for dividends under the Commercial Code of Japan is based on the amount recorded in the Company's general books of account. The adjustments mentioned in Note 2, which have not been recorded in the Company's general books of account have no effect on retained earnings available for the payment of dividends under the Code. The amount of the Company's retained earnings available for dividends as of March 31, 2003 was 8,250,074 thousand.

## 6. SEVERANCE-PAYMENT AND PENSION PLANS

The Company has a contract with Asahi Kasei to allow individuals utilized by the Company who are employed by Asahi Kasei to participate in their severance-payment plan and contributory and non-contributory pension plans. Under this contract, the Company is liable for severance payments based on the individual's length of service with the Company (see Note 1 as to settlement of the liability).

Under the severance-payment plan, employees (other than certain directors) are entitled, upon reaching mandatory retirement age of 60 or upon earlier voluntary retirement, to severance payments based generally on compensation at the time of retirement and years of service.

The pension plans cover substantially all employees. The contributory pension plan generally provides for lifetime pension payments, whereas the non-contributory pension plan provides pension payments for a period of ten years, commencing upon the mandatory retirement at age 60. The benefits under the plans are based on factors generally the same as those for the severance-payment plan.

Charges to operations for the years ended March 31, 2003, 2002, and 2001 with respect to the Companies' severance-payment and pension plans were ¥144,147 thousand, ¥146,736 thousand, and ¥139,714 thousand, respectively.

## 7. INCOME TAXES

The effective income tax rates of the Companies for the years ended March 31, 2003, 2002, and 2001 were 33.0%, 27.3%, and 33.4%, respectively, compared to the normal Japanese statutory income tax rate of 41.7%. The effective income tax rate for 2003, 2002, and 2001 were less than the statutory rate, due principally to a lower tax rate applicable to income (loss) of A-S (Taiwan) and ASCOT.

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Japanese corporation tax law allows taxpayers to carry forward for 5 years the remainder of credit limitations that are not actually used and also to carry forward for 3 years the excess of foreign taxes.

On March 31, 2003, a tax reform law was enacted in Japan, which changed the normal effective statutory tax rate from approximately 41.7% to 40.4%, effective for years beginning April 1, 2004. The effect of this change on deferred taxes in the consolidated statements of operations for the year ended March 31, 2003 was to increase in net loss by approximately ¥28 million.

The approximate effects of temporary differences that gave rise to deferred tax balances at March 31, 2003 and 2002 were as follows:

|   | Net Deferred<br>Tax Assets<br>(Current) | Net Deferred<br>Tax Assets<br>(Non-<br>Current) |
|---|---|---|
|   | (in thousands)                          |   |
| <b>2003</b>                                     |   |   |
| Inventories                                     | ¥ 79,119                                |   |
| Accrued vacation pay                            | 29,369                                  |   |
| Accrued bonus                                   | 44,994                                  |   |
| Accrued social welfare tax                      | 5,955                                   |   |
| Undistributed earnings of NAG                   | (97,237)                                |   |
| Depreciation                                    |   | ¥ 103,306                                       |
| Excess of A-S (Taiwan) land book over tax basis |   | (842,557)                                       |
| Investment                                      |   | 210,443   |
| Net loss of ASC                                 | 141,916                                 | 588,814   |
| Net loss of AST                                 |   | 48,793  |
| Other temporary differences                     | (553)                                   | 1,700   |
| <b>Total</b>                                    | <b>¥ 203,563</b>                        | <b>¥ 110,499</b>                                |

|   | Net Deferred<br>Tax Assets<br>(Current) | Net Deferred<br>Tax<br>Liabilities<br>(Non-<br>Current) |
|---|---|---|
|   | (in thousands)                          |   |
| <b>2002</b>                                     |   |   |
| Inventories                                     | ¥ 26,682                                |   |
| Accrued vacation pay                            | 32,546                                  |   |
| Enterprise taxes                                | 36,136                                  |   |
| Accrued bonus                                   | (151,190)                               |   |
| Depreciation                                    |   | ¥ (39,436)  |
| Excess of A-S (Taiwan) land book over tax basis |   | (842,557)   |



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|                             |   |          |   |          |
|-----------------------------|---|----------|---|----------|
| Reserve for retirement plan |   |          |   | 243,454  |
| Investment                  |   |          |   | 542,895  |
| Net loss of AST             |   |          |   | 72,509   |
| Other temporary differences |   | 7,159    |   | 888      |
| Total                       | ¥ | (48,667) | ¥ | (22,247) |

**8. OTHER COMPREHENSIVE INCOME (LOSS)**

Change in accumulated other comprehensive income (loss) is as follows:

|   | (in thousands) |            |            |
|---|----------------|------------|------------|
|   | 2003           | 2002       | 2001       |
| <b>Unrealized loss on investment securities:</b>            |                |            |            |
| Balance at beginning of year                                | ¥ 1,638        | ¥ (18,074) | ¥ (14,991) |
| Adjustments for the year                                    | (1,679)        | 19,712     | (3,083)    |
| Balance at end of year                                      | (41)           | 1,638      | (18,074)   |
| <b>Foreign currency translation adjustment:</b>             |                |            |            |
| Balance at beginning of year                                | (25,090)       | (61,482)   | (435,829)  |
| Adjustments for the year                                    | (424,849)      | 36,392     | 374,347    |
| Balance at end of year                                      | (449,939)      | (25,090)   | (61,482)   |
| <b>Total accumulated other comprehensive income (loss):</b> |                |            |            |
| Balance at beginning of year                                | (23,452)       | (79,556)   | (450,820)  |
| Adjustments for the year                                    | (426,528)      | 56,104     | 371,264    |
| Balance at end of year                                      | ¥ (449,980)    | ¥ (23,452) | ¥ (79,556) |

**9. SIGNIFICANT TRANSACTIONS AND BALANCES WITH SHAREHOLDERS AND AFFILIATED COMPANIES**

During the years ended March 31, 2003, 2002, and 2001, transactions with shareholders, other than payments with respect to severance-payment and pension plans described in Notes 1 and 7, and affiliated companies consisted principally of the following:

|  | (in thousands) |         |           |
|--|----------------|---------|-----------|
|  | 2003           | 2002    | 2001      |
| <b><u>Asahi Kasei, shareholder</u></b>               |                |         |           |
| Net sales  |                | ¥ 1,475 |           |
| Office and plant administrative service fees charged | ¥ 275,527      | 384,549 | ¥ 410,235 |
| Plant utilities charged                              | 397,444        | 371,322 | 617,849   |
| Rent charged (see Note 11)                           | 92,761         | 135,007 | 134,667   |
| Interest income                                      | 179            | 1,602   | 1,543     |
| Purchases of machinery                               |                | 29,920  |           |

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|               |  |         |        |
|---------------|--|---------|--------|
| Dividend paid |  | 138,802 | 42,595 |
|---------------|--|---------|--------|

Clark-Schwebel, shareholder

|           |  |        |       |
|-----------|--|--------|-------|
| Net sales |  | 13,309 | 1,848 |
|-----------|--|--------|-------|

|               |  |         |        |
|---------------|--|---------|--------|
| Dividend paid |  | 106,142 | 32,573 |
|---------------|--|---------|--------|

Asahi Finance Co., Ltd., affiliated company

|                              |  |     |       |
|------------------------------|--|-----|-------|
| Interest on loans receivable |  | 947 | 5,813 |
|------------------------------|--|-----|-------|

|               |       |     |  |
|---------------|-------|-----|--|
| Interest paid | 2,091 | 369 |  |
|---------------|-------|-----|--|

|                |     |  |  |
|----------------|-----|--|--|
| Commitment fee | 290 |  |  |
|----------------|-----|--|--|

Asahi Chemical Trading Service Co., Ltd., affiliated company

|           |        |        |        |
|-----------|--------|--------|--------|
| Net sales | 12,353 | 10,405 | 25,043 |
|-----------|--------|--------|--------|

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|  | (in thousands) |           |           |
|--|----------------|-----------|-----------|
|  | 2003           | 2002      | 2001      |
| <u>Asahi Kasei Information System Co. Ltd., affiliated company</u> |                |           |           |
| Purchase of software   | ¥ 273,991      |           |           |
| System support fees charged  | 42,572         | ¥ 80,991  | ¥ 27,269  |
| Computer business support  |                | 3,045     | 5,655     |
| <u>Sun Trading Co., Ltd., affiliated company</u>                   |                |           |           |
| Net sales  | 18,770         | 13,049    | 19,317    |
| <u>Asahi AT Home Co., Ltd., affiliated company</u>                 |                |           |           |
| Net sales  | 6,517          | 4,725     | 3,890     |
| <u>NAG, affiliated company</u>                                     |                |           |           |
| Purchases of raw materials   | 771,493        | 1,287,438 | 2,387,968 |
| Commission received  |                | 6,073     | 15,328    |
| <u>Moriyama Hohsoh Co., Ltd., affiliated company</u>               |                |           |           |
| Service fees charged   | 385,917        | 506,486   | 553,015   |
| Dividends  | 150            | 150       |           |
| <u>Hexcel Fabrics, affiliated company</u>                          |                |           |           |
| Net sales  | 4,789          | 8,962     | 9,311     |
| Purchase of raw materials  |                | 1,614     |           |
| <u>Hexcel-Schwebel, affiliated company</u>                         |                |           |           |
| Net Sales  | 14,450         |           |           |
| Purchase of materials  | 4,585          |           |           |
| <u>Hexcel-Co., affiliated company</u>                              |                |           |           |
| Royalty fee  | 5,997          |           |           |

Significant balances with shareholders and affiliated companies at March 31, 2003 and 2002 were as follows:

