

FINANCIAL HIGHLIGHTS
(In thousands, except per share amounts)

	<u>Years Ended December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Revenue	\$137,280	\$104,720	\$84,770
Net income available to common stockholders	94,485	7,375	7,312
Net income per share (assuming dilution)	63.55	5.30	5.19
Total assets	157,317	83,554	69,548
Total debt*	10,136	31,507	24,755
Stockholders' equity	124,541	29,829	23,136

* Includes subordinated debentures in 2003 and 2002 and redeemable preferred stock

BUSINESS SEGMENTS

The Hallwood Group Incorporated (the "Company") (AMEX:HWG) is a holding company that operates in the textile products and energy business segments. These two business segments are reported as continuing operations. The Company's former real estate and hotel business segments have been reclassified as discontinued operations.

EXECUTIVE PROMOTION

I am pleased to report that Mr. William L. Guzzetti has been promoted to President and Chief Operating Officer effective March 9, 2005. I know that you share with me in wishing Bill much success in his new position.

ASSET DISPOSITIONS AND DEBT REDUCTION

In July 2004, the Company disposed of its general and limited partner investments in its former Hallwood Realty Partners, L. P. affiliate and related assets for approximately \$66.1 million. Concurrent with the transaction, approximately \$14.4 million of the proceeds were used to satisfy all of Hallwood's bank debt. In addition, approximately \$6.4 million was used to redeem the 10% Subordinated Debentures in September 2004.

In December 2004, the Company disposed of its common stock investment in its former Hallwood Energy Corporation affiliate for approximately \$55.8 million. Results of operations through the date of the transaction are included in continuing operations.

TO OUR STOCKHOLDERS

We are pleased to present the Company's 2004 Annual Report, which includes results for the years ended December 31, 2004, 2003 and 2002. This has been a very successful year for our Company. Our share price increased from \$25 on March 18, 2004, to \$134 per share on March 18, 2005, and reached a high of \$155 per share on April 6, 2005.

Continuing Operations

For the 2004 year, income from continuing operations was \$54.7 million, or \$36.79 per share (assuming dilution), compared to income of \$3.7 million, or \$2.59 per share in 2003, and a loss of \$6,000, or \$(0.02) per share in 2002, on revenue of \$137.3 million, \$104.7 million and \$84.8 million, respectively.

Textile Products

The Company's Brookwood Companies Incorporated subsidiary ("Brookwood") is an integrated textile company focused on woven nylon products. Converting, design, marketing and administrative operations are conducted at its New York City offices. Through its Rhode Island dyeing and finishing plant and nearby laminating plant, Brookwood develops and produces innovative woven fabrics and related products through specialized finishing, treating and coating processes.

Brookwood is a market leader in its industry and is seeking to expand its high tech textile businesses to drive sales and profits. It produces laminated fabrics using its own branded breathable film, including "Glacier X-Treme[®]," "Storm-Tech[®]," "Assault[®]," "Barrier Assault Textile Technology[™]" and "Batt[™]". In addition, Brookwood markets other consumer branded fibers and fabrics such as "Cordura[®]" and "Supplex[®]".

Brookwood enjoyed its most profitable year in calendar 2004 and posted revenues of \$136.3 million, compared to \$104.7 million in 2003 and \$84.8 million in 2002. Its operating income before interest and taxes was \$18.5 million, compared to \$6.7 million in 2003 and \$3.2 million in 2002. During 2004 Brookwood increased its volume as a supplier of specialized fabric to United States military contractors.

Energy

The Company has investments in three private energy partnerships. Since January 2002, the Company has invested over \$20.7 million for minority interests in its energy affiliates. All of these investments are accounted for on the equity basis of accounting, which included a gain from the Hallwood Energy Corporation transaction in the amount of \$62.3 million.

As of the date of this letter, Hallwood Energy III, L.P. ("HE III"), the principal affiliate, had drilled 19 wells in the Barnett Shale Formation of Johnson County, Texas, and anticipates that it could drill in excess of 32 additional wells during 2005. Another affiliate, Hallwood Exploration, L.P., commenced 3-D seismic operations in South Louisiana, and exploratory drilling is expected to follow in 2006. A third affiliate, Hallwood Energy II, L.P. continues to acquire Barnett Shale acreage outside the HE III area, and anticipates initiating drilling operations in mid 2005.

Discontinued Operations

For the 2004 year, income from discontinued operations was \$39.8 million, including a gain from the Hallwood Realty Partners, L.P. transaction in the amount of \$52.7 million.

In December 2004, the Company terminated its remaining hotel lease. No longer in the hotel business, the Company has reclassified those operations as discontinued for all periods presented herein.

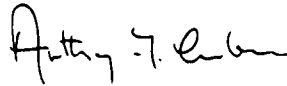
Business Plan

The Board of Directors is considering various proposals, to enable the Company and its stockholders to best realize the value of the Company's assets and businesses, which may include a return of capital to stockholders. No determinations have yet been made and there can be no assurance that any changes in the Company will result from the deliberations.

Acknowledgments

Once again I wish to thank our employees for their continued efforts, and our stockholders and bank lenders for their continued support.

Sincerely,



Anthony J. Gumbiner
Chairman and Chief Executive Officer

April 6, 2005