Receivables from

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|  | 2003           |        | 2002     |
|--|----------------|--------|----------|
|  | (in thousands) |        |          |
| Affiliated companies:                    |                |        |          |
| Sun Trading Co., Ltd.                    | ¥              | 5,892  | ¥ 4,477  |
| Asahi Chemical Trading Service Co., Ltd. |                | 6,375  | 4,020    |
| Clark-Schwebel Fiber Glass               |                |        | 4,583    |
| Hexcel Schwebel Corporation              |                | 6,850  |          |
| Hexcel Fabrics                           |                | 4,790  | 4,456    |
| Other                                    |                | 551    | 440      |
| <b>Total receivables</b>                 | ¥              | 24,458 | ¥ 17,976 |

Payables to

|                                       | 2003           |           | 2002 |         |
|---------------------------------------|----------------|-----------|------|---------|
|                                       | (in thousands) |           |      |         |
| Shareholder - Asahi Kasei             | ¥              | 1,283,039 | ¥    | 78,453  |
| Affiliated companies:                 |                |           |      |         |
| Asahi Kasei Wakkar Silicone Co., Ltd. |                |           |      | 718     |
| Asahi Kasei Amidas Co., Ltd.          |                |           |      | 309     |
| NAG                                   |                | 93,761    |      | 312,699 |
| Moriyama Hohsoh Co., Ltd.             |                | 32,762    |      | 16,916  |
| Hexcel Schwebel Corporation           |                | 656       |      |         |
| Total payables                        | ¥              | 1,410,218 | ¥    | 409,093 |

**10. LEASE AGREEMENTS AND RENT EXPENSE**

The Company leases office and warehouse space and the land upon which its plant is situated from Asahi Kasei, shareholder, under lease agreements which are cancelable by the Company without material penalties. The office and warehouse space is leased on a month-to-month or quarterly basis and the land is leased under the terms of an agreement which provides for automatic annual renewals. Rent expense for the years ended March 31, 2003, 2002, and 2001, principally relating to the above lease agreements, amounted to ¥92,761 thousand, ¥156,497 thousand, and ¥164,948 thousand, respectively.

**11. FORWARD EXCHANGE CONTRACTS**

The Financial Accounting Standards Board issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* in June 1998 and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, an amendment of FASB Statement No. 133 in June 2000. These statements require all derivatives to be recognized as assets or liabilities on the balance sheet and measured at fair value. Changes in the fair value of derivatives should be recognized in either net income or other comprehensive income, depending on the designated purpose of the derivative. These statements for the Company were effective as of April 1, 2001.

The Company uses derivative financial instruments for purposes to reduce its exposure to fluctuations in foreign currencies and to minimize the risk and cost associated with financial activities, primarily related to U.S. dollar denominated accounts receivable. Gains or losses on these derivatives are recorded in the consolidated statement of operations as an offset to the related gains or losses on the hedged accounts receivable.

As of March 31, 2003, total contract amounts of forward exchange contracts to sell foreign currency were USD 512 thousand. These contracts mature at various dates through May 31, 2003, and their fair values were ¥682 thousand.

**12. COMMITMENTS AND CONTINGENCIES**

Purchase commitments for capital expenditures totaled ¥95,868 thousand at March 31, 2003.

The Company has guaranteed a portion of NAG's bank loans in an aggregate amount of ¥519,000 thousand. With respect to certain other borrowings of NAG, the Company has agreed to maintain its 50% ownership in NAG as long as any portion of the loan balance remains unpaid.

**Report of Independent Accountants**

To the Shareholders of NITTOBO ASCO Glass Fiber Co., Ltd.:

In our opinion, the accompanying balance sheet and the related statements of income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of NITTOBO ASCO Glass Fiber Co., Ltd. at December 31, 2002 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers  
Taipei, Republic of China  
May 28, 2003



**Report of Independent Accountants**

To the Shareholders of Asahi-Schwebel (Taiwan) Co., Ltd.:

In our opinion, the accompanying balance sheet and the related statements of income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Asahi-Schwebel (Taiwan) Co., Ltd. at March 31, 2003 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers  
Taipei, Republic of China  
April 11, 2003

**REPORT OF INDEPENDENT AUDITORS**

To the Board of Directors of Hexcel S.A.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholder's equity and comprehensive income and of cash flows present fairly, in all material respects, the financial position of Hexcel S.A. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets effective January 1, 2002.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP  
Stamford, Connecticut  
July 8, 2003

**Hexcel S.A. and Subsidiaries****Consolidated Balance Sheets****As of December 31,**

| (In millions)  | 2002     | 2001     |
|--|----------|----------|
| <b>Assets</b>  |          |          |
| Current assets:                                      |          |          |
| Cash and cash equivalents                            | \$       | \$       |
| Accounts receivable, net                             | 39.1     | 37.7     |
| Accounts receivable, related parties                 | 3.2      | 2.0      |
| Notes receivable, related parties                    | 9.4      | 8.9      |
| Inventories, net                                     | 24.8     | 19.7     |
| Prepaid expenses and other assets                    | 2.7      | 3.6      |
| Total current assets                                 | 79.2     | 71.9     |
| Net property, plant and equipment                    | 33.5     | 30.3     |
| Goodwill, net  | 1.8      | 1.5      |
| Note receivable, related party                       | 15.7     |          |
| Other assets   | 1.2      | 0.1      |
| Total assets   | \$ 131.4 | \$ 103.8 |
| <b>Liabilities and Stockholder's Equity</b>          |          |          |
| Current liabilities:                                 |          |          |
| Notes payable  | \$ 1.7   | \$ 3.2   |
| Accounts payable                                     | 15.5     | 14.1     |
| Accounts payable, related parties                    | 6.0      | 5.0      |
| Accrued compensation and benefits                    | 7.1      | 5.2      |
| Business consolidation and restructuring liabilities |          | 2.7      |
| Other accrued liabilities                            | 3.7      | 2.6      |
| Total current liabilities                            | 34.0     | 32.8     |
| Long-term retirement obligations                     | 2.7      | 2.4      |
| Other non-current liabilities                        | 3.6      | 5.3      |
| Total liabilities                                    | 40.3     | 40.5     |
| Commitments and contingencies (see Note 13)          |          |          |
| Stockholder's equity:                                |          |          |
| Parent's net investment                              | 87.5     | 76.8     |
| Accumulated other comprehensive income (loss)        | 3.6      | (13.5)   |
| Total stockholder's equity                           | 91.1     | 63.3     |

|  |    |              |    |       |
|--|----|--------------|----|-------|
| Total liabilities and stockholder's equity | \$ | <b>131.4</b> | \$ | 103.8 |
|--|----|--------------|----|-------|

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

**Hexcel S.A. and Subsidiaries****Consolidated Statements of Operations****For the Years Ended December 31,**

| (In millions)                                     | 2002     | 2001     |
|---|----------|----------|
| Net sales   | \$ 200.7 | \$ 218.1 |
| Cost of sales                                     | 165.2    | 181.5    |
| Gross margin                                      | 35.5     | 36.6     |
| Selling, general and administrative expenses      | 15.8     | 19.0     |
| Research and technology expenses                  | 2.0      | 2.5      |
| Business consolidation and restructuring expenses | 1.4      | 3.4      |
| Operating income                                  | 16.3     | 11.7     |
| Interest income (expense), net                    | 0.4      | (0.1)    |
| Income before income taxes                        | 16.7     | 11.6     |
| Provision for income taxes                        | 6.0      | 4.4      |
| Net income  | \$ 10.7  | \$ 7.2   |

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

Hexcel S.A. and Subsidiaries

Consolidated Statements of Stockholders' Equity and Comprehensive Income

For the Years Ended December 31, 2002 and 2001

| (In millions)            | Parent's Net<br>Investment | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Stockholders'<br>Equity | Comprehensive<br>Income |
|--------------------------|----------------------------|--|----------------------------------|-------------------------|
| Balance, January 1, 2001 | \$ 69.6                    | \$ (6.8)   | \$ 62.8                          |                         |



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|  |    |             |       |               |    |             |
|--|----|-------------|-------|---------------|----|-------------|
| Net income                                   |    | 7.2         |       | 7.2           | \$ | 7.2         |
| Currency translation adjustments             |    |             | (3.8) | (3.8)         |    | (3.8)       |
| Net unrealized loss on financial instruments |    |             | (2.9) | (2.9)         |    | (2.9)       |
| <b>Comprehensive income</b>                  |    |             |       |               | \$ | 0.5         |
| <b>Balance, December 31, 2001</b>            | \$ | <b>76.8</b> | \$    | <b>(13.5)</b> | \$ | <b>63.3</b> |



|  |    |      |      |      |    |      |
|--|----|------|------|------|----|------|
| Net income                                   |    | 10.7 |      | 10.7 | \$ | 10.7 |
| Currency translation adjustments             |    |      | 13.3 | 13.3 |    | 13.3 |
| Net unrealized gain on financial instruments |    |      | 3.8  | 3.8  |    | 3.8  |
| <b>Comprehensive income</b>                  |    |      |      |      | \$ | 27.8 |
| <b>Balance, December 31, 2002</b>            | \$ | 87.5 | \$   | 3.6  | \$ | 91.1 |

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

**Hexcel S.A. and Subsidiaries****Consolidated Statements of Cash Flows****For the Years Ended December 31,**

| (In millions)   | 2002    | 2001   |
|---|---------|--------|
| <b>Cash flows from operating activities</b>                     |         |        |
| Net income  | \$ 10.7 | \$ 7.2 |
| Reconciliation to net cash provided by operations:              |         |        |
| Depreciation  | 5.3     | 6.2    |
| Amortization of goodwill  |         | 0.1    |
| Loss on disposal of fixed assets                                |         | 0.4    |
| Deferred income taxes   | 1.3     | (0.5)  |
| Business consolidation and restructuring expenses               | 1.4     | 3.4    |
| Business consolidation and restructuring payments               | (4.3)   | (0.7)  |
| Changes in assets and liabilities:                              |         |        |
| Decrease in accounts receivable                                 | 4.3     | 2.4    |
| Decrease (increase) in inventories                              | (1.3)   | 3.9    |
| Decrease (increase) in prepaid expenses and other assets        | 0.8     | (2.2)  |
| Increase (decrease) in accounts payable and accrued liabilities | 0.3     | (5.8)  |
| Changes in other non-current assets and long-term liabilities   | (0.8)   | 0.9    |
| Net cash provided by operating activities                       | 17.7    | 15.3   |
| <b>Cash flows from investing activities</b>                     |         |        |
| Capital expenditures  | (3.4)   | (5.4)  |
| Proceeds from sale of fixed assets                              | 0.3     |        |
| Net cash used for investing activities                          | (3.1)   | (5.4)  |
| <b>Cash flows from financing activities</b>                     |         |        |
| Borrowings under senior credit facility, net                    | 1.4     |        |
| Repayment of European credit and overdraft facilities, net      | (2.8)   | (1.4)  |
| Loans to related parties, net                                   | (13.2)  | (9.0)  |
| Net cash used for financing activities                          | (14.6)  | (10.4) |
| Effect of exchange rate changes on cash and cash equivalents    |         |        |
| Net increase (decrease) in cash and cash equivalents            |         | (0.5)  |
| Cash and cash equivalents at beginning of year                  |         | 0.5    |
| Cash and cash equivalents at end of year                        | \$      | \$     |

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 - Significant Accounting Policies**

*Nature of Operations and Basis of Consolidation*

Hexcel S.A. was incorporated to operate under the laws of a French Société Anonyme (S.A.), and is a wholly-owned subsidiary of Hexcel Corporation, a Delaware corporation. The consolidated financial statements include the historic assets, liabilities and related operations of Hexcel S.A. and its subsidiaries ( Hexcel S.A. or the Company ). All significant intercompany transactions have been eliminated.

The consolidated financial statements include an allocation of certain of Hexcel Corporation's corporate expenses. These expenses have been allocated to Hexcel S.A. on a basis considered by management to reasonably reflect the utilization of the services provided to Hexcel S.A., or the benefit obtained by Hexcel S.A. Measures and activity indicators used for allocation purposes include sales revenue, headcount, property and payroll expense. The Company's allocated corporate expenses included primarily administrative type costs. These allocations are not necessarily indicative of the amounts that would have been incurred or that would have been recorded by the Company if it existed on a stand-alone basis.

Hexcel S.A. is a leading producer of advanced structural materials. The Company develops, manufactures and markets lightweight, high-performance reinforcement products and composite materials for use in commercial aerospace, space and defense, electronics, and industrial applications. The Company's materials are used in a wide variety of end products, such as commercial and military aircraft, space launch vehicles and satellites, printed wiring boards, computers, cellular telephones, soft body armor, high-speed trains and ferries, cars and trucks, wind turbine blades, reinforcements for bridges and other structures, and recreational equipment.

*Use of Estimates*

The preparation of the consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Estimates are used for, but not limited to, allowances for doubtful accounts, inventory allowances, product warranty, depreciation and amortization, business consolidation and restructuring costs, employee benefits, income taxes, and contingencies. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents.

*Inventories*

Inventories are valued at the lower of cost or market, with cost determined using the first-in, first-out and average cost methods. The Company provides allowances for obsolete and unmarketable inventory. As of December 31, 2002 and 2001, inventory allowances were \$3.3 million and \$4.5 million, respectively.

*Property, Plant and Equipment*

Property, plant and equipment are recorded at cost and depreciated over estimated useful lives using the straight-line method. The estimated useful lives range from 10 to 20 years for buildings and improvements, from 6 to 15 years for machinery and manufacturing equipment, and from 3 to 5 years for office equipment. Repairs and maintenance are expensed as incurred, while major replacements and betterments are capitalized and depreciated over the estimated life of the related asset.

*Goodwill and Other Purchased Intangibles*

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets of an acquired business. Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No.142, Goodwill and Other Intangible Assets, ( FAS 142 ). Prior to adopting FAS 142, goodwill was amortized on a straight-line basis over estimated economic lives, i.e. 20 years. As a result of adopting FAS 142, goodwill is no longer amortized, but instead is tested for impairment at the reporting unit level at least annually and whenever events or changes in circumstances indicate that goodwill might be impaired. A reporting unit is the lowest level of an entity that is a business and can be distinguished from other activities, operations, and assets of the entity. If, during the annual impairment review, the book value of the reporting unit exceeds the fair value, the implied fair value of the reporting unit's goodwill is compared with the carrying amount of the unit's goodwill. If the carrying amount exceeds the implied fair value, goodwill is written down to its implied value. FAS 142 requires management to estimate the fair value of each reporting unit, as well as the fair value of the assets and liabilities of each reporting unit, other than goodwill. The implied fair value of goodwill is determined as the difference between the fair value of a reporting unit, taken as a whole, and the fair value of the assets and liabilities of such reporting unit. No impact to the Company's consolidated financial statements was identified upon completion of the transitional impairment test required by FAS 142. The Company's annual impairment testing date is during the fourth quarter of each year.

*Impairment of Long-Lived Assets*

Other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the assets from the estimated undiscounted future net cash flows, before interest and taxes, of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires estimates of these cash flows and fair value. The calculation of fair value may be determined based either on discounted cash flows or third party appraised values depending on the nature of the asset.

*Stock-Based Compensation*

Hexcel Corporation has provided certain employees of Hexcel S.A. with stock-based compensation, which is based upon Hexcel Corporation's publicly traded common share price (refer to Note 11). Stock-based compensation is accounted for under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ). Accordingly, compensation expense is not recognized when options are granted at the fair market value on the date of grant.

The Company has elected to continue following APB 25 to account for its stock-based compensation plans. The effects on net income as if the Company had applied the fair value method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( FAS 123 ) for the years ended December 31, 2002 and 2001 are as follows:

| (in millions)      | 2002 | 2001 |
|--------------------|------|------|
| <b>Net income:</b> |      |      |

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|   |    |       |    |       |
|---|----|-------|----|-------|
| Net income, as reported   | \$ | 10.7  | \$ | 7.2   |
| <i>Add:</i> Stock-based compensation expense included in reported net income, net of tax                            |    |       |    |       |
| <i>Deduct:</i> Stock-based compensation expense determined under fair value based method for all awards, net of tax |    | (0.1) |    | (0.1) |
| Pro forma net income  | \$ | 10.6  | \$ | 7.1   |



*Currency Translation*

The assets and liabilities of Hexcel S.A. are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. Cumulative currency translation adjustments are included in accumulated other comprehensive income (loss) in the stockholder's equity section of the consolidated balance sheets. Realized gains and losses from currency exchange transactions are recorded in selling, general and administrative expenses in the consolidated statements of operations and were not material to Hexcel S.A.'s consolidated results of operations in 2002 or 2001.

*Revenue Recognition*

Product sales are recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured, which is generally at the time of shipment. The Company accrues for sales returns and allowances based on its historical experience at the time of sale.

*Product Warranty*

The Company provides for an estimated amount of product warranty at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience.

*Shipping and Handling Costs*

The Company recognizes shipping and handling costs as incurred as a component of cost of sales in the consolidated statements of operations. Shipping and handling costs billed to the customer for reimbursement purposes were not significant.

*Research and Technology*

Research and technology costs are expensed as incurred.

*Income Taxes*

The Company provides for income taxes using the liability approach prescribed by the Financial Accounting Standards Board ( FASB ) in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ( FAS 109 ), and has been calculated on a separate return basis. Under the liability approach, deferred income tax assets and liabilities reflect tax carryforwards and the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets require a valuation allowance when it is more likely than not that some portion of the deferred tax assets may not be realized. The realization of deferred tax assets is dependent upon the timing and magnitude of future taxable income prior to the expiration of the deferred tax assets attributes. When events and circumstances so dictate, the Company evaluates the realizability of its deferred tax assets and the need for a valuation allowance by forecasting future taxable income.

*Concentration of Credit Risk*

Financial instruments that potentially subject Hexcel S.A. to significant concentrations of credit risk consist primarily of trade accounts receivable. The Company's sales to Airbus S.A.S. and its related subcontractors accounted for approximately 28% and 33% of the Company's 2002 and 2001 net sales, respectively. No other customer accounted for more than 10% of the Company's net sales. The Company performs ongoing credit evaluations of its customers' financial condition but generally does not require collateral or other security to support customer receivables. The Company establishes an allowance for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends, credit insurance and other financial information. As of December 31, 2002 and 2001, the allowance for doubtful accounts was \$1.2 million and \$1.4 million, respectively. Bad debt expense was \$0.2 million in 2002 and \$0.3 million in 2001.

*Dependence on Suppliers*

Hexcel S.A.'s ability to timely deliver its products is dependent upon the availability of quality materials used in these products. The Company depends in part upon suppliers to manufacture, assemble and deliver certain items in a timely and satisfactory manner. The Company obtains certain materials from single or a limited number of sources. A significant interruption in the delivery of such items could have a material adverse effect on the Company's consolidated financial condition, results of operations, and cash flows.

*Derivative Financial Instruments*

Hexcel S.A. uses various financial instruments, such as foreign currency forward exchange contracts, to manage its risk to market fluctuations by generating cash flows that offset, in relation to their amount and timing, the cash flows of certain foreign currency denominated transactions. The Company designates its foreign currency forward exchange contracts as cash flow hedges against forecasted foreign currency denominated transactions and reports the effective portions of changes in fair value of the instruments in other comprehensive income until the underlying hedged transactions affect income (see Note 12). The Company does not use financial instruments for trading or speculative purposes.

Effective January 1, 2001, Hexcel S.A. adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), and its corresponding amendments under Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, (FAS 138). FAS 133 requires an entity to recognize all derivatives as either assets or liabilities on its balance sheet and measure those instruments at fair value. Gains or losses resulting from changes in the fair values of those derivatives are accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The adoption of FAS 133 and FAS 138 did not have a material effect on the Company's consolidated financial position or results of operations.

*Recently Issued Accounting Standards*

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (FAS 146). FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured, initially at fair value, only when the liability is incurred; therefore, nullifying Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3) that required a liability for an exit cost to be recognized at the date of an entity's commitment to an exit plan. This change in accounting would be expected to result in a delayed recognition of certain types of costs, especially facility closure costs. The provisions of FAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. Since FAS 146 is effective only for new exit or disposal activities, adoption of this standard will not affect amounts currently reported in the Company's consolidated financial statements. However, the adoption of FAS 146 could affect the types and timing of costs included in any future business consolidation and restructuring programs. The Company adopted FAS 146 as of January 1, 2003.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, (FAS 148). FAS 148 amends FAS 123 to present alternative methods of transition for an entity that voluntarily adopts the fair value based method of accounting for stock-based employee compensation, and provides modifications to the disclosure provisions to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation in quarterly and annual financial statements. At this time, the Company has not

voluntarily adopted the fair value method of accounting under FAS 123. However, appropriate disclosures about the effects on reported net income of the Company's accounting policy with respect to stock-based employee compensation are provided above.

In November 2002, the FASB issued Financial Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, (FIN 45). FIN 45 requires a guarantor to disclose (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor's obligations under the guarantee; and (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability at fair value for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002.

FIN 45 also addresses the disclosure requirements regarding product warranties. Instead of disclosing the maximum potential amount of future payments under the product warranty guarantee, a guarantor is required to disclose its accounting policy and methodology used in determining its liability for product warranties, as well as, a tabular reconciliation of the changes in the guarantor's product warranty liability for the reporting period. The Company has included the new disclosures for product warranty herein (refer to Note 13).

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149). FAS 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under FAS 133. FAS 149 is generally effective for contracts entered into or modified after June 30, 2003, and should be applied prospectively. The Company is currently reviewing the provisions of this accounting standard, but does not expect a material impact to its consolidated financial position or results of operations upon adoption.

## Note 2 - Goodwill

Upon the Company's adoption of FAS 142 as of January 1, 2002, amortization of goodwill ceased. Although no amortization expense was recognized in 2002, the consolidated statements of operations include amortization expense of \$0.1 million in 2001.

Net income for the years ended December 31, 2002 and 2001, adjusted to exclude amortization expense, net of tax, are as follows:

| (in millions)                     | 2002    | 2001   |
|-----------------------------------|---------|--------|
| <b>Net income:</b>                |         |        |
| Net income                        | \$ 10.7 | \$ 7.2 |
| Goodwill amortization, net of tax |         | 0.1    |
| Adjusted net income               | \$ 10.7 | \$ 7.3 |

The gross carrying amount and accumulated amortization of goodwill, by the Company's reportable segments, as of December 31, 2002 and 2001, are as follows:

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| <i>(in millions)</i> | December 31, 2002     |                          |        | December 31, 2001     |                          |        |
|----------------------|-----------------------|--------------------------|--------|-----------------------|--------------------------|--------|
|                      | Gross Carrying Amount | Accumulated Amortization | Net    | Gross Carrying Amount | Accumulated Amortization | Net    |
| Reinforcements       | \$ 1.5                | \$ 0.4                   | \$ 1.1 | \$ 1.2                | \$ 0.3                   | \$ 0.9 |
| Composites           | 1.0                   | 0.3                      | 0.7    | 0.9                   | 0.3                      | 0.6    |
| Goodwill             | \$ 2.5                | \$ 0.7                   | \$ 1.8 | \$ 2.1                | \$ 0.6                   | \$ 1.5 |

Changes in the net carrying amount of goodwill for the years ended December 31, 2002 and 2001, by reportable segment, are as follows:

| (in millions)                          | Reinforcements |            | Composites |            | Total         |
|--|----------------|------------|------------|------------|---------------|
| <b>Balance as of January 1, 2001</b>   | \$             | 1.1        | \$         | 0.6        | \$ 1.7        |
| Amortization of goodwill               |                | (0.1)      |            |            | (0.1)         |
| Currency translation adjustments       |                | (0.1)      |            |            | (0.1)         |
| <b>Balance as of December 31, 2001</b> | \$             | 0.9        | \$         | 0.6        | \$ 1.5        |
| Currency translation adjustments       |                | <b>0.2</b> |            | <b>0.1</b> | <b>0.3</b>    |
| <b>Balance as of December 31, 2002</b> | \$             | <b>1.1</b> | \$         | <b>0.7</b> | \$ <b>1.8</b> |

**Note 3 - Business Consolidation and Restructuring Programs**

*November 2001 Program*

In November 2001, the Company announced, in conjunction with Hexcel Corporation, a program to restructure its business operations reflecting the revised business outlook for build rate reductions in commercial aircraft production, the continued depressed business conditions in the electronics market and the weakness in the global economy. The program targeted a reduction in cash fixed costs compared to previous spending rates and included company-wide reductions in managerial, professional, indirect manufacturing and administrative employees along with organizational rationalization. In connection with this program, the Company recognized charges of \$3.4 million in 2001. During 2002, the Company continued the implementation of this program and recognized business consolidation and restructuring expenses of \$1.4 million, which were expensed as incurred. The Company reduced its workforce by 68 employees as a result of this program.

Business consolidation and restructuring activities for this program and in the aggregate for Hexcel S.A. for the two years ended December 31, 2002, consisted of the following:

| (in millions)                                     | Employee<br>Severance | Facility &<br>Equipment | Total |
|---|-----------------------|-------------------------|-------|
| <b>Balance as of January 1, 2001</b>              | \$                    | \$                      | \$    |
| Business consolidation and restructuring expenses | 3.0                   | 0.4                     | 3.4   |
| Cash expenditures                                 | (0.3)                 | (0.4)                   | (0.7) |
| <b>Balance as of December 31, 2001</b>            | \$ 2.7                | \$                      | 2.7   |
| Business consolidation and restructuring expenses | 0.8                   | 0.6                     | 1.4   |
| Cash expenditures                                 | (3.7)                 | (0.6)                   | (4.3) |
| Currency translation adjustments                  | 0.2                   |                         | 0.2   |
| <b>Balance as of December 31, 2002</b>            | \$                    | \$                      | \$    |

**Note 4 - Inventories**

| (in millions)      | December 31,   |                |
|--------------------|----------------|----------------|
|                    | 2002           | 2001           |
| Raw materials      | \$ 6.4         | \$ 5.3         |
| Work in progress   | 3.6            | 3.2            |
| Finished goods     | 14.8           | 11.2           |
| <b>Inventories</b> | <b>\$ 24.8</b> | <b>\$ 19.7</b> |



**Note 5 Net Property, Plant and Equipment**

| (in millions)                     | December 31, |        |    |        |
|-----------------------------------|--------------|--------|----|--------|
|                                   |              | 2002   |    | 2001   |
| Land                              | \$           | 2.6    | \$ | 2.4    |
| Buildings                         |              | 11.0   |    | 8.6    |
| Equipment                         |              | 82.6   |    | 68.4   |
| Property, plant and equipment     |              | 96.2   |    | 79.4   |
| Less: accumulated depreciation    |              | (62.7) |    | (49.1) |
| Net property, plant and equipment | \$           | 33.5   | \$ | 30.3   |

**Note 6 - Notes Payable**

| (in millions)                            | December 31, |        |
|--|--------------|--------|
|  | 2002         | 2001   |
| Senior Credit Facility                   | \$ 1.6       | \$ 3.2 |
| European credit and overdraft facilities | 0.1          | 3.2    |
| Total notes payable                      | \$ 1.7       | \$ 3.2 |

#### *Senior Credit Facility*

Hexcel S.A. and its operating subsidiaries participated as a party to Hexcel Corporation's global credit facility (the Senior Credit Facility). The Senior Credit Facility, made available by a syndicate of banks, provided for ongoing working capital and other financing requirements. The Senior Credit Facility, which consisted of revolving credit, overdraft and term loan facilities, provided Hexcel Corporation and participating subsidiaries with committed lines of approximately \$297.6 million as of December 31, 2002, subject to certain limitations and facility sublimits relating to Hexcel Corporation's European subsidiaries. Hexcel S.A. had borrowing sublimits of \$40.0 million (\$20.0 million for each of its two operating subsidiaries) under the Senior Credit Facility. In addition, available borrowings for Hexcel S.A. and its operating subsidiaries were subject to borrowing base limitations computed as a percentage of eligible accounts receivable. Hexcel S.A.'s accounts receivable served as collateral for its advances under the Senior Credit Facility. As of December 31, 2002, Hexcel S.A.'s drawings under the Senior Credit Facility were \$1.6 million.

Hexcel Corporation and participating subsidiaries were subject to various financial covenants and restrictions under the Senior Credit Facility computed on a consolidated basis. Financial covenants and restrictions included limitations on incurring debt, granting liens, selling assets, repaying subordinated indebtedness, redeeming capital stock and paying dividends. At December 31, 2002, Hexcel Corporation was in compliance with all financial covenants under its Senior Credit Facility.

Hexcel S.A.'s weighted average interest rate on borrowings under the Senior Credit Facility was 6.65% for the year ended December 31, 2002. The Senior Credit Facility was scheduled to expire in 2004. On March 19, 2003, the Senior Credit Facility was paid in full (see Note 17).

#### *European Credit and Overdraft Facilities*

In addition to the Senior Credit Facility, Hexcel S.A. has access to limited credit and overdraft facilities provided by various local banks. These credit and overdraft facilities are terminable at the discretion of the lenders. The interest rates on these credit and overdraft facilities for the two years ended December 31, 2002, ranged from 3.3% to 5.1%. The aggregate maturities of the European credit and overdraft facilities are classified as current, as they are repayable on demand.

**Note 7 - Leasing Arrangements**

Certain processing equipment and manufacturing facilities are leased under operating leases. Rental expense under operating leases was \$0.2 million in 2002.

Scheduled future minimum lease payments under noncancelable leases as of December 31, 2002 were:

(in millions)

| <b>Payable during years ending December 31:</b> | <b>Operating</b> |
|---|------------------|
| 2003  | \$ 0.7           |
| 2004  | 1.2              |
| 2005  | 1.2              |
| 2006  | 1.2              |
| 2007  | 1.0              |
| Thereafter                                      | 4.9              |
| <b>Total minimum lease payments</b>             | <b>\$ 10.2</b>   |

**Note 8 - Related Party Transactions**

Hexcel S.A. conducts sales and purchase transactions with Hexcel Corporation and its subsidiaries. Hexcel S.A. also receives a commission from or pays a commission to Hexcel Corporation and its subsidiaries for sales services when product is shipped to certain countries or customers. In addition, Hexcel Corporation provides certain management, legal, tax, treasury and accounting services to Hexcel S.A. for a management fee.

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The following table provides the related party transactions for the years ended December 31, 2002 and 2001:

| (in millions)                                | 2002    | 2001    |
|--|---------|---------|
| Net sales                                    | \$ 44.2 | \$ 51.6 |
| Purchases                                    | 41.3    | 51.7    |
| Commissions received for sales services, net | 0.6     | 0.9     |
| Management fees                              | 3.4     | 5.7     |

As a result of these sales and purchase transactions, the Company had the following outstanding receivable and payable balances to and from Hexcel Corporation and its subsidiaries as of December 31, 2002 and 2001:

| (in millions)       | 2002   | 2001   |
|---------------------|--------|--------|
| Accounts receivable | \$ 3.2 | \$ 2.0 |
| Accounts payable    | 6.0    | 5.0    |

In 2002, Hexcel S.A. loaned Hexcel Holding (UK) Limited, a subsidiary of Hexcel Corporation, \$15.7 million with interest payable through July 2003 at 7.3%, with the interest rate to be adjusted thereafter. In addition, short-term loans are made from time-to-time to affiliated companies in Europe. Interest rates on short-term loans are at LIBOR plus 0.8% p.a. The recorded short-term notes receivable, related parties balance was \$9.4 million and \$8.9 million at December 31, 2002 and 2001 respectively. The Company recognized interest income of \$1.1 million and \$0.3 million for the years ended December 31, 2002 and 2001, respectively, on related party loans.

**Note 9 Retirement and Other Postretirement Benefit Plans**

Hexcel S.A provides all eligible employees with retirement benefits based on mandatory collective bargaining agreements. The calculation is performed annually and depends on employee seniority and staff level. As of December 31, 2002 and 2001, the Company had \$2.1 million and \$1.9 million, respectively, recorded in long-term retirement obligations relating to this retirement benefit.

In addition, Hexcel S.A. has recorded a long-term retirement obligation of \$0.6 million and \$0.5 million as of December 31, 2002 and 2001, respectively, to provide stated benefits to participating employees upon retirement. The retirement benefits were calculated by an independent actuary and relate to five employees.

**Note 10 - Income Taxes**

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Income before income taxes and the provision for income taxes, for the two years ended December 31, 2002, were as follows:

| (in millions)                    | 2002    | 2001    |
|----------------------------------|---------|---------|
| Income before income taxes:      | \$ 16.7 | \$ 11.6 |
| Provision for income taxes:      |         |         |
| Current                          | \$ 4.7  | \$ 4.9  |
| Deferred                         | 1.3     | (0.5)   |
| Total provision for income taxes | \$ 6.0  | \$ 4.4  |

A reconciliation of the provision for income taxes at the French statutory income tax rate of 35.4% and 36.4% to the effective income tax rate, for the years ended December 31, 2002 and 2001 respectively, is as follows:

| (in millions)  | 2002   | 2001   |
|--|--------|--------|
| Provision for taxes at French statutory rate                                 | \$ 5.9 | \$ 4.1 |
| Impact of different international tax rates, permanent differences and other | 0.1    | 0.3    |
| Total provision for income taxes   | \$ 6.0 | \$ 4.4 |

*Deferred Income Taxes*



Deferred income taxes result from net operating loss carryforwards and temporary differences between the recognition of items for income tax purposes and financial reporting purposes. Principal components of deferred income taxes as of December 31, 2002 and 2001, were:

| (in millions)              | 2002 |       | 2001 |       |
|----------------------------|------|-------|------|-------|
| Pension and profit sharing | \$   | 1.2   | \$   | 1.0   |
| Accelerated depreciation   |      | (4.6) |      | (3.6) |
| Reserves and other, net    |      | 0.5   |      | 1.3   |
| Net deferred tax liability | \$   | (2.9) | \$   | (1.3) |

**Note 11 Stock-Based Incentive Plans**

Hexcel Corporation has in effect various stock option and management incentive plans for eligible employees. Certain Hexcel S.A. employees are eligible to participate in these plans. The plans provide for awards in the form of stock options, stock appreciation rights, restricted stock, restricted stock units and other awards that are based on Hexcel Corporation's common stock price. Options to purchase Hexcel Corporation's common stock are generally granted at the fair market value on the date of grant. Substantially all of these options have a ten-year term and generally vest over a three-year period, except that the vesting period may be accelerated under certain circumstances.

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Stock option data for Hexcel S.A. employees participating in the Hexcel Corporation stock option plan for the years ended December 31, 2002 and 2001, was:

|   | Number of<br>Options | Weighted Average<br>Exercise Price |
|---|----------------------|------------------------------------|
| Options outstanding as of January 1, 2001   | 211,658              | \$ 11.22                           |
| Options granted                             | 26,900               | \$ 10.31                           |
| Options exercised                           | (11,735)             | \$ 5.91                            |
| Options expired or canceled                 | (5,467)              | \$ 14.34                           |
| Options outstanding as of December 31, 2001 | 221,356              | \$ 11.31                           |
| Options granted                             | <b>35,900</b>        | <b>\$ 2.74</b>                     |
| Options exercised                           |                      | \$                                 |
| Options expired or canceled                 | <b>(9,110)</b>       | <b>\$ 10.19</b>                    |
| Options outstanding as of December 31, 2002 | <b>248,146</b>       | <b>\$ 10.11</b>                    |

The total number of options exercisable for Hexcel S.A. employees participating in the Hexcel Corporation stock option plan as of December 31, 2002 and 2001 were 195,616 and 194,456, respectively, at a weighted average exercise price per share of \$11.45 for both year-ends.

The following table summarizes information about stock options outstanding for Hexcel S.A. employees participating in the Hexcel Corporation stock option plan as of December 31, 2002:

| Range of<br>Exercise Prices | Number of<br>Options<br>Outstanding | Options Outstanding                                 |  | Weighted<br>Average<br>Exercise<br>Price | Options Exercisable                 |  |
|-----------------------------|-------------------------------------|---|--|--|-------------------------------------|--|
|                             |                                     | Weighted<br>Average<br>Remaining<br>Life (in Years) |  |  | Number of<br>Options<br>Exercisable | Weighted<br>Average<br>Exercise<br>Price |
| \$ 2.74 5.74                | 35,900                              | 9.03  |  | \$ 2.74                                  |                                     | \$                                       |
| \$ 5.75 8.75                | 45,900                              | 4.79  |  | \$ 7.07                                  | 45,900                              | \$ 7.07                                  |
| \$ 8.76 10.49               | 25,209                              | 8.32  |  | \$ 10.30                                 | 8,579                               | \$ 10.27                                 |
| \$ 10.50 12.49              | 105,004                             | 2.10  |  | \$ 11.97                                 | 105,004                             | \$ 11.97                                 |
| \$ 12.50 24.00              | 36,133                              | 2.52  |  | \$ 15.78                                 | 36,133                              | \$ 15.78                                 |
| \$ 2.74 24.00               | 248,146                             | 4.29  |  | \$ 10.11                                 | 195,616                             | \$ 11.45                                 |

The weighted average fair value of stock options granted to Hexcel S.A. employees participating in the Hexcel Corporation stock option plan during 2002 and 2001 was \$1.92 and \$5.67, respectively, and was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

|                          | 2002         | 2001  |
|--------------------------|--------------|-------|
| Expected life (in years) | <b>5</b>     | 4     |
| Interest rate            | <b>2.78%</b> | 4.35% |
| Volatility               | <b>88.6%</b> | 68.9% |

Dividend yield

*Employee Stock Purchase Plan ( ESPP )*

Hexcel S.A. participates in Hexcel Corporation's ESPP, under which eligible employees may contribute up to 10% of their base earnings toward the quarterly purchase of Hexcel Corporation common stock at a purchase price equal to 85% of the fair market value of the common stock on the purchase date. The maximum number of shares of common stock reserved for issuance under the ESPP is 0.5 million. During 2002 and 2001, approximately one thousand shares of Hexcel Corporation common stock were issued to employees of Hexcel S.A. under the ESPP.

**Note 12 Derivative Financial Instruments**

*Foreign Currency Forward Exchange Contracts*

Hexcel S.A. is exposed to the impact of exchange rate volatility between the U.S. dollar and its functional currency, the Euro. During 2001, Hexcel S.A. entered into a number of foreign currency forward exchange contracts to exchange U.S. dollars for Euros at fixed rates on specified dates through March 2005. The aggregate notional amount of these contracts was \$25.0 million and \$32.9 million at December 31, 2002 and 2001, respectively. The purpose of these contracts is to hedge a portion of the forecasted transactions of Hexcel S.A. under long-term sales contracts with certain customers. These contracts are expected to provide Hexcel S.A. with a more balanced matching of future cash receipts and expenditures by currency, thereby reducing the Company's exposure to fluctuations in currency exchange rates. Effectiveness of the hedges is calculated by comparing the cumulative change in fair value of the underlying transaction being hedged to the cumulative change in fair value of the foreign currency forward exchange contracts based on changes in forward rates. For the years ended December 31, 2002 and 2001, hedge ineffectiveness was immaterial and the fair value of the foreign currency cash flow hedges recognized in comprehensive income was a net gain of \$3.8 million and a net loss of \$2.9 million, respectively. Approximately \$0.4 million of the amounts recorded in accumulated other comprehensive income (loss) at December 31, 2002, is expected to be reclassified into earnings in fiscal 2003 as the hedged sales are recognized.

**Note 13 Commitments and Contingencies**

Hexcel S.A. is involved in litigation, investigations and claims arising out of the normal conduct of its business, including those relating to commercial transactions, as well as to employment and health and safety matters. The Company estimates and accrues its liabilities resulting from such matters based on a variety of factors, including outstanding legal claims and proposed settlements, and assessments by internal and external counsel of pending or threatened litigation. Such estimates exclude counterclaims against other third parties and 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 and related matters with any degree of certainty, it is the Company'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, results of operations or cash flows of the Company.

*Letters of Credit*

Letters of credit are purchased guarantees that ensure the performance or payment to third parties in accordance with specified terms and conditions. The Company had a letter of credit of \$1.7 million outstanding as of December 31, 2002 to cover payment of certain raw materials.

*Product Warranty*

The Company provides for an estimated amount of product warranty at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience. Warranty expense for the years ended December 31, 2002 and 2001, and accrued warranty cost, included in other accrued liabilities in the consolidated balance sheets at December 31, 2002 and 2001, was as follows:

| (in millions)                          | <b>Product<br/>Warranty</b> |              |
|--|-----------------------------|--------------|
| <b>Balance as of January 1, 2001</b>   | \$                          | <b>0.8</b>   |
| Warranty expense                       |                             | 4.1          |
| Deductions and other                   |                             | (3.7)        |
| <b>Balance as of December 31, 2001</b> | \$                          | <b>1.2</b>   |
| Warranty expense                       |                             | <b>1.2</b>   |
| Deductions and other                   |                             | <b>(1.6)</b> |
| <b>Balance as of December 31, 2002</b> | \$                          | <b>0.8</b>   |



**Note 14 Supplemental Cash Flow Information**

Supplemental cash flow information, including non-cash financing and investing activities, for the years ended December 31, 2002 and 2001, consist of the following:

| (in millions)  | 2002   | 2001   |
|----------------|--------|--------|
| Cash paid for: |        |        |
| Interest       | \$ 0.5 | \$ 0.4 |
| Taxes          | \$ 5.0 | \$ 6.0 |

#### Note 15 Comprehensive Income

Comprehensive income represents net income (loss) and other unrealized gains and losses, such as cash flow hedging activities and foreign currency translation adjustments, affecting shareholder's equity that are not reflected in the consolidated statements of operations. The components of comprehensive income are reported on the consolidated statements of stockholder's equity and comprehensive income.

The components of accumulated other comprehensive income (loss) as of December 31, 2002 and 2001 were as follows:

| (in millions)  | 2002   | 2001      |
|--|--------|-----------|
| Currency translation adjustments                       | \$ 2.7 | \$ (10.6) |
| Net unrealized gains (losses) on financial instruments | 0.9    | (2.9)     |
| Accumulated other comprehensive income (loss)          | \$ 3.6 | \$ (13.5) |

#### Note 16 Segment Information

The financial results for Hexcel S.A.'s business segments have been prepared using a management approach, which is consistent with the basis and manner in which Hexcel S.A.'s management internally segregates financial information for the purposes of assisting in making internal operating decisions. Hexcel S.A. evaluates performance based on operating income and generally accounts for intersegment sales based on arm's-length prices. Corporate and other expenses are not allocated to the business segments, except to the extent that the expenses can be directly attributable to the business segments. Accounting principles used in the segment information are generally the same as those used for the consolidated financial statements. Hexcel S.A.'s business segments and related products are as follows:

*Reinforcements:* This segment manufactures and sells carbon, glass and aramid fiber fabrics. These reinforcement products comprise the foundation of most composite materials, parts and structures. The segment weaves electronic fiberglass fabrics that are a substrate for printed circuit boards. All of the Company's electronics sales come from reinforcement fabric sales. This segment also sells products for industrial applications such as decorative blinds and soft body armor. In addition, this segment sells to the Company's Composites business segment, to Hexcel Corporation and its subsidiaries, and to other third-party customers in the commercial aerospace and space and defense markets.

*Composites:* This segment manufactures and sells composite materials, including prepregs, honeycomb, structural adhesives, sandwich panels and specially machined honeycomb parts, primarily to the commercial aerospace and space and defense markets, as well as to industrial markets. This segment also sells to Hexcel Corporation and its subsidiaries.

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The following table presents financial information of the Company's business segments as of December 31, 2002 and 2001, and for the years then ended:

| (in millions)  | Reinforcements | Composites | Eliminations | Total    |
|--|----------------|------------|--------------|----------|
| <b>Net Sales (a)</b>                                     |                |            |              |          |
| 2002   | \$ 96.2        | \$ 104.5   | \$           | \$ 200.7 |
| 2001   | 95.8           | 122.3      |              | 218.1    |
| <b>Intersegment sales</b>                                |                |            |              |          |
| 2002   | \$ 20.4        | \$         | \$ (20.4)    | \$       |
| 2001   | 22.5           |            | (22.5)       |          |
| <b>Operating income</b>                                  |                |            |              |          |
| 2002   | \$ 6.4         | \$ 9.9     | \$           | \$ 16.3  |
| 2001   | 3.1            | 8.6        |              | 11.7     |
| <b>Depreciation and amortization</b>                     |                |            |              |          |
| 2002   | \$ 3.5         | \$ 1.8     | \$           | \$ 5.3   |
| 2001   | 4.3            | 1.9        |              | 6.2      |
| <b>Business consolidation and restructuring expenses</b> |                |            |              |          |
| 2002   | \$ 0.8         | \$ 0.6     | \$           | \$ 1.4   |
| 2001   | 2.5            | 0.9        |              | 3.4      |
| <b>Business consolidation and restructuring payments</b> |                |            |              |          |
| 2002   | \$ 2.9         | \$ 1.4     | \$           | \$ 4.3   |
| 2001   | 0.7            |            |              | 0.7      |
| <b>Segment assets</b>                                    |                |            |              |          |
| 2002   | \$ 62.6        | \$ 68.8    | \$           | \$ 131.4 |
| 2001   | 47.5           | 56.3       |              | 103.8    |
| <b>Capital expenditures</b>                              |                |            |              |          |
| 2002   | \$ 2.6         | \$ 0.8     | \$           | \$ 3.4   |
| 2001   | 4.4            | 1.0        |              | 5.4      |

(a) Includes sales to Hexcel Corporation and its subsidiaries.

*Geographic Data*

Net sales by geographic area consisted of the following for the two years ended December 31, 2002 and 2001:

| (in millions)         | 2002    | 2001    |
|-----------------------|---------|---------|
| <b>Net sales: (a)</b> |         |         |
| France                | \$ 76.9 | \$ 90.2 |
| Italy                 | 25.0    | 31.3    |
| Germany               | 17.4    | 24.0    |

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|                              |    |              |    |       |
|------------------------------|----|--------------|----|-------|
| Other                        |    | <b>81.4</b>  |    | 72.6  |
| Total consolidated net sales | \$ | <b>200.7</b> | \$ | 218.1 |

(a) Includes sales to Hexcel Corporation and its subsidiaries.

Net sales are attributed to geographic areas based on the location of customers. All long-lived assets, such as of property, plant and equipment and other tangible assets, are located in France.

**Note 17 Subsequent Events**

On March 19, 2003, Hexcel Corporation completed the refinancing of its capital structure through the simultaneous closings of three financing transactions: the completion of its previously announced sale of mandatorily redeemable convertible preferred stock for \$125.0 million, the issuance of \$125.0 million of 9-7/8% senior secured notes, due 2008, and the establishment of a new \$115.0 million senior secured credit facility, also due 2008. In connection with the refinancing, the Senior Credit Facility was paid in full, including all outstanding advances of Hexcel S.A. under the facility.

*Senior Pledge under the Senior Secured Notes, due 2008*



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Hexcel Corporation issued \$125.0 million of 9-7/8% senior secured notes at a price of 98.95% of face value. The senior secured notes, due October 1, 2008, are secured by a first priority security interest in



Hexcel Corporation issued \$125.0 million of 9-7/8% senior secured notes at a price of 98.95% of face value. The s

substantially all of Hexcel's and its U.S. subsidiaries' property, plant and equipment, intangibles, intercompany notes and other obligations receivable, and 100% of the outstanding voting stock of certain of Hexcel's U.S. subsidiaries. In addition, the senior secured notes are secured by a pledge of 65% of the stock of Hexcel S.A. and Hexcel's U.K. first-tier holding company. This pledge of foreign stock is on an equal basis with a substantially identical pledge of such stock given to secure the obligations under Hexcel Corporation's new senior secured credit facility, described below. The senior secured notes are also guaranteed by Hexcel's material domestic subsidiaries.



*Stock Pledge under the Senior Secured Credit Facility*

**On March 19, 2003, Hexcel Corporation entered into a \$115.0 million asset-based senior secured credit facility with a new syndicate of lenders led by Fleet Capital Corporation, as agent. The credit facility matures on March 31, 2008. Borrowers under the credit facility do not include Hexcel S.A., or its operating subsidiaries.**



All obligations under the credit facility are secured by a first priority security interest in accounts receivable, inventory and cash and cash equivalents of Hexcel Corporation and its material U.S. subsidiaries. In addition, all obligations **under the credit facility are secured by a pledge of 65% of the stock of Hexcel S.A. and Hexcel's U.K. first-tier holding company, and certain intercompany notes. This pledge of foreign stock and certain intercompany notes is on an equal basis with a substantially identical pledge of such stock and intercompany notes given to secure the obligations under the senior secured notes, described above.**

*Factoring Facility*



In May 2003, the Company entered into an accounts receivable factoring facility with a third party to provide Hexcel S.A. with 20.0 million in borrowing capacity. Borrowings under this facility bear interest at 1.00% p.a. over LIBOR plus a 0.18% usage fee. This facility also provides for the payment of customary fees and expenses.

**REPORT OF INDEPENDENT AUDITORS**

To the Board of Directors of Hexcel Holdings (UK) Limited:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholder's equity (deficit) and comprehensive income and of cash flows present fairly, in all material respects, the financial position of Hexcel Holdings (UK) Limited and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets effective January 1, 2002.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP  
Stamford, Connecticut  
July 8, 2003

**Hexcel Holdings (UK) Limited and Subsidiaries**  
**Consolidated Balance Sheets**  
**As of December 31,**

| (In millions)   | 2002     | 2001     |
|---|----------|----------|
| <b>Assets</b>   |          |          |
| Current assets:   |          |          |
| Cash and cash equivalents   | \$ 6.7   | \$ 3.1   |
| Accounts receivable, net  | 32.3     | 34.0     |
| Accounts receivable, related parties                              | 4.1      | 3.6      |
| Inventories, net  | 19.5     | 20.2     |
| Prepaid expenses and other assets                                 | 2.8      | 0.5      |
| Total current assets  | 65.4     | 61.4     |
| Net property, plant and equipment                                 | 56.0     | 49.3     |
| Goodwill, net   | 11.5     | 9.7      |
| Other assets  | 15.1     | 13.8     |
| Total assets  | \$ 148.0 | \$ 134.2 |
| <b>Liabilities and Stockholder's Equity (Deficit)</b>             |          |          |
| Current liabilities:  |          |          |
| Notes payable and current maturities of capital lease obligations | \$ 71.5  | \$ 1.7   |
| Notes payable, related parties                                    | 9.4      | 8.9      |
| Accounts payable  | 13.6     | 10.6     |
| Accounts payable, related parties                                 | 8.4      | 4.9      |
| Accrued compensation and benefits                                 | 5.8      | 3.6      |
| Business consolidation and restructuring liabilities              | 5.5      | 6.8      |
| Other accrued liabilities   | 8.0      | 16.0     |
| Total current liabilities   | 122.2    | 52.5     |
| Long-term notes payable and capital lease obligations             | 2.6      | 90.4     |
| Long-term notes payable, related parties                          | 78.8     |          |
| Long-term retirement obligations                                  | 15.1     | 3.0      |
| Other non-current liabilities                                     | 2.4      | 6.8      |
| Total liabilities   | 221.1    | 152.7    |
| Commitments and contingencies (see Note 13)                       |          |          |
| Stockholder's equity (deficit):                                   |          |          |
| Parent's net investment   | (68.4)   | (10.3)   |
| Accumulated other comprehensive loss                              | (4.7)    | (8.2)    |
| Total stockholder's equity (deficit)                              | (73.1)   | (18.5)   |
| Total liabilities and stockholder's equity (deficit)              | \$ 148.0 | \$ 134.2 |

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

**Hexcel Holdings (UK) Limited and Subsidiaries**  
**Consolidated Statements of Operations**  
**For the Years Ended December 31,**

| (In millions)                                     | 2002     | 2001     |
|---|----------|----------|
| Net sales   | \$ 247.1 | \$ 298.3 |
| Cost of sales                                     | 199.6    | 234.3    |
| Gross margin                                      | 47.5     | 64.0     |
| Selling, general and administrative expenses      | 19.0     | 24.7     |
| Research and technology expenses                  | 4.5      | 5.2      |
| Business consolidation and restructuring expenses | 2.2      | 9.8      |
| Operating income                                  | 21.8     | 24.3     |
| Interest expense                                  | 6.1      | 6.6      |
| Income before income taxes                        | 15.7     | 17.7     |
| Provision for income taxes                        | 4.9      | 5.8      |
| Net income  | 10.8     | 11.9     |

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

**Hexcel Holdings (UK) Limited and Subsidiaries**  
**Consolidated Statements of Stockholder's Equity (Deficit) and Comprehensive Income**  
**For the Years Ended December 31, 2002 and 2001**

| (In millions)            | Parent's Net<br>Investment | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Stockholder's<br>Equity (Deficit) | Comprehensive<br>Income |
|--------------------------|----------------------------|--|--|-------------------------|
| Balance, January 1, 2001 | \$ (0.4)                   | \$ (0.1)   | \$ (0.5)                                   |                         |
| [Redacted content]       |                            |  |  |                         |

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|  |    |               |       |              |    |               |
|--|----|---------------|-------|--------------|----|---------------|
| Net income                                   |    | 11.9          |       | 11.9         | \$ | 11.9          |
| Currency translation adjustments             |    |               | (5.1) | (5.1)        |    | (5.1)         |
| Net unrealized loss on financial instruments |    |               | (3.0) | (3.0)        |    | (3.0)         |
| <b>Comprehensive income</b>                  |    |               |       |              | \$ | 3.8           |
| Contributions from parent                    |    | 3.2           |       | 3.2          |    |               |
| Distributions to parent                      |    | (25.0)        |       | (25.0)       |    |               |
| <b>Balance, December 31, 2001</b>            | \$ | <b>(10.3)</b> | \$    | <b>(8.2)</b> | \$ | <b>(18.5)</b> |

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|  |    |               |              |              |               |               |
|--|----|---------------|--------------|--------------|---------------|---------------|
| Net income                                   |    | <b>10.8</b>   |              | <b>10.8</b>  | \$            | <b>10.8</b>   |
| Currency translation adjustments             |    |               | <b>6.1</b>   |              | <b>6.1</b>    | <b>6.1</b>    |
| Net unrealized gain on financial instruments |    |               | <b>5.5</b>   |              | <b>5.5</b>    | <b>5.5</b>    |
| Minimum pension obligation                   |    |               | <b>(8.1)</b> |              | <b>(8.1)</b>  | <b>(8.1)</b>  |
| <b>Comprehensive income</b>                  |    |               |              |              | \$            | <b>14.3</b>   |
| Contributions from parent                    |    | <b>4.2</b>    |              |              | <b>4.2</b>    |               |
| Distributions to parent                      |    | <b>(73.1)</b> |              |              | <b>(73.1)</b> |               |
| <b>Balance, December 31, 2002</b>            | \$ | <b>(68.4)</b> | \$           | <b>(4.7)</b> | \$            | <b>(73.1)</b> |



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

**Hexcel Holdings (UK) Limited and Subsidiaries****Consolidated Statements of Cash Flows**

For the Years Ended December 31,

| (In millions)   | 2002    | 2001    |
|---|---------|---------|
| <b>Cash flows from operating activities</b>                               |         |         |
| Net income  | \$ 10.8 | \$ 11.9 |
| Reconciliation to net cash provided by operations:                        |         |         |
| Depreciation  | 6.5     | 6.2     |
| Amortization of goodwill  |         | 0.7     |
| Deferred income taxes   | 0.5     | (2.6)   |
| Business consolidation and restructuring expenses                         | 2.2     | 9.8     |
| Business consolidation and restructuring payments                         | (4.2)   | (1.7)   |
| Changes in assets and liabilities:  |         |         |
| Decrease in accounts receivable   | 7.5     | 1.0     |
| Decrease in inventories   | 4.2     | 10.7    |
| Decrease (increase) in prepaid expenses and other assets                  | (0.4)   | 0.3     |
| Decrease in accounts payable and accrued liabilities                      | (5.3)   | (4.0)   |
| Decrease in net accounts receivable and accounts payable, related parties | 1.5     | (4.3)   |
| Changes in other non-current assets and long-term liabilities             | (2.0)   | (0.6)   |
| Net cash provided by operating activities                                 | 21.3    | 27.4    |
| <b>Cash flows from investing activities</b>                               |         |         |
| Capital expenditures  | (4.5)   | (10.9)  |
| Other   | 0.1     | (2.4)   |
| Net cash used for investing activities                                    | (4.4)   | (13.3)  |
| <b>Cash flows from financing activities</b>                               |         |         |
| Proceeds (repayments) of notes payable and capital lease obligations, net | (20.8)  | (1.2)   |
| Proceeds from issuance of debt, related parties                           | 76.3    | 5.6     |
| Contributions from parent   | 4.2     | 3.2     |
| Distributions to parent   | (73.1)  | (25.0)  |
| Net cash used for financing activities                                    | (13.4)  | (17.4)  |
| Effect of exchange rate changes on cash and cash equivalents              | 0.1     | 2.8     |
| Net increase (decrease) in cash and cash equivalents                      | 3.6     | (0.5)   |
| Cash and cash equivalents at beginning of year                            | 3.1     | 3.6     |
| Cash and cash equivalents at end of year                                  | \$ 6.7  | \$ 3.1  |

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - Significant Accounting Policies

#### *Nature of Operations and Basis of Consolidation*

Hexcel Holdings (UK) Limited was incorporated in the United Kingdom on November 7, 2000 and is a wholly-owned subsidiary of Hexcel Corporation, a Delaware corporation. The consolidated financial statements include the historical assets, liabilities and related operations of Hexcel Holdings (UK) Limited and its subsidiaries ( HH U.K. or the Company ). All significant intercompany transactions have been eliminated.

The consolidated financial statements include an allocation of certain of Hexcel Corporation's corporate expenses. These expenses have been allocated to HH U.K. on a basis considered by management to reasonably reflect the utilization of the services provided to HH U.K., or the benefit obtained by HH U.K. Measures and activity indicators used for allocation purposes include sales revenue, headcount, property and payroll expense. The Company's allocated corporate expenses included primarily administrative type costs. These allocations are not necessarily indicative of the amounts that would have been incurred or that would have been recorded by the Company if it existed on a stand-alone basis.

HH U.K. is a leading producer of advanced structural materials. The Company develops, manufactures and markets lightweight, high-performance composite materials for use in commercial aerospace, space and defense, and industrial applications. The Company's materials are used in a wide variety of end products, such as commercial and military aircraft, space launch vehicles and satellites, high-speed trains and ferries, cars and trucks, wind turbine blades, and recreational equipment. The Company serves primarily the European market with manufacturing and/or sales offices in the United Kingdom, Austria, Belgium, Germany, Italy and Spain.

#### *Use of Estimates*

The preparation of the consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Estimates are used for, but not limited to, allowances for doubtful accounts, inventory allowances, product warranty, depreciation and amortization, business consolidation and restructuring costs, employee benefits, income taxes, and contingencies. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. These investments consist primarily of Eurodollar time deposits and are stated at cost, which approximates fair value.

*Inventories*

Inventories are valued at the lower of cost or market, with cost determined using the first-in, first-out and average cost methods. The Company provides allowances for obsolete and unmarketable inventory. As of December 31, 2002 and 2001, inventory allowances were \$3.2 million and \$3.7 million, respectively.

*Property, Plant and Equipment*

Property, plant and equipment are recorded at cost and depreciated over estimated useful lives using accelerated and straight-line methods. The estimated useful lives range from 10 to 40 years for buildings, 12 years for leasehold improvements, and from 4 to 14 years for machinery and equipment. Repairs and maintenance are expensed as incurred, while major replacements and betterments are capitalized and depreciated over the estimated life of the related asset.

*Goodwill and Other Purchased Intangibles*

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets of an acquired business. Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No.142, Goodwill and Other Intangible Assets, ( FAS 142 ). Prior to adopting FAS 142, goodwill was amortized on a straight-line basis over estimated economic lives, ranging from 15 to 30 years. As a result of adopting FAS 142, goodwill is no longer amortized, but instead is tested for impairment at the reporting unit level at least annually and whenever events or changes in circumstances indicate that goodwill might be impaired. A reporting unit is the lowest level of an entity that is a business and can be distinguished from other activities, operations, and assets of the entity. If, during the annual impairment review, the book value of the reporting unit exceeds the fair value, the implied fair value of the reporting unit's goodwill is compared with the carrying amount of the unit's goodwill. If the carrying amount exceeds the implied fair value, goodwill is written down to its implied value. FAS 142 requires management to estimate the fair value of each reporting unit, as well as the fair value of the assets and liabilities of each reporting unit, other than goodwill. The implied fair value of goodwill is determined as the difference between the fair value of a reporting unit, taken as a whole, and the fair value of the assets and liabilities of such reporting unit. No impact to the Company's consolidated financial statements was identified upon completion of the transitional impairment test required by FAS 142. The Company's annual impairment testing date is during the fourth quarter of each year.

*Impairment of Long-Lived Assets*

Other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the assets from the estimated undiscounted future net cash flows, before interest and taxes, of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires estimates of these cash flows and fair value. The calculation of fair value may be determined based either on discounted cash flows or third party appraised values depending on the nature of the asset.

*Stock-Based Compensation*

Hexcel Corporation has provided certain employees of HH U.K. with stock-based compensation, such as stock options and restricted stock units, which are based upon Hexcel Corporation's publicly traded common share price (refer to Note 11). Stock-based compensation is accounted for under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ). Accordingly, compensation expense is not recognized when options are granted at the fair market value on the date of grant. The Company does, however, recognize compensation expense for restricted stock units over the defined vesting periods.

The Company has elected to continue following APB 25 to account for its stock-based compensation plans. The effects on net income as if the Company had applied the fair value method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( FAS 123 ) for the years ended December 31, 2002 and 2001 are as follows:

| (in millions)                 | 2002    | 2001    |
|-------------------------------|---------|---------|
| <b>Net income:</b>            |         |         |
| Net income, as reported       | \$ 10.8 | \$ 11.9 |
| Property, Plant and Equipment |         | 255     |

|   |    |       |         |
|---|----|-------|---------|
| <i>Add:</i> Stock-based compensation expense included in reported net income, net of tax                            |    |       |         |
| <i>Deduct:</i> Stock-based compensation expense determined under fair value based method for all awards, net of tax |    | (0.5) | (0.4)   |
| Pro forma net income  | \$ | 10.3  | \$ 11.5 |



*Currency Translation*

The assets and liabilities of HH U.K. are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. Cumulative currency translation adjustments are included in accumulated other comprehensive income (loss) in the stockholder's equity section of the consolidated balance sheets. Realized gains and losses from currency exchange transactions are recorded in selling, general and administrative expenses in the consolidated statements of operations and were not material to HH U.K.'s consolidated results of operations in 2002 or 2001.

*Revenue Recognition*

Product sales are recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured, which is generally at the time of shipment. The Company accrues for sales returns and allowances based on its historical experience at the time of sale.

*Product Warranty*

The Company provides for an estimated amount of product warranty at the time revenue is recognized. This estimated amount is provided by product and based on historical warranty experience.

*Shipping and Handling Costs*

The Company recognizes shipping and handling costs as incurred as a component of cost of sales in the consolidated statements of operations. Shipping and handling costs billed to the customer for reimbursement purposes were not significant.

*Research and Technology*

Research and technology costs are expensed as incurred.

*Income Taxes*

The Company provides for income taxes using the liability approach prescribed by the Financial Accounting Standards Board ( FASB ) in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ( FAS 109 ), and has been calculated on a separate return basis. Under the liability approach, deferred income tax assets and liabilities reflect tax carryforwards and the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets require a valuation allowance when it is more likely than not that some portion of the deferred tax assets may not be realized. The realization of deferred tax assets is dependent upon the timing and magnitude of future taxable income prior to the expiration of the deferred tax assets attributes. When events and circumstances so dictate, the Company evaluates the realizability of its deferred tax assets and the need for a valuation allowance by forecasting future taxable income.

*Concentration of Credit Risk*

Financial instruments that potentially subject HH U.K. to significant concentrations of credit risk consist primarily of trade accounts receivable. The Company's sales to EADS, including Airbus, and its subcontractors accounted for approximately 34% and 37% of the Company's 2002 and 2001 net sales, respectively. In addition, one other customer accounted for approximately 14% of 2002 net sales. No other customers accounted for more than 10% of the Company's net sales in 2002 and 2001. The Company performs ongoing credit evaluations of its customers' financial condition but generally does not require collateral or other security to support customer receivables. The Company establishes an allowance for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends and other financial information. As of December 31, 2002 and 2001, the allowance for doubtful accounts was \$0.5 million and \$0.4 million, respectively. Bad debt expense was \$0.1 million in both 2002 and 2001.

### *Dependence on Suppliers*

HH U.K.'s ability to timely deliver its products is dependent upon the availability of quality materials used in these products. The Company depends in part upon suppliers to manufacture, assemble and deliver certain items in a timely and satisfactory manner. The Company obtains certain materials from single or a limited number of sources. A significant interruption in the delivery of such items could have a material adverse effect on the Company's consolidated financial condition, results of operations, and cash flows.

### *Derivative Financial Instruments*

HH U.K. uses various financial instruments, such as foreign currency forward exchange contracts, to manage its risk to market fluctuations by generating cash flows that offset, in relation to their amount and timing, the cash flows of certain foreign currency denominated transactions. The Company designates its foreign currency forward exchange contracts as cash flow hedges against forecasted foreign currency denominated transactions and reports the effective portions of changes in fair value of the instruments in other comprehensive income until the underlying hedged transactions affect income (see Note 12). The Company does not use financial instruments for trading or speculative purposes.

Effective January 1, 2001, HH U.K. adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), and its corresponding amendments under Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, (FAS 138). FAS 133 requires an entity to recognize all derivatives as either assets or liabilities on its balance sheet and measure those instruments at fair value. Gains or losses resulting from changes in the fair values of those derivatives are accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The adoption of FAS 133 and FAS 138 did not have a material effect on the Company's consolidated financial position or results of operations.

### *Recently Issued Accounting Standards*

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (FAS 146). FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured, initially at fair value, only when the liability is incurred; therefore, nullifying Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3) that required a liability for an exit cost to be recognized at the date of an entity's commitment to an exit plan. This change in accounting would be expected to result in a delayed recognition of certain types of costs, especially facility closure costs. The provisions of FAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. Since FAS 146 is effective only for new exit or disposal activities, adoption of this standard will not affect amounts currently reported in the Company's consolidated financial statements. However, the adoption of FAS 146 could affect the types and timing of costs included in any future business consolidation and restructuring programs. The Company adopted FAS 146 as of January 1, 2003.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, (FAS 148). FAS 148 amends FAS 123 to present alternative methods of transition for an entity that voluntarily adopts the fair value based method of accounting for stock-based employee compensation, and provides modifications to the disclosure provisions to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation in quarterly and annual financial statements. At this time, the Company has not

voluntarily adopted the fair value method of accounting under FAS 123. However, appropriate disclosures about the effects on reported net income of the Company's accounting policy with respect to stock-based employee compensation are provided above.

In November 2002, the FASB issued Financial Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, (FIN 45). FIN 45 requires a guarantor to disclose (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor's obligations under the guarantee; and (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability at fair value for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002